INTRODUCTION TO IPSAS

IFAC

Presentation

Contents

Financial Statements

Statements of Financial Position, Financial Performance and Changes in Net Assets/Equity

The Handbook of International Public Sector Accounting Pronouncements is the primary authoritative source of international generally accepted accounting principles for public sector entities.

This module covers the requirements in IPSAS 1, *Presentation of Financial Statements*.

IPSAS 1, Presentation of Financial Statements

The objective of this Standard is to prescribe the manner in which general purpose financial statements should be presented to ensure comparability both with the entity's financial statements of previous periods and with the financial statements of other entities. To achieve this objective, this Standard sets out overall considerations for the presentation of financial statements, guidance for their structure, and minimum requirements for the content of financial statements prepared under the accrual basis of accounting.

IPSAS 1 does not deal with the recognition, measurement and disclosure requirements for specific transactions and events. Participants should refer to the current IPSASB handbook to reference the appropriate IPSASs that set out the requirements related to these specific transactions or events. Also, participants may refer to other modules which cover these requirements.

At the end of this session, participants should:

- Understand the requirements for presentation, structure and content of general purpose financial statements prepared and presented under the accrual basis of accounting.
- Know the minimum requirements for disclosure of financial information on the face of the statements of financial position, financial performance, changes in net assets/equity and statement of cash flows.
- Understand the distinction between information to be provided in financial statements, supplementary schedules and notes.

Objectives of Financial Statements

- To meet information needs of service recipients and resource providers for accountability and decision making
- Users need information about:
  - The performance of the entity e.g. meeting service delivery and other operating and financial objectives;
  - Managing resources it is responsible for
  - Complying with legislative & other authority
  - Liquidity and solvency
  - Sustainability of service delivery and other operations
  - Capacity to adapt to changing circumstances

Background:

General-purpose financial statements are developed primarily to respond to information needs of service recipients and resource providers who do not possess the authority to require a public sector entity to disclose the information they need for accountability and decision-making

Financial statements present summarized information about the financial position, financial performance and cash flows of an entity. The objective of general-purpose financial statements is to provide financial information to a wide range of users who are not in a position to demand reports tailored to meet their particular information needs. Users of general-purpose financial statements include taxpayers and ratepayers, members of the legislature, creditors, suppliers, the media, and employees.

General-purpose financial statements cannot be expected to fulfill all of the users' needs. Some information, such as related performance information and narrative can only be provided by financial reports other than financial statements. General purpose financial statements may include summarized information from other reports and/or may include references to these other reports.

The Conceptual Framework discusses the information needs of service recipients and resource providers.

Required Financial Statements

- A complete set of financial statements includes:
  - Statement of financial position
  - Statement of financial performance
  - Statement of changes in net assets/equity
  - Cash flow statement
  - Comparison of budget and actual amounts
  - Notes
  - Comparative information in respect of the preceeding period

Provided the information provided in the statements is consistent with the requirements of IPSAS, the naming convention is not critical. For example, the statement of financial position may be referred to as a balance sheet or statement of assets and liabilities. The statement of performance may also be referred to as a statement of revenues and expenses, an income statement, an operating statement or a profit and loss statement. The notes may include items referred to as schedules.

Comparative Information

- Required for previous period for all amounts reported
- Included for narrative and descriptive information when relevant to understanding

Comparability of information over reporting periods assists users in making and evaluating decisions, especially by allowing the assessment of trends in financial information. Except when an IPSAS permits or requires otherwise, comparative information shall be disclosed in respect of the previous period for all amounts reported in the financial statements.

Comparative information is included for narrative and descriptive information when it is relevant to understanding the financial statements.

In some cases, narrative information provided in the financial statements for the previous period(s) continues to be relevant in the current period. For example, details of a legal dispute, the outcome of which was uncertain at the last reporting date and is yet to be resolved, are disclosed in the current period. Users benefit from information (a) that the uncertainty existed at the last reporting date, and (b) about the steps that have been taken during the period to resolve the uncertainty.

Presentation and Disclosure

- Consistency of presentation and classification in financial statements is retained unless
  - Another is more appropriate
  - An IPSAS requires a change
- If changed, comparative amounts reclassified
- Disclosure for reclassified items or class of item
- Disclosure on face of statements or in notes

Background:

The presentation and classification of items in the financial statements is retained from one period to the next.

The presentation and classification is changed if:

- It is apparent that another presentation or classification would be more appropriate; or
- An IPSAS requires a change in presentation.

If the presentation or classification of items is amended, comparative amounts are reclassified unless that is impracticable. In some circumstances, it is impracticable to reclassify comparative information for a particular prior period to achieve comparability with the current period.

For example, data may not have been collected in the prior period(s) in a way that allows reclassification, and it may not be practicable to recreate the information.

Disclosure is made of the nature, reason and amount of each item or class of item reclassified.

When it is impracticable to reclassify comparative amounts, an entity discloses the reason for not reclassifying the amounts and the nature of the adjustments that would have been made if the amounts had been reclassified.

Disclosure may be on the face of financial statements or in notes - certain items that must be disclosed on the face of each of the financial statements.

Materiality and Aggregation

- Each material class of similar items shall be presented separately
- Items of a dissimilar nature or function shall be presented separately unless immaterial
- Specific requirements in IPSASs need not be satisfied if information immaterial

Financial statements result from processing large numbers of transactions or other events that are aggregated into classes according to their nature or function. Financial statements should use terminology to describe any classification of items so that significant information is presented clearly and is readily understandable. Excessive detail can result in confusion and misinterpretation. Items not significant in themselves would be grouped with other items as most closely approximate their nature.

The process of aggregation and classification is the presentation of condensed and classified data for presentation as line items on the face of the statement of financial position, statement of financial performance, statement of changes in net assets/equity, and cash flow statement, or in the notes. If a line item is not individually material, it is aggregated with other items either on the face of those statements or in the notes. An item that is not sufficiently material to warrant separate presentation on the face of those statements may nevertheless be sufficiently material for it to be presented separately in the notes.

Applying the concept of materiality means that specific recognition, measurement, or disclosure requirements in an IPSAS need not be satisfied if the information is not material.

Offsetting

- Assets and liabilities, and revenue and expenses shall not be offset
  - Measuring assets net of valuation allowances is not offsetting
  - Netting of revenue and expenses may be appropriate if it reflects the substance of the transaction

Assets and liabilities, and revenue and expenses, are not offset unless required or permitted by an IPSAS.

It is important that assets and liabilities, and revenue and expenses, are reported separately. Offsetting in the statement of financial performance or the statement of financial position, except when offsetting reflects the substance of the transaction or other event, detracts from the ability of users both (a) to understand the transactions, other events and conditions that have occurred, and (b) to assess the entity's future cash flows.

Measuring assets net of valuation allowances – for example, obsolescence allowances on inventories and doubtful debts allowances on receivables – is not offsetting.

