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Dear Sir

EXPOSURE DRAFT 24: FINANCIAL REPORTING UNDER THE CASH BASIS OF ACCOUNTING – DISCLOSURE REQUIREMENTS FOR RECIPIENTS OF EXTERNAL ASSISTANCE

The UK National Audit Office (NAO) welcomes the opportunity to comment on the proposals contained in Exposure Draft (ED) 24. The UK NAO is the external auditor of all UK Central Government departments including the UK Department for International Development (DFID). DFID provides external aid in the form of grants to a range of bodies including Governments, Multilateral Organisations (such as the United Nations and associated bodies) and Non-Governmental Organisations (NGOs) around the world. Some of these bodies may prepare Financial Statements on the cash basis of accounting and the proposed requirements of Exposure Draft (ED) 24: Disclosure Requirements for Recipients of External Aid may therefore be applicable to these bodies if the ED becomes a standard.

In undertaking the audit of DFID's financial statements, the NAO are required to confirm that grants paid by DFID have been properly accounted for by the recipients and that the recipients have used the grants in accordance with any grant conditions attached to them. The NAO have, over recent years, visited a number of countries and some 30 NGOs to follow DFID development grants and assess the accounting for grants by recipients.

The NAO therefore have an interest in ensuring that aid grants received by bodies are appropriately disclosed in the recipients' financial statements. The following observations on ED 24 have therefore been prepared by the NAO from the perspective of a user of the financial statements. We have set out our overall comments in this letter and our detailed comments on the specific matters referred for comment in the attached annex.

Overall comments

It is important that disclosure requirements placed upon bodies receiving external assistance are proportionate to the needs of the users of the financial statements. In some countries in receipt of aid grants from DFID the accounting and auditing regimes are relatively less developed. And the accounting and audit arrangements of many NGOs in developing countries would not meet the standards set, for example, by the UK Statement of Recommended Practice for Charities (the Charities SORP). It is therefore appropriate that the IPSASB should be seen to develop standards for financial reporting, and the NAO endorses the need for a standard covering the reporting of grants received.

At the same time, however, it is important that standards are capable of being implemented by those who will be required to do so, and are not unduly onerous to implement. Whilst the current

ED could be viewed as setting the “gold” standard for accounting and disclosure, it needs to be practical in its application to bodies whose accounting and reporting systems may not be sufficient to support the high standards implicit in the ED. The NAO is not convinced that the current ED provides sufficient advice for bodies that will not, for whatever reason, be able to meet the standard proposed. It appears to the NAO that there needs to be clearer guidance to the users of the ED as to what information is essential in all circumstances, and what is additional good practice.

A further major issue to consider on this topic is what part the donors themselves might play in bringing their requirements for financial reporting and accounting onto a cohesive and consistent basis. We are aware for example of the work of the OECD Development Assistance Committee in this area and actions taken by donors to harmonise the requirements that they attach to their grants. We believe that it is vitally important for the success of the IPSASB work for there to be a commonality of purpose as between the standard setter and the preparers and users of financial statements. Bringing about improvements in financial reporting in recipient country accounts is likely to require the investment of scarce resource and such countries are more likely to be willing to do this if they can see evidence of such common purpose.

Yours sincerely

A handwritten signature in black ink that reads "Mary Radford". The signature is written in a cursive style with a large initial 'M' and 'R'.

Mary Radford
DIRECTOR

Financial Audit Policy

EXPOSURE DRAFT 24 – DISCLOSURE REQUIREMENTS FOR RECIPIENTS OF EXTERNAL ASSISTANCE

UK NAO RESPONSES TO THE SPECIFIC MATTERS FOR COMMENT

1. Whether the proposed definition of “external assistance” in paragraph 5 is sufficiently broad to encompass all official resources received.

Yes, but see our further comments about “in kind” assistance under item 6.

2. Whether other sources of assistance such as assistance provided by non-governmental organisations (NGOs) should also be included in the definition of “external assistance”. Currently the Exposure Draft requires that entities disclose all official resources received. Official resources as defined in paragraph 5 would exclude certain assistance received from NGOs.

We do not believe that at present such assistance should be included in the definition of “external assistance”. There is a wide range of NGOs and the national NGOs in developing countries in particular do not always have sufficiently sophisticated accounting, financial reporting and auditing arrangements to support the level of data and disclosure that would be required, nor necessarily to make use of the information in recipient country accounts.

3. Whether the Exposure Draft should specify the categories of external assistance as required in paragraphs 13-15 or only require the disclosure of external assistance by “major classes” without further specification.

