UPDATE
PUBLIC SECTOR COMMITTEE
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535 Fifth Avenue, 26th Floor Tel: (212) 286-9344
New York, New York 10017 Fax: (212) 286-9570
Internet: http://www.ifac.org

Introduction

The outcome of the PSC's deliberations at its last meeting, in May 2001, is outlined below.

The PSC is currently undertaking the first stage of an ongoing project to develop and maintain International Public Sector Accounting Standards (IPSASs) for financial reporting by governments and other public sector entities (the Standards Project). The Attachment to this Update summarizes the IPSASs issued to date and the exposure drafts currently on issue.

The PSC continues to make good progress on its Standards Project and other aspects of its work program. At this meeting, the PSC agreed five International Public Sector Accounting Standards, two Exposure Drafts of proposed IPSASs and a Study on Governance in the Public Sector. The IMF and World Bank have agreed to provide some (though not all) of the funding necessary for the second stage of the PSC's Standards Project, and the PSC continues to seek additional funding from other potential Funders.

PSC Meeting, 30 April – 3 May 2001

IPSASs and Exposure Drafts Approved

At this meeting, the PSC approved for issue in late June 2001 the following International Public Sector Accounting Standards (IPSASs):

- *Revenue from Exchange Transactions*
- *Inventories*
- *Construction Contracts*
- *Financial Reporting in Hyperinflationary* Economies

An IPSAS on *Lease* was also approved for issue in the fourth quarter of 2001 after final review of editorial amendments at the PSC's next meeting.

Exposure Drafts (EDs) of these IPSASs were issued for comment in July 2000. The comment period ended on 30 November 2000 (30 January 2001, in respect of the ED on *Leases*). Between 30 and 40 responses were received on each ED. Responses were strongly supportive of the issuance of IPSASs based on the EDs.

At this meeting, the PSC also approved for issue in late June 2001 the following exposure drafts:

- *Related Party Disclosures*
- *Provisions, Contingent Liabilities and Contingent Assets*

The major features of these IPSASs and EDs are outlined below.

IPSAS 9 *Revenues from Exchange Transactions*

IPSAS 9 is based on IAS 18 *Revenue* and establishes requirements for the accounting treatment of revenue from exchange transactions. Like IAS 18, the IPSAS applies to revenues from the rendering of services, sale of goods, interest, royalties and dividends. Non-exchange revenue such as taxation revenue, is not dealt with by this IPSAS. The PSC acknowledges that accounting for such non-exchange revenue is a significant issue for the public sector which should be dealt with as a high priority in stage two of the Standards Project.

IPSAS 10 *Inventories*

IPSAS 10 is based on IAS 2 *Inventories* and establishes the accounting treatment of inventories held by public sector entities. The IPSAS deals with both inventories held for sale in an exchange transaction and inventories held for distribution at no, or nominal, charge. The IPSAS requires that:

- inventories held to generate net cash inflows are to be measured at the lower of cost or net realizable value; and
- inventories held for distribution at no, or nominal, charge are to be measured at the lower of historical cost or current replacement cost.

The PSC also agreed that the last-in-first-out (LIFO) method of calculating inventory costs is not relevant for the public sector and should not be allowed by the IPSAS.

IPSAS 11 *Construction Contracts*

IPSAS 11 is based on IAS 11 *Construction Contracts*. It deals with both commercial and non-commercial contracts and provides guidance on the allocation of contract costs

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and expenses and, where applicable, contract revenue to the reporting periods in which construction work is performed.

The scope of the standard includes contracts where revenue is derived from parties to the construction contract, from third parties, or by appropriation from government.

IPSAS 12 *Financial Reporting in Hyperinflationary Economies*

IPSAS 12 is based on IAS 29 *Financial Reporting in Hyperinflationary Economies*. IPSAS 12 describes characteristics of an economy that indicate whether it is experiencing a period of hyperinflation, and:

- requires entities reporting in the currency of a hyperinflationary economy to restate their financial statements using a general-price index; and
- explains that where a general price index is not available, it may be necessary to estimate inflation by, for example, reference to changes in the exchange rate between the reporting currency and a relatively stable foreign currency.