Netting of revenue with related expenses arising on the same transaction is appropriate when this presentation reflects the substance of the transaction.

Minimum Disclosures on Statement of Financial Position

ASSETS		***LIABILITIES***
1. Property, plant and equipment 2. Investment property 3. Intangible assets 4. Financial assets 5. Investments 6. Inventories 7. Recoverables from non-exchange transactions 8. Receivables from exchange transactions 9. Cash and cash equivalents		1. Taxes and transfers payable 2. Social benefit liabilities 3. Payables 4. Provisions 5. Financial liabilities 6. Non-controlling interests NET ASSETS/ EQUITY
Additional items relevant to understanding statements		

Additional line items, headings, and sub-totals are presented on the face of the statement of financial position when such presentation is relevant to an understanding of the entity's financial position.

IPSAS 1 does not prescribe the order or format in which items are to be presented. IPSAS 1 simply provides a list of items that are sufficiently different in nature or function to warrant separate presentation on the face of the statement of financial position.

The judgment on whether additional items are presented separately is based on an assessment of:

a) The nature and liquidity of assets;

b) The function of assets within the entity; and

c) The amounts, nature and timing of liabilities.

Current/Non-current Distinction

- Statement of financial position presents current and non-current assets and liabilities separately
- Current asset is cash or cash equivalents or item expected to be realized within twelve months after the reporting date
- Current liability is expected to be settled within 12 months after the reporting date

An entity shall present current and non-current assets, and current and non-current liabilities, as separate classifications on the face of its statement of financial position.

A current asset is:

a) expected to be realized in, or is held for sale or consumption in the normal operating cycle;

b) held primarily for the purpose of being traded;

c) It is expected to be realized within twelve months after the reporting date; or

d) It is cash or a cash equivalent

All other assets (e.g., tangible, intangible, and financial assets of a long-term nature) are classified as non-current.

A current liability is:

a) expected to be settled in the normal operating cycle;

b) held primarily for the purpose of being traded;

c) due to be settled within twelve months after the reporting date; or

d) entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date.

All other liabilities shall be classified as non-current.

Public Sector Entity Consolidated Statement of Financial Position

As at December 31, 20X2 (in thousands of currency units)

	20X2	20X1
ASSETS		
Current assets	x,xxx,xxx	x,xxx,xxx
Non-current assets	x,xxx,xxx	x,xxx,xxx
Total assets	x,xxx,xxx	x,xxx,xxx
LIABILITES		
Current Liabilities	x,xxx,xxx	x,xxx,xxx
Non-current liabilities	x,xxx,xxx	x,xxx,xxx
Total liabilities	x,xxx,xxx	x,xxx,xxx
NET ASSETS/EQUITY	x,xxx,xxx	x,xxx,xxx
Total liabilities and net assets/equity	x,xxx,xxx	x,xxx,xxx

Note the requirements that are illustrated.

- Statement of Financial Position is clearly identified.

The following information is prominently displayed:

- The name of the reporting entity;
- The financial statements cover the economic entity;
- The reporting date (appropriate for this component of the financial statements);
- The presentation currency; and
- The level of rounding used.

Key messages displayed include:

- Distinction between current and noncurrent assets and liabilities; and
- Net assets/equity.

IPSAS 1 requires presentation of specific sub-classifications of assets, liabilities and net assets/equity be shown on the face of the statement. This has not been illustrated due to space limitations.

Statement of Financial Performance

- As a minimum, the face of the statement includes:
  - Revenue
  - Finance costs
  - Share of the surplus or deficit of associates and joint ventures
  - Gain or loss attributable to disposal of assets or discontinuing operations
  - Surplus or deficit
- Additional items are presented if relevant to users understanding of financial performance

Normally, all items of revenue and expense recognized in a period are included in surplus or deficit. This includes the effects of changes in accounting estimates. However, circumstances may exist when particular items may be excluded from surplus or deficit for the current period. IPSAS 3, Accounting Policies, Changes in Accounting Estimates and Errors, deals with two such circumstances: the correction of errors and the effect of changes in accounting policies.

Other IPSASs deal with items that may meet definitions of revenue or expense, but are usually excluded from surplus or deficit. For example, revaluation surpluses resulting from adoption of the revaluation model. (see IPSAS 17, *Property, Plant and Equipment*).

Note that there are additional requirements for entities that have adopted IPSAS 41, *Financial Instruments* (the effective date is January 1, 2023). The additional items to be presented are:

- Separately present within revenue interest revenue calculated using the effective interest method; and gains and losses arising from the derecognition of financial assets measured at amortized cost;
- Impairment losses; and
- Gains or losses from reclassifying financial assets as financial assets measured at fair value through surplus or deficit.

Additional line items, headings, and subtotals are included on the face of the statement of financial performance, and the descriptions used and the ordering of items are amended when this is necessary to explain the elements of performance. Factors to be considered include materiality and the nature and function of the components of revenue and expenses

Items Presented on Face or in Notes

- Revenue by operations
  - Analysis of expenses classified by nature or function
- Material revenues and expenses such as
  - Revenue by operations
  - Write-downs and reversals
  - Restructuring costs
  - Gains or losses on disposals
  - Reversals of provisions
  - Other unusual or material items

When items of revenue and expense are material, their nature and amount shall be disclosed separately.

Examples:

a) Write-downs of inventories to net realizable value or of property, plant, and equipment to recoverable amount or recoverable service amount as appropriate, as well as reversals of such write-downs;

b) Restructurings of the activities of an entity and reversals of any provisions for the costs of restructuring;

c) Disposals of items of property, plant, and equipment;

d) Privatizations or other disposals of investments;

e) Discontinuing operations;

f) Litigation settlements; and

g) Other reversals of provisions.

An entity shall present, either on the face of the statement of financial performance or in the notes, a sub-classification of total revenue, classified in a manner appropriate to the entity's operations.

Expenses are sub-classified to highlight the costs and cost recoveries of particular programs, activities, or other relevant segments of the reporting entity. This analysis is provided in one of two ways.

The first form of analysis is the nature of expense method where expenses are aggregated according to their nature (for example, depreciation, purchases of materials, transport costs, employee benefits, and advertising costs), and are not reallocated among various functions within the entity. This method may be simple because no allocations of expenses to functional classifications are necessary.

The second option is the function of expense method and classifies expenses according to the program or purpose for which they were made. This method can provide more relevant information to users than the classification of expenses by nature, but allocating costs to functions may require arbitrary allocations and involves considerable judgment. The expenses associated with the main functions undertaken by the entity are shown separately. In the example in the slides, the entity has functions relating to the provision of health and education services.

The choice between the function of expense method and the nature of expense method depends on historical and regulatory factors and the nature of the entity. Management should select the most relevant and reliable presentation.