From the perspective of a user of accounts prepared on a cash basis, we consider that the key areas for disclosure are:

- External assistance received, analysed preferably by donor;
- Loans received analysed preferably by lender;
- Interest and principal repayments of loans analysed by lender.

This information is essential so that the donors can track all amounts paid to the recipient and ensure that they have been received and accounted for. For loan repayments, the disclosures ensure that donors receive all amounts remitted by the borrower. These disclosures represent a strong detective control over fraud.

Because the donors need to be able to track the receipt of assistance they have paid, it is important that external assistance received is analysed by donor and not amalgamated with other donors. This type of analysis could usefully be included as a note to the financial statements. Where there are multiple grant agreements with a single donor, the donor will usually require a reconciliation between the various grants paid and the total shown as received. This reconciliation should be prepared as part of the accounting package, but is not essential for it to be part of the disclosure in the formal financial statements.

4. The proposal to disclose the balance of, and changes in, undrawn external assistance during the period (paragraph 22).

We can understand how information of this nature might be useful to users of the financial statements of recipient countries but we would question the proposed level of detail. We would

again refer to the fact that the proposed standard is aimed at entities preparing accounts on a cash basis. While some indication of the “facilities” available to the entity by way of undrawn assistance might be useful the nature of the disclosure suggested appears to be more appropriate to an entity that has adopted the accrual basis of accounting.

5. The proposal to disclose the terms and conditions of external assistance agreements as required by paragraphs 26-28 and any non-compliance thereof (paragraph 36).

Again we can understand how some summary information of this type might be useful to general users of the financial statements, such as the fact that there are conditions that might limit the use of or lead to the suspension of assistance. We do not think however that the proposed level of detail is appropriate nor that it will actually be that helpful to donors or potential donors, who we assume will be amongst the major users of the financial statements.

Donors and lenders who are considering providing grants and loans are likely to seek direct knowledge of the terms of the terms and conditions of existing external assistance. Additional disclosure by the recipient in the financial statements, is not essential for their purposes and we are unsure which other class of user might benefit from the proposal. And in many recipient countries’, the inclusion of this information in the annual financial statements will add unduly to the volume of information presented as well as potentially providing an onerous increase in the scope of responsibilities for both preparers and auditors of the financial statements.

6. Whether the proposals in paragraph 44 as noted below are appropriate:

a) to disclose the fair value of non-cash goods-in-kind; and

b) that fair value should be based on the prices of equivalent goods or services in the recipient country.

We can understand that for many recipient countries the fair value equivalent, however established, of such goods could be significant. However, as the financial statements in question are meant to be prepared on a cash basis we are dubious as to the merits of this proposal. The nature and limitations of the cash basis of accounting should be clear to users and we wonder whether such attempts to expand the scope of the accounts towards a more “full-cost” basis of accounting will only serve to confuse users. At an earlier stage in the IPSASB standards project we believe it was clear that respondents did not really support mixed models of accounting in that cash and accrual were the only two bases recognised generally. We continue to support this view.

7. Whether the disclosures proposed are appropriate. If the disclosures are considered excessive, the IPSASB would welcome input on which disclosures should not be required. The IPSASB would also welcome input on any key disclosures that have not been dealt with and should be required.

We do not support all of the proposed disclosures for the reasons noted. In essence annual financial statements should not be viewed as a universal document for disclosing financial health: in particular the purpose of financial statements prepared on a cash basis is to report transactions in the year. Additional information such as that relating to terms and conditions, guarantees, balances available, outstanding debts, debt rescheduling are all pertinent financial data for countries in receipt of external assistance, but we do not believe that they should be required disclosures in a set of cash based financial statements. Some or all of them might be encouraged by way of voluntary additional information but for the purposes of consistency, comparability and to ensure the audit remit is also clear such voluntary disclosures might be better included in a

statement accompanying the financial statements somewhat akin to the Operating and Financial Review or similar statements produced by the publicly traded entities in many jurisdictions.

8. Whether the proposal in paragraph 54:

a) For a transition period of two years is sufficient to apply this Standard. Is a longer transition period necessary to ensure the appropriate authorities in each recipient country are able to access the data necessary to properly account for external assistance?

Based on our responses above, if the exposure draft is approved as it stands we would anticipate that most of the recipient countries that we have had contact with would require more than two years to make the transition in respect of most of the proposed disclosures including those relating to the balance on undrawn assistance.

b) To exempt the requirement to disclose comparative figures during the first year of application of the Standard is appropriate.

We would support this exemption.