IPSAS 13 *Leases*
(to be issued in the fourth quarter 2001)

This IPSAS is based on IAS 17 *Leases.* The IPSAS establishes requirements for financial reporting of leases and sale and leaseback transactions by public sector entities, whether as lessee or lessor. The PSC decided that because the IPSAS on *Leases* and the proposed IPSAS on *Property, Plant and Equipment* are closely related, it was preferable that the two IPSASs be released at the same time. Accordingly, the release of this IPSAS has been deferred to later in 2001. (See the section on Work in Progress below for a report on progress on the IPSAS on *Property, Plant and Equipment*.)

ED 20 *Related Party Disclosures*
(to be issued in late June for comment by 31 October 2001)

The PSC approved an ED based on IAS 24 *Related Party Disclosures*. The ED explains that in the public sector the incidence and consequences of certain related party relationships and transactions differs from the private sector. Consequently, the ED does not require the disclosure of detailed information about transactions that occur under normal operating conditions.

The ED differs from IAS 24 in that it includes additional guidance on the nature of related party relationships that arise in the public sector, the identity of key management personnel of public sector entities, and the information about related party relationships and transactions that should be disclosed for accountability purposes. The ED also specifically requires the disclosure of certain information about the remuneration of key management personnel.

ED 21 *Provisions, Contingent Liabilities and Contingent Assets*
(to be issued in late June for comment by 31 October 2001)

The PSC approved, subject to final review by members out of session, an ED based on IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*. Consistent with IAS 37, the ED defines provisions as liabilities of uncertain timing or amount and includes requirements for the recognition and measurement of these provisions, and the disclosure of information about contingent assets and contingent liabilities.

Governments and their agencies often make commitments to provide on-going health, pension, education and other social welfare type services and benefits to the community at no, or nominal, charge to recipients. The PSC acknowledges that for some social policy obligations the "obligating event" may not be clear and IAS 37 had not been developed to explicitly deal with these public sector specific circumstances. Consequently, the PSC agreed that this ED should exclude from its scope provisions that arise from such social policy commitments. The PSC intends to initiate a separate project to consider the appropriate financial reporting treatment of provisions arising from social policy obligations in the second phase of its Standards Project.

Work in Progress

ED 14 *Property, Plant and Equipment*

The ED was issued in July 2000 for comment by 30 January 2001. At this meeting the PSC reviewed the almost 40 submissions received. Submissions reflected a high level of support for the propositions included in the ED. The most contentious issue was whether heritage and cultural assets should be recognised and could be measured reliably. The PSC agreed that, in principle, all property, plant and equipment (including military, infrastructure, heritage and cultural assets) should be recognised. However, the PSC has not completed its deliberations on the basis of measurement appropriate for heritage and cultural assets. These, issues will be further discussed at the PSC's next meeting.

Invitation To Comment (ITC) on *Impairment of Assets*

The ITC was issued in July 2000 and sought the views of constituents on the application of an impairment test to non-current assets held by public sector entities. The period for comment ended on 30 January 2001. At this meeting the PSC reviewed the 30 submissions received on the ED.

The submissions were very supportive of the tentative views expressed by the PSC in the ITC. However, those submissions identified that for assets that are not held for their ability to generate cash inflows there are a number of complex issues that need to be considered in determining:

- what indicators should be applied to test for impairment;
- where an impairment loss is indicated, how that loss should be measured; and
- whether alternative approaches to the identification and measurement of impairment are appropriate dependent on whether assets are carried at historical cost or at revalued amounts.

