# INTRODUCTION TO IPSAS

Other Pronouncements

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# Conceptual Framework

# Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities

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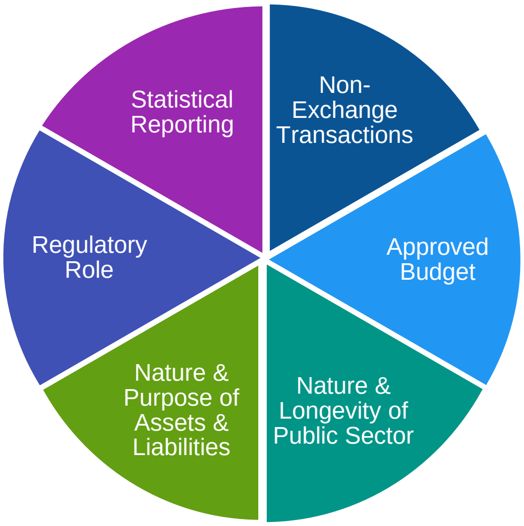
The *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities (the Conceptual Framework)* establishes the concepts that underpin general purpose financial reporting by public sector entities that adopt the accrual basis of accounting. The IPSASB will apply these concepts in developing new IPSAS and Recommended Practice Guidelines (RPGs) applicable to the preparation and presentation of general-purpose financial reports (GPFRs) of public sector entities.

The Conceptual Framework does not establish authoritative requirements for financial reporting by public sector entities that adopt IPSASs, nor does it override the requirements of IPSASs or RPGs.

Authoritative requirements relating to the recognition, measurement and presentation of transactions and other events and activities are specified in IPSAS. If there is a conflict between the requirements in an IPSAS and the *Conceptual Framework*, entities should follow the IPSAS. The role of the *Conceptual Framework* is to guide the IPSASB as it develops IPSASs and RPGs, and over time it is expected that any conflicts will be addressed.

The *Conceptual Framework* can provide guidance in dealing with financial reporting issues that are not dealt with by IPSAS or RPGs. In these circumstances, preparers and others can refer to and consider the applicability of the definitions, recognition criteria, measurement principles, and other concepts identified in the *Conceptual Framework*.

# Key Characteristics of the Public Sector



### *The volume and financial significance of non-exchange transactions including involuntary transactions*

In a non-exchange transaction, an entity receives value from another party without directly giving approximately equal value in exchange. Such transactions are commonplace in the public sector, where many entities are substantially financed by taxation (or contributions) or transfers from other entities, which are initially financed through taxation. The level and quality of services received by an individual, or group of individuals, is not normally related to the amount contributed by them through taxation. Depending on the provisions of the program, an individual may have to pay a charge or fee and/or may have had to make specified contributions to access certain services. Notwithstanding this characteristic, such transactions are, generally, of a non-exchange nature, because the amount that an individual or group of individuals obtains in benefits will not be approximately equal to the amount of any fees paid or contributions made by the individual or group. The prevalence and importance of non-exchange transactions may have an impact on how they, and the resulting balances, are recognized, measured, and presented to best support assessments of the entity by service recipients and resource providers.

The collection of taxation is a legally mandated involuntary transaction between individuals or entities and the government. Tax-raising powers can vary considerably between jurisdictions, particularly the relationship between the powers of the national government and those of subnational governments and other public sector entities. International public sector entities are largely funded by transfers from national or regional governments. These may be governed by treaties and conventions or may be on a purely voluntary basis.

The involuntary nature of taxes and transfers is one of the main reasons why the accountability objective of financial reporting is important in the public sector.

### *The importance of the approved budget*

Most governments and other public sector entities prepare annual financial budgets typically covering the revenue to be raised and other spending plans. In many jurisdictions there is a constitutional requirement to prepare and make publicly available a budget approved by the legislature (or equivalent). Legislation often defines the contents of that documentation. A government's approved budget is the primary method by which the legislature exercises oversight and constituents and their elected representatives hold the entity's management financially accountable. The approved budget is often the basis for setting taxation levels, and is part of the process for obtaining legislative approval for spending.

Because of the approved budget's significance, information that enables users to compare actual spending, revenues and the resulting surplus or deficit with the budget estimates is important.

Reporting against budget is commonly the mechanism for demonstrating compliance with legal requirements relating to the raising and use of public finances. Comparisons between forecast and actual information also facilitate an assessment of the extent to which a public sector entity has met its financial objectives and therefore promotes accountability and informs decision making in subsequent budgets.

### *The longevity of the public sector and the nature of public sector programs*

The going concern principle that underpins the preparation of the financial statements has often been difficult to interpret in the public sector. Because of sovereign powers, particularly the power to tax, the net assets/liabilities position may not be the overriding factor in determining whether a national government can meet its obligations as they fall due.

There are two further reasons why going concern has been difficult to interpret. The first reason is that many public sector programs are long term and the ability to meet commitments depends upon future taxation and contributions. Many commitments arising from public sector programs do not meet the definition of a liability and the power to levy future taxation may not meet the definition of an asset. Such commitments and powers may therefore not be recognized in the financial statements.

Consequently the financial statements cannot provide all the information that users need on long-term programs, particularly those delivering social benefits. Reports on the long-term sustainability of key programs are therefore relevant to assessments of accountability by resource providers and service recipients. The financial consequences of many decisions will have an impact many years or even decades into the future, so GPFRs containing prospective financial information on the long-term sustainability of an entity's finances, covering lengthy time horizons, are necessary for accountability and decision-making purposes.

The second reason is the nature and longevity of governments and public sector entities themselves. Although political control may change regularly, national governments generally have very long lives. While they may encounter severe financial difficulties and may default on sovereign debt obligations governments continue to exist.

If sub-national entities get into financial difficulties, national governments might act as lenders of last resort or provide large scale guarantees. The main service delivery commitments of sub-national entities may continue to be funded by a higher level of government. Sub-national entities may also be amalgamated. In other cases public sector entities that are unable to meet their liabilities as they fall due may continue to exist by restructuring their operations.

### *The nature and purpose of assets in the public sector*

In the public sector, the primary reason for holding property, plant, and equipment and other assets is generally to provide services rather than to generate cash flows. Because of the nature of public sector service provision, a significant proportion of assets deployed by public sector entities are specialized in nature, for example roads and military assets. There may be a limited market for such assets and, even then, they may need considerable adaptation in order to be used by other operators. These factors may have implications for their measurement.

Governments and other public sector entities may hold items that contribute to the historical and cultural character of a nation or region (for example, art treasures, historical buildings, and other artifacts). They may also be responsible for national parks and other areas of natural significance with native flora and fauna. Such items and areas are not generally held for sale, even if markets exist. Rather, governments and public sector entities have a responsibility to preserve and maintain them for current and future generations.

