



**INTERNATIONAL FEDERATION  
OF ACCOUNTANTS**

**ITEM 12.1**

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DATE: 25 SEPTEMBER 2003  
MEMO TO: MEMBERS OF THE IFAC PUBLIC SECTOR COMMITTEE  
FROM: LI LI LIAN  
SUBJECT: **STUDY 14 (2<sup>ND</sup> EDITION)**

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**ACTION REQUIRED**

The Committee is asked to:

- **review** the major changes to Study 14; and
- **approve** the draft Study 14 (2<sup>nd</sup> edition) (subject to any amendments agreed at the meeting) for publication.

**AGENDA MATERIAL:**

	<b>Pages</b>
12.2 Extracts from Study 14 identifying main changes	12.2-12.36
12.3 Report from the drafting subcommittee	2 <sup>nd</sup> distribution

**BACKGROUND**

In the last PSC Meeting in Vancouver, Members agreed that:

- Study 14 will be updated at least once per year, and more frequently, if needed.
- A drafting sub-committee will be established to review the draft Study 14 (2<sup>nd</sup> edition) and make recommendations to the PSC on whether Study should be published or required further amendment. The sub-committee comprises the Norwegian and Australian members.

The draft Study 14 (2<sup>nd</sup> edition) was sent to the sub-committee in early September with a request for comment by the end of this month. Their report will be included in the second distribution of Agenda materials.

The Study has been updated since Vancouver. It now reflects that ED 23 *Impairment of Assets* has been issued.

The extracts of the Study included at Agenda 12.2 identify the major changes proposed. (These major changes have not yet been agreed by the drafting sub-committee.) Changes to other parts of the Study are of an editorial nature and include consequential changes to those matters identified in the extracts. For example, ED 21 has been issued as IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets* and the Cash Basis IPSAS was issued in January 2003 (replacing ED 9).

A full copy of the Study is available upon request. (Please note it is about 270 pages long).

**Li Li Lian**

**ASSISTANT PROJECT MANAGER**

## Extracts of Main Changes Proposed to Study 14 *Transition to the Accrual Basis of Accounting: Guidance for Governments and Government Entities* (2<sup>nd</sup> Edition)

The main changes proposed to Study 14 are summarized in a table on a chapter by chapter basis. Where possible, Staff have attached the extracts of those changes in Appendix 1 (App 1) of this paper. It should be noted that the relevant sections that reflect the issue of ED 23 *Impairment of Assets* are attached in the beginning of App 1.

**Table Outlining Major Changes:**

Chapter/Section of Study 14	Proposed Changes
Cover	<ul style="list-style-type: none"> <li>Note a change in edition and publication date. <i>(The cover is illustrated in App 1)</i></li> </ul>
Acknowledgement	<ul style="list-style-type: none"> <li>Change edition and to show that the 1st edition of Study 14 was prepared by PSPNZ on behalf of PSC. <i>(Illustrated in App 1)</i></li> </ul>
Foreword	<ul style="list-style-type: none"> <li>Update to reflect that PSC has issued 20 accrual IPSASs and one comprehensive Cash Basis IPSAS <i>(The Foreword is illustrated in App 1)</i></li> </ul>
Part I Introduction	<ul style="list-style-type: none"> <li>Reflect that PSC has issued 21 IPSASs</li> <li>Invite readers to provide input to the Study (instead of in Part IV of the document) <i>(Part I is illustrated in App 1)</i></li> </ul>
Chapter 1 Introduction	<ul style="list-style-type: none"> <li>INTOSAI will assume the role of providing public sector guidance on ISAs where appropriate. <i>(Relevant para illustrated in App 1)</i></li> <li>ED 9 has been issued as the Cash Basis IPSAS. <i>(Relevant section illustrated in App 1)</i></li> <li>New Occasional Papers issued. <i>(Relevant section illustrated in App 1)</i></li> <li>References and web sites updated</li> </ul>
Ch 2 Managing the Process	<ul style="list-style-type: none"> <li>References and web sites updated</li> </ul>
Ch 3 Skills assessment and training	<ul style="list-style-type: none"> <li>The discussion paper on outlining 'competence' has now been published as an International Education Paper. <i>(Relevant section illustrated in App 1)</i></li> <li>References and web sites updated</li> </ul>
Ch 4 Accounting Policy Issues	<ul style="list-style-type: none"> <li>Note that entity's are required to comply with IPSASs when they are in force rather than when they are issued. <i>(Relevant section illustrated in App 1)</i></li> <li>HM Treasury's Resource Accounting Manual is updated annually</li> <li>IASB has issued a new Standard on first-time application of IFRSs to replace SIC 8. <i>(Relevant section illustrated in App 1)</i></li> <li>Cash Basis IPSAS has been issued. <i>(Relevant section illustrated in App 1)</i> <ul style="list-style-type: none"> <li>standard wording paragraph affected: Each chapter in the Study, except for Chapters 1-3, includes a paragraph for the section under the heading "Relevance to the Cash</li> </ul> </li> </ul>

Chapter/Section of Study 14	Proposed Changes
	<p>Basis of Accounting”. For Chapters 6-15, there is a standard wording that notes that the issues discussed in each Chapter will assist those intending to prepare financial statements on the cash basis of accounting and also disclose in the notes some accrual accounting information. For Chapters 4 &amp; 5, the wording in the “Relevance to the Cash Basis of Accounting” has a slight variation to the standard wording paragraph</p> <ul style="list-style-type: none"> <li>○ reflect that ED 9 is now a Standard and has new requirements and an encouragements section</li> <li>• References and web sites updated</li> </ul>
Ch 5 Reporting Entity Issues	<ul style="list-style-type: none"> <li>• Cash Basis IPSAS issued – standard wording paragraph affected. (There is a slight variation to this standard wording paragraph.) <i>(Relevant section illustrated in App 1)</i></li> <li>• References and web sites updated</li> </ul>
Ch 6: Assets	<ul style="list-style-type: none"> <li>• ED 23 <i>Impairment of Assets</i> has been issued. Staff have provided a short summary of the ED. <i>(Relevant section illustrated in App 1)</i></li> <li>• ED 21 has been replaced by IPSAS 19 <i>(Relevant section illustrated in App 1)</i></li> <li>• Cash Basis IPSAS issued – standard wording paragraph affected</li> <li>• References and web sites updated</li> </ul>
Ch 7: Liabilities	<ul style="list-style-type: none"> <li>• ED 21 has been replaced by IPSAS 19.</li> <li>• Ch 7 discusses the liability aspects of financial instruments. It also discusses the Draft Standard prepared by the Joint Working Group on Financial Instruments. The IASB has recently announced that they will consider the results of the Draft Standard as part of a long-term project. In the mean time, they have issued a new ED to address internal inconsistencies between their disclosure standard (IAS 32) on financial instruments and the recognition and measurement standard (IAS 39) and to incorporate guidance from current SICs. Study 14 now discusses the main changes proposed to IAS 39, <i>Financial Instruments: Recognition and Measurement</i> rather than focus on the Draft Standard. Staff will monitor IAS 39 and update Study 14 where appropriate. <i>(Relevant section illustrated in App 1)</i></li> <li>• Cash basis IPSAS has been issued – standard wording paragraph affected</li> <li>• References and web sites updated</li> </ul>