Expenses Classified by Nature

Revenues	x,xxx,xxx
Expenses	
Employee benefits	(x,xxx,xxx)
Grants & other transfers payments	(x,xxx,xxx)
Depreciation & amortization	(x,xxx,xxx)
Other expenses	(x,xxx,xxx)
Total expenses	(x,xxx,xxx)
Surplus/(deficit)	x,xxx,xxx

Expenses by Functional Classification

Revenues	x,xxx,xxx
Expenses	
Health	(x,xxx,xxx)
Education	(x,xxx,xxx)
Social protection	(x,xxx,xxx)
Other expenses	(x,xxx,xxx)
Total expenses	(x,xxx,xxx)
Surplus/(deficit)	x,xxx,xxx

Public Sector Entity Consolidated Statement of Financial Performance

For the year ended December 31, 20X2(in thousands of currency units)

	20X2	20X1
Revenues		
Taxes	x,xxx,xxx	x,xxx,xxx
Fees, fines, penalties and licenses	x,xxx,xxx	x,xxx,xxx
Transfers from other governments	x,xxx,xxx	x,xxx,xxx
Other revenue	x,xxx,xxx	x,xxx,xxx
Total revenue	x,xxx,xxx	x,xxx,xxx
Expenses		
General government	x,xxx,xxx	x,xxx,xxx
Public order and safety	x,xxx,xxx	x,xxx,xxx
Social protection	x,xxx,xxx	x,xxx,xxx
Total expenses	x,xxx,xxx	x,xxx,xxx
Surplus/Deficit for the period	x,xxx,xxx	x,xxx,xxx

Note the IPSAS 1 requirements illustrated. For example,

a) Statement of Financial Performance clearly identified.

b) The following information prominently displayed:

   (i) The name of the reporting entity;

   (ii) The financial statements cover the economic entity (consolidated statements);

   (iii) The reporting date (appropriate for this component of the financial statements);

   (iv) The presentation currency; and

   (v) The level of rounding used.

c) Key messages shown

   (i) the revenues recognized in the period

   (ii) the cost of government services provided in the period

   (iii) surplus or deficit from operations

The statement of financial performance reports the surplus or deficit from operations in the accounting period. It measures, in monetary terms, the extent to which an entity has maintained its net assets in the period. The entity discloses the revenues by source recognized in the period, the cost of services provided in the period by function and the difference between them. Since the entity is disclosing expenses by function, the nature of expense is disclosed in notes or supplementary schedules to the financial statements.

Statement of Changes in Net Assets/Equity

Statement of changes in net assets/equity required showing on the face

1. Surplus or deficit for the period
2. Revenue and expense recognized directly in net assets/equity
3. Total revenue and expense for the period (the sum of above) – attributable to owners & to minority interest
4. Effect of changes in accounting policies

Because it is important to consider all items of revenue and expense in assessing changes in an entity's financial position between two reporting dates a statement of changes in net assets/equity that highlights an entity's total revenue and expenses, including those that are recognized directly in net assets/equity is required.

Changes in an entity's net assets/equity between two reporting dates reflect the increase or decrease in its net assets during the period. Other IPSASs may require some items (such as revaluation increases and decreases) to be recognized directly as changes in net assets/equity.

An entity shall present a statement of changes in net assets/equity showing on the face of the statement:

a) Surplus or deficit for the period;
b) Each item of revenue and expense for the period that, as required by other standards, is recognized directly in net assets/equity, and the total of these items;
c) Total revenue and expense for the period (calculated as the sum of (a) and (b)), showing separately the total amounts attributable to owners of the controlling entity and to minority interest; and
d) For each component of net assets/equity separately disclosed, the effects of changes in accounting policies and corrections of errors recognized in accordance with IPSAS 3.

Statement of Changes in Net Assets/Equity (continued)

On the face or in notes

1. Transactions with owners, showing distributions separately
2. Balance of accumulated surpluses or deficits at beginning and end of period and changes during the period
3. Reconciliation for each component of net assets/equity beginning and end

Present on the face or in the notes:

a) Amounts of transactions with owners acting in their capacity as owners, showing distributions to owners separately;
b) Balance of accumulated surpluses or deficits at the beginning of the period and at the reporting date, and the changes during the period; and

c) To the extent that components of net assets/ equity are separately disclosed, reconciliation between the carrying amount of each component of net assets/equity at the beginning and the end of the period, separately disclosing each change.

Public Sector Entity Consolidated Statement of Changes in Net Assets/Equity

For the Year Ended December 31, 20X2 (in thousands of currency units)

	Reserve	Acc Surplus Deficit	Total
Balance at December 31, 20X0	x,xxx	x,xxx	x,xxx
Changes in accounting policy		xxx	xxx
Restated balance, December 31, 20X0	x,xxx	x,xxx	x,xxx
Change in net assets/equity for period			
Surplus/Deficit for the period		x,xxx	x,xxx
Balance at December 31, 20X1	x,xxx	x,xxx	x,xxx
Change in net assets/equity for period			
Surplus/Deficit for the period		x,xxx	x,xxx
Balance at December 31, 20X2	x,xxx	x,xxx	x,xxx

Note the requirements illustrated:

a) Statement of Changes in net assets/equity is clearly identified.

b) The following information prominently displayed:

(i) The name of the reporting entity;

(ii) The financial statements cover the economic entity;

(iii) The reporting date (appropriate for this component of the financial statements);

(iv) The presentation currency; and

(v) The level of rounding used.

c) Key messages shown:

(i) The changes in an entity's net assets/ equity between two reporting dates; and.

(ii) Whether the net asset/equity position was maintained during the period.

This illustration assumes an adjustment of the previous reported balance due to an accounting policy change in accordance with IPSAS 3.

The change in net assets/equity for each period presented results only from a surplus or deficit. There are no items of revenue and expense for the periods presented that, as required by other standards, is recognized directly in net assets/equity. Therefore the total revenue and expense for the period is the surplus for the period. In this illustration there are no amounts attributable to owners of the controlling entity and to minority interests.

Notes to Financial Statements

- Present information about the basis of preparation of the financial statements and the specific accounting policies
- Disclose required information not presented on the face of statements and
- Provide additional information
- Significant judgments made
- Information about estimation uncertainty

Notes and schedules that are integral to the financial statements report information that is necessary for a fair presentation of an entity's financial position, results of operations, change in net assets/equity and cash flow.

They are useful for clarifying and explaining items in the financial statements and are cross-referenced to the specific financial statement items to which they relate. They have the same significance as if the information or explanations were set forth in the body of the statements themselves.

The notes should present information about the basis of preparation of the financial statements and the specific accounting policies used.

Notes are normally presented in the following order, which assists users in understanding the financial statements and comparing them with financial statements of other entities:

a) A statement of compliance with IPSASs;

b) A summary of significant accounting policies applied;

c) Supporting information for items presented on the face of the statement of financial position, statement of financial performance, statement of changes in net assets/equity, or cash flow statement, in the order in which each statement and each line item is presented; and

d) Other disclosures, including:

   i. Contingent liabilities (see IPSAS 19), and unrecognized contractual commitments; and

   ii. Non-financial disclosures, e.g., the entity's financial risk management objectives and policies (see IPSAS 30).