Governments also often have powers over natural resources such as mineral reserves, water, fishing grounds and forests. These powers allow governments to grant licenses for the use of such resources or to obtain royalties and taxes from their use.

Governments may also assume rights over phenomena such as the electromagnetic spectrum.

In these areas, and in the areas outlined above, there may be implications for both the definition of an asset, as well as for the recognition and measurement of any such assets.

### *The regulatory role of public sector entities*

Many governments and other public sector entities have powers to regulate entities operating in certain sectors of the economy, either directly or through specifically created agencies. The underlying public policy rationale for regulation is to safeguard the interests of consumers, in accordance with specified public policy objectives. Regulatory intervention also occurs where there are market imperfections or market failure for particular services, or to mitigate against factors such as pollution, the impact of which is not transmitted through pricing. Such regulatory activities are carried out in accordance with legal processes.

Governments may also regulate themselves and other public sector entities. Judgment may be necessary to determine whether such regulations create rights of, and obligations on, public sector entities that require recognition as assets and liabilities, or whether the public sector entity's ability to amend such regulations has an impact on how such rights and obligations should be accounted for.

### *Relationship to statistical reporting*

Many governments produce two types of ex-post financial information: (a) government finance statistics (GFS) on the general government sector for the purpose of macroeconomic analysis and decision making, and (b) general purpose financial statements (GPFS) for accountability and decision making at an entity level, including GPFSs for the whole of government reporting entity.

The overarching standards for macro-economic statistics are set out in the System of National Accounts (SNA). The SNA is a framework for a systematic and detailed description of the national economy and its components, including the general government sector. Internationally recognized macroeconomic statistical methodologies are harmonized with the SNA to the extent possible, while remaining consistent with their own specific objectives. In the public sector, for non-European Union government finance statistics, the Government Finance Statistics Manual (GFSM), issued by the International Monetary Fund is the key source of guidance for the compilation of government finance statistics and is consistent with the SNA. The European System of Accounts (ESA) provides the legislative rules for nations that are member states of the European Union. ESA is broadly consistent with the SNA and GFSM as regards the definitions, accounting rules and classifications, but has some presentational differences.

IPSAS financial statements and GFS reports have much in common. Both show (a) financial, accrual-based information, (b) a government's assets, liabilities, revenue, and expenses and (c) comprehensive information on cash flows. There is also considerable overlap between the two reporting frameworks that underpin this information. IPSASs and GFS reporting guidelines do have some important differences, as a result of their different objectives, their focus on different reporting entities and the different treatment of some transactions and events. The removal of differences between the two bases of accounting that are not fundamental to their different objectives and a reliance on a single integrated financial information system to generate both IPSAS-compliant financial statements and GFS reports can provide benefits to users in terms of report quality, timeliness and understandability.

## Objectives and Users of General-Purpose Financial Reporting

- Objectives of Financial Reporting
  - Provide information about entity useful to users of GPFRs
  - Accountability purposes and decision-making purposes
    - Reflects service delivery objective and nature of funding
  - Respond to information needs of users
- Users of GPFRs
  - Primary users:  service recipients and resource providers

The objectives of financial reporting by public sector entities are to provide information about the entity that is useful to users of GPFRs for accountability purposes and for decision-making purposes. The identification of accountability as an objective of financial reporting reflects the fact that most governments and public sector entities have a service delivery rather than profit seeking objective, and the nature of their funding—mainly through taxation, but also transfers from other tiers of government.

Financial reporting is not an end in itself. Its purpose is to provide information useful to users of GPFRs. The objectives of financial reporting are therefore determined by reference to the users of GPFRs, and their information needs.

The primary users of GPFRs are service recipients and resource providers (taxpayers, donors, lenders and other resource providers) and their representatives. By focusing on the needs of this class of users the needs of other users will also be satisfied.

## Qualitative Characteristics

- Relevance
- Faithful Representation
- Understandability
- Timeliness
- Comparability
- Verifiability

These are the qualitative characteristics of financial reporting that are identified and explained in the Conceptual Framework. The qualitative characteristics of information included in GPFRs are the attributes that make that information useful to users and support the achievement of the objectives of financial reporting.

Each of the qualitative characteristics is integral to, and works with, the other characteristics to provide information useful for achieving the objectives of financial reporting. However, in practice, all qualitative characteristics may not be fully achieved, and a balance or trade-off between certain of them may be necessary.

Financial and non-financial information is **relevant** if it is capable of making a difference in achieving the objectives of financial reporting. Financial and non-financial information is capable of making a difference when it has confirmatory value, predictive value, or both.

To be useful in financial reporting, information must be a **faithful representation** of the economic and other phenomena that it purports to represent. Faithful representation is attained when the depiction of the phenomenon is complete, neutral, and free from material error. Information that faithfully represents an economic or other phenomenon depicts the substance of the underlying transaction, other event, activity or circumstance. This may not always be the same as its legal form. The Conceptual Framework uses the term “faithful representation” rather than “reliability” to describe what is substantially the same concept. In addition, it does not explicitly identify substance over form and prudence as components of faithful representation.

Neither “substance over form” nor “prudence” are included as qualitative characteristics (QCs) in their own right. Substance over form is not identified as a separate or additional qualitative characteristic because it is already embedded in the notion of faithful representation.

The IPSASB is of the view that the notion of prudence is also reflected in the explanation of neutrality as a component of faithful representation, and the acknowledgement of the need to exercise caution in dealing with uncertainty.

**Understandability** is the quality of information that enables users to comprehend its meaning. Explanations of financial and non-financial information and commentary on service delivery and other achievements during the reporting period and expectations for future periods should be written in plain language, and presented in a manner that is readily understandable by users.

**Timeliness** means having information available for users before it loses its capacity to be useful for accountability and decision-making purposes. Having relevant information available promptly can enhance its usefulness as input to assessments of accountability and its capacity to inform and influence decisions that need to be made. A lack of timeliness can mean information is less useful.

**Comparability** is the quality of information that enables users to identify similarities in, and differences between, two sets of phenomena. Comparability is not a quality of an individual item of information, but rather a quality of the relationship between two or more items of information. Comparability differs from consistency. Consistency refers to the use of the same accounting principles or policies and basis of preparation, either from period to period within an entity or in a single period across more than one entity. Comparability is the goal, and consistency helps in achieving that goal.

**Verifiability** is the quality of information that helps assure users that information in GPFRs faithfully represents the economic and other phenomena that it purports to represent.

## Constraints on Information Included in GPFRs

- Materiality
- Cost-Benefit
- Balance between Qualitative Characteristics (QCs)

In addition to the QCs, the Framework **identifies pervasive constraints on information** included in GPFRs.