<b>Chapter/Section of Study 14</b>	<b>Proposed Changes</b>
Ch 8 Revenues and Expenses	<ul style="list-style-type: none"> <li>• Reflect that the PSC has established two steering committees to assist in developing guidance on non-exchange revenue and social policy obligations</li> <li>• Updated GFS Manual was issued in Dec 2001</li> <li>• Cash Basis IPSAS issued               <ul style="list-style-type: none"> <li>○ Standard wording paragraph affected</li> <li>○ To update the requirements from the Cash Basis IPSAS</li> </ul> </li> <li>• References and web sites updated</li> <li>• PSC is now considering an ED on impairment of assets (<i>Relevant section illustrated in App 1</i>)</li> </ul>
Part IV – Specific Topics	<ul style="list-style-type: none"> <li>• Update to include new Chapters 16 &amp; 17 dealing with segments and related parties</li> <li>• Delete invitation to provide input (this was moved to Part I Introduction)</li> </ul> <i>(Part IV is illustrated in App 1)</i>
Ch 9 Cash	<ul style="list-style-type: none"> <li>• Updated Glossary issued since Study 14 was published</li> <li>• Cash Basis IPSAS was issued:               <ul style="list-style-type: none"> <li>○ Standard wording paragraph affected</li> <li>○ Note that the definition of cash is different for the cash basis and the accrual basis</li> <li>○ Cash Basis IPSAS has provided guidance on control of cash. To change the examples used in Ch 9 (paras 9.15 – 9.16) to conform with the Cash Basis IPSAS</li> <li>○ reflect that ED 9 is now a Standard and has new requirements and an encouragements section (<i>Relevant section illustrated in App 1</i>)</li> </ul> </li> <li>• References and web sites updated</li> </ul>
Ch 10 Intangible Assets	<ul style="list-style-type: none"> <li>• To note IASB recently issued an ED on proposed amendments to IAS 38, <i>Intangible Assets</i>. The Study summarizes the proposed main changes to IAS 38. (<i>Relevant section illustrated in App 1</i>)</li> <li>• Update GFSM 2001 published in December 2001</li> <li>• SIC 32 on Web site costs has been issued and provides further guidance on internally generated assets</li> <li>• To note that IASB is currently considering a project on extractive industries</li> <li>• Cash Basis IPSAS was issued – standard wording paragraph affected</li> <li>• References and web sites updated</li> </ul>
Ch 11 Financial Instruments	<ul style="list-style-type: none"> <li>• To provide a short summary of the ED on financial instruments. (<i>Relevant section illustrated in App 1</i>)</li> <li>• Cash Basis IPSAS was issued – standard wording paragraph affected</li> <li>• References and web sites updated</li> </ul>
Ch 12 Employee-Related Liabilities	<ul style="list-style-type: none"> <li>• To reflect that the PSC deferred the project on employee benefits. (<i>Relevant section illustrated in App 1</i>)</li> <li>• Cash Basis IPSAS was issued –standard wording paragraph affected</li> <li>• References and web sites updated</li> </ul>

<b>Chapter/Section of Study 14</b>	<b>Proposed Changes</b>
Ch 13 Liabilities arising from SPO	<ul style="list-style-type: none"> <li>• To note that the PSC has established a steering committee to assist in developing guidance on SPO. <i>(Relevant section illustrated in App 1)</i></li> <li>• For IPSAS 19, to reflect that the wording for the exclusion scope for social policy obligations has changed from the ED. <i>(Relevant section illustrated in App 1)</i></li> <li>• ED 21 has been replaced by IPSAS 19</li> <li>• Cash Basis IPSAS was issued – standard wording paragraph affected</li> <li>• References and web sites updated</li> </ul>
Ch 14 Non-Exchange Revenue (NXR)	<ul style="list-style-type: none"> <li>• To note that the PSC has established a steering committee to assist in developing guidance on NXR. <i>(Relevant section illustrated in App 1)</i></li> <li>• Cash Basis IPSAS was issued – standard wording paragraph affected</li> <li>• References and web sites updated</li> </ul>
Chapter 15 Foreign Currency	<ul style="list-style-type: none"> <li>• Cash Basis IPSAS was issued – standard wording paragraph affected</li> </ul>
Chapter 16 Segment Reporting	<ul style="list-style-type: none"> <li>• In light of the issuance of IPSAS 18, to include an additional chapter (Ch 16) outlining the major requirements on the disclosure of segment reporting <i>(Ch 16 is illustrated in App 1)</i></li> </ul>
Chapter 17 Related Party Disclosures	<ul style="list-style-type: none"> <li>• In light of the issuance of IPSAS 20, to include an additional chapter (Ch 17) outlining the major requirements on related party disclosures <i>(Ch 17 is illustrated in App 1)</i></li> </ul>

## ***Appendix 1 to Agenda Item 12.2 – Proposed Marked-Up Changes***

This section is new, it was not provided to the PSC in Vancouver. This area shows the main changes to Study 14 due to the issuance of ED 23.

### ***Chapter 6: Assets***

#### **Property, Plant and Equipment – Impairment of Assets**

6.66 An asset is impaired when its carrying amount exceeds its recoverable service amount. The recoverable service amount is determined as the higher of its net selling price and its value in use. Exposure Draft International Public Sector Accounting Standard ED 23 *Impairment of Assets* provides guidance on how to account for impairment of all assets, except for those for which accounting requirements are included in other IPSASs. Appendix 2 to this Chapter provides a brief summary of the requirements proposed in ED 23.

#### ***Chapter 6's Appendix 2: Summary of Exposure Draft 23 Impairment of Assets***

Exposure Draft International Public Sector Accounting Standard ED 23 *Impairment of Assets* deals with the impairment of all assets in public sector entities other than:

- Government Business Enterprises (GBEs); and
- those for which accounting requirements for impairment are included in other International Public Sector Accounting Standards (IPSASs).

GBEs are profit-oriented entities. In substance, they no different from entities conducting similar activities in the private sector. They are defined in IPSASs as having the following characteristics:

- is an entity with the power to contract in its own name;
- has been assigned the financial and operational authority to carry on a business;
- sells goods and services, in the normal course of its business, to other entities at a profit or full cost recovery;
- is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm's length); and
- is controlled by a public sector entity.

ED 23 defines an “impairment” as a loss in the future economic benefits or service potential of an asset, over and above the systematic recognition of the loss of the asset's future economic benefits or service potential through depreciation.

It distinguishes between cash-generating and non-cash-generating assets. It defines cash-generating assets as assets held by (a) public sector GBEs; and (b) public sector entities other than GBEs to generate a commercial rate of return. Any asset other than a cash-generating asset is regarded as being a non-cash-generating asset.

### **Accounting for Impairment of Cash-Generating Assets**

ED 23 proposes that the impairment of cash-generating assets in the public sector should be accounted for in accordance with IAS 36 *Impairment of Assets*. Under IAS 36 an impairment loss should be recognized whenever the recoverable amount of an asset is less than its carrying amount. The recoverable amount of an asset is determined as the higher of its net selling price and its value in use. Net selling price is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, after deducting any direct incremental disposal costs. Value in use is the present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life.

Where it is not possible to determine the recoverable amount for an individual asset, IAS 36 requires that the recoverable amount for the asset's cash-generating unit (CGU) be determined. The CGU is the smallest identifiable group of assets that generates cash inflows from continuing use, and that is largely independent of the cash inflows from other assets or groups of assets.

Under IAS 36, assets other than goodwill that contribute to the future cash flows of two or more CGUs are regarded as "corporate assets". As corporate assets do not generate separate cash inflows, the impairment of corporate assets are dealt with as part of the impairment of the cash generating unit to which the corporate assets belongs.

### **Accounting for Impairment of Non-Cash-Generating Assets**

ED 23 contains detailed proposals for accounting for the impairment of non-cash-generating assets. It includes guidance on identifying an impaired asset, measuring its recoverable service amount, recognizing or reversing any resulting impairment loss, and disclosing information on impairment losses or reversals of impairment losses.

The Exposure Draft (ED) proposes that an asset should be regarded as impaired when its carrying amount exceeds its recoverable service amount. It identifies key indicators that an impairment loss may have occurred and states that an entity is required to make a formal estimate of recoverable service amount where any of those indicators is present.

Under the ED, the recoverable service amount of an asset is determined as the higher of its net selling price and its value in use. Net selling price is the amount obtainable from the sale of an asset in an arms length transaction between knowledgeable willing parties, less the costs of disposal. Value in use is the present value of the remaining service potential of the asset determined using one of the following three approaches as appropriate:

- Depreciated replacement cost approach;
- Restoration cost approach; and
- Service units approach.

When the asset's recoverable service amount is less than its carrying amount, the entity should recognize an impairment loss and reduce the carrying amount of the asset to its recoverable service amount.

### **Reversal of impairment loss**

ED 23 proposes that the entity should assess at each reporting date whether there is an indicator that an impairment loss recognized for an asset in prior years may no longer exist or may have decreased. The ED identifies a minimum set of indicators of a reversal of an impairment loss and proposes that the entity should estimate an asset's recoverable service amount when annual assessments indicate that a previous loss no longer exists or has decreased.

The ED proposes that an impairment loss recognized in prior years should be reversed if, and only if, there has been a change in the estimates used to determine recoverable service amount. However, the ED requires an impairment loss be reversed only to the extent the reversal does not increase the carrying amount of the asset above the carrying amount that would have been determined for the asset had no impairment loss been recognized. Under the ED, a reversal of an impairment loss should be recognized as revenue in the statement of financial performance.

### **Disclosure**

The ED proposes that, when impairment losses are recognized or reversed, the entity should disclose certain information by class of assets and by segments. Further disclosure is required if impairment losses recognized or reversed are material to the financial statements of the entity as a whole.

