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Exposure Draft 61, Amendments to Financial Reporting under the Cash Basis of Accounting (the Cash Basis IPSAS)

Electronic response received

Group	Accounting Standards Group of the Centre des Professions Financières (ASGC)
Country/Region	France
Organization/Individual	Finance profession association

Comments to the exposure draft 61
on the amendments to financial reporting under the Cash IPSAS

The exposure draft 61 is specially welcomed since improvements of the Cash IPSAS were expected since the report of the task force on the review of the cash basis IPSAS was published in 2010.

The thorough revision of the Standard proposed in this document brings substantial progress. However more could have been expected in order to make the Standard 1) even more users friendly and 2) more in line with the common language and practice of the public financial management and reporting.

Indeed it should be not overlooked that presently in most jurisdictions the main piece of financial information requested and used by the Legislature relates to the budget execution. Certainly the role of the Financial Statements as a major piece of financial information is growing in the public sector. However standards setters should always keep in mind that using Financial Statements as a major piece of financial information in the public sector is conditioned by their ability to be easily understood and utilized by the Legislature and more generally a broad public beyond a set of specialists.

Therefore the thrust of the comments and suggestions below is oriented according to these concerns, and more precisely for following grounds.

The preparers, users and auditors of public sector entities in countries using Cash IPSAS need a not too sophisticated approach to the financial statements, since these jurisdictions usually have not developed an extensive public financial reporting and even, in some cases, the basics of budget execution and cash control may not be met yet.

Furthermore the use of a rather abstract language, usual in the world of sophisticated accounting and auditing, may discourage the use of the standard in the jurisdictions where it is needed the most.

Finally, and it is an issue that also concerns the whole IPSAS work and in particular the draft conceptual framework, there is not enough obvious coherence with the usual concepts and vocabulary of public finance. An example of this weakness, developed below, is the embarrassment about the definition of the users of the Financial Statements which is more of a list inspired by the private sector practice than a definition in coherence with the proper system and governance of public financial management, including control, audit and reporting.

A) General comment on the structure

"The IPSASB proposes to remove from Part 1 of the Cash Basis IPSAS requirements relating to the preparation of consolidated financial statements and the disclosure of information about external assistance and payments made by third parties. The IPSASB proposes that these requirements be modified and relocated as encouragements in Part 2 of the Cash Basis IPSAS. Part 2 of the IPSAS will encourage, but not require, the preparation of consolidated financial statements and the disclosure of certain information about external and other assistance and payments made by third parties."

The two sets of requirements related to (1) the consolidation and (2) the information about external assistance seem to rely on a different rationale in the Cash IPSAS.

(1) The relocation in part 2 as encouragement of the *information on consolidation* is certainly welcome, as this information concerns a limited number of jurisdictions.

(2) On the contrary appropriate *information on external assistance* is a major issue for most of the developing countries using the Cash IPSAS and moreover, among the stakeholders, for all donors, which are very concerned by extensive and accurate accounting information on the grants and loans they provide. So disclosure of these pieces of information should remain an authoritative requirement in part I.

However, for the sake of clarity, it doesn't seem advisable to maintain as a separate column in the Consolidated Statement of Cash Receipts and Payments the payments by third parties, as in the current version of the Standard. The information needed should appear in one or several notes and tables with all explanations needed by the stakeholders.

B) Comments on the amendments to the standard

Pages 1 and 2: structure of the standard

1 *"Part 1 is mandatory. It sets out the requirements which are applicable to all entities "*

It seems better to add **«public»** to «entities» in order to be more specific and coherent with the § 1.1 Scope of the requirements

2 Same comment for the next sentence.

3 3d bullet point c)

" Clarify that the role the Cash Basis IPSAS is intended to play in the IPSASB's overall standards setting strategy is primarily as a step on the path to adoption of the accrual basis IPSASs, rather than as an end in itself. »

Although it is explicitly mentioned in the objectives of the Cash IPSAS, P.8 that the path of transition to accruals will depend on the circumstances of the jurisdiction, it could be useful to briefly mention this point already in this initial chapter, adding **"the path of transition towards the accrual basis of IPSAS depending on the circumstances of each jurisdiction**".