Information is material if its omission or misstatement could influence the discharge of accountability by the entity, or the decisions that users make on the basis of the entity's GPFRs prepared for that reporting period. **Materiality** depends on both the nature and amount of the item judged in the particular circumstances of each entity. GPFRs may encompass qualitative and quantitative information about service delivery achievements during the reporting period, and expectations about service delivery and financial outcomes in the future. Consequently, it is not possible to specify a uniform quantitative threshold at which a particular type of information becomes material.

Financial reporting imposes **costs**. The benefits of financial reporting should justify those costs. Assessing whether the **benefits** of providing information justify the related costs is often a matter of judgment, because it is often not possible to identify and/or quantify all the costs and all the benefits of information included in GPFRs.

The qualitative characteristics work together to contribute to the usefulness of information. For example, neither a depiction that faithfully represents an irrelevant phenomenon, nor a depiction that unfaithfully represents a relevant phenomenon, results in useful information. Similarly, to be relevant, information must be timely and understandable.

The *Conceptual Framework* acknowledges that in some cases, a **balancing or trade-off** between qualitative characteristics may be necessary to achieve the objectives of financial reporting. The relative importance of the qualitative characteristics in each situation is a matter of professional judgment.

## The Reporting Entity

- Government or other public sector organization, program or identifiable area of activity that prepares GPFRs
- Key characteristics
  - Raising & Use of Resources; and
  - Service recipients or resource providers dependent on GPFRs
- May comprise two or more separate entities
- Separate legal identity not essential

Chapter 4 of the *Conceptual Framework* deals with the reporting entity—that is to say what bodies should develop and issue GPFRs.

At its simplest, a public sector reporting entity is a government or other public sector organization, program or identifiable area of activity that prepares GPFRs.

The key characteristics of a public sector reporting entity are that:

- It is an entity that raises resources from, or on behalf of, constituents and/or uses resources to undertake activities for the benefit of, or on behalf of, those constituents; and
- There are service recipients or resource providers dependent on GPFRs of the entity for information for accountability or decision-making purposes.

A public sector reporting entity may comprise two or more separate entities that present GPFRs as if they are a single entity—such a reporting entity is referred to as a group reporting entity.

The government and many public sector entities have a separate legal. However, a public sector reporting entity may be an organization, administrative arrangement or program without a separate legal identity.

## Elements in Financial Statements

| | | |
|---|---|---|
| Asset | Revenue | Ownership Contributions |
| Liability | Expense | Ownership Distributions |

Financial statements portray the financial effects of transactions and other events by grouping them into broad classes which share common economic characteristics. These broad classes are termed the elements of financial statements. Elements are the building blocks from which financial statements are constructed. These building blocks provide an initial point for recording, classifying and aggregating economic data and activity in a way that provides users with information that meets the objectives of financial reporting and achieves the qualitative characteristics of financial reporting while taking into account the constraints on information included in GPFRs.

The *Conceptual Framework* defines the following elements that make up the financial statements:

An **asset** is a resource presently controlled by the entity as a result of a past eventA **liability** is a present obligation of the entity for an outflow of resources that results from a past event.

**Revenue** is increases in the net financial position of the entity, other than increases arising from ownership contributions.

**Expense** is decreases in the net financial position of the entity, other than decreases arising from ownership distributions.

**Ownership contributions** are inflows of resources to an entity, contributed by external parties in their capacity as owners, which establish or increase an interest in the net financial position of the entity.

**Ownership distributions** are outflows of resources from the entity, distributed to external parties in their capacity as owners, which return or reduce an interest in the net financial position of the entity.

## Recognition in Financial Statements

- Item satisfies definition of an element
- Can be measured in a way that:
  - Achieves qualitative characteristics; and
  - Takes account of constraints
- Recognition criteria are not incorporated in element definitions

The *Conceptual Framework* identifies the criteria that must be satisfied in order for an element to be recognized in the financial statements. Recognition is the process of incorporating and including in amounts displayed on the face of the appropriate financial statement an item that meets the definition of an element and can be measured in a way that achieves the qualitative characteristics and takes account of the constraints on information included in GPFRs.

The recognition criteria are high level.

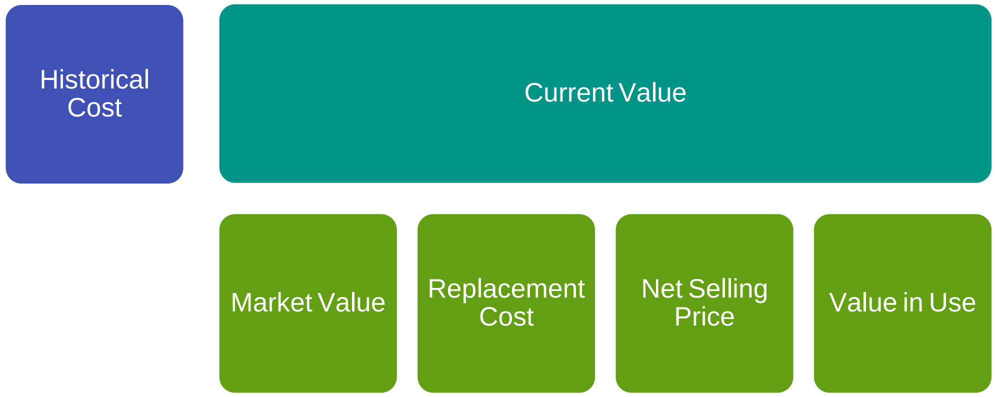
In determining whether an element should be recognized there are two types of uncertainty that need to be considered. The first is uncertainty about whether the definition of an element has been satisfied. The second is measurement uncertainty—whether the element can be measured in a manner that achieves the qualitative characteristics.

The IPSASB took the view that the definitions of elements should not contain recognition criteria. Consequently, an item may satisfy the definition of an element, but not meet the recognition criteria because it cannot be measured reliably.

## Measurement of assets and liabilities in Financial Statements

The objective of measurement is to select those measurement bases that most fairly reflect the cost of services, operational capacity and financial capacity of the entity in a manner that is useful in holding the entity to account, and for decision-making purposes. The Conceptual Framework identifies a number of measurement bases for measuring assets and liabilities.