In the process of applying the entity's accounting policies, management makes various judgments, apart from those involving estimations, that can significantly affect the amounts recognized in the financial statements. For example, management makes judgments in determining for example, whether the substance of the relationship between the reporting entity and other entities indicates that these other entities are controlled by the reporting entity.

Questions and Discussion

Visit the IPSASB webpage

http://www.ipsasb.org

That concludes our module on the presentation of financial statements. Participants should refer to the review questions to test themselves on their knowledge.

Review Questions

Question 1

An entity has decided that a change to functional classification of expenses from the classification based on their nature would be more relevant to users of its financial statements.

What are the requirements of IPSAS 1 for making such a change?

Question 2

IPSAS allows the offsetting of assets and liabilities and revenue and expenses..

True or false? Why?

Question 3

An entity has set up a valuation allowance for uncollectible taxes.

Can the entity net the valuation allowance against the taxes receivable asset for presentation purposes in its statement of financial position? Why?

Question 4

Under IPSAS 1 and other IPSAS, required disclosures may be made either on the face of the financial statements or in notes.

True or false? Why?

Question 5

A government has an inventory of developed industrial land for resale. At the reporting date, the government has been publicly promoting the sale of the land. There is an active market for the land, although, due to the nature of the market, a sale may take more than 12 months.

Is the land held for resale a current asset?

Answers to Review Questions

Question 1

When presentation or classification of items in the financial statements is amended, comparative amounts shall be reclassified. When comparative amounts are reclassified, an entity shall disclose:

a) **The nature of the reclassification;**

b) **The amount of each item or class of items that is reclassified; and**

c) **The reason for the reclassification. (IPSAS 1, paragraph 55)**

Question 2

The answer is false (although there are limited exceptions).

It is important that assets and liabilities, and revenue and expenses, are reported separately, although there are exceptions. Offsetting in the statement of financial performance or the statement of financial position, except when offsetting reflects the substance of the transaction or other event, detracts from the ability of users both (a) to understand the transactions, other events and conditions that have occurred, and (b) to assess the entity's future cash flows.

Some transactions an entity undertakes do not generate revenue but are incidental to the main revenue-generating activities. The results of such transactions are presented, when this presentation reflects the substance of the transaction or other event, by netting any revenue with related expenses arising on the same transaction. For example, it may be appropriate to net expenses reimbursed under a contractual arrangement with a third party such as supplier's warranty agreement.

Question 3

The answer is yes. Measuring assets net of valuation allowances – for example, obsolescence allowances on inventories and doubtful debts allowances on receivables – is not offsetting.

Question 4

The answer is false.

IPSAS 1 requires particular disclosures to appear on the face of the statement of financial position, statement of financial performance, and statement of changes in net assets/equity. Other disclosures may be made either on the face of those statements or in the notes. (IPSAS 1, paragraph 59) Preparers of financial statements should check the disclosure requirements of other IPSASs to determine the appropriate presentation of required disclosures.

Question 5

The developed industrial land may be classified as current as it is expected to be realized in the entity's normal operating cycle.

Cash Flow Statement

Cash Flow Statement

The Handbook of International Public Sector Accounting Pronouncements is the primary authoritative source of international generally accepted accounting principles for public sector entities.

This module covers the requirements in IPSAS 2, *Cash Flow Statements.*

Objective of Cash Flow Statement

- Mandatory
- Provides users with basis to assess how entity generates and uses cash
- Users can assess effect activities had on financial position
- Information has predictive value
    - Amounts, timing and certainty of future cash flows
    - Future cash requirements
    - Sustainability of activities

Users of an entity's financial statements are generally interested in how the entity generates and uses cash and cash equivalents.

The cash flow statement identifies

a) the sources of cash inflows,

b) the items on which cash was expended during the reporting period, and

c) the cash balance as at the reporting date.

The cash flow statement reports the opening and closing cash and cash equivalent balances and shows the changes during the period.

Users are interested in the affect activities had on financial position of the entity.

Information on cash flows has predictive value. Although providing historical information about changes in cash and cash equivalents of an entity, the statement of cash flow can be used to predict:

a) the amounts and timing of future cash flows;

b) future cash requirements;

c) ability to fund changes in the scope and nature of its activities; and

d) the sustainability of the entity's activities.

Cash and Cash Equivalents

Cash	*Cash Equivalents*
• Cash • Demand deposits	• Short- term liquid investments (3 months or less) • Readily convertible • Insignificant risk
Components must be disclosed	

Cash comprises cash on hand and demand deposits. Cash equivalents are:

- short-term, highly liquid investments that are readily convertible to known amounts of cash;
- subject to an insignificant risk of changes in value; and
- held for the purpose of meeting short term cash commitments rather than for investment or other purposes.

For an investment to qualify as a cash equivalent:

a) it must be readily convertible to a known amount of cash;

b) have a maturity date of less than 3 months; and

c) be subject to an insignificant risk of changes in value. (*IPSAS 2*, paragraph 9)

Illustrative Examples Cash and Cash Equivalents

Scenario 1

An entity acquires a three year fixed rate government bond in an active market two months before its maturity.

- Is the bond cash and cash equivalent? Explain.

Answer:

The investment is a cash equivalent. It is short term (maturity date within two months of purchase date), highly liquid (traded in active market), readily converted to a known amount of cash (capital plus interest at maturity or at market value if sold before maturity) and subject to an insignificant risk of changes in value (government bond with fixed interest rate close to maturity unlikely to fluctuate significantly in value).

Illustrative Examples Cash and Cash Equivalents

Scenario 2

An entity's general bank fluctuates between having a balance and overdraft in accordance with the entity's cash receipts and payments cycle. The overdraft is repayable on demand.

- Is overdraft part of cash and cash equivalents? Explain.

Answer:

The bank overdraft is a cash equivalent. It is repayable on demand and forms an integral part of the entity's cash management.

Cash Flow Statement

Report cash flows classified by:

- Operating activities - derived from main cash- generating activities e.g. revenue from taxes, payments to suppliers
- Investing activities - purchase/sale of assets and other long-term investments for resources contributing to future service delivery
- Financing activities - changes in the size and composition of contributed capital and borrowings of entity (e.g., payment of interest; issuance of debt)

Cash flow arising from operating activities is a key indicator of the extent to which operations are funded from revenues of the period. The amount of the net cash flows from operations assists in showing:

a) the ability of the entity to maintain its operating capability, repay obligations and make new investments, without recourse to external sources of financing; and

b) an indication of the extent to which an entity has financed its current activities through current period revenues (e.g., taxation, fees and service charges, investment income, etc.)

Information about the specific components of historical operating cash flows is useful, in conjunction with other information, in forecasting future operating cash flows.