4 part I requirements: role of the Cash basis IPSAS

«The IPSASB is of the view that the objectives of financial reporting can best be achieved by adoption of the accrual IPSASs. Consequently the IPSASB encourages governments and other public sector entities to present financial statements that comply with the requirements of the accrual IPSASs. However, the IPSASB appreciates that in some jurisdictions a transitionary process may be necessary to achieve that end. The Cash Basis IPSAS has been developed as an intermediate step to assist in the transition to the accrual basis of financial reporting and adoption of accrual IPSASs. It is not intended as an end in itself.

The role of the encouraged disclosures in Part 2 of the Standard is to support an entity's transition to the accrual basis of financial reporting and adoption of the accrual IPSASs.

The path chosen to transition to the accrual basis of financial reporting and adoption of the accrual IPSASs will reflect jurisdiction circumstances and, consequently, may differ from jurisdiction to jurisdiction. The IPSASB does not specify that a particular transitional path should be adopted nor that entities must necessarily adopt the Cash Basis IPSAS as the first step in the transition process.»

This § should be rewritten in order to emphasize the importance of:

- Having sound Cash Financial Statements before initiating a transition process toward accruals

Cash IPSAS cannot be considered only as an *intermediate* step; it has its proper consistency and significance, mostly rooted, in developing countries, in basic accounting principles and practices that may even be poorly understood and applied. **So the first concern is to have the Cash IPSAS consistently and extensively applied before considering it as a step in a transition process.**

- Preparing this transition by introducing pieces of information on accruals into the FSs (see below comments N° 7, 8, 14 and 15).

The best way to emphasize that transition towards accruals is wished and possible is to develop in the Cash IPSAS detailed provisions on pieces of accrual accounting to introduce in notes to Cash based Financial Statements. In this matter there is a room for some **educational content** in the Standard.

5 § 1.13

General purpose financial statements are developed primarily to respond to the informative needs of service recipients and resource providers who are not in a position to demand reports tailored to meet their specific information needs, and representatives of these users.

The problem raised here reflects a general weakness of the draft Conceptual Framework and the accruals IPSASs. Indeed in the draft conceptual framework, following definition: "The primary users of general purpose financial reports (GPFRs) are service recipients (and their representatives) and resource providers (and their representatives)" reflect a too limited vision of what are a public sector entity, its objectives, and its governance.

In the presentation of the users of public entities, priority should be given to the legal and institutional framework; so governance structure of public entities should be mentioned in the first place. Furthermore there is no need to present **Legislature** and **Parliament** distinctly**,** since Parliament may be a monocameral or a bicameral Legislature. Furthermore the Parliament as such and not the members of the Parliament must be mentioned as in most jurisdictions the Financial Statements are submitted to the Parliament as a legal entity. For public sub-entities, which are under the authority of another entity, this controlling entity (consolidating or not consolidating the sub-entities) is also to mention in the first place among the users.

There are also other public stakeholders: the Supreme Audit Institutions and other bodies auditing public entities at the regional level should be explicitly mentioned; the International Financial Institutions that are not common lenders should be cited distinctly among the public bodies concerned by the financial statements.

Then the list of other users should be presented in a more functional way by categories that could be, among others, the citizens, the taxpayers, the providers of external resources, the private and public entities contracting with the entity.

6 § *1.2.1*

Control of an entity: An entity controls another entity when the entity is exposed, or has rights, to variable benefits from its involvement with the other entity and has the ability to affect the nature or amount of those benefits through its power over the other entity.

This definition introduced in the draft amendment, reflects a purely economic vision of the public entities, **without due consideration to the legal environment**, however different it may be. Furthermore the use of the word "benefits" may raise some ambiguity and confusion and requires clarification: it is not obvious that it includes the service potential that can be expected from controlled entities and excludes all kinds of public sector enterprises.

7 §1.3.10.

Entities that report using the cash basis of accounting frequently collect information on items that are not recognized under cash accounting. Examples of the type of information that may be collected include details of:
(a) Receivables, payables, borrowings and other liabilities, non-cash assets and accruing revenues and expenses;
(b) Commitments and contingent liabilities; and
(c) Performance indicators and the achievement of service delivery objectives.