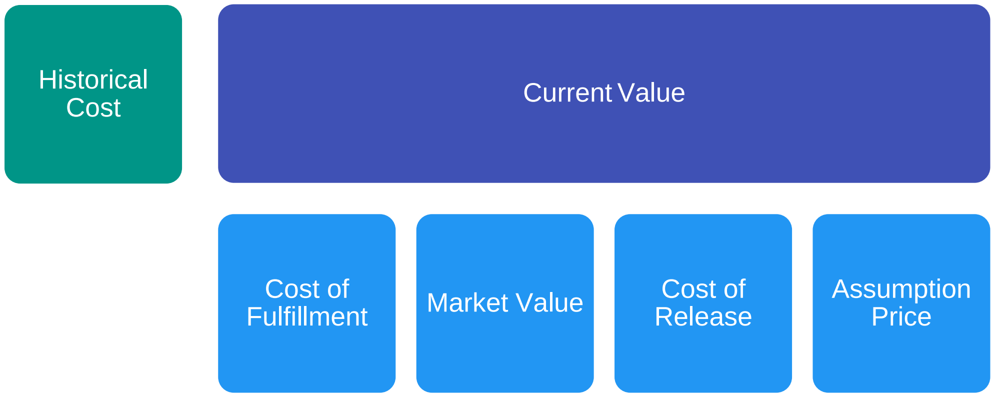
## Measurement bases for assets




The Framework identifies five measurement bases for assets and provides guidance on the high level, but non-specific circumstances when it is appropriate to apply them. After much consideration the IPSASB decided not to define “fair value”, but instead to define **market value**. In addition the *Conceptual Framework* suggests that, for entities adopting current values, **replacement cost** may be the appropriate measurement basis for specialized assets that are held primarily for the delivery of services, rather than the generation of cash flows.

**Net selling price** and **value in use** are also identified as measurement bases. They are likely to be used in more limited circumstances, such as when a decision has been made that an asset will be sold and in determining impairments.

## Measurement bases for liabilities




These are the measurement bases identified in the *Conceptual Framework* for liabilities. **Historical cost** is again identified.

**Cost of fulfillment** is: The costs that the entity will incur in fulfilling the obligations represented by the liability, assuming that it does so in the least costly manner.

**Cost of release** refers to the amount of an immediate exit from the obligation. Cost of release is the amount that either the creditor will accept in settlement of its claim, or a third party would charge to accept the transfer of the liability from the obligor.

**Assumption price** is the amount which the entity would rationally be willing to accept in exchange for assuming an existing liability.

Cost of fulfillment will often be the relevant measurement basis, because in the case of non-exchange transactions in the public sector, there are often very limited circumstances under which a third party will accept the transfer of a liability, or evidence of the amount that an entity would rationally be willing to accept in exchange for assuming an existing liability. Nevertheless, there may be circumstances where cost of release and assumption price provide relevant information.

## Presentation in General Purpose Financial Reports

- Information Selection
- Information Location
- Information Organization

The *Conceptual Framework* adopts a broader scope perspective to presentation, considering how information should be presented in general purpose financial reports, not just in the financial statements.

Decisions on information selection address what information is reported:

- In the financial statements; and
- In GPFRs outside the financial statements (other GPFRs).

Decisions on information location are made about which:

- Financial report information is located within; and
- Component of a financial report information is located within.

Information organization addresses the arrangement, grouping and ordering of information, which includes decisions on:

- How information is arranged within a GPFR; and
- The overall structure of a GPFR.

## Questions and Discussion

That concludes our session on the *Conceptual Framework*. Participants should refer to the review questions to test themselves on their knowledge.

Visit the IPSASB webpage

http://www.ipsasb.org

# Review Questions

## Question 1

Where there is an inconsistency between an IPSAS and the Conceptual Framework, preparers should apply the Conceptual Framework.

**True or False?**

## Question 2

What are the characteristics of the public sector that the IPSASB has identified as underpinning the development of IPSASs and that are addressed in the preface to the public sector conceptual framework?

## Question 3

Elements are the building blocks from which financial statements are constructed.

**What elements does the Conceptual Framework identify?**

# Answers to Review Questions

## Question 1

**The correct answer is false.**

The Conceptual Framework does not establish authoritative requirements for financial reporting by public sector entities that adopt IPSASs, nor does it override the requirements of IPSASs or RPGs. Authoritative requirements relating to the recognition, measurement and presentation of transactions and other events and activities are specified in IPSASs. If there is a conflict between the requirements in an IPSAS and the Conceptual Framework, entities should follow the IPSAS.

## Question 2

The key characteristics of the public sector that are acknowledged and responded to in the public sector conceptual framework are:

- **The volume and financial significance of non-exchange transactions including involuntary transactions**
- **The importance of the approved budget**
- **The nature and purpose of assets in the public sector**
- **The longevity of the public sector and the nature of public sector programs**
- **The regulatory role of public sector entities**
- **Relationship to statistical reporting**

## Question 3

The elements identified in the Conceptual Framework are:

- An **asset** is a resource presently controlled by the entity as a result of a past event.
- A **liability** is a present obligation of the entity for an outflow of resources that results from a past event.
- **Revenue** is increases in the net financial position of the entity, other than increases arising from ownership contributions.
- **Expense** is decreases in the net financial position of the entity, other than decreases arising from ownership distributions.
- **Ownership contributions** are inflows of resources to an entity, contributed by external parties in their capacity as owners, which establish or increase an interest in the net financial position of the entity.
- **Ownership distributions** are outflows of resources from the entity, distributed to external parties in their capacity as owners, which return or reduce an interest in the net financial position of the entity.

# Recommended Practice Guidelines

## Recommended Practice Guidelines

- RPG 1, *Reporting on the Long-Term Sustainability of an Entity's Finances*
- RPG 2, *Financial Statement Discussion and Analysis*
- RPG 3, *Reporting Service Performance Information.*

The IPSASB has developed Recommended Practice Guidelines to deal with areas of general-purpose financial reporting that are outside of financial statements. Because these are often addressing evolving or developing areas of reporting the RPGs are not mandatory.

## RPG 1, Reporting on the Long-Term Sustainability of Public Finance

The Recommended Practice Guideline (RPG) provides guidance on reporting on the long-term sustainability of a public sector entity's finances ("reporting long-term fiscal sustainability information"). The RPG also provides information on the impact of current policies and decisions made at the reporting date on future inflows and outflows and supplements information in the general-purpose financial statements ("financial statements").

The aim of this reporting is to provide an indication of the projected long-term sustainability of an entity's finances over a specified time horizon in accordance with stated assumptions.

The financial statements are at the core of financial reporting. However, they don't provide information on (a) inflows for expected resources that will be realized in the future but are not recognized as assets at the reporting date or (b) future obligations that are not recognized as liabilities at the reporting date. Information on the long-term sustainability of an entity's finances can therefore complement information in the financial statements and help meet the objectives of financial reporting.

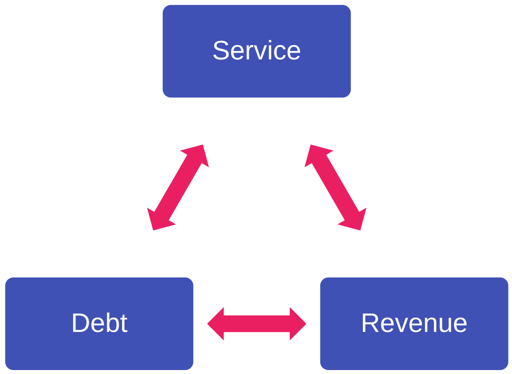
## Long-Term Fiscal Sustainability Information under RPG 1

- Projections of future inflows and outflows, which can be displayed in tabular statements or graphical formats, and a narrative discussion explaining the projections
- A narrative discussion of the dimensions of long-term fiscal sustainability including any indicators used to portray the dimensions; and
- A narrative discussion of the principles, assumptions and methodology underlying the projections.