The PSC agreed that these issues should be further considered at the next meeting with a view to releasing an ED in early 2002. The PSC also tentatively agreed that the ED should require that for assets held primarily for their ability to generate net cash inflows, the provisions of IAS 36, *Impairment of Assets* should apply.

ED 9 *Financial Reporting under the Cash Basis of Accounting*

The ED was issued in May 2000 for comment by 30 November 2000. At this meeting the PSC reviewed the 41 submissions received. Respondents were strongly of the view that a Standard on the cash basis should be developed and supported the majority of the propositions in the ED. However, there were differing views on whether third party payments should be considered as part of the cash flows of the entity, and whether the financial statement should include only the cash flows encompassed by the budget, or all cash flows controlled by the entity. Some respondents also noted that there would be practical difficulties in preparing financial statements that reflected all the cash balances and cash flows that a government controlled.

The PSC is aware that a majority of its constituents prepare financial statements on the cash basis and is concerned that it has received relatively few responses to this ED, particularly from developing countries which generally adopt the cash basis of reporting. Consequently, the PSC has decided to extend its due process by including a further period of targeted consultation. In co-operation with the World Bank, the PSC will approach a number of developing countries to consider their views on the proposals in the ED, and to gain a better appreciation of the practical difficulties that may be encountered in complying with the proposals in the ED.

The period of extended consultation is expected to be completed by the end of 2001 and, depending on the outcome of the consultation, a Standard will be finalized early in 2002.

Non Standards Project Activities

In addition to work on the Standards Project, the PSC also deals with other matters as time allows. At this meeting these matters included the following:

Governance in the Public Sector

In June 2000 the PSC issued for comment a proposed study *Corporate Governance in the Public Sector*. Responses were due in November 2000. At this meeting, the PSC considered responses received on the proposed study and agreed a number of changes, including a new title - *Governance in the Public Sector*. The Study is being revised and will be circulated to PSC members for approval with a final version expected to be issued in the third quarter of 2001.

Next PSC meeting : September 2 – 4, 2001

For further information please contact:

Ian Mackintosh, Chairman PSC (ian.mackintosh@asic.gov.au)
Paul Sutcliffe, Standards Project Director (psutcliffe@ifac.org)
Jim Sylph, IFAC Technical Director (jimsylph@ifac.org)
Simon Lee, PSC Technical Manager (simonlee@ifac.org)

ATTACHMENT

Summary of PSC Standards Project Documents

<u>BACKGROUND PAPER*</u>

IFAC PSC Study11 *Governmental Accounting Issues and Practices* aims to assist governments in the preparation of their financial reports and contains a detailed description of the common bases of accounting used by governments: cash accounting (including modified cash accounting) and accrual accounting (including modified accrual accounting). The Study also provides examples of actual financial statements prepared under each basis.

<u>INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS (IPSASs)</u>*****

IPSAS 1 *Presentation of Financial Statements* sets out the overall considerations for the presentation of financial statements, guidance for the structure of those statements and minimum requirements for their content under the accrual basis of accounting.

IPSAS 2 *Cash Flow Statements* requires the provision of information about the changes in cash and cash equivalents during the period from operating, investing and financing activities.

IPSAS 3 *Net Surplus or Deficit for the Period, Fundamental Errors and Changes in Accounting Policies* specifies the accounting treatment for changes in accounting estimates, changes in accounting policies and the correction of fundamental errors, defines extraordinary items and requires the separate disclosure of certain items in the financial statements.

IPSAS 4 *The Effect of Changes in Foreign Exchange Rates* deals with accounting for foreign currency transactions and foreign operations. IPSAS 4 sets out the requirements for determining which exchange rate to use for the recognition of certain transactions and balances and how to recognize in the financial statements the financial effect of changes in exchange rates.

IPSAS 5 *Borrowing Costs* prescribes the accounting treatment for borrowing costs and requires either the immediate expensing of borrowing costs or, as an allowed alternative treatment, the capitalization of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset.

