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IPSASB Technical Director, Mr. John Stanford

Date	From	Our reference
July 31, 2016	Prof.Dr. Frans van Schaik	

Subject

Your reference

Deloitte's Comment letter Exposure Draft 61 Cash-basis IPSAS

Dear Mr. Stanford:

Deloitte Touche Tohmatsu Limited is pleased to respond to the IPSASB Exposure Draft 61 Cash-basis IPSAS.

Our responses to the invitation to comment questions are included in the Appendix to this letter.

If you have any questions concerning our comments, please contact Frans van Schaik at +31655853527 or fvanschaik@deloitte.nl.

Yours sincerely,

Frans Van Schaik

Deloitte's Global Leader Public Sector Accounting and Auditing

Appendix

1. **We welcome the explicit statement in the draft Standard that Cash-basis IPSAS financial statements constitute an intermediate step towards comprehensive accrual accounting IPSAS financial statements.** Under the heading Objective, subheading Role of the Cash Basis IPSAS the draft standard includes the statement "The Cash Basis IPSAS has been developed as an intermediate step to assist in the transition to the accrual basis of financial reporting and adoption of accrual IPSASs. It is not intended as an end in itself." This statement is much clearer in this respect than the current standard and we consider this a clear improvement.
2. **We also welcome the objective of ED 61 to ensure that requirements and encouragements in the Standard are not contrary to or exceed those of the equivalent accrual IPSASs, except where such differences are appropriate to reflect adoption of the cash basis.** However, we think that the ED does not achieve this objective for the following two reasons:

2.1 Difference in disclosure requirements:

The proposed Cash-basis IPSAS includes the following requirements in bold letters:

"1.4.9 *An entity shall disclose in the notes to the financial statements together with a commentary, the nature and amount of:*

(a) ***Significant cash balances that are not available for use by the entity;***
(b) ***Significant cash balances that are subject to external restrictions; and***
(c) ***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."***

The equivalent paragraph in IPSAS 2 Cash Flow Statements is merely a non-mandatory paragraph in grey letters:

"61. 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."

In order to make the Cash-basis IPSAS consistent with IPSAS 2 Cash Flow Statements, we think there is a need to rephrase the requirements in paragraph 1.4.9 and turn them into encouragements and move them to part II of the standard.

2.2 Difference in timeliness of financial statements:

The guidance provided by the Cash-basis IPSAS about the timeliness of financial statements differs from the guidance provided by IPSAS 1 Presentation of Financial Statements. The Cash-basis includes an encouragement to issue financial statements within three months, while IPSAS 1 does not:

Cash-basis IPSAS, paragraph 1.4.4: "An entity should be in a position to issue its financial statements within six months of the reporting date, although a timeframe of no more than three months is strongly encouraged."

IPSAS 1 Presentation of Financial Statements, paragraph 69: "The usefulness of financial statements is impaired if they are not made available to users within a reasonable period after the reporting date. An entity should be in a position to issue its financial statements within six months of the reporting date."

In order to make the Cash-basis IPSAS consistent with IPSAS 1 Presentation of Financial Statements, we think there is a need to rephrase the guidance relating to timeliness.

3. **All requirements in the Cash-basis IPSAS that are not also requirements in the accrual suite of IPSAS standards should be removed.** This is a logical consequence of the acknowledgment that the Cash-basis IPSAS is an intermediate step towards the full set of accrual IPSAS standards. We therefore agree with the removal of the requirement to disclose payments by third parties on behalf of the entity (1.3.24) and the requirements relating to recipients of external assistance (1.10), as these requirements do not appear in the accrual-basis IPSAS standards.

4. **Financial statements that exclude controlled entities are likely to be misleading.** An important lesson learnt from the sovereign debt crisis is that governments tend to maintain a range of agencies, state-owned enterprises and special purpose vehicles that obfuscate the financial position and performance of the economic entity as a whole. Substantial liabilities and cash outflows may be hiding in these controlled entities. Allowing the reporting entity to exclude controlled entities from IPSAS compliant financial statements carries the risk that users of the financial statements will draw the wrong conclusions. One of the lessons learnt from the sovereign debt crisis is that government debt and related cash outflows tend to be understated if financial statements are not prepared on a consolidated basis.

5. **Financial statements that exclude controlled entities do not meet the qualitative characteristics of financial information, because they are neither complete nor comparable.** Paragraph 1.3.27 of the proposed Cash-basis IPSAS states:
   "General purpose financial statements shall present information that is:
   (c)(i) A faithful representation of the cash receipts, cash payments and cash balances of the entity and the other information disclosed in the financial statements in that it is:
   (i) Complete; […]
   (d) Comparable"
   Financial statements that exclude controlled entities are not complete because cash inflows and outflows ultimately controlled by the entity (directly or indirectly) are not recognized in the statement of cash receipts and payments. Financial statements that exclude controlled entities are not comparable because one government may have corporatized its road agency, while still holding all its shares, and another government operates its road infrastructure as an integral part of its Department of Transport. The financial statements of those two governments will look very different even though the economic reality of the two arrangements is the same.

6. **The Basis for Conclusions (BC) of the draft Standard fails to explain why the IPSASB concluded that the objectives of government financial reporting (accountability and improved decision-making) can be achieved with financial statements that exclude controlled entities.** We are of the opinion that financial statements that exclude controlled entities are not useful in holding a government accountable because they exclude information about significant government-controlled cash flows. We are also of the opinion that these financial statements do not contribute to improved decision-making because they are potentially misleading.

7. **The draft Standard allows the reporting entity to include or exclude controlled entities at will, causing the reporting entity under the Cash-basis IPSAS to be nebulous.** Paragraph 1.1.4 "A reporting entity is an individual entity that presents financial statements or, where a controlling entity elects to present group financial statements, a reporting entity may comprise a controlling entity and one or more controlled entities that present financial statements as if they are a single entity." In our opinion, leaving the composition of the reporting entity at the discretion of the reporting entity facilitates manipulation of the financial information presented by including entities that look good and excluding entities that look bad. Using the word group in this context may be confusing to the users of the financial statements because IFRS defines a group as 'a parent and its subsidiaries', a concept similar to the economic entity under IPSAS. We therefore think that the word group should be removed from the Cash-basis IPSAS paragraph 1.4.23 which requires the reporting entity to disclose "whether the financial statements cover an individual entity or a group of entities".

8. **If the IPSASB goes ahead and allows the reporting entity to draw its own boundaries, which we do not recommend, these financial statements should not be labeled 'IPSAS financial statements'**. At best these should be labeled 'transitional IPSAS financial statements' (similar to IPSAS 33 First-time Adoption of Accrual Basis IPSASs), 'separate financial statements' (similar to IPSAS 34 Separate Financial Statements) or 'standalone IPSAS financial statements'. The label 'transitional IPSAS financial statements' should be allowed for a limited period only, e.g. three years.
9. **By removing the consolidation requirement from the Cash-basis IPSAS, the intermediate step from current accounting practices of many countries towards the Cash-basis IPSAS becomes tiny and the subsequent step from the Cash-basis IPSAS towards the full accrual IPSAS becomes huge.** This may entice governments to quickly become 'IPSAS compliant' by preparing financial statements in accordance with the stripped Cash-basis IPSAS, and stop right there, since the steps towards accrual accounting IPSAS is out of reach. For the Cash-basis IPSAS to be a credible step towards accrual IPSAS it should still be a significant step on the long and winding road towards compliance with the full suite of accrual IPSAS standards.