According to RPG 1, long-term fiscal sustainability information usually includes the above information.

An entity presents projections of future inflows and outflows, including capital expenditure that are prepared on the basis of current policy assumptions, and assumptions about future economic and other conditions.

## Dimensions of Long-Term Fiscal Sustainability




The three dimensions are inter-related as changes in one dimension affect the other dimensions. For example, future services and entitlements to beneficiaries (the service dimension) are funded by revenue and/or debt. A single dimension can be analyzed by holding the other two dimensions constant. For example, by holding the existing levels of services and revenues constant an entity can illustrate the effect of such assumptions on the level of debt. The relationships between the dimensions of long-term fiscal sustainability are illustrated in the RPG.

There are two aspects to each dimension: capacity and vulnerability. Capacity is the ability of the entity to change or influence the dimension, and vulnerability is the extent of the entity's dependence on factors outside its control or influence.

### RPG 2, Financial Statement Discussion and Analysis

This Recommended Practice Guideline (RPG) provides guidance for preparing and presenting financial statement discussion and analysis. Financial statement discussion and analysis assists users to understand the financial position, financial performance and cash flows presented in the general-purpose financial statements (hereafter referred to as "financial statements").

## RPG 2: Financial statement discussion and analysis

An explanation of the significant items, transactions and events presented in an entity's financial statements and the factors that influenced them.

Financial statement discussion and analysis provides information useful to users for accountability and decision-making purposes by enabling users to gain an insight into the operations of the entity from the perspective of the entity itself. It also provides the opportunity to reflect the entity's interpretation of significant items, transactions and events affecting the financial position, financial performance and cash flows of the entity. Therefore, financial statement discussion and analysis complements the information in the financial statements.

The content of financial statement discussion and analysis should be consistent with the financial statements and the underlying items, transactions and events, as well as assumptions such as those relating to recognition and measurement.

## RPG 2: Information to be Provided

- Overview of operations
- Objectives and strategies
- Analysis of financial statements
- Principal risks and uncertainties.

Financial statement discussion and analysis should include the following, without merely replicating information in the financial statements:

**a)** An overview of the entity's operations and the environment in which it operates;

**b)** Information about the entity's objectives and strategies;

**c)** An analysis of the entity's financial statements including significant changes and trends in an entity's financial position, financial performance and cash flows; and

**d)** A description of the entity's principal risks and uncertainties that affect its financial position, financial performance and cash flows, an explanation of changes in those risks and uncertainties since the last reporting date and its strategies for bearing or mitigating those risks and uncertainties.

# RPG 3, Reporting Service Performance Information

The primary function of governments and most public sector entities is to provide services to constituents. Users of general-purpose financial reports (GPFRs) need information on service performance to hold entities accountable and to make decisions, including decisions with respect to resources for services.

*Reporting Service Performance Information* supports entities' reporting of high-quality service performance information.

## RPG 3: Information to be Provided

- Service Performance Objectives
- Performance Indicators
- Total Cost.

Service performance information is information on the services that the entity provides, an entity's service performance objectives and the extent of its achievement of those objectives.

## Service Performance Objectives

- A service performance objective is a description of the planned result(s) that an entity is aiming to achieve expressed in terms of inputs, outputs, outcomes or efficiency.

Service performance objectives may be expressed using performance indicators of inputs, outputs, outcomes or efficiency; or through a combination of one or more of these four performance indicators. A service performance objective may also be expressed using a narrative description of a desired future state resulting from provision of services.

### *Performance Indicators*

Performance indicators may be quantitative measures, qualitative measures, and/or qualitative descriptions of the nature and extent to which an entity is using resources, providing services, and achieving its service performance objectives.

### *Achievement of Service Performance Objectives*

The service performance information presented should be tailored to the entity's service performance objectives. Information on actual service performance may include effectiveness performance indicators.

## Types of Performance Indicators

- Inputs
- Outputs
- Outcomes
- Efficiency
- Effectiveness

The types of performance indicator are as follows:

- **Inputs**: Inputs are the resources used by an entity to provide outputs.
- **Outputs**: Outputs are the services provided by an entity to recipients external to the entity.
- **Outcomes**: Outcomes are the impacts on society, which occur as a result of, or are reasonably attributable to, the entity's outputs.
- **Efficiency**: Efficiency is the relationship between (a) inputs and outputs, or (b) inputs and outcomes.
- **Effectiveness**: Effectiveness is the relationship between actual results and service performance objectives.

### *Principles for Presentation of Service Performance Information*

Presentation of service performance information should be appropriate to the entity's service performance objectives. It should make clear the relationship between the entity's service performance objectives and its service performance achievements.

The presentation of service performance information should meet the qualitative characteristics of financial reporting.

The pervasive constraints on information in GPFRs should also be applied to service performance information.

The service performance information presented should take account of the entity's specific circumstances.

## Questions and Discussion

That concludes our session on the Recommended Practice Guidelines (RPGs). Participants should refer to the review questions to test themselves on their knowledge.

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## Review Questions

### Question 1

Which of the following statements best describes Recommended Practice Guidelines?

- **a)** Mandatory guidance on areas of general-purpose financial reporting that are outside of financial statements;
- **b)** Mandatory guidance on areas of general-purpose financial reporting within the financial statements; or
- **c)** Non-mandatory guidance on areas of general-purpose financial reporting that are outside of financial statements..

### Question 2

What are the three dimensions of long-term fiscal sustainability?

### Question 3

Which type of performance indicator evaluates the relationship between actual results and service performance objectives?

# Answers to Review Questions

## Question 1

**The correct answer is (c) non-mandatory guidance on areas of general-purpose financial reporting that are outside of financial statements.**

Recommended Practice Guidelines have been developed to deal with areas of general-purpose financial reporting that are outside of financial statements. Because these often address evolving or developing areas of reporting, Recommended Practice Guidelines are not mandatory.

## Question 2

The three dimensions of long-term fiscal sustainability are:

**a)** Service dimension

**b)** Revenue dimension

**c)** Debt dimension.

## Question 3

The type of performance indicator evaluates the relationship between actual results and service performance objectives is **effectiveness**.

The other types of performance indicator are:

- **Inputs**: Inputs are the resources used by an entity to provide outputs.
- **Outputs**: Outputs are the services provided by an entity to recipients external to the entity.
- **Outcomes**: Outcomes are the impacts on society, which occur as a result of, or are reasonably attributable to, the entity's outputs.
- **Efficiency**: Efficiency is the relationship between (a) inputs and outputs, or (b) inputs and outcomes.

