

THE WORLD BANK

COMMENTS ON EXPOSURE DRAFT #24, *FINANCIAL REPORTING UNDER THE CASH BASIS OF ACCOUNTING – DISCLOSURE REQUIREMENTS FOR RECIPIENTS OF EXTERNAL ASSISTANCE*, PUBLISHED BY THE INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS BOARD

Introduction

The World Bank submits the following comments on Exposure Draft #24, *Financial Reporting Under the Cash Basis of Accounting – Disclosure Requirements for Recipients of External Assistance*, issued by the International Public Sector Accounting Standards Board. The comments have been prepared under the auspices of the Bank's Financial Management Sector Board.

As one of the co-sponsors of this project, the Bank strongly supports the overall objectives of the Exposure Draft, which are to enhance the consistency and quality of financial reporting by recipients of external assistance, while reducing the compliance costs associated with such reporting. The Exposure Draft seeks to do this by shifting the basis of reporting away from project- and donor-specific special purpose financial reports, in favor of compliance with a generally accepted international standard.

Given these objectives, in our view the IPSASB's principal objectives should be to ensure that:

- The due process for completion of the standard will stand up to scrutiny.
- It is realistic to expect that governments and other public sector entities will be in a position to adopt the standard.
- The technical requirements of the proposed standard are coherent, consistent with the IPSASB's conceptual framework, and understandable to users.

In this context, our comments are set out below. These comments are intended positively, and are aimed at assisting the IPSASB in developing a high quality standard that contributes to our shared objective – an improvement in the quality of financial reporting in the public sector.

General Observations

1. Due Process

Notwithstanding the recent expansion of the membership of the IPSASB, developing country input to its deliberations is limited. The technical debate within the Board is dominated by the (majority) developing country members, and tends to be concerned with technical financial reporting questions, to the exclusion of any substantive

consideration of implementation challenges, or specific issues that are likely to arise in the predominantly low-capacity environments where the IPSASB is hoping that this standard will be implemented.

Partly to counterbalance its membership profile, the Board has in the past sought to undertake ‘field-testing’ of its draft pronouncements, with a view to highlighting specific implementation issues that may arise in developing countries. Whilst these ‘field tests’ have enjoyed only limited success, in our view they are an important component of the IPSASB’s due process at this critical stage in its evolution as a standards-setter.

We note that the OECD Joint Venture on Public Financial Management made a late suggestion that this Exposure Draft be ‘field-tested’. However, we recognize that this suggestion came after the IPSASB’s approval of the Exposure Draft; moreover, the 4-month exposure period in this case did not allow for any meaningful ‘field-testing’ to take place.

In our view it is essential for the IPSASB to receive substantive input on this Exposure Draft from preparers and auditors of governmental financial reports in developing countries, in order for there to be a mature discussion about implementation issues. We are aware that several IPSASB developing country members are facilitating submissions from preparers and/or auditors in their own jurisdictions; and that the IFAC Developing Nations Task Force has also undertaken to make its own submission. Once the exposure period closes, we strongly encourage the IPSASB to undertake a quick review of the profile of respondents, to gauge the degree to which developing country preparers and auditors have made their views known. If there is only limited developing country participation, we would recommend that alternative means of outreach to the developing country constituency be instigated, and we would be happy to assist in this endeavor, to the extent that we can make a useful contribution.

Given the topic of this Exposure Draft, in our view the credibility of a future standard will be seriously undermined if the IPSASB is not able to demonstrate that the views of recipients of external assistance have been taken into account in the exposure process.

2. Adoption of the Standard

(i) Technical Complexity

There is considerable scope for improvement in the quality and consistency of financial information provided by recipients of external assistance. In the absence of generally accepted practice in this area, financial reporting focuses on meeting the information requirements of donors, rather than catering to the needs of general purpose users. There is therefore little question of the need for the standardization that this Exposure Draft proposes.

That said, we are concerned that the requirements of the Exposure Draft are highly prescriptive and complex. Specifically we have concerns about the following:

- Paragraphs 13 – 14: the requirement to disclose separately:
 - I. External assistance received directly in cash;
 - II. External assistance paid by third parties that are part of the economic entity;
 - III. External assistance paid by third parties that are not part of the economic entity
- Paragraph 22: the requirement to disclose undrawn external assistance, categorized by type of assistance, by financial instrument (loan or grant), by source, and by currency.
- Paragraph 44 – the requirement to disclose the fair values of goods and services received in kind.

We are also concerned about the complexity of the illustrative disclosures in Appendix 1.

We recommend that the IPSASB:

- a) Reconsider the proposed disclosure requirements, taking into account the limited capacity of many of the entities that may seek to comply with this standard;
- b) Review the proposed levels of detail being proposed (for example, in paragraphs 13 -14 and 22), and whether the additional benefits this information might confer on general purpose users of financial statements would outweigh the incremental compliance costs;
- c) Consider whether the proposed disclosures could be categorized into those that are mandatory, and those that are voluntary, consistent with the approach adopted in the Cash Basis IPSAS, *Financial Reporting Under the Cash Basis of Accounting*;
- d) Reflect any changes to the proposed disclosure requirements in a simplified Appendix I.