### **Comparison with IAS 36**

While ED 23 is based on IAS 36, there are substantial differences. For example:

- ED 23 deals with the impairment of assets of public sector entities while IAS 36 deals with the impairment of cash-generating assets of profit-oriented entities. ED 23 requires that the impairment of cash-generating assets of public sector entities including those of Government Business Enterprises be accounted for under IAS 36.
- The method of measurement of value in use of a non-cash-generating asset under ED 23 is different from that applied to a cash-generating asset under IAS 36. ED 23 measures the value in use of a non-cash-generating asset as the present value of the asset's remaining service potential by reference to the depreciated replacement cost, restoration cost and service units approaches. IAS 36 measures the value in use of a cash-generating asset as the present value of future cash flows from the asset.
- ED 23 deals with "corporate assets" in the same manner as other non-cash-generating assets while IAS 36 deals with them as part of related cash-generating units.

## ***Chapter 8: Revenues and Expenses***

### ***Appendix: Accounting Policies***

This Appendix illustrates examples of accounting policies for a selection of revenue and expense items. These policies are examples of policies that may be developed by a central



entity for internal application by all individual entities forming part of a whole-of-government reporting entity. Because of the wide variation in types of revenue and expense items which exist between various types of entities and jurisdictions, some potential policies (for example, revenue classifications) have not been illustrated.

These policies comply with relevant IPSASs such as IPSAS 9, IPSAS 11 and IPSAS 12.

However, it is possible that other policies that are consistent with these standards could also be developed – the appropriateness of a particular policy for a revenue or expense item depends on the exact conditions under which the revenue is earned or the expense is incurred. Recognition points for revenue and expense items may therefore vary between entities within a jurisdiction and between jurisdictions. For example, in the absence of an IPSAS on impairment, this entity has chosen to base its policy directions on *Exposure Draft International Public Sector Accounting Standard ED 23 Impairment of Assets* and International Accounting Standard IAS 36, *Impairment of Assets*, with some adaptation to reflect the fact that some of its assets are not held for their ability to generate net cash inflows. Other sources of authoritative guidance on impairment may be available within particular jurisdictions. ~~The Public Sector Committee has signaled that it intends to consider impairment of assets in its future work program.~~

### Impairment of Assets

#### *Impairment of Assets – Cash-generating Assets*

When an asset is held for its ability to generate net cash inflows, its impairment is accounted for in accordance with International Accounting Standard IAS 36, *Impairment of Assets*. An impairment loss is to be recognized as an expense for assets carried at cost, and as a revaluation decrease for assets carried at revalued amounts to the extent of its revaluation reserve surplus. An asset is regarded as impaired when its carrying amount exceeds its recoverable amount. Recoverable amount is to be measured by reference to the higher of net selling price and value in use.

The following factors may be used as possible indicators of impairment<sup>1</sup>.

Where an indicator of impairment exists, an impairment test is to be applied:

- a change in the extent to which an asset is used or is expected to be used;
- a change in the manner in which the asset is used before the previously expected date;
- significant technological development with an adverse effect on the entity in the environment which the entity operates or in the market to which the asset is dedicated;
- physical damage;
- a decline in, or cessation of, the demand or need for services worse than expected report on the economic performance of provided by the asset;

<sup>1</sup> ~~The Invitation to Comment, *Impairment of Assets* (IFAC, June 2000) IAS 36 *Impairment of Assets* included these factors as possible indicators of impairment and measurements of impairment losses. The PSC has not yet issued an IPSAS which deals with these matters.~~

- ~~a decision to halt the construction of the asset before it is complete or in a usable condition;~~
- a change in the law, government policy or environment that limits the extent to which the asset can be used; or
- a significant decline in the observable market value of the asset as a result of the passage of time or normal use.

#### Impairment of Assets – Non-cash-generating Assets

An impairment loss is to be recognized as an expense for assets carried at cost. Property, plant and equipment carried at fair value need not be tested for impairment since any impairment is taken into account in the revaluation. An asset is regarded as impaired when its carrying amount exceeds its recoverable service amount. Recoverable service amount is to be measured by reference to the higher of net selling price and value in use.

In assessing whether a non-cash-generating asset is impaired, the following factors may be used as possible indicators of impairment<sup>1</sup>:

- a change in the extent to which an asset is used or is expected to be used;
- a change in the manner in which the asset is used before the previously expected date;
- significant long-term technological development with an adverse effect on the entity in the environment which the entity operates or in the market to which the asset is dedicated;
- physical damage;
- a decline in, or cessation of, the demand or need for services provided by the asset;
- a decision to halt the construction of the asset before it is complete or in a usable condition; or
- a change in the law, government policy or environment that limits the extent to which the asset can be used.

~~Where an asset is held for its ability to generate net cash inflows, impairment is to be measured in accordance with International Accounting Standard IAS 36, *Impairment of Assets*. Impairment is to be measured by reference to the higher of net selling price and value in use (present value of future cash flows).~~

~~Where an asset is not held for its ability to generate net cash inflows, the observable market value of the asset is to be used in measuring any impairment loss.~~

~~Where an asset does not have an observable market value and the asset continues to have utility for the entity, its depreciated replacement cost is to be used in measuring any impairment loss. Where an asset does not have an observable market value and the asset no~~

<sup>1</sup> ~~Both~~ ED 23 *Impairment of Assets* (IFAC, September 2003) ~~and IAS 36 *Impairment of Assets*~~ included these factors as possible indicators of impairment and measurements of impairment losses. The PSC will consider the comments received arising from this Exposure Draft in 2004.

~~longer has utility for the entity, or its ability to utilize the asset has been significantly restricted, a disposal value (net selling price) should be used.~~

Most of the extracts in this section were provided in the Vancouver meeting.

**IFAC  
Public  
Sector  
Committee**

~~April 2002~~MM YYYY

**Study 14**

# Transition to the Accrual Basis of Accounting: Guidance for Governments and Government Entities

Issued by the  
International  
Federation of  
Accountants



## FOREWORD

Many of the International Federation of Accountants Public Sector Committee's (PSC's) constituents, including some currently reporting on a cash basis, have expressed support for the application of the accrual basis of accounting to governmental financial reporting. This support is based on the view that accrual information includes, supplements and enhances the cash information currently provided and benefits both internal and external users. Many of these constituents also sought guidance from the PSC on the process of transition from the cash to the accrual basis. This Study has been prepared in response to that request. It identifies key issues to be addressed in the migration from the cash to the accrual basis of accounting. It also identifies alternate approaches that can be adopted in implementing the accrual basis of accounting in an efficient and effective manner in the public sector. This Study will be updated periodically to reflect newly issued IPSASs and other additional implementation issues and experiences. Readers are encouraged to confirm with the PSC on the status of the latest version available.

The PSC has ~~made significant progress in developing~~ a core set of accrual-based International Public Sector Accounting Standards (IPSASs) ~~to be applied when either the accrual or the cash basis of accounting is adopted. By the end of 2002, I anticipate that the PSC will have issued twenty IPSASs on the accrual basis of Accounting,~~ and a comprehensive IPSAS on the cash basis of accounting. These IPSASs establish an authoritative set of independent international financial reporting standards for governments and others in the public sector organizations. Application of the IPSASs will support developments in public sector financial reporting directed at improving decision-making, financial management, and accountability. The PSC considers the IPSASs to be an integral element of reforms directed at promoting social and economic development.

The PSC believes governments and government entities will find the Study useful as they deal with the many and complex technical, systems and cultural issues necessary to implement an accrual system. The Study identifies key requirements of IPSASs. It also identifies other sources of useful guidance on issues not dealt with by IPSASs. However, readers should note this Study does not establish new or additional authoritative requirements and should not be considered a substitute for the IPSASs themselves. It is intended that this be a "living document" and be updated periodically as further IPSASs are issued, and additional implementation issues and experiences are identified.

Ian Mackintosh  
Chairman  
Public Sector Committee  
International Federations of Accountants

April 2002MM YYYY

## PART I – INTRODUCTION

This Study is intended to assist governments and government entities wishing to migrate to the accrual basis of accounting in accordance with International Public Sector Accounting Standards (IPSASs). It may also assist governments and government entities complying with the financial reporting requirements of the on a comprehensive cash basis of accounting, including the adoption of the major principles in any future IPSAS which is developed from Exposure Draft International Public Sector Accounting Standard – Cash Basis IPSAS ED-9 Financial Reporting Under #The Cash Basis of Accounting in making the additional encouraged disclosures.