# Financial Reporting under the Cash Basis of Accounting

## Cash Basis IPSAS

The IPSASB considers that the *Cash Basis IPSAS* is an important step forward in improving the consistency and comparability of financial reporting under the cash basis of accounting and encourages the adoption of this Standard. However, adoption of this IPSAS should not be seen as the end of the journey. The IPSASB encourages governments to progress to the accrual basis of accounting and to harmonize national requirements with the IPSASs prepared for application by entities adopting the accrual basis of accounting. Entities intending to adopt the accrual basis of accounting at some time in the future may find other publications of the IPSASB helpful, particularly *Study 14, Transition to the Accrual Basis of Accounting: Guidance for Governments and Government Entities*.

## Structure of Standard

- Two Parts
- Part 1 – Mandatory
- Part 2 – Encouraged Additional Disclosures.

There are two parts to the Cash Basis IPSAS.

Part 1 is mandatory. This part sets out the requirements which are applicable to all entities preparing general purpose financial statements under the cash basis of accounting. Part 1:

- Defines the cash basis of accounting;
- Establishes requirements for the disclosure of information in the financial statements and supporting notes; and
- Deals with a number of specific reporting issues.

An entity which claims to be reporting under the Cash Based IPSAS must comply with all the requirements of this Part of the Standard

Part 2 is not mandatory. It identifies additional accounting policies and disclosures that an entity is encouraged to adopt. These are intended to enhance its financial accountability and the transparency of its financial statements. Part 2 also includes explanations of alternative methods of presenting certain information.

## Objective

- Prescribe the manner in which general purpose financial statements should be presented under the cash basis of accounting
- Information about the *cash receipts, cash payments and cash balances* of an entity is necessary for accountability purposes and provides input useful for assessments of the ability of the entity to generate adequate cash in the future and the likely sources and uses of cash.

The purpose of the Cash Basis IPSAS is to prescribe the manner in which general purpose financial statements should be presented under the cash basis of accounting.

Information about the cash receipts, cash payments and cash balances of an entity is necessary for accountability purposes and provides input useful for assessments of the ability of the entity to generate adequate cash in the future and the likely sources and uses of cash. In making and evaluating decisions about the allocation of cash resources and the sustainability of the entity's activities, users require an understanding of the timing and certainty of cash receipts and cash payments.

Compliance with the requirements and encouragements of the Standard will enhance comprehensive and transparent financial reporting of the cash receipts, cash payments and cash balances of the entity. It will also enhance comparability with the entity's own financial statements of previous periods and with the financial statements of other entities which adopt the cash basis of accounting.

The information required by the Cash Basis IPSAS relates only to cash receipts, cash payments and cash balances. This is much less information than is provided under the accrual basis of accounting.

## Definitions

- Cash
  - Cash on hand, demand deposits and cash equivalents.
- Cash basis
  - A basis of accounting that recognizes transactions and other events only when cash is received or paid.
- Cash equivalents
  - Short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value
  - Usually three months or less to maturity.

The Cash Basis IPSAS includes further definitions:

- Cash flows are inflows and outflows of cash.
- Cash payments are cash outflows.
- Cash receipts are cash inflows.
- Control of cash arises when the entity can use or otherwise benefit from the cash in pursuit of its objectives and can exclude or regulate the access of others to that benefit.

Because the definition of cash used in the Cash Based IPSAS includes cash equivalents, it is consistent with the definition of cash and cash equivalents used in IPSAS 2, *Cash Flow Statements*.

## Financial Statements

- A statement of cash receipts and payments which recognizes all cash receipts, cash payments and cash balances controlled by the entity;
- Accounting policies and explanatory notes; and
- When the entity makes publicly available its approved budget, a comparison of budget and actual amounts either as a separate additional financial statement or as a budget column in the statement of cash receipts and payments.

The statement of cash receipts and payments recognizes all the cash receipts, cash payments and cash balances controlled by the entity. It is important to know when an entity controls cash.

Amounts deposited in the bank account of an entity are controlled by that entity. In some cases, cash which a government entity:

**a)** Collects on behalf of its government (or another entity) is deposited in its own bank account before transfer to consolidated revenue or another general government account; and

**b)** Is to transfer to third parties on behalf of its government is initially deposited in its own bank account prior to transfer to the authorized recipient.

In these cases, the entity will control the cash for only the period during which the cash resides in its bank account prior to transfer to consolidated revenue or another government-controlled bank account, or to third parties.

Entities may elect to disclose additional information. Where this additional information is not prepared using the cash basis of accounting, the information is presented in the notes. The disclosures made should be clearly described and readily understandable.

## Information to be Presented

- Total Cash Receipts and Payments
  - Classification appropriate to entity's operations
- Opening and Closing Cash Balances
  - Balances not available for the entity's use, or subject to external restrictions are disclosed in the Notes
- Amounts – Gross Basis, except:
  - Transactions administered on behalf of another entity
  - Items in which the turnover is quick, the amounts are large, and the maturities are short.

The statement of cash receipts and payments should present the following amounts for the reporting period:

- Total cash receipts of the entity showing separately a sub-classification of total cash receipts using a classification basis appropriate to the entity's operations;
- Total cash payments of the entity showing separately a sub-classification of total cash payments using a classification basis appropriate to the entity's operations; and
- Beginning and closing cash balances of the entity.

An entity should disclose in the notes to the financial statements together with a commentary, the nature and amount of:

- Significant cash balances that are not available for use by the entity;
- Significant cash balances that are subject to external restrictions; and
- 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.

Total cash receipts and total cash payments, and cash receipts and cash payments for each sub-classification of cash receipt and payment, should be reported on a gross basis, except that cash receipts and payments may be reported on a net basis when:

- They arise from transactions which the entity administers on behalf of other parties and which are recognized in the statement of cash receipts and payments; or
- They are for items in which the turnover is quick, the amounts are large, and the maturities are short.

Line items, headings and sub-totals should be presented in the statement of cash receipts and payments when such presentation is necessary to present fairly the entity's cash receipts, cash payments and cash balances.

An entity's selection of the classifications of cash receipts and cash payments disclosed is a matter for professional judgment. The Cash Basis IPSAS provides guidance on this selection, and examples of different classifications that may be appropriate for some entities:

"Total cash receipts may be classified to, for example, separately identify cash receipts from: taxation or appropriation; grants and donations; borrowings; proceeds from the disposal of property, plant and equipment; and other ongoing service delivery and trading activities. Total cash payments may be classified to, for example, separately identify cash payments in respect of: ongoing service delivery activities including transfers to constituents or other governments or entities; debt reduction programs; acquisitions of property, plant and equipment; and any trading activities. Alternative presentations are also possible, for example total cash receipts may be classified by reference to their source and cash payments may be sub-classified by reference to either the nature of the payments or their function or program within the entity, as appropriate."

