



April 6, 2012

The Group of Twenty Deputies and Finance Ministers
C/- His Excellency José Antonio Meade
Secretary of Finance and Public Credit
Secretariat of Finance and Public Credit, México
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**PUBLIC SECTOR FINANCIAL MANAGEMENT, TRANSPARENCY, AND ACCOUNTABILITY
RECOMMENDATIONS FOR THE G-20 NATIONS – MEETING OF G-20 DEPUTIES AND FINANCE
MINISTERS; APRIL 19-20, 2012**

Dear Secretary Meade:

The International Federation of Accountants (IFAC) is pleased to provide the following recommendations for consideration by the G-20 Deputies and Finance Ministers at their meeting on April 19-20, 2011 in Washington DC, USA. These recommendations focus on the need for enhanced public sector financial management, transparency, and accountability.

Through its membership, currently 167 professional accountancy organizations in 127 countries and jurisdictions, IFAC represents approximately 2.5 million accountants in public practice, industry and commerce, government, and education. As the global organization for the accountancy profession, IFAC is committed to contributing to the highest quality professional services by the accountancy profession around the world. IFAC, through the independent standard-setting boards that it supports, and in conjunction with the international regulatory community, sets international auditing and assurance, ethics, education, and public sector accounting standards. IFAC also issues guidance to encourage high-quality performance by professional accountants in business.

This letter follows up previous submissions to the G-20 in 2009, 2010, and 2011. This year IFAC shall be making two submissions. The first, this letter, is addressed to G-20 Deputies and Finance Ministers and focuses solely on public sector financial management, transparency, and accountability. The second submission shall be addressed to G-20 Leaders, and issued closer to the Leaders' Summit to be held in June. It will discuss matters pertaining to economic growth and long term sustainability. Our aim in taking this approach in 2012 is to