In order to encourage the transition to accruals, **importance of items a and b should be stressed and commented in detail**, with a mention on their importance in the path to accruals.

8 § 1.3.17

The sub-classifications (or classes) of total cash receipts and payments which will be disclosed in accordance with paragraphs 1.3.12 and 1.3.14 are a matter of professional judgment.

Here should be mentioned as good practice to use the classification by Major Classes of Cash Flows in the format required by IPSAS 2 Cash Flow Statements as developed in part II, § 2.1.23 and appendix 3 (see below **15**)

9 §1.3.27

«Constraints on information included in financial statements are that it is material, satisfies a cost-benefit assessment, and achieves an appropriate balance between the qualitative characteristics identified in (a) to (f) above.»

The concept of "constraints of information" needs clarification; furthermore even if the cost-benefit assessment may be useful, it should be recalled in the Standard that the pieces of information required for producing the Financial Statements are in most jurisdictions required by law. So a balance has to be achieved between i) the cost of gathering the information, ii) the intrinsic quality of the Financial Statements and iii) the degree of completeness in the implementation of the regulatory framework.

10 §1.4.8

The emphasis shall be clearly put in priority on the whole of government

11 § 1.5. Correction of error

« Potential current period errors discovered in the current period are corrected before the financial statements are authorized for issue. »

This provision needs clarification and should be mentioned separately from the following sentences, which appear to concern only errors related to previous years.

There are indeed two sets of possible errors: a) errors relate to previous years and discovered during the preparation of the current year Financial Statements; b) current period errors.

It may happen that errors related to previous years remain unexplained. It may also happen that current period errors cannot be corrected. In both cases these unexplained errors jeopardize the quality of the Financial Statements and, when material, may lead the public audit institution to qualify its opinion.

Therefore the Standard should be more explicit on the treatment of both categories of errors and cannot avoid mentioning that the Financial Statements are deemed to reveal any unexplained error or difference.

12 Budget reporting

There are three main reasons to include an extended reporting on budget execution and to require a detailed comparison with the Consolidated Cash Statement:

As recognized by all IFIs and well summarized in the first sentence of the SIGMA-OECD book on "managing public expenditure", "the national budget is the single most important policy vehicle for giving effect to a country's economic and social priorities within the scarce resources that are available to government for public expenditure".

Numerous developing and transition countries have developed a more or less reliable budget execution reporting based on basic accounting methods, from which they derive most of the information required for the production of the Financial Statements.

Numerous developed countries have also developed since the beginning of parliamentary regimes sophisticated budget execution control and reporting processes based on budget accounting systems; these systems are more and more in accordance with the general accounting principles; so they are a solid basis for the preparation of the Financial Statements.

So the Standard should, in front of § 1.9, stress the importance of budget reporting and the need to have an extensive comparison with the Consolidated Cash statement (see below 13).

As mentioned above, attention should be given to using concepts and terminology as near as possible to those used in budget reporting ; for example the concept of "actual" or "actual amounts" should be replaced by "budget outturn" or "budget execution", since in the Standard actual amounts is first of all used for the Financial Statements. The heading before 1.7.41. "Reconciliation of *Actual Amounts* on a Comparable Basis and *Actual Amounts* in the Financial Statements" is particularly confusing.

13 § 1. 9. 17 to 19

When the budget and financial statements are not prepared on a comparable basis, a separate statement of comparison of budget and actual amounts is presented. In these cases, to ensure that readers do not misinterpret financial information which is prepared on different bases, the financial statements ***could usefully clarify*** *that the budget and the accounting bases differ and the statement of comparison of budget and actual amounts is prepared on the budget basis*.

The wording « could usefully clarify » is too weak; it is **an essential piece of information to clearly identify the different bases on which both sets of information are established**.

In particular it is not unusual that the budget outturn is reported on modified cash basis, where payments on budget appropriations for the financial year made during a short period after the end of the year are accounted for in the year's outturn. The Standard should consider giving guidance on the methodology to be used for establishing in this case the comparison between budget outturn and actual amounts.