## Payments by Function

An example of how cash payments could be classified by their function is shown below.

| | 200X Payments | 200X-1 Payments |
|---|---|---|
| **Health services** | (x) | (x) |
| **Education services** | (x) | (x) |
| **Capital acquisitions** | (x) | (x) |
| **Borrowing costs** | (x) | (x) |
| **Other** | (x) | (x) |
| **Total payments** | (x) | (x) |

## Payments by Nature

An example of how cash payments could be classified by their nature is shown below.

| | 200X Payments | 200X-1 Payments |
|---|---|---|
| **Wages and salaries** | (x) | (x) |
| **Transportation costs** | (x) | (x) |
| **Capital acquisitions** | (x) | (x) |
| **Borrowing costs** | (x) | (x) |
| **Other** | (x) | (x) |
| **Total payments** | (x) | (x) |

## Notes and Accounting Policies

- Notes
  - Basis of Preparation
  - Specific Accounting Policies
  - Additional Information Necessary for Fair Presentation
  - Presented in a Systematic Manner
- Accounting Policies
  - Each Policy Necessary for a Proper Understanding
- Errors Corrected in Opening Cash Balance
  - Comparative Period Restated.

The notes to the financial statements of an entity should:

- Present information about the basis of preparation of the financial statements and the specific accounting policies selected and applied for significant transactions and other events; and
- Provide additional information which is not presented on the face of the financial statements but is necessary for a fair presentation of the entity’s cash receipts, cash payments and cash balances.

Notes to the financial statements should be presented in a systematic manner. Each item on the face of the statement of cash receipts and payments and other financial statements should be cross referenced to any related information in the notes.

The accounting policies section of the notes to the financial statements should describe each specific accounting policy that is necessary for a proper understanding of the financial statements, including the extent to which the entity has applied any transitional provisions in the Cash Basis IPSAS.

Inappropriate accounting treatments are not rectified either by disclosure of the accounting policies used, or by notes or explanatory material.

When an error arises in relation to a cash balance reported in the financial statements, the amount of the error that relates to prior periods should be reported by adjusting the cash at the beginning of the period. Comparative information should be restated, unless it is impracticable to do so.

## Budget (Where Made Publicly Available)

- Original and Final Budgets
- Actual Amounts on a Comparable Basis
- Explanation of Material Differences
    - Note Disclosure
    - Other Documents (Cross-Reference) Where Available
- Reconciliation of Actual Amounts on a Comparable Basis and Actual Amounts in the Financial Statements.

An entity that makes publicly available its approved budget(s) should present a comparison of the budget amounts and actual amounts either as a separate additional financial statement or as additional budget columns in the statement of cash receipts and payments.

The comparison of budget and actual amounts should present separately for each level of legislative oversight:

- The original and final budget amounts;
- The actual amounts on a comparable basis; and
- By way of note disclosure, an explanation of material differences between the budget and actual amounts, (unless such explanation is included in other public documents issued in conjunction with the financial statements, and a cross reference to those documents is made in the notes).

An entity may present a comparison of budget and actual amounts as additional budget columns in the statement of cash receipts and payments only where the financial statements and the budget are prepared on a comparable basis.

The actual amounts presented on a comparable basis to the budget should, where the financial statements and the budget are not prepared on a comparable basis, be reconciled to the total cash receipts and total cash payments, identifying separately any basis, timing and entity differences. The reconciliation may be disclosed on the face of the statement of comparison of budget and actual amounts or in the notes to the financial statements.

# Part 2: Encouraged Additional Disclosures

- Going Concern
- Administered Transactions
- Major Classes of Cash Flows
- Related Party Disclosures
- Assets, Liabilities, Revenues and Expenses
- Comparison with Budget
- Consolidated Financial Statements
- Joint Arrangements
- Payments by Third Parties
- Recipients of External and Other Assistance
- Cash Flow Statement Format.

### *Going Concern*

Entities are encouraged to make an assessment of the entity's ability to continue as a going concern. The disclosure of material uncertainties related to events or conditions which may cast significant doubt upon the entity's ability to continue as a going concern.

The Cash Basis IPSAS notes that the determination of whether an entity is a going concern is primarily relevant for individual entities rather than for the government as a whole.

### *Administered Transactions*

An entity is encouraged to disclose the amount and nature of cash flows and cash balances resulting from transactions administered by the entity as an agent on behalf of others where those amounts are outside the control of the entity.

### *Major Classes of Cash Flows*

An entity is encouraged to disclose:

**a)** An analysis of total cash payments using a classification based on either the nature of the payments or their function within the entity, as appropriate; and

**b)** Proceeds from borrowings. In addition, the amount of borrowings may be further classified into type and source.

### *Related Party Disclosures*

An entity is encouraged to disclose the information required IPSAS 20, *Related Party Disclosures* (see Presentation module).

### *Assets, Liabilities, Revenues and Expenses*

An entity is encouraged to disclose information about the assets, liabilities, revenues and expenses of the entity.

The disclosure of information about assets, liabilities and the costs and revenues of particular programs and activities will enhance accountability and provide information useful for decision-making purposes.

Such disclosures may not be comprehensive in the first instance; entities are encouraged to progressively develop and build on them as they transition to full adoption of the accrual IPSAS.

### *Comparison with Budget*

If the entity does not make publicly available its approved budget, the entity is nevertheless encouraged to disclose a comparison of actual amounts with budgets. Entities that do make their budget publicly available are required to disclose a comparison of budget and actual amounts (see *earlier* in this Module).

### *Joint Arrangements*

An entity is encouraged to make disclosures about joint arrangements which are necessary for a fair presentation of the cash receipts and payments of the entity during the period and the balances of cash as at the reporting date

### *Payments by Third Parties on Behalf of the Entity*

When during the reporting period a reporting entity has been formally advised that payments have been made to directly settle its obligations or purchase goods and services for its benefit by third parties (or the entity has otherwise verified that such payments have been made) the entity is encouraged to disclose:

**a)** Total payments made by such third parties; and

**b)** A sub-classification of the total amount of such payments using a classification basis appropriate to the entity's operation.

### *Cash Flow Statement Format*

An entity which is completing its adoption of accrual IPSAS is encouraged to present a statement of cash receipts and payments in the same format as that required by IPSAS 2, *Cash Flow Statements*.

## Consolidated Financial Statements

**Definitions**

- Controlled entity
  - Entity that is under the control of another entity
- Controlling entity
  - Entity that has one or more controlled entities
- Economic entity
  - A controlling entity and its controlled entities

**Consolidation Procedures**

- Cash Balances and Transactions Eliminated in Full
- Adjustments for:
  - Different Accounting Periods
  - Different Accounting Policies.