Cash flows from operating activities are primarily derived from the principal cash-generating activities of the entity. Examples of cash flows from operating activities are:

a) Cash receipts from taxes, levies, and fines;

b) Cash receipts from charges for goods and services provided by the entity;

c) Cash receipts from grants or transfers and other appropriations[1] or other budget authority made by central government or other public sector entities;

d) Cash receipts from royalties, fees, commissions, and other revenue;

e) Cash payments to other public sector entities to finance their operations (not including loans);

f) Cash payments to suppliers for goods and services;

g) Cash payments to and on behalf of employees.

[1] In some jurisdictions, there may not be a clear distinction between appropriations or budgetary authorizations for current activities, capital works, and contributed capital. In these cases, the appropriation or budget authorization should be classified as cash flows from operations, and this fact should be disclosed in the notes to the financial statements. (IPSAS 2, paragraph 24).

Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.

The separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which cash outflows have been made for resources that are intended to contribute to the entity's future service delivery.

Only cash outflows that result in a recognized asset in the statement of financial position are eligible for classification as investing activities.

The more common examples of cash flows arising from investing activities are:

a) Cash payments to acquire and cash receipts from the sale of property, plant and equipment, intangibles, and other long-term assets;

b) Cash payments to acquire and cash receipts for the sales of long term investments (excluding those classified as cash equivalents or those held for dealing or trading purposes);

c) Cash advances and loans made to and cash receipts from the repayment of advances and loans made to other parties. (IPSAS 2, paragraph 25)

Financing activities - Cash flows that result in changes in the size and composition of contributed capital and borrowings of the entity.

Examples of cash flows arising from financing activities are:

a) Cash proceeds from issuing debentures, loans, notes, bonds, mortgages, and other short or long-term borrowings;

b) Cash repayments of amounts borrowed; and

c) Cash payments by a lessee for the reduction of the outstanding liability relating to a finance lease. (IPSAS 2, paragraph 26)

The disclosure of cash flows arising from financing activities is useful in predicting claims on future cash flows by providers of capital to the entity. For example, inflows from issuing of debentures, loans, notes, bonds, mortgages, and other short or long-term borrowings will result in future outflows for principal repayment and debt service.

Reporting Operating Activities

Direct Method	***Indirect Method***
Discloses • major classes of gross cash receipts • gross cash payments	*Surplus/deficit adjusted for* • noncash transactions • deferrals • accruals
Use of direct method preferred	

Under the direct method, information is reported about major classes of operating revenues, operating expenses and other items in the statement of financial performance except items of revenue or expense associated with investing or financing cash flows.

Under the indirect method, the net cash flow from operating activities is determined by adjusting net surplus or deficit from ordinary activities for the effects of:

a) Changes during the period in inventories and operating receivables and payables;

b) Non-cash items such as depreciation, provisions, deferred taxes, unrealized foreign currency gains and losses, undistributed surpluses of associates, and minority interests; and

c) All other items for which the cash effects are investing or financing cash flows. (IPSAS 2, paragraph 30)

Entities are encouraged to report cash flows from operating activities using the direct method. The direct method provides information that (a) may be useful in estimating future cash flows, and (b) not available under the indirect method.

Public Sector Entity Consolidated Statement of Cash Flows (Direct Method)

For the year ended December 31, 20X2 (in thousands of currency units)

	20X2	20X1
Cash Flows from Operating Activities		
Receipts		
Fees, fines, penalties and licenses	x,xxx,xxx	x,xxx,xxx
Other revenue	x,xxx,xxx	x,xxx,xxx
Payments		
Employee costs	(x,xxx,xxx)	(x,xxx,xxx)
Other expenses	(x,xxx,xxx)	(x,xxx,xxx)
Net cash from operating activities	x,xxx,xxx	x,xxx,xxx
Cash Flows From Investing Activities		
Purchase of plant and equipment	(x,xxx,xxx)	(x,xxx,xxx)
Cash Flows from Financing Activities		
Proceeds from borrowing	x,xxx,xxx	x,xxx,xxx
Net increase (decrease) in cash	x,xxx,xxx	x,xxx,xxx
Cash beginning of period	x,xxx,xxx	x,xxx,xxx
Cash, end of period	x,xxx,xxx	x,xxx,xxx

The illustrative example is based on the IPSASB preferred approach of the direct method of reporting cash flows from operating activities.

Note the disclosure requirements illustrated.

The following disclosure requirements are illustrated.

a) Statement of cash flows clearly identified.

b) The following information prominently displayed:

  (i) The name of the reporting entity;

  (ii) The financial statements cover the economic entity (consolidated statements);

  (iii) The reporting date (appropriate for this component of the financial statements);

  (iv) The presentation currency; and

  (v) The level of rounding used.

c) Key messages shown

  (i) information about major classes of operating revenues, operating expenses and other items' cash flows

  (ii) cash flows from operating, investing and financing activities

  (iii) the opening and closing balance of cash and cash equivalents

Implementation guidance in IPSAS 2, *Cash Flow Statements* gives a more robust example of a cash flow statement for both the direct method and the indirect method.

Public Sector Entity Consolidated Statement of Cash Flows (Indirect Method)

For the year ended December 31, 20X2 (in thousands of currency units)

	20X2	20X1
Cash Flows from Operating Activities		
Surplus deficit for period	x,xxx,xxx	x,xxx,xxx
Adjustments for non-cash items		
Depreciation Expense	x,xxx,xxx	x,xxx,xxx
Increase in receivables	(x,xxx,xxx)	(x,xxx,xxx)
Increase in payables	x,xxx,xxx	x,xxx,xxx
Net cash flows from operating activities	x,xxx,xxx	x,xxx,xxx
Cash Flows From Investing Activities		
Purchase of plant and equipment	(x,xxx,xxx)	(x,xxx,xxx)
Cash Flows from Financing Activities		
Proceeds from borrowing	x,xxx,xxx	x,xxx,xxx
Net increase (decrease) in cash	x,xxx,xxx	x,xxx,xxx
Cash beginning of period	x,xxx,xxx	x,xxx,xxx
Cash, end of period	x,xxx,xxx	x,xxx,xxx

The illustrative example is based on the IPSASB alternative approach of the indirect method of reporting cash flows from operating activities.

The following disclosure requirements are illustrated.

a) Statement of cash flows clearly identified.

b) The following information prominently displayed:

    (i) The name of the reporting entity;

    (ii) The financial statements cover the economic entity (consolidated statements);

    (iii) The reporting date (appropriate for this component of the financial statements);

    (iv) The presentation currency; and

    (v) The level of rounding used.

c) Key messages shown

    (i) cash flows from operating, investing and financing activities

    (ii) the opening and closing balance of cash and cash equivalents

Implementation guidance in IPSAS 2, *Cash Flow Statements* gives a more robust example of a cash flow statement for both the direct method and the indirect method.