~~Part I of this Study addresses general issues associated with the transition to accrual accounting including factors influencing the nature and speed of the transition, options in respect of the transition paths, and the management of the transition process. It also considers issues associated with the identification, design and delivery of training.~~

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~~The main purpose of this Study is to help entities intending to move to the accrual basis of accounting and comply with the accrual-based IPSASs. The Study 14 also includes a discussion of all IPSASs issued and certain topics not addressed by current IPSASs or Exposure Drafts. Where the Study discusses topics not addressed by current IPSASs or Exposure Drafts, the requirements of other authoritative accounting pronouncements such as International Accounting Standards (IASs) are used to illustrate the practical implementation issues associated with that topic. The IASs were prepared and published by the International Accounting Standards Committee (IASC). In 2001 the International Accounting Standards Board (IASB) was established to replace the IASC. The Standards that the IASB has stated that the standards it will issue will be referred to as International Financial Reporting Standards (IFRSs). The first seventeen-twenty accrual-based IPSASs are based on IASs to the extent appropriate for the public sector. The use of IFRSs, IASs or other standards to illustrate such topics does not necessarily reflect the views of the PSC on any issue. The Study is not an accounting manual, nor does it attempt to establish authoritative accounting practices or standards.~~

Part I of this Study addresses general issues associated with the transition to accrual accounting, including factors influencing the nature and speed of the transition, options in respect of the transition paths, and the management of the transition process. It also considers issues associated with the identification, design and delivery of training.

This Study should be considered a work in progress. The first edition of the Study was published in April 2002. It will be revised periodically to reflect developments in IPSASs and input received by the PSC on the experiences of readers in migrating to reporting on an accrual basis. A brief summary of major changes will be prepared to accompany each revision.

## **Acknowledgement**

The first edition of this Study was prepared by Public Sector Performance (NZ) Ltd (<http://www.pspnz.co.nz>) on behalf of the Public Sector Committee of the International Federation of Accountants.

## **Chapter 1: Introduction**

*INTOSAI will assume the role of providing public sector guidance on ISAs where appropriate.*

- 1.1 This Study was issued by the Public Sector Committee (PSC) of the International Federation of Accountants (IFAC). IFAC is an organization of national professional accountancy organizations that represent accountants employed in public practice, business and industry, the public sector and education. The PSC focuses on the accounting, auditing and financial reporting needs of national, regional and local governments, related governmental entities, and the constituencies they serve. It addresses these needs by issuing and promoting benchmark guidance, conducting educational and research programs, and facilitating the exchange of information among accountants and those who work in the public sector. The International Organization of Supreme Audit Institutions (INTOSAI) and the International Audit and Assurance Standards Board (IAASB) have formed a joint working group to provide public sector guidance on ISAs, where appropriate. It is anticipated that this working group will be operational by the end of 2003.

*This paragraph was added to address to constituents who wanted to know why there were only the cash basis and accrual basis IPSASs.*

- 1.4 International Public Sector Accounting Standards (IPSASs) focus on two bases of accounting – the cash basis and the accrual basis. The PSC issued an Invitation to Comment *Which Bases of Accounting* in 1999 which sought views on whether IPSASs should be developed for modified cash and modified accrual bases as well as the cash and accrual bases. There was overwhelming support for the development of IPSASs for only the cash and accrual basis of accounting, supported by guidance on the paths that may be adopted in migrating to the accrual accounting basis.

*To reflect the issuance of the Cash-Basis IPSAS*

- 1.7 The PSC has also issued ~~Exposure Draft~~ the Cash Basis IPSAS-ED-9 ~~Financial Reporting Under #The Cash Basis of Accounting~~. Although the focus of this Study is on the transition to the accrual basis, some parts of the Study may also assist readers who are seeking information ~~which may be useful for~~ in complying with any IPSAS on the cash basis that is developed based on Exposure Draft the Cash Basis IPSAS-ED-9. Appendix 2 of this Chapter explains the relevance of specific Chapters of this Study for entities intending to comply with ~~Exposure Draft IPSAS-ED-9~~ the Standard. In addition,

Appendix 2 of Chapter 4 illustrates the accounting policies that may be required in order for an entity to comply with ~~Exposure Draft IPSAS ED 9~~<sup>+</sup> the Standard.

*To reflect the new publication of Occasional Papers*

1.14 The PSC is considering supporting this Study with a series of Occasional Papers documenting case studies from specific jurisdictions on their transition to the accrual basis of accounting. Occasional Papers published to date are:

- Occasional Paper 1 *Implementing Accrual Accounting in Government: The New Zealand Experience*;
- Occasional Paper 2 *Auditing Whole of Government Financial Statements: The New Zealand Experience*;
- Occasional Paper 3 *Perspectives on Accrual Accounting*; ~~and~~
- Occasional Paper 4 *The Delegation of Public Services in France, An Original Method of Public Administration: Delegated Public Service*;
- Occasional Paper 5 *Resource Accounting: Framework of Accounting Standard Setting in the UK Central Government Sector*; and
- Occasional Paper 6 *The Modernization of Government Accounting in France: The Current Situation, The Issues, The Outlook*
- An Occasional papers on the ~~Modernization of Government Accounting in France and Resource Accounting and Budgeting in the United Kingdom~~ Governmental Accounting System in Argentina is ~~are~~ currently being finalized for publication.

### **5. Chapter 1, Appendix 2:**

Appendix 2 summarizes the relevance of the discussion in the Study to entities wanting to prepare their financial statements under the cash basis of accounting on a chapter by chapter basis.

## **PART III – FINANCIAL ELEMENTS**

### **Chapter 6          Assets**

Not required for cash basis reporting.  
Relevant to the extent that an entity maintains records of certain assets and discloses them as encouraged in the Cash Basis IPSAS, and wishes to begin planning for the introduction of accrual accounting.

<sup>+</sup> ~~As more IPSASs are released, the implications of certain accounting issues for the cash basis of accounting will be considered and this may eventually lead to a revision of the IPSAS based on Exposure Draft IPSAS ED 9 (or the subsequent IPSAS) and the disclosures required under the cash basis of accounting.~~



Chapter 7	Liabilities	Not required for cash basis reporting. Relevant to the extent that most entities operating under the cash basis of accounting maintain comprehensive records of debt and borrowings <u>and disclose them as encouraged in the Cash Basis IPSAS.</u>
Chapter 8	Revenues and Expenses	Not required for cash basis reporting. <u>Relevant to the extent that entities intend to prepare additional disclosure on revenue and expenses incurred during the period.</u> <del>Relevant to the extent that some entities recognize certain receivables and payables. The discussion on classification and disclosure of components of revenue is relevant.</del>
<b>PART IV – SPECIFIC TOPICS</b>		
Chapter 9	Cash	General relevance.
Chapter 10	Intangible Assets	Not required for cash basis reporting. <u>Relevant to the extent that entities intend to prepare additional disclosure on intangible assets.</u>
(Note: The narrative for Chapter 10 is the same for Chapters 11-14 (financial Instruments, employee-related liabilities, liabilities arising from social policy obligations and non-exchange revenue). Therefore, they have not been reproduced in this attachment.		
Chapter 15	Foreign Currency	<del>Not required for cash basis reporting. Exposure Draft IPSAS ED 9 contains proposals for the translation of cash flows and cash balances.</del> <u>Relevant for entities that need to translate foreign exchange cash flows and balances.</u>
<u>Chapter 16</u>	<u>Segment Reporting</u>	Not required for cash basis reporting. <u>Relevant for entities intending to prepare a statement of segments under the cash basis of accounting.</u>
<u>Chapter 17</u>	<u>Related Party Disclosures</u>	<u>Relevant for entities intending to provide related party disclosures as encouraged in Part 2 of the Standard.</u>

## Chapter 2: Managing the Process

*The PSC has actioned a working group on the possible convergence of IPSAS/GFS/ESA*

2.53 It is also desirable to design financial reporting systems so that they can provide the data required for other forms of governmental reporting such as Government Finance Statistics (GFS). The revised GFS Manual (GFSM) 2001 is on an accrual basis, but there are some differences between the systems that will require adjustments if the same data set is to be used for both sets of financial reporting.

2.54 The PSC has created a working group to identify the main differences between IPSASs, the GFSM 2001 and ESA 95/SNA 1993 to ascertain whether harmonization and convergence is possible for some or all of these differences; and where differences remain, to assess the need for, and format of, reconciliation statements. The Working Group is chaired by the PSC and attended by representatives of the IMF, OECD, Eurostat and other constituents. Please refer to the PSC's web site for further information on this Working Group

## Chapter 3: Skills Assessment and Training

3.11 3<sup>rd</sup> dot point: *This discussion paper has been published as an International Education Paper.*

- ~~Competence Based Approaches to the Preparation and Work of the Professional Accountant~~Towards Competent Professional Accountants (IFAC, 2003~~4~~). This paper explores the topic of accountant competency, providing an analysis of approaches used by various accountancy institutes around the world. The ~~discussion Paper~~ seeks to define the term "competence" and "capabilities", provides guidance to accountancy membership bodies ~~on their role in developing competencies and capabilities~~adapting their own qualifications to a competence-based approach, and assesses various ~~methods~~issues surrounding the competence-based approaches and how they can be dealt with. The framework within the paper draws together ~~an~~two different approaches to develop competent professional accountants: the functional analysis which focuses on performance outcomes approach (accountants performing roles and tasks in the workplace to a defined standard) and ~~an~~the second approach which focuses on capabilities such as inputs approach (knowledge, skills and abilities).