Moreover the Standard should explicitly state that **no budgetary procedure or practice can legitimate an exception to the principle that any cash transaction shall be accounted for**.

Finally the wording "the reconciliation of budget and financial statements is needed where both are not prepared on a comparable basis" may be misleading since it seems to imply that this situation as an exception, whereas experience shows that in most jurisdictions budget execution and financial statements are not prepared on a comparable basis.

14 Part 2 General comment:

The IPSAS Board should consider introducing priorities in the encouraged disclosures and, in particular, gathering under a common sub-header " elements of transition towards accrual accounting " all disclosures that will in a further step lead to the production of accrual based Financial Statements.

It should concern i) the disclosure of major classes of cash flow and ii) the information on receivables, payables, borrowings and other liabilities, non-cash assets and accruing revenues and expenses, commitments and contingent liabilities

15 2.1. 14 **Disclosure of Major Classes of Cash Flows**

As mentioned **in 9,** this provision could be usefully referred to in the part I provision related to the cash flow (1.3. 12 to 16), since it is a key piece of information that can improve the quality of information.

Furthermore the IPSAS Board should consider merging with this provision the major features of the annex 3 on IPSAS 2 « Cash Flow Statements », and putting the emphasis on the distinction between financing, investing and operating activities as a best practice to be recommended.

16 § 2.1.4. Going concern

"The determination of whether an entity is a going concern is primarily relevant for individual entities rather than for the government as a whole."

Using the concept of « going concern », directly borrowed from the private sector, is rather uncanny as the whole of government is concerned. So following wording is suggested:

"The determination of whether an entity is a going concern may be relevant for individual entities".

More generally, as a public entity is concerned, even if an economic rationale lies behind *"the entity's ability to continue as a going concern"* the determination to continue or not is a decision taken by the controlling authority in accordance with the relevant legal framework.

Therefore it would be advisable to entirely rewrite the § 2.1.4 in order to harmonize content and wording of this provision with the legal environment of public entities.

C) Further issues that the revision of the standard should need to take into consideration

From the outset, the Cash IPSAS has excluded, for the sake of coherence and simplicity, accounting systems based on modified cash. However if the door of the Cash IPSAS had been opened to jurisdictions using modified cash, the number of jurisdictions adopting Cash IPSAS would certainly have been higher. Indeed in numerous countries modified cash is used as a practical way to solve issues raised at year-end by the execution of budgetary operations. **So modified cash is not a system in itself but only a technical arrangement of cash accounting.**

Therefore the extension of the standard to modified cash merits consideration. The standard could incorporate a provision whereby receipts and payments related to revenues and expenditures of the period could be implemented during a supplementary period of time and included in the outturn of the period. This supplementary period shall be short and, in any case, limited to one month.

This provision could be added in the part II of the standard with, if needed, references in part I.

It could also be mentioned that if the duration of the supplementary period were harmonized with the budgetary rule (see comment B 13), the comparison between budget outturn and actual amounts would be easier.

D) Basis for conclusions (Part I and part II)
Each part of the Standard is accompanied by a "basis for conclusions "which is welcomed.

However, in our view, these addenda to the Standard should take into account the comments above, in particular **as the emphasis on the transition to accruals is concerned.**

There is **an unacceptable ambiguity** between the wording in BC 3 and BC 4b:

BC3

"Despite its limited adoption, the IPSASB's strategy consultation in 2014 found that there is strong support for retention of the Cash Basis IPSAS, ***whether as a Standard in its own right or as first step on the transition*** *to the accrual basis of financial reporting and adoption of accrual IPSASs and, in some cases, for revisions to its requirements to remove obstacles to its adoption."*

BC 4 b

"Clarify that the role the Cash Basis IPSAS is intended to play in the IPSASB's standards setting strategy is ***primarily as a step on the path to adoption of the accrual basis IPSASs, rather than an end in itself "***

In our view this last wording needs to be amended in order to clearly state that Cash IPSAS remains a Standard in its own right and that transition to accruals is desirable and recommended if the conditions are reasonably met for such a transition.