Netting

Cash flows may be reported on a net basis when:

- Cash receipts collected and payments made on behalf of others (e.g. collection of taxes by one level of government for another level of government)
- Cash receipts and payments when
    - Turnover is quick
    - Amounts are large
    - Maturities are short

  (e.g. purchase and sale of investments)

Cash flows may be reported on a net basis when:

a) Cash receipts collected and payments made on behalf of others are reflective of the activities of the other party; and

    b) Cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short (e.g. purchase and sale of investments).

Item (a) refers only to transactions where the resulting cash balances are controlled by the reporting entity. Examples of such cash receipts and payments include:

a) The collection of taxes by one level of government for another level of government, not including taxes collected by a government for its own use as part of a tax-sharing arrangement;

b) The acceptance and repayment of demand deposits of a public financial institution;

c) Funds held for customers by an investment or trust entity; and

d) Rents collected on behalf of, and paid over to, the owners of properties.

Examples of cash receipts and payments referred to item (b) are advances made for, and the repayment of:

a) The purchase and sale of investments; and

b) Other short-term borrowings, for example, those that have a maturity period of three months or less.

Disclosures

- Changes in liabilities arising from financing activities
- Components of cash and cash equivalents
- Additional information relevant to users in understanding the financial position and liquidity of entity
  - Amount of undrawn borrowing facilities and restrictions
  - Cash flows from interests in joint ventures
  - Amount and nature of restricted cash balances
- Reconciliation of the surplus/deficit with net cash flow from operating activities when direct method used

Entities should disclosure information to enable users of financial statements to evaluate changes in liabilities arising from financing activities. This should include both changes arising from cash flows and non-cash changes.

An entity should disclose the components of cash and cash equivalents.

Additional information may be relevant to users in understanding the financial position and liquidity of an entity. Disclosure of this information, together with a description in the notes to the financial statements, is encouraged, and may include:

a) The amount of undrawn borrowing facilities that may be available for future operating activities and to settle capital commitments, indicating any restrictions on the use of these facilities;

b) The aggregate amounts of the cash flows from each of operating, investing, and financing activities related to interests in joint ventures reported using proportionate consolidation; and

c) The amount and nature of restricted cash balances.

Entities reporting cash flows from operating activities using the direct method are also encouraged to provide a reconciliation, either as part of the cash flow statement or in the notes, of the surplus/deficit from ordinary activities with the net cash flow from operating activities. The reconciliation is prepared in the same way as the indirect method of presenting a cash flow statement.

Questions and Discussion

Visit the IPSASB webpage http://www.ipsasb.org

That concludes our module on the cash flow statement. Participants should refer to the review questions to test themselves on their knowledge.

Review Questions

Question 1

Entities are encouraged to report cash flows from operating activities using the direct method.

Which statement best describes this method of reporting?

a) A reconciliation of the surplus/deficit with the net cash flow from operating activities

b) Surplus or deficit for the period is adjusted for effects of noncash transactions, deferrals

c) Major cash flows from operating revenues, expenses and other items in the statement of financial performance are reported.

Question 2

Which of the following are cash flows from operating activities?

a) Cash receipts from taxes, levies, fines, fees

b) Cash transfers (excluding capital) made to other public sector entities

c) Cash payments for salaries, wages and benefits

d) Cash payments of interest and principal

e) Cash receipts from sale of property plant and equipment

f) Items a, b and c

g) All of the above

Question 3

Which of the following are cash flows from investing activities?

a) Cash payments to acquire property, plant and equipment;

b) Gain or loss on sale of property, plant and equipment;

c) Cash proceeds from issuing debentures for the acquisition of property, plant and equipment;

d) Cash payments that reduce the outstanding liability under a finance lease;

e) Items a and b above;

f) All of the above.

Answers to Review Questions

Question 1

The answer is (c).

Under the direct method, the net cash flow from operating activities includes information about major classes of operating revenues, operating expenses and other items in the statement of financial performance except items of revenue or expense associated with investing or financing cash flows.

Under the direct method, information about major classes of gross cash receipts and gross cash payments may be obtained either:

a) From the accounting records of the entity; or

b) By adjusting operating revenues, operating expenses (interest and similar revenue, and interest expense and similar charges for a public financial institution), and other items in the statement of financial performance for:

   (i) Changes during the period in inventories and operating receivables and payables;

   (ii) Other noncash items; and

   (iii) Other items for which the cash effects are investing or financing cash flows.

Under the indirect method, the net cash flow from operating activities is determined by adjusting net surplus or deficit from ordinary activities for the effects of:

a) Changes during the period in inventories and operating receivables and payables;

b) Non-cash items such as depreciation, provisions, deferred taxes, unrealized foreign currency gains and losses, undistributed surpluses of associates, and minority interests;

c) All other items for which the cash effects are investing or financing cash flows; and

d) The impact of any extraordinary items that are classified as operating cash flows.

.

Question 2

The answer is (f).

Cash flows from operating activities are primarily derived from the principal cash-generating activities of the entity. For other examples of cash flows from operating activities, refer to IPSAS 2, paragraph 22.

Cash repayments of amounts borrowed are financing activities. Cash receipts from the sale of property, plant and equipment are investing activities.

Question 3

The answer is (a).

Cash payments to acquire property, plant and equipment, intangibles, and other long-term assets

The gain or loss on disposal of property, plant and equipment is a non-cash transaction. The actual cash receipts from the disposal of property plant and equipment is a cash flow from an investing activity.

Cash proceeds from issuing debentures for the acquisition of property, plant and equipment and cash payments that reduce the outstanding liability under a finance lease are both financing activities.

Related Party Disclosures

Related Party Transactions IPSAS 20

The Handbook of International Public Sector Accounting Pronouncements is the primary authoritative source of international generally accepted accounting principles for public sector entities.

IPSAS 20, *Related Party Disclosures*, contains requirements on the disclosure of related party relationships and certain transactions with related parties.

Applying IPSAS 20 involves identifying related parties (the reporting entity's controlled and controlling entities, associates, and key management personnel and their close family members) 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.

Objective

- Disclose existence of related parties where control exists – identifying parties that control or significantly influence
- Disclose information about related party transactions – determining what to disclose
- Substance over form

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.

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.

Disclosure of transactions with key management personnel and their close family members is intended to reduce the risk of these related parties entering into transactions that expose the entity to risks or are on more favorable terms than usual.

Defining Related Parties

Parties considered related if one party has the ability to:

- Control the other party or
- Exercise significant influence

Or if the related party entity and another entity are subject to common control

Significant influence is the power to participate in the financial and operating policy decisions of an entity, but not control those policies.

Significant influence may be exercised in several ways, usually by representation on the board of directors or equivalent governing body but also by, for example, participation in (a) the policy making process, (b) material transactions between entities within an economic entity, (c) interchange of managerial personnel, or (d) dependence on technical information. Significant influence may be gained by an ownership interest, statute, or agreement. With regard to an ownership interest, significant influence is presumed in accordance with the definition contained in IPSAS 36.