## Chapter 4: Accounting Policies Issues

*To reflect that entities are only required to comply to IPSASs in force, rather than on issue.*

4.14 Entities may choose to adopt IPSASs at a time suitable for them. This will vary between jurisdictions depending upon the approach taken to adoption of accrual accounting and the time frame adopted. An entity can claim full compliance with accrual-based IPSASs only when it has complied with the requirements of all IPSASs ~~on issue~~in force.

To reflect that the IASB has issued IFRS 1.

- 4.16 There may be other issues which arise on first-time ~~application~~-adoption of IPSASs which are not dealt with by IPSASs currently on issue. For example, how should an entity deal with any changes in reported figures, such as accumulated balances and comparative amounts, ~~caused by~~arising from the first-time ~~application~~-adoption of IPSASs? Entities will need to develop their own policies in relation to such issues. Other authoritative pronouncements may be helpful in identifying and dealing with such issues. ~~For example, the International Financial Reporting Interpretations Committee (IFRIC) of the International Accounting Standards Board (IASB) Interpretation SIC 8 First Time Application of IASs as the Primary Basis of Accounting (IASB, August 1998). The International Accounting Standards Board has recently published International Financial Reporting Standard IFRS 1, First-time Adoption of International Financial Reporting Standards that replaced the International Financial Reporting Interpretations Committee (IFRIC) of the International Accounting Standards Board (IASB) Interpretation SIC 8 First Time Application of IASs as the Primary Basis of Accounting. IFRS 1 requires retrospective application on all recognized assets and liabilities, except for certain optional and mandatory exemptions. The Standard also provides guidance on the treatment of adjustments to accumulated surpluses/deficits arising from the first-time application of International Accounting Financial Reporting Standards<sup>1</sup>. IFRS 1 differs from SIC 8 by clarifying that an entity applies the latest version of IFRSs, and requires disclosures on how the transition to IFRSs affected an entity's reported financial position, financial performance and cash flows.~~

~~Footnote 1: At the time of writing, the International Accounting Standards Board (IASB) was considering the development of a standard on first time adoption which would replace SIC 8. Details of the proposals under consideration are available on the IASB web site.~~

## Chapter 6: Assets

### Cash Basis Standard Wording paragraph

#### Relevance to the Cash Basis of Accounting

- 6.134 The issues identified in this Chapter are relevant for entities intending to provide additional note disclosure on the nature and amount of various categories of assets ~~comply with any future IPSAS based on~~encouraged by the Cash Basis IPSAS ED-9 Financial Reporting Under ~~the Cash Basis of Accounting if they wish to provide additional note disclosure on the nature and amount of various categories of assets.~~ Although an entity may provide additional disclosures within the financial statements or as supplementary information, such amounts cannot be included in the amounts shown on the face of the primary financial statements of cash receipts and payments.

- 4.174.17 An entity ~~wanting to reporting on a comprehensive~~the cash basis of accounting ~~including the adoption of the major principles in any future IPSAS based on~~in accordance with the Exposure Draft ED-9 Cash Basis IPSAS Financial Reporting Under ~~the Ca~~

Slight variation on the standard cash basis para

*Basis of Accounting*, ~~would~~ will disclose the accounting policies used in the preparation of its financial statement(s) as required by the Standard.

- 4.18 Accounting policies are defined in the Cash Basis IPSAS. The Standard also provides guidance on the selection of accounting policies and requires the disclosure of significant accounting policies in the notes to the financial statements.

- 5.18 For those preparing consolidated cash basis reports, the ~~determination of the reporting entity and the preparation~~ preparation of a consolidated ~~primary financial statement~~ cash receipts and payments involves substantially the same process as for the accrual basis. The consolidation requirements for the cash basis of accounting ~~will be~~ addressed in the ~~future IPSAS based on Exposure Draft International Public Sector Accounting Standard~~ Cash Basis IPSAS ED-9 Financial Reporting Under The Cash Basis of Accounting.

Slight variation on the standard cash basis para

## **Chapter 7: Liabilities**

*Note that ED 19 has been replaced by IPSAS 19.*

- 7.25 Items not meeting these criteria may meet the definition of a contingent liability. Contingent liabilities are defined in ~~Exposure Draft~~ IPSAS ED-219. Contingent liabilities are not recognized. Details of contingent liabilities are disclosed in the notes to the financial statements. In accordance with ~~Exposure Draft~~ IPSAS ED-219, paragraph 38, “If it becomes probable that an outflow of future economic benefits or service potential will be required for an item previously dealt with as a contingent liability, a provision is recognized in the financial statements of the period in which the change in probability occurs (except in the extremely rare circumstances where no reliable estimate can be made).”

*To update that the IASB is currently updating Standards on financial instruments*

- 7.28 In June 2002, the International Accounting Standards Board (IASB) published an exposure draft of proposed amendments to the financial instruments standards – IAS 32 and IAS 39. As part of its improvement project, the IASB invited the IAS 39 Implementation Guidance Committee (IGC<sup>1</sup>) to function as an Advisory Committee to the IASB in identifying and reviewing issues that should be addressed in the exposure draft. The proposed amendments aim to reduce some complexity by clarifying and adding guidance, eliminating internal inconsistencies, and incorporating key elements of existing Standing Interpretations Committee (SIC) Interpretations and guidance from the IGC. Currently, the exposure draft does not reconsider the fundamental approach to accounting for financial instruments. IAS 39 is likely to be updated and may be replaced by a more comprehensive standard at some time in the future. As discussed later in

<sup>1</sup> The IGC consists of senior experts in financial instruments with experience as accounting standard setters, auditors, bankers, and preparers from a range of countries. IGC also includes observers from the Basel Committee on Banking Supervision, the International Organization of Securities Commissions (IOSCO) and the European Commission.

~~Chapter 11, a group of international and national standard setters has prepared a *Draft Standard* outlining proposals for a more comprehensive standard (Financial Instruments Joint Working Group, December 2000).~~

- 7.29 As discussed later in Chapter 11, in December 2000, a group of international and national standard setters (the Financial Instruments Joint Working Group) issued a *Draft Standard* outlining proposals on the approach to accounting for financial instruments. The major issue regarding domestic currency liabilities is whether they should be measured at face value (cost less principal repayments and amortization) or fair value (market values). The Joint Working Group *Draft Standard*, referred to in paragraph 7.28 above, proposed measurement of virtually all financial instruments at fair values. The IASB recently announced that they will study further the Joint Working Group's *Draft Standard* and basis for conclusions. This work would be preparatory to any decisions on how to progress this topic.

~~7.30 If international and national standard setters adopt the proposals in the Joint Working Group *Draft Standard* the proposals could have a significant impact on the accounting policies used for external financial reporting of financial instruments, including debt. However, as mark to market information is commonly used to manage debt portfolios, the implications for debt management systems may be far less (many entities currently recognize debt on a cost basis and disclose fair values as additional information). Although at the time of writing, these proposals are still at a consultation stage, when considering the functionality requirements for debt management systems it would be prudent to allow for the generation of accounting entries on a mark-to-market basis.~~

## PART IV – SPECIFIC TOPICS

Part IV of this Study discusses implementation issues arising from the recognition of certain assets, liabilities, revenues and expenses that are not covered in Part III. These topics have been dealt with separately in order to allow the reader to focus on the issues associated with ~~these~~ them ~~topics~~ in more depth than would have occurred in Part III.

Part IV also discusses the implementation issues for disclosures of segment reporting (in Chapter 16) and related parties (in Chapter 17).

The Chapters focusing on specific asset topics are:

- Chapter 9 *Cash*; and
- Chapter 10 *Intangible Assets*.

Chapter 11 *Financial Instruments* deals with issues in financial reporting of financial assets and liabilities.

The Chapters focusing on specific liability topics are:

- Chapter 12 *Employee-Related Liabilities*; and
- Chapter 13 *Liabilities Arising From Social Policy Obligations*.

