IPSAS B International Public Sector Accounting Standards Board®

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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	Auditor-General
Country/Region	Turks and Caicos Islands
Organization/Individual	Individual

GENERAL CONCERNS ABOUT THE CASH BASIS OF ACCOUNTING;

Thanks for the opportunity to be able to provide my comments.

While there may be benefits of having a phased approach to proper public sector accounting, my years of experience in auditing public sector accounts have given me significant insight into the downfalls of this approach to accounting. I am a fellow of the ACCA and a CFE. I have over 20 years' experience in auditing, around 5 of those in auditing public sector accounts.

ISSUES/CONCERNS:

1. By moving items to part 2 'Encouraged but not required' gives the Finance Ministry the option NOT to disclose. It is used as a way to indicate to auditors that MATERIAL information is not required to be accounted for and therefore NO form of controls are placed on NON-CASH ECONOMIC TRANSACTIONS. While it is in the judgment of the auditor to determine what may be material of any public sector entity preparing accounts on the Cash Basis of Accounting (CBoA), it will mean that governments will consistently get highly qualified accounts based on the fact that NON-CASH ECONOMIC TRANSACTIONS (NCET) are not disclosed or reported on properly to the public.

2. Given that there is no requirement to account for these non-cash items means that there is little or no transparency. NCET such as Assets, liabilities, accounts receivable, payable, contingent liabilities, pensions etc. are not reported on which are MATERIAL AND SIGNIFICANT ITEMS OF PUBLIC INTEREST. Non-consolidation, while a good move to give governments the chance to phase into consolidating all public interest entities, does little during that time to capture critical items that need to be monitored, controlled, disclosed and accounted for.

3. The mere fact of having items which need to be reported to the public, being at the option of the Treasury/Accounting Departments of Finance Ministries, means that they DON'T have to disclose it which inhibits transparency. Responses from these entities are that IT IS NOT REQURED and therefore there is little or no effort to monitor these transactions which are usually in the millions or even billions.

4. By not reporting non-cash items, or not having it as a requirement under the CBoA implies that there is no control or monitoring over it and in times of recessions or industry specific depressions (such as oil, gas, tourism), it means that these countries are none the wiser as to what their medium to long term obligations are.

   For example;

   a. Pensions are not required under the Cash Basis of Accounting. However, worldwide there have been significant shortfalls in funding for these. When governments (through statutory bodies) receive funds from contributors in exchange for future retirement benefits, under a cash basis system, they are not required and therefore not disclosed. Shortfalls have been allowed to accumulate and when deficits occur the government then has to step in to bridge that shortfall. This is a high public interest matter which impacts the citizenry. Admittedly these can occur under an accruals basis of reporting as well. However, under accruals accounting, it can be captured and dealt with earlier rather than later.

b. In addition, liabilities which are not disclosed or not required to be disclosed or consolidated, escape the attention of the public and amounts are borrowed with little transparency on the long term financial impact. Statutory bodies and other public organizations when they borrow on their own, without consolidation, the central government is not aware, their Parliaments are not aware and the public is not aware. Examples are clearly shown in Greece and Spain about the pitfalls of the cash basis of accounting.

c. No requirement to report Accounts Receivables or Arrears, leaves it open to the Governments, not to focus on collection of funds that are owed to the Government and impacts much needed revenue.

d. When governments have liabilities which are not required to be disclosed, they can sell these liabilities at heavy discounts to associates who in turn make money on it. E.g. mortgages on houses when repossessed can be sold at a significantly lower cost (when the value is much higher) and there is no requirement under the cash basis of accounting to report these transactions. It means therefore that a $1 million house can be sold for $100,000 and the record will show only the cash exchange but not the loss. No requirement to report these things result in a less than accurate account of the substance of the transaction. It impacts significantly the “substance over form” argument of transactions under the CBoA.

e. In countries where the key assets are its land, these can be sold off for any amount and while the cash is recorded, the true value of the land is not known. This encourages corruption and there are examples where these kinds of transactions have occurred where lands are sold at significantly discounted rates. Again true values are not reflected.

f. Some governments grant non-cash concessions or tax breaks to entities interested in investing in their economies. This is giving up a benefit that would have been collected had the tax breaks not been allowed. This is used as a mechanism to reward companies who may have connections with senior government officials. This concession gives public resources away without properly accounting or disclosing it.

There are many more examples.

It is not to say that accrual accounting has its shortfalls, but it mandates that Government ensure that there are controls in place to properly account for significant NON-CASH ECONOMIC RESOURCES. ***The Cash Basis of Accounting is NOT properly aligned to the types, level and complexity of transactions that are entered into especially when it is PUBLIC ECONOMIC RESOURCES we are dealing with.***

However, overall the CBoA can likely be used by some governments as a way NOT to disclose and/or account for items that can have a huge dollar impact and larger public interest impact. To provide more avenues for governments to NOT require them to adhere to proper accounting rules for some of the NON-CASH ECONOMIC TRANSACTIONS will make financial statements reported on the cash basis of accounting misleading and not reflect a true and fair view of the Government and by extension the public will not be properly informed and as a consequence transparency is inhibited.

The cash basis of accounting DOES NOT align well with a PUBLIC REQUIREMENT TO ACCOUNT FOR RECEIPT AND USE OF ALL ECONOMIC RESOURCES. IT INHIBITS TRANSPARENCY AND ACCOUNTABILITY.

Recommendation:

If consolidation is to be encouraged rather than mandatory, more items in the encouraged parts should at least be moved into the required Part 1 of the Cash Basis of Accounting. In particular assets, liabilities, contingent liabilities, arrears, pensions or similar types of transactions. For example a materiality amount should be set for disclosure and/or accounting e.g. non-cash economic transactions over $1million or as the case may be.

The Cash Basis of Accounting mandatory requirements needs to be aligned to account for Cash AND MATERIAL NON-CASH ECONOMIC TRANSACTIONS OR PUBLIC RESOURCES that are bartered in exchange for other benefits. These non-cash transactions are used as areas for corruption and inhibits transparency and accountability.