Examples of Related Parties

a) Entities that directly, or indirectly through one or more intermediaries, control, or are controlled by, the reporting entity;

b) Associates (see IPSAS 36, *Investments in Associates and Joint ventures*);

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

The reporting entity must create a process to identify and review its related parties. The process will include:

a) Identifying the reporting entity's controlled and controlling entities. IPSAS 35, *Consolidated Financial Statements*, provides guidance on the concept of "control" of another entity for financial reporting purposes;

b) Identifying the reporting entity's associates. IPSAS 36, *Investments in Associates and Joint Ventures*, provides guidance on associates;

c) Identifying individuals and entities which have joint control over the reporting entity. IPSAS 37, *Joint Arrangements*, provides guidance on joint arrangements. Although the definition of related parties in IPSAS 20 does not specifically refer to individuals or entities that have joint control over the reporting entity, for the purposes of IPSAS 20, significant influence is defined to encompass entities subject to joint control;

d) 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

- Transfer of resources or obligations between related parties
- Price may or may not be charged
- Economic dependence excluded

Related party transactions include all transfers of resources or obligations between related parties, regardless of whether a price is charged. However, only certain related party transactions must be disclosed in the financial statements. IPSAS 20 does not require disclosure of transactions between related parties if they are on normal terms and conditions.

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

a) Review its relationship with its related parties; and

b) Identify what constitutes the normal operating procedures/mandate with its related parties and develop new policies to deal with any uncertainties.

If an entity is required to maintain a register of interests for elected or high-ranking officials, this would be a useful starting point for identifying information relating to key management personnel.

Disclosure

- Accountability
- Transparency
- Related party relationships disclosed
- Transactions disclosed – types, elements to clarify significance
- Key management personnel details

To comply with the disclosure requirements of IPSASs regarding related party disclosures, an entity will need to:

a) Identify all of its related parties.

b) Identify and maintain records of the relevant related party transactions. These records should outline:

   (i) The nature of the related party relationships;

   (ii) Types of transaction that have occurred; and

   (iii) 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.

c) Identify and disclose aggregate remuneration of key management personnel (see also IPSAS 39, *Employee Benefits*) and all other remuneration and compensation provided to key management personnel and their close family members.

d) 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:

   (i) The amount advanced and the terms and conditions thereof;

   (ii) The amount repaid during the period and the closing balance of all loans and receivables; and

   (iii) Where the recipient is not a member of the governing body nor part of the senior management group of the entity, the relationship of the individual to the governing body or senior management group.

Questions and Discussion

Visit the IPSASB webpage

http://www.ipsasb.org

That concludes our module on related party disclosures. Participants should refer to the review questions to test themselves on their knowledge.

Review Questions

Question 1

A government agency discloses its relationships and transactions with related parties.

Which of the following are related parties?

- **a)** A company owned by the husband of the chief executive of a government Agency
- **b)** A controlled entity of a government agency
- **c)** An associate of a government agency?
- **d)** A junior employee.

Question 2

Entities are required to collect information about transaction with key management personnel and their close family members?

What types of transaction should be disclosed?

Answers to Review Questions

Question 1

The answer is (a), (b) and (c).

The following are examples of related parties:

a) Entities that directly, or indirectly through one or more intermediaries, control, or are controlled by, the reporting entity;

b) Associates (see IPSAS 36, *Investments in Associates and Joint Ventures*);

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.

Question 2

The items of information that entities will need to collect in respect of key management personnel and their close family members are:

a) Remuneration and compensation provided; and

b) Loans that are not widely available to persons who are not key management personnel and loans whose availability is not widely known by members of the public.

Budget Information

Introduction

The Handbook of International Public Sector Accounting Pronouncements is the primary authoritative source of international generally accepted accounting principles for public sector entities.

Presentation of Budget Information

- Applies to public sector entities that make their approved budget publicly available
- Does not require that entities make their budgets available
- Does not establish requirements about the basis of accounting in a budget or the presentation of information in a budget
- Enhances the transparency of financial statement and demonstrates accountability

The budget is an important document for many governments. Reporting comparisons of budgets and the results of budget execution enhances the transparency of financial statements and is an important element in demonstrating accountability, particularly for those entities that make their budgets publicly available.

Budgets are not static. They are often updated throughout the reporting period and differing versions of a budget may be made available to the public at different points in the reporting period. Because there can be more than one budget IPSAS 24 establishes the following definitions:

a) Original budget is the initial approved budget for the budget period.

b) Approved budget means the expenditure authority derived from laws, appropriation bills, government ordinances, and other decisions related to the anticipated revenue or receipts for the budgetary period.

c) Final budget is the original budget adjusted for all reserves, carry over amounts, transfers, allocations, supplemental appropriations, and other authorized legislative, or similar authority changes applicable to the budget period.

Budgets can also be for more than one year.

IPSAS 24 therefore distinguishes between annual and multiyear budgets.

Presentation

- Comparison of budgeted amounts and actual amounts
- If financial statements and budget prepared on comparable basis (e.g., accrual f/s & accrual budget)
    - Additional budget columns in the financial statements
    - Separate additional financial statement
- If financial statements and budget not prepared on comparable basis (e.g. accrual f/s & cash budget) separate additional financial statement required
- Comparable basis to the budget

IPSAS 24 requires the presentation of a comparison of budgeted amounts (original and final budget) and actual amounts in the financial statements. The comparison must be provided for each level of legislative oversight. The way in which this comparison is presented depends on whether the financial statements and the budget are prepared on a comparable basis.

If the financial statements and the budget are prepared on a comparable basis (for example, accrual financial statements and an accrual budget) the comparison may be presented by way of additional columns in the primary financial statements or in a separate statement. If the financial statements and the budget are prepared on a different basis (for example, accrual financial statements and cash basis budget) the comparison must be presented in a separate statement.

The comparison between budget and actual amounts must be presented on a comparable basis to the budget (for example, if the budget is presented on a cash basis then the comparison of budgeted and actual amounts must also be presented on the cash basis).

Comparable basis means the actual amounts are presented on the same accounting basis, the same classification basis, for the same entities, and for the same period as the approved budget. On a comparable basis means that:

a) the same accounting basis is used (i.e., cash or accrual),

b) the amounts are for the same economic entity (i.e. the same entities),

c) the same classifications are used and

d) the budget and financial statements are for the same fiscal period.

The figures in the comparison statement must be reconciled to key figures in the financial statements.

Note Disclosures

- Material differences between the budget and actual amounts
- Explanation of whether changes between the original and final budget are from reallocations within the budget, or of other factors
- Explanation of the budgetary basis and classification basis adopted in the approved budget;
- Period of the approved budget; and
- Entities included in the approved budget

IPSAS 24 also specifies note disclosures to help the reader understand the comparison.