The issues discussed in these two Chapters also relate to the recognition of the associated expenses.

Chapter 14 *Non-Exchange Revenue* focuses on the major source of revenue for many public sector entities.

Chapter 15 *Foreign Currency* explains the implications of adopting International Public Sector Accounting Standard IPSAS 4 *The Effects of Changes in Foreign Exchange Rates* to account for foreign currency gains and losses.

~~The Public Sector Committee (PSC) intends to revise this Study periodically to include explanations of the requirements of recently issued International Public Sector Accounting Standards. This revision process will not be continuous and at any point in time IPSASs additional to those included herein may be on issue. Consequently, readers will need to monitor IPSASs as they are issued on the IFAC website ([www.ifac.org](http://www.ifac.org)). As part of the revision process the PSC may develop further Chapters for inclusion in this Part or amend these Chapters. Readers are invited to provide suggestions for specific topics, along with examples of implementation strategies or issues that have arisen in their jurisdictions.~~

## Chapter 9: Cash

To reflect some of the requirements in the Cash Basis IPSAS

### Foreign Currency Bank Accounts

- 9.31 Under the accrual basis, differences between opening and closing balances due to the movement in rates are separately disclosed within the Cash Flow Statement. The method of translating foreign currency bank accounts under the accrual basis of accounting is set out in International Public Sector Accounting Standard IPSAS 4 *The Effects of Changes in Foreign Exchange Rates*. Under the cash basis, entities with funds in foreign currency bank accounts will generally have reported these balances as part of their cash balances at year-end.
- 9.32 Unrealized gains and losses arising from changes in foreign currency exchange rates are not cash flows. The reconciliation of the effect of exchange rate changes on the cash balances held by an entity should be presented separately in the financial statements.

### Relevance to the Cash Basis of Accounting

- ~~9.36 Many of the issues identified in this Chapter are relevant for entities intending to comply with the requirements of any future IPSAS based on Exposure Draft International Public Sector Accounting Standard IPSAS ED 9 *Financial Reporting Under the Cash Basis of Accounting*. The IPSAS based on IPSAS ED 9 is yet to be released. The identification of the reporting entity and the consolidation of the reporting entity's cash flows are likely to be the largest issues.~~
- ~~9.37 An additional issue raised in Exposure Draft IPSAS ED 9 is whether an entity should recognize in its primary financial statement the cash flows in respect of cash payments made on its behalf, even where these transactions do not flow through the entity's bank account. This situation could occur under the terms of a grant or loan agreement where a multi-lateral development agency makes payments directly to contractors on behalf of the entity. The IPSAS based on IPSAS ED 9 is yet to be released.~~
- 9.419.36 Many of the issues identified in this Chapter are relevant for entities intending to comply with the requirements of the Cash Basis IPSAS *Financial Reporting Under The Cash Basis of Accounting*. For example, the use of advance accounts, imprest accounts and foreign currency bank accounts are similarly treated for both the cash basis of accounting and accrual basis of accounting.
- 9.37 The Cash Basis IPSAS also defines cash and control of cash and requires that only the cash controlled by the entity be recognized. "Control of cash" is defined as when the entity can use or otherwise benefit from the cash in pursuit of its objectives and can exclude or regulate the access of others to that benefit. The Standard notes that amounts deposited in the bank account of an entity are controlled by the entity. This means that cash collected on behalf of another entity and deposited in its own bank account before transfer to an account controlled by another government account is controlled by the entity for the period during which the cash resides in the bank account prior being transferred. However, the Standard allows the collecting entity to report the cash received and paid on a net basis.



9.439.38 The Cash Basis IPSAS encourages an entity intending to migrate to the accrual basis of accounting to present its statement of cash receipts and payments in accordance with IPSAS 2 *Cash Flow Statements*.

## **Chapter 10: Intangible Assets**

*To update the IASB issued an ED to improve the existing IAS 38, Intangible Assets*

- 10.1 There is currently no IPSAS on intangible assets. ~~International Public Sector Accounting Standard IPSAS 6 Consolidated Financial Statements and Accounting for Controlled Entities deals with one component of intangible assets: the identification and recognition of goodwill on acquisition of another entity.~~ In the absence of an IPSAS, IAS 38 may be used to illustrate implementation issues associated with intangible assets. IAS 38 was developed by the International Accounting Standards Committee (IASC). The use of IAS 38 as an illustrative accounting standard in this Chapter does not represent the considered position of the PSC in relation to the applicability of the requirements in IAS 38 to the public sector. Readers should also be aware that, ~~at the time of writing, the current work program of~~ in December 2002, the IASB ~~includes projects that have the potential to amend certain of the requirements of IAS 38~~ published *Exposure Draft of Proposed Amendments to IAS 36 Impairment of Assets and IAS 38 Intangible Assets*. This exposure draft was issued as part of its project on business combinations. A short summary of the proposed amendments to IAS 38 is provided at the end of the chapter. The IASB also included in its work program, a project to consider other intangible assets not related to a business combination. Other authoritative pronouncements on intangible assets from a range of jurisdictions are listed in the References section at the end of this Chapter.

### **Summary of Proposed Main Changes to IAS 38**

10.21 In December 2002, the IASB issued *Exposure Draft of Proposed Amendments to IAS 36 Impairment of Assets and IAS 38 Intangible Assets*. This exposure draft was issued as part of its project on business combinations. Proposed changes include:

- amending the definition of intangible assets by removing the requirement for the asset to be “held for use in the production or supply of goods or services, for rental to others, or for administrative purposes”;
- specifying that the ‘identifiable’ criterion in the definition of intangible assets is met when the asset is separable and arises from contractual or other legal rights;
- explaining that, with the exception of an assembled workforce, sufficient information can be reasonably expected to exist to measure reliably the fair value of an intangible asset acquired in a business combination;
- the removal of the rebuttable presumption that an intangible asset cannot exceed twenty years. The ED has also added that intangible assets can have an indefinite useful life based on an analysis of relevant factors; and



- the non-amortization of intangible assets with indefinite useful lives, but that the useful lives be reviewed each reporting period; and
- for intangible assets that exceed beyond twenty years, the assets be tested for impairment each financial year end.

## **Chapter 11: Financial Instruments**

*To update that the IASB issued EDs to replace the financial instruments Standards.*

11.911.9 In June 2002, the IASB issued an exposure draft that contained proposed amendments to the two standards dealing with financial instruments – IAS 32, *Financial Instruments: Disclosure and Presentation* and IAS 39, *Financial Instruments: Recognition and Measurement*. The objective of the Exposure Draft is to improve the existing requirements in IAS 32 and IAS 39. The amendments incorporate key elements of existing Standing Interpretations Committee (SIC) Interpretations and issues identified by the IAS 39 Implementation Guidance Committee and other interested parties and eliminate internal inconsistencies. Improvements proposed in the exposure draft for IAS 39 include:

- clarifying the derecognition provisions of a financial asset by establishing guiding principles of the continuing involvement approach that disallows derecognition to the extent to which the transferor has continuing involvement in an asset or a portion of an asset it has transferred. It is not necessary to consider the risk-reward approach to assess whether derecognition is appropriate;
- financial instruments are permitted to be measured at fair value, with changes in fair value to be recognized as net income (or loss) in the profit and loss in the periods in which they arise;
- additional guidance on how to determine fair value using the fair value techniques;
- providing guidance on how to evaluate an impairment in a financial instrument;  
and

11.9• all disclosure requirements in IAS 39 have been moved to IAS 32.

11.10 The IASB has on its agenda a longer-term project to reconsider the fundamental approach to accounting for financial instruments. The current review of IAS 39 ~~The measurement approach adopted in IAS 39 is currently subject to review. Proposals for a more comprehensive standard includes~~ the views of the International Accounting Standards Committee (IASC) Joint Working Group (JWG), which have been published in the Draft Standard and Basis for Conclusions – Accounting for Financial Instruments and Similar Items (Financial Instruments Joint Working Group, December 2000)<sup>1</sup>. The Draft Standard

<sup>1</sup> The JWG was formed in 1997 for the sole purpose of developing a coherent framework for reporting financial instruments at fair value. That framework was to be based on the principles discussed in the March 1997 Discussion Paper, *Accounting for Financial Assets and Financial Liabilities*, issued by the IASB and the Canadian Institute of Chartered Accountants, as further developed or amended as a result of the deliberations of the JWG. The JWG consists of nominees of accounting standard setters or other professional organizations in Australia, Canada, Item 12.2 *Extracts of Changes to Study 14*

proposed replacement of most of IAS 39 and International Accounting Standard IAS 32, *Financial Instruments: Disclosure and Presentation*. The proposals in the Draft Standard include:

- measurement of virtually all financial instruments at fair value;
- recognition of virtually all gains and losses resulting from changes in fair value in the Statement of Financial Performance in the periods in which they arise;
- the prohibition of special accounting for financial instruments used in hedging relationships;
- adoption of a components approach for accounting for transfers of financial assets; and
- some expansion of disclosures about financial instruments, financial risk positions and Statement of Financial Performance effects.

~~While the current review of IAS 39 encompasses certain of the proposals of the draft standard, further work on the draft standard is not currently on the short-term timetable of the IASB.~~

~~11.10 Although these proposals could have a significant impact on the reported balances of some entities, entities complying with IPSAS 15 would already have information on fair values for disclosure purposes.~~

~~11.11 Discussion of issues associated with the measurement of certain financial assets and liabilities at fair values, including the estimation of fair value when little or no market evidence is available, is found in Preliminary Views on Major Issues Related to Reporting Financial Instruments and Certain Related Assets and Liabilities at Fair Value (FASB 1999). The recommendations in the JWG Draft Standard for fair value measurement are broadly similar to those in the Preliminary Views, though some details differ. A discussion of some differences is found in the JWG Draft Standard.~~

## **Chapter 12: Employee-related Liabilities**

*To reflect that the PSC deferred the project on employee benefits.*

12.9 At the time of ~~writing~~issue of this Study (2<sup>nd</sup> Edition), there is no IPSAS dealing with the recognition of liabilities arising from employee-related expenses. ~~Exposure Draft~~ International Public Sector Accounting Standard IPSAS ~~ED-219~~ *Provisions, Contingent Liabilities and Contingent Assets* excludes provisions arising from employee benefits. International Accounting Standard IAS 19, *Employee Benefits* is one source of guidance on the recognition of employee-related expenses, including pension costs. The IASB is currently performing a limited convergence project on post employment benefits. The

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France, Germany, Japan, New Zealand, the Nordic Federation, the United Kingdom, and the United States, as well as the IASB. The positions taken in the Draft Standard reflect the views of a majority of the members of the JWG. They do not necessarily represent the view of the organizations that nominated the members of the JWG. The draft Standard and the comments letters from constituents ~~Updates on developments in this area~~ can be ~~monitored/downloaded~~ at <http://www.iasb.org.uk>. The IASB recently announced that they will study further the results of the Joint Working Group's Draft Standard and basis for conclusions on financial instruments and similar items. This work would be preparatory to any decisions on how to proceed with this topic.

Item 12.2 *Extracts of Changes to Study 14*

PSC Berlin November 2003

Public Sector Committee (PSC) has ~~not yet deferred~~ considerationed of the application of this standard to public sector entities until the IASB has completed its review of IAS 19; but has indicated its intention to develop an IPSAS on employee benefits. Examples of other authoritative pronouncements are included in the References to this Chapter. Despite the fact that ~~Exposure Draft IPSAS ED-219~~ does not apply to employee ~~entitlements~~benefits, the guidance in ~~Exposure Draft IPSAS ED-219~~ may be useful where the accounting standard being applied by an entity does not contain guidance on a specific employee ~~entitlement~~benefit, or where the entity is uncertain whether an obligation meets the definition of an employee ~~entitlement~~benefit.

### **Chapter 13: Liabilities arising from Social Policy Obligations**

*To note the change of wordings in the exclusion scope from ED 21 to IPSAS 19 and that PSC has set up a steering committee on social policy obligations.*

- 13.1 This Chapter addresses issues associated with the identification and recognition of liabilities arising from the social ~~policy obligations~~benefits of provided by governments for which the government does not receives ~~no or nominal~~ consideration that is approximately equal to the value of goods and services provided, directly in return from the recipients of those benefits. Social ~~benefits~~policy obligations arising from exchange transactions ~~will be~~are dealt with by the IPSAS based on ~~Exposure Draft~~ International Public Sector Accounting Standard IPSAS ~~ED-219~~ *Provisions, Contingent Liabilities and Contingent Assets* (refer Chapter 7). In addition, this Chapter does not address issues associated with employee-related liabilities (refer Chapter 12).
- 13.5 At the time of ~~writing~~issue of this Study (2<sup>nd</sup> Edition), there is no IPSAS dealing specifically with the accounting treatment of liabilities arising from social policy obligations. ~~In addition, Exposure Draft IPSAS ED-21 excludes from the scope of the Standard provisions and contingent liabilities that arise from social benefits which the entity provides to the community and for which no or nominal consideration is expected directly in return from the recipients of those benefits.~~The PSC has established a Steering Committee to assist in the development of guidance on this issue. The Steering Committee is now preparing an Invitation to Comment which is the first step in the process of developing an IPSAS and is intended to provide the basis to initiate a full public discussion of the issues.

### **Chapter 14, paragraphs 14.2 – 14.3**

*To note that the PSC has set up a steering committee on non-exchange revenue.*

- 14.2 There is currently no IPSAS dealing with the definition and recognition of non-exchange revenue. The PSC has established a Steering Committee to assist in the development of guidance on this issue. The Steering Committee is now preparing an Invitation to Comment which is the first step in the process of developing an IPSAS and is intended to provide the basis to initiate a full public discussion of the issues.

- 14.3 Other sources of guidance include a G4+1<sup>1</sup> Special Report, Accounting by Recipients for Non-Reciprocal Transfers, Excluding Contributions by Owners: Their Definition, Recognition and Measurement (Westwood and Mackenzie, 1999) which considered the appropriate treatments for non-reciprocal transfers, and Governmental Accounting Standards Board (GASB) Statements 33 and 36 dealing with the recognition of non-exchange transactions on a modified accrual basis (GASB 1998 and 2000). International Accounting Standard IAS 20 Accounting for Government Grants and Disclosure of Government Assistance deals with the recognition of government grants and assistance by enterprises. International Accounting Standard IAS 41, Agriculture also provides guidance in relation to government grants. ~~It~~ However, these Standards does not focus on taxation and other ~~the~~ types of non-exchange revenues that may be received by the government itself.

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1 The G4+1 ~~is~~ was an international group of standard setters. The standard-setting bodies associated with this Special Report were: Australian Accounting Standards Board, Canadian Accounting Standards Board, International Accounting Standards Board, New Zealand Financial Reporting Standards Board, United Kingdom Accounting Standards Board, and United States Financial Accounting Standards Board. The Group was disbanded in February 2001.

## PART IV – SPECIFIC TOPICS

Part IV of this Study discusses implementation issues arising from the recognition of certain assets, liabilities, revenues and expenses that are not covered in Part III. These topics have been dealt with separately in order to allow the reader to focus on the issues associated with them ~~in more depth than would have occurred in Part III. It also considers implementation issues for segment reporting (in Chapter 16) and related parties (Chapter 17).~~

The Chapters focusing on specific asset topics are:

- Chapter 9 *Cash*; and
- Chapter 10 *Intangible Assets*.

Chapter 11 *Financial Instruments* deals with issues in financial reporting of financial assets and liabilities.

The Chapters focusing on specific liability topics are:

- Chapter 12 *Employee-Related Liabilities*; and
- Chapter 13 *Liabilities Arising From Social Policy Obligations*.

The issues discussed in these two Chapters also relate to the recognition of the associated expenses.

Chapter 14 *Non-Exchange Revenue* focuses on the major source of revenue for many public sector entities.

Chapter 15 *Foreign Currency* explains the implications of adopting International Public Sector Accounting Standard IPSAS 4 *The Effects of Changes in Foreign Exchange Rates* to account for foreign currency gains and losses.

The Public Sector Committee (PSC) intends to revise this Study periodically to include explanations of the requirements of recently issued International Public Sector Accounting Standards. This revision process will not be continuous and at any point in time IPSASs additional to those included herein may be on issue. Consequently, readers will need to monitor IPSASs as they are issued on the IFAC website ([www.ifac.org](http://www.ifac.org)). As part of the revision process the PSC may develop further Chapters for inclusion in this Part or amend these Chapters. ~~Readers are invited to provide suggestions for specific topics, along with examples of implementation strategies or issues that have arisen in their jurisdictions.~~

## **CHAPTER 16: SEGMENT REPORTING**

### **Key Points**

- International Public Sector Accounting Standard IPSAS 18 Segment Reporting (<http://www.ifac.org/PublicSector/>) contains guidance on the disclosure of segment reporting.
- In order to apply IPSAS 18, entities need to ensure they have systems for identifying the different activities that will be grouped as separate segments. Reporting these segments will provide information for accountability and decision-making purposes.