A possible basis for categorizing disclosures as mandatory and optional as suggested at (c) above would be to: require disclosure of all items that would not impact the primary accounting records that would be maintained in a cash accounting system (viz., external assistance received by the reporting entity in cash or cash equivalents) and encourage but not require the disclosure of items that would not impact the accounting records.

(ii) *Inter-relationship Between ED24 and the Cash Basis IPSAS, Financial Reporting Under the Cash Basis of Accounting*

ED24 is presented as an adjunct to, and should be read in conjunction with, the Cash Basis IPSAS. This approach is consistent with the initial project brief, which was for the development of a separate standard on the subject of development assistance.

However, now that the proposed requirements have been promulgated in the Exposure Draft, we would recommend that the IPSASB give serious consideration to combining the content of this Exposure Draft with the broader requirements of the omnibus Cash Basis IPSAS. In our view, this would considerably simplify for users the task of

complying with the IPSASB's recognition and disclosure requirements for cash accounting.

When the Cash Basis IPSAS was issued, the IPSASB made a commitment to review its implementation experience after two years. The occasion of this review would present an opportunity to consolidate the two documents into one.

3. Technical Issues

Specific Matters for Comment

1. The proposed definition of 'external assistance'

The ED defines External Assistance as '...all official resources which the recipient can use or otherwise benefit from in pursuit of its objectives'. This definition is clearly sufficiently broad to encompass all official resources received.

2. Whether other sources of assistance should be included

The draft standard aims to enhance accountability for the use of external assistance received. In this context, there appear to be no compelling reasons for the scope of the standard to be restricted to official resources.

3. Specification of the categories of external assistance

We fully support the proposal to require separate disclosure of the major classes of external assistance received. However, we do not agree with the Exposure Draft's proposals to specify the categories of external assistance (*viz.*, development assistance, trade finance, emergency assistance, military assistance and balance of payments assistance). This proposal pre-supposes that preparers of financial statements will maintain their accounting records in a way that facilitates such categorization for financial reporting purposes. In our view, this is unlikely to be the case, especially in light of the donor-centric nature of the proposed categories.

Where preparers do not maintain their accounting records in a way that supports the categories proposed by the Exposure Draft, complying with the standard will be more costly than would otherwise be the case. We also question whether specifying the categories will result in the provision of information that is meaningful for users. Given the considerable overlap between the proposed categories (for example: development assistance usually provides balance of payments support; certain types of military assistance support economic development), there is likely to be some inconsistency in the reporting of these categories in different entities' financial statements.

For these reasons, we recommend that the standard require the disclosure of the major classes of external assistance received, but should not seek to specify what those categories are – similar to the approach adopted in other IPSASs for other financial statement elements.

- 4. *Disclosure of the balance of, and changes in, undrawn external assistance***
- 5. *Disclosure of the terms and conditions of external assistance agreements, and any non-compliance therewith***
- 6. *Disclosure of the fair value of non-cash goods-in-kind***
- 7. *The appropriateness of the proposed disclosures***

Items 3-7 are all concerned with the proposed disclosure requirements under the draft standard, certain aspects of which we have already commented on (see above, specifically in relation to items 3 and 7).

With regard to item 4, our view is that excessive detail is being proposed. We would support the requirement to disclose the balance of undrawn external assistance, but it is not clear what additional benefits would flow from an analysis of movements, split into loans and grants, and categorized by type of assistance.

With regard to item 5, we generally support the requirement to disclose the terms and conditions of external assistance agreements. In our view it is unlikely that a requirement to disclose non-compliance with those terms and conditions will be adopted.

With regard to item 6, we question whether the likely costs of collecting reliable information on the fair values of non-cash goods received in kind are justified by the benefits to users of disclosing this information.

8. *Transitional Provisions*

The transitional period (2 years) for full compliance with the standard appears reasonable. We concur with exempting the requirement to disclose comparative figures during the first year of application.

Other Technical Issues

- Introductory paragraph – the preamble to the Standard should state clearly that full compliance with the Cash Basis IPSAS requires compliance with the requirements of this Standard.
- Paragraphs 7-9 outlines some circumstances under which the various types of assistance may be provided, and the nature of the relationships between recipients and development agencies. Since the circumstances under which individual recipients contract with development agencies may vary widely, we would suggest that much of the content of these paragraphs could be omitted. The substantive technical issue being raised – that statements of intent/pledges are binding on neither party – should, however, be retained.
- Appendix 3 addresses rescheduling and canceling debt. As this is not the subject matter of this Standard, we suggest that it be deleted.