These include:

a) An explanation of material differences between the budget and actual amounts.

There is an exception to this requirement if this information is provided in another public document issued in conjunction with the financial statements and the financial statements include a cross reference to that other document;

b) An explanation of whether changes between the original and final budget are a consequence of reallocations within the budget, or of other factors. Again, this explanation may be in the notes to the financial statements or in another document

c) An explanation of the budgetary basis and classification basis adopted in the approved budget;

d) The period of the approved budget; and

e) The entities included in the approved budget.

Questions and Discussion

Visit the IPSASB webpage http://www.ipsasb.org

That concludes our module on the presentation of budget information. Participants should refer to the review questions to test themselves on their knowledge.

Review Questions

Question 1

Which of the following describe the purpose of IPSAS 24?.

a) To require entities to make approved budgets publicly available

b) To provide information to users of general purpose financial reports that demonstrates compliance with the legally adopted budget for accountability.

c) Provide information that users need to assess an entity's performance against plans for the period.

d) Provide guidance on the preparation of budgets on a comparable basis as the financial statements.

Answers to Review Questions

Question 1

Items (b) and (c) best describe the purpose of IPSAS 24.

The reporting of a comparison of budget amounts with actual amounts on a comparable basis in the financial statements provides users with information about an entity's compliance with the legally adopted budget.

Provision of a comparison of budget amounts with actual amounts on a comparable basis in the financial statements provides users with information needed to assess an entity's performance against plans for the period.

This standard does not require approved budgets to be made publicly available, nor does it require that the financial statements disclose information about, or make comparisons with, approved budgets that are not made publicly available.

IPSASs do not establish standards or specify requirements for the formulation or presentation of approved budgets that are made publicly available.

Foreign Exchange

Foreign Exchange IPSAS 4

The Handbook of International Public Sector Accounting Pronouncements is the primary authoritative source of international generally accepted accounting principles for public sector entities.

IPSAS 4, *The Effects of Changes in Foreign Exchange Rates*, contains guidance on accounting for foreign currency transactions and foreign operations.

In order to apply IPSAS 4, entities will need to ensure they have systems for identifying the transactions and balances referred to in IPSAS 4 and have classified foreign operations as either foreign operations that are integral to the operations of the reporting entity or as foreign entities.

The adoption of accrual accounting is often associated with an increased emphasis on the management of foreign exchange risk. This may involve the development of policies regarding exposures to individual currencies and financial institutions, and the types of instruments to be used to manage those exposures.

Scope

- Transactions in foreign currencies
- Foreign operations
- Presentation currency

IPSAS 4:

a) Deals with accounting for foreign currency transactions and foreign operations;

b) Sets out the requirements for determining which exchange rate to use for the recognition of certain transactions and balances; and

c) Explains how to recognize the financial effect of changes in exchange rates in the financial statements.

A foreign exchange gain or loss occurs when there are transactions payable or receivable in foreign currency and exchange rates change between the time of recognition of the transaction and the time of payment. Such gains or losses may be realized or unrealized at the end of the reporting period. Gains or losses may also occur due to changes in the rates used to translate the balances associated with foreign operations.

As noted in the International Monetary Fund (IMF) and World Bank's *Revised Guidelines for Public Debt Management* (IMF and World Bank, 2014), excessive unhedged foreign exchange exposures are a common pitfall in public debt management. Excessive amounts of foreign currency denominated debt and foreign exchange indexed debt can leave governments vulnerable to volatile and possibly increasing debt service costs if their exchange rates depreciate, and the risk of default if they cannot roll over their debts.

Many governments will also have significant foreign exchange risk exposures arising from government entities' purchases and sales. The adoption of accrual accounting provides a government with a timely opportunity to review its management of foreign exchange exposures, both in relation to debt and the operations of its entities. Options include the establishment of specific thresholds beyond which cover will be taken, or remaining uninsured at the whole-of-government level (sometimes referred to as self-insuring). Foreign currency management of risks associated with the operations of individual entities can occur at an entity level or as a centralized function.

Functional Currency

- Currency of the primary economic environment in which the entity operates
- Generally straightforward
- Revenue raised; costs settled
- Foreign currency items generally translated to functional currency.

IPSAS 4 requires that an entity initially record its foreign currency transactions in the entity's functional currency.

At each reporting date an entity must translate all foreign currency items into the functional currency. The rate which must be used depends on the type of item (for example, foreign currency monetary items are translated using the closing rate).

Recognition

Initially:

- Apply spot exchange rate to foreign currency amount at transaction date

Subsequent

- Foreign currency monetary items at closing rate
- Nonmonetary items measured at historical cost translated at transaction date
- Nonmonetary items at fair value translated at date when fair value determined.

A foreign currency transaction is recorded, on initial recognition in the functional currency, by applying to the foreign currency amount the spot exchange rate between the functional currency and the foreign currency at the date of the transaction.

The date of a transaction is the date on which the transaction first qualifies for recognition in accordance with IPSASs. For practical reasons, a rate that approximates the actual rate at the date of the transaction is often used, for example, an average rate for a week or a month might be used for all transactions in each foreign currency occurring during that period. However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.

Exchange Differences

- Monetary items – recognize differences in surplus/deficit
- Nonmonetary item – recognize where related gain/loss recognized – net assets/ equity or surplus/deficit
- Monetary item part of foreign operations – surplus/deficit of separate financial statements.

Exchange differences arising on settlement of monetary items and on translation of monetary items at a rate different from when initially recognized are generally recognized in surplus or deficit. However, exchange differences arising from monetary items that form part of the reporting entity's net investment in a foreign operation are recognized in a separate component of net assets/equity in the consolidated financial statements (and subsequently recognized in surplus or deficit on disposal of that net investment).

Disclosure

- Exchange differences recognized in surplus/deficit
- Net exchange differences on net assets/equity
- Change in functional currency

Questions and Discussion

Visit the IPSASB webpage

http://www.ipsasb.org

That concludes our module on foreign exchange. Participants should refer to the review questions to test themselves on their knowledge.

Review Questions

Question 1

Which of the following describes the rate to be used when initially recognizing a foreign exchange transaction?

a) The average exchange rate for the year

b) The spot rate at the transaction date

c) The spot rate at the end of the reporting period.

Question 2

Which items are subsequently measured at the closing rate?

a) Foreign currency monetary items

b) Nonmonetary items measured at historical cost

c) Nonmonetary items measured at Fair value

Answers to Review Questions

Question 1

The answer is (b), the spot rate at the transaction date

Foreign exchange transactions are recognized using the spot rate at the transaction date, not the reporting date. While an average rate may be used where rate that approximates the actual rate at the date of the transaction, the use of an annual average is not appropriate.

Question 2

The answer is (a), foreign currency monetary items.

Nonmonetary items measured at historical cost are translated at transaction date. Nonmonetary items measured at fair value are translated at the date at which the fair value was determined.