### **Introduction**

- 16.1 This Chapter outlines the requirements of IPSAS 18 and explains the steps that an entity would need to complete if it is to comply with IPSAS 18.
- 16.2 Segment reporting provides information to assist users of the financial statements to better understand the entity's past performance and to identify the resources allocated to support the major activities of the entity. The disclosure of information by segments also enhances transparency of financial reporting and enables the entity to better discharge its accountability obligations.

### **Definitions**

- 16.3 IPSAS 18, paragraph 9, defines a segment as “distinguishable activity or group of activities of an entity for which it is appropriate to separately report financial information for the purpose of evaluating the entity's past performance in achieving its objectives and for making decisions about the future allocation of resources”<sup>1</sup>.

### **Reporting Structures**

- 16.4 An entity complying with the requirements of IPSAS 18 will have to identify and determine each distinguishable activity or group of activities as separate segments and this involves judgment.
- 16.5 In most cases, the major classifications of activities identified in budget documentation will reflect the segments for which information is reported to the senior management of the entity. These are a useful starting point in determining segments. This is because the senior management will require information about segments to enable them to evaluate the performance of the entity and for decision making in the future. However, management often requires more detailed information, so an aggregate of this information may be appropriate.
- 16.6 Other examples where financial information is often aggregated and reported include:
- major economic classifications of activities undertaken by the general government (these may reflect the Government Finance Statistics (GFSM 2001))

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<sup>1</sup> It should be noted that definition of segments in IPSAS 18 differs from IAS 14, *Segment Reporting* (revised 1997).

- functional classifications by government) and major trading activities undertaken by GBEs;
- portfolio responsibilities of individual ministers or members of the executive government;
- “service segments” – distinguishable component of an entity that is engaged in providing related outputs or achieving particular operating objectives consistent with the overall mission of each entity; and
- “geographical segments” – distinguishable component of an entity that is engaged in providing outputs or achieving particular operating objectives within a particular geographical area.

### **Information Requirements**

#### **16.7 Entities intending to comply with IPSAS 18 will need to:**

- identify the nature, component and relevant activities of each segment reported;
- develop segment accounting policies that conform to the accounting policies adopted for preparing and presenting financial statements;
- identify each individual segment revenue, segment expense, total carrying amount of segment assets and segment liabilities and provide a reconciliation between the segmental information and the aggregate information in the financial statements;
- be able to generate the total cost incurred to acquire segment assets;
- be able to generate the aggregate of the entity’s share of net surplus (deficit) of associates, joint ventures, or other investments accounted for under the equity method if substantially all of those associates’ operations are within a single segment;
- develop policies on the basis of pricing inter-segment transfers; and
- be able to identify the prior period segment data, when there is a change in segment accounting policies or a creation of a newly identified segment. This is because an entity will need to disclose the restated comparative information.

### **Relevance to Cash Basis of Accounting**

**16.8** An entity preparing its financial statements on the cash basis of accounting may provide a statement of segmental information on the cash basis in its general purpose financial statements. Other information which the entity may disclose in that statement include the types of goods and services provided by each reported service segment, the composition of each reported geographical segment and if neither service nor geographical basis of segmentation is adopted, the nature of the segment and activities encompassed by it.

**16.9** Many of the other issues identified in this Chapter are relevant to entities intending to provide additional information encouraged by the Cash Basis IPSAS *Financial Reporting Under The Cash Basis of Accounting*.



## **References**

International Federation of Accountants (IFAC), IPSAS 18 *Segment Reporting*,  
<http://www.ifac.org/PublicSector/>, June 2002.

International Federation of Accountants (IFAC), IPSAS *Financial Reporting Under The Cash  
Basis of Accounting*, <http://www.ifac.org/PublicSector/>, January 2003.



## **CHAPTER 17: RELATED PARTY DISCLOSURES**

### **Key Points**

- International Public Sector Accounting Standard IPSAS 20 *Related Party Disclosures* (<http://www.ifac.org/PublicSector/>) contains requirements on the disclosure of related party relationships and certain transactions with related parties.
- Applying IPSAS 20 involves identifying which parties control or significantly influence the reporting entity and making the required disclosures about them.
- To comply with the Standard, a reporting entity will need to have in place:
  - mechanisms to identify related party transactions that are not conducted within the parameters of the normal operating procedures/mandate of the reporting entity; and
  - records of the remuneration and benefits received by the key management personnel and their close family members, from the reporting entity.

### **Introduction**

- 17.1 Related party relationships exist throughout the public sector – Ministers and other elected/appointed members of the government and senior management can exert significant influence on the operations of government departments and other entities. Government departments and entities frequently conduct activities necessary for the discharge of their responsibilities and achievement of their objectives through separate controlled entities, and through entities over which they have significant influence.
- 17.2 IPSAS 20 requires the disclosure of the existence of related party relationships where control exists, and the disclosure of information about transactions between the entity and its related parties in certain circumstances. The information is required for accountability purposes and to facilitate a better understanding of the financial position and performance of the reporting entity.

### **Definitions**

- 17.3 IPSAS 20 contains definitions of key management personnel, remuneration, close members of the family of an individual and significant influence on the reporting entity.
- 17.4 Parties are defined as related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions or if the related party entity and another entity are subject to common control. Related parties include:
- (a) entities that directly, or indirectly through one or more intermediaries, control, or are controlled by the reporting entity;
  - (b) associates;
  - (c) individuals owning, directly or indirectly, an interest in the reporting entity that gives them significant influence over the entity, and close members of the family of any such individual;

- (d) key management personnel, and close members of the family of key management personnel; and
- (e) entities in which a substantial ownership interest is held, directly or indirectly, by any person described in (c) or (d), or over which such a person is able to exercise significant influence.

### **Related Party Disclosures**

17.5 It will be necessary for the reporting entity to create a process to identify and review its related parties. The process will include:

- identifying the reporting entity's controlled and controlling entities. International Public Sector Accounting Standard IPSAS 6 *Consolidated Financial Statements and Accounting for Controlled Entities* provides guidance on the concept of 'control' of another entity for financial reporting purposes;
- identifying the reporting entity's associates. International Public Sector Accounting Standards IPSAS 7 *Accounting for Investments in Associates* provides guidance on what is an associate; and
- maintaining a record of the reporting entity's key management personnel and their close family members. This record will include information on:
  - the amount of remuneration and benefits received from the reporting entity; and
  - entities in which a substantial ownership interest is held (directly or indirectly) by the key management personnel and their family.

### **Related Party Transactions**

17.6 Related party transactions are transfers of resources or obligations between related parties, regardless of whether a price is charged. However, they exclude transactions with any other entity that is a related party:

- solely because of its economic dependence on the reporting entity or the government of which it forms part; and
- that are within the normal operating procedures of the reporting entity.

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

- review its relationship with its related parties; and
- identify what constitutes the normal operating procedures/mandate with its related parties and develop new policies to deal with any uncertainties.

### **Related Party Disclosures**

17.8 To comply with the disclosure requirements of IPSASs, an entity will have to:

- identify all of its related parties;
- identify and maintain records of the relevant related party transactions. These records should outline:
  - the nature of the related party relationships;
  - types of transaction that have occurred; and

- other elements of the transactions necessary to clarify the significance of the transactions to its operations such as the terms and conditions of these transactions;
- identify and disclose all the remuneration and benefits (both direct and indirect) of key management personnel and their close family members derived from the reporting entity. Currently, there is no International Public Sector Accounting Standard on the measurement of employee benefits. International Accounting Standard IAS 19, *Employee Benefits* provides guidance on measurement of certain employee benefits; and
- identify loans provided to key management personnel and their close family members, the availability of which is not widely available to persons who are outside the key management group or which are not widely known by the public. Management should establish policies and criteria on when and how such loans can be approved. An entity providing these types of loans should have systems that are able to generate:
  - the amount advanced and the terms and conditions thereof;
  - the amount repaid during the period and the closing balance of all loans and receivables; and
  - where the recipient is not a member of the governing body nor part of the senior management, the relationship of the individual as such.

#### **Relevance to the Cash Basis of Accounting**

17.9 The issues identified in this Chapter are relevant for entities intending to provide additional disclosure on related party disclosures as encouraged in Part 2 of the Cash Basis IPSAS *Financial Reporting Under The Cash Basis of Accounting*.

## **References**

International Federation of Accountants (IFAC), IPSAS 20 *Related Party Disclosures*, <http://www.ifac.org/PublicSector/>, October 2002.

International Federation of Accountants (IFAC), Cash Basis IPSAS *Financial Reporting Under The Cash Basis of Accounting*, <http://www.ifac.org/PublicSector/>, January 2003.