A controlling entity, is encouraged to present consolidated financial statements which consolidates all its controlled entities, foreign and domestic by applying the following consolidation procedures:

**a)** Cash balances and cash transactions between entities within the economic entity are eliminated in full;

**b)** When the financial statements used in a consolidation are drawn up to different reporting dates, adjustments are made for the effects of significant cash transactions that have occurred between those dates and the date of the controlling entity's financial statements; and

**c)** Consolidated financial statements are prepared using uniform accounting policies for like cash transactions. If it is not practicable to use uniform accounting policies in preparing the consolidated financial statements, that fact should be disclosed together with the proportions of the items in the consolidated financial statements to which the different accounting policies have been applied.

## Scenario

- Ministry A controls Agencies B and C
- Ministry A reports receipts of $10,000,000 and payments of $9,000,000
- Agency B reports receipts of $2,000,000 and payments of $2,100,000. Receipts include $1,500,000 (appropriation) from Ministry A and $300,000 (payment for services) from Agency C
- Agency C reports receipts of $1,000,000 and payments of $900,000
- What are the group receipts and payment totals?.

***Answer:***

| Receipts | Ministry A | Agency B | Agency C | TOTAL |
|---|---|---|---|---|
| Reported | 10,000,000 | 2,000,000 | 1,000,000 | **13,000,000** |
| Eliminate: | | | | |
| Ministry A pays Agency B | | (1,500,000) | | **(1,500,000)** |
| Agency C pays Agency B | | (300,000) | | **(300,000)** |
| **TOTAL** | **10,000,000** | **200,000** | **1,000,000** | **11,200,000** |

| Payments | Ministry A | Agency B | Agency C | TOTAL |
|---|---|---|---|---|
| Reported | 9,000,000 | 2,100,000 | 900,000 | **12,000,000** |
| Eliminate: | | | | |
| Ministry A pays Agency B | (1,500,000) | | | **(1,500,000)** |
| Agency C pays Agency B | | | (300,000) | **(300,000)** |
| **TOTAL** | **7,500,000** | **2,100,000** | **600,000** | **10,200,000** |

The consolidated receipts total is $11,200,000 and the consolidated payments total is $10,200,000.

## External Assistance and Other Assistance

The Cash Basis IPSAS includes the following definitions relating to external assistance and other assistance:

### External Assistance

- **External Assistance** means all official resources which the recipient can use or otherwise benefit from in pursuit of its objectives.
- **Official Resources** means all loans, grants, technical assistance, guarantees or other forms of assistance provided or committed under a binding agreement by multilateral or bilateral external assistance agencies or by a government, or agencies of a government, other than to a recipient of the same nation as the government or government agency providing, or committing to provide, the assistance.
  - Bilateral e.g., USAID, Swiss Agency for Development and Cooperation
  - Multilateral e.g. World Bank, IMF, United Nations.

The Cash Basis IPSAS defines bilateral and multilateral external assistance agencies as follows:

- Bilateral External Assistance Agencies are agencies established under national law, regulation or other authority of a nation for the purpose of, or including the purpose of, providing some or all of that nation's external assistance.
- Multilateral External Assistance Agencies are all agencies established under international agreement or treaty for the purpose of, or including the purpose of, providing external assistance.

The fact that such agencies are established in law by governments distinguishes them from Non-Governmental Organizations (NGOs).

### Other Assistance

Other Assistance means resources provided by non-governmental organizations (NGOs) and gifts and donations or other forms of assistance voluntarily provided by individuals and private sector organizations which the recipient can use or otherwise benefit from in pursuit of its objectives. Other assistance does not include official resources, taxes, fines and fees, resources provided in an exchange transaction or resources provided by the government or agencies of a government of the same nation as the recipient.

# External and Other Assistance – Encouraged Disclosures

- Total amount of assistance received in cash
- Total assistance paid by third parties to directly settle obligations of the entity or purchase goods and services on its behalf when advised by the third party or otherwise verified by the recipient
- The total amount of assistance received as loans and as grants
- Significant classes of providers of assistance and the amount provided
- By significant class and amount, the purposes for which assistance was received and used
- The balance of undrawn external assistance loans and grants available at reporting date.

Entities are encouraged to separately disclose external assistance received and other assistance received.

The full details of the encouraged disclosures for external assistance are as follows; entities are also encouraged to make the same disclosures for other assistance.

**a)** The total amount of external assistance received in cash during the period unless disclosed as a separate class of cash receipt on the face of the statement of cash receipts and payments;

**b)** The total external assistance paid by third parties during the period to directly settle obligations of the entity or purchase goods and services on behalf of the entity when advised by the third party or otherwise verified by the recipient;

**c)** The total amount of external assistance received during the period as loans and the total amount received as grants;

**d)** The significant classes of providers of external assistance and the amount provided;

**e)** By significant class and amount, the purposes for which external assistance was received and used during the reporting period showing separately amounts provided by way of loans and grants; and

**f)** The balance of undrawn external assistance loans and grants available at reporting date to fund future operations when the amount of the loans or grants available to the recipient is specified in a binding agreement and the satisfaction of any substantial terms and conditions that determine, or affect access to, that amount is highly likely, showing separately:

(i) Total external assistance loans;

(ii) Total external assistance grants; and

(iii) The purposes for which the undrawn loan assistance and undrawn grant assistance may be used.

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# Review Questions

## Question 1

The beginning and closing cash balances of the entity reported in the statement of cash receipts and payments should include cash on hand and demand deposits.

**True or False?**

## Question 2

The Cash Basis IPSAS requires cash payments to be presented using a classification appropriate to entity's operations.

**Education Services, Health Services and Defense Services are examples of line items presented under what type of classification?**

## Question 3

An entity that makes publicly available its approved budget(s) should present a comparison of the budget amounts and actual amounts as additional budget columns in the statement of cash receipts and payments.

**True or False?**

# Answers to Review Questions

## Question 1

**The correct answer is False.**

The beginning and closing cash balances of the entity reported in the statement of cash receipts and payments should include cash on hand, demand deposits and cash equivalents. Cash equivalents are short-term (i.e., usually three months or less to maturity), highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value

## Question 2

**Education Services, Health Services and Defense Services are examples of line items presented under a "payments by function" classification.**

The other classification illustrated in the Cash Basis IPSAS is a "payments by nature" classification, which includes line items such as wages and salaries and transportation costs.

## Question 3

**The correct answer is False.**

An entity that makes publicly available its approved budget(s) is required to present a comparison of the budget amounts and actual amounts. However, it may present the comparison either as a separate additional financial statement or as additional budget columns in the statement of cash receipts and payments. In addition, an entity may present a comparison of budget and actual amounts as additional budget columns in the statement of cash receipts and payments only where the financial statements and the budget are prepared on a comparable basis.