IPSAS 6 *Consolidated Financial Statements and Accounting for Controlled Entities* requires all controlling entities to prepare consolidated financial statements which consolidate all controlled entities on a line by line basis. The Standard also contains a detailed discussion of the concept of control as it applies in the public sector and guidance on determining whether control exists for financial reporting purposes.

IPSAS 7 *Accounting for Investments in Associates* requires all investments in associate to be accounted for in the consolidated financial statements using the equity method of accounting, except when the investment is acquired and held exclusively with a view to its disposal in the near future in which case the cost method is required.

IPSAS 8 *Financial Reporting of Interests in Joint Ventures* requires proportionate consolidation to be adopted as the benchmark treatment for accounting for such joint venturers entered into by public sector entities. However, IPSAS 8 also permits – as an allowed alternative – joint ventures to be accounted for using the equity method of accounting.

<u>STANDARDS TO BE RELEASED IN JUNE 2001</u>

IPSAS 9 *Revenue from Exchange Transactions* specifies requirements for the recognition and measurement of revenue arising from exchange transactions.

IPSAS 10 *Inventories* specifies requirements for the treatment for inventories held for sale and for distribution at no, or nominal charge, to the recipient.

IPSAS 11 *Construction Contracts* specifies requirements for the treatment of contract costs and revenues arising from construction contracts undertaken by public sector entities.

IPSAS 12 ***Financial Reporting in Hyperinflationary Economies*** specifies requirements for financial reporting under conditions of hyperinflation.

<u>STANDARDS TO BE RELEASED IN FOURTH QUARTER 2001</u>

IPSAS 13 ***Leases*** specifies requirements for the recognition and measurement of leasing transactions entered into by public sector entities**.**

<u>EXPOSURE DRAFTS/INVITATION TO COMMENT – COMMENT PERIOD EXPIRED – UNDER CONSIDERATION BY PSC*</u>

ED 9 ***Financial Reporting Under the Cash Basis of Accounting*** proposes requirements for the preparation and presentation of the cash flow statement and supporting accounting policy notes under the cash basis of accounting. It includes requirements relating to the identification of the reporting entity and the structure and the minimum content of the cash flow statement. ***Comment period closed: November 30, 2000***.

ED 14 ***Property, Plant and Equipment*** proposes the accounting treatment for property, plant and equipment, including the basis and timing of their initial recognition, and the determination of their ongoing carrying amounts and related depreciation. ***Comment period closed: January 30, 2001.***

ITC ***Impairment of Assets*** – In addition to these exposure drafts the PSC has published an Invitation to Comment (ITC) on *Impairment of Assets*. The purpose of the ITC is to seek comments on the appropriate accounting treatment for the impairment of assets. It reflects the tentative position of the PSC that an impairment test should be applied to all assets but that the cash flow test required by IAS 36 *Impairment of Assets* is not appropriate for assets held by public sector entities for the delivery of goods and services rather than the generation of positive cash flows for the entity. ***The comment period closed: January 30, 2001***.

<u>EXPOSURE DRAFTS CURRENTLY ON ISSUE FOR COMMENT*</u>

ED 16 ***Events After the Reporting Date*** proposes requirements for the disclosure of certain events that occur after the reporting date. ***Comment deadline: May 31, 2001.***

ED 17 ***Segment Reporting*** proposes requirements for the disclosure of financial statement information about distinguishable activities of reporting entities. ***Comment deadline: May 31, 2001.***

ED 18 ***Financial Instruments: Disclosure and Presentation*** proposes requirements for the presentation of on-balance-sheet financial instruments and identifies the information that should be disclosed about both on-balance-sheet (recognized) and off-balance-sheet (unrecognised) financial instruments. ***Comment deadline: May 31, 2001.***

ED 19 ***Investment Property*** proposes the accounting treatment, and related disclosures, for investment property. ***Comment deadline: May 31, 2001.***

****Copies of these documents are available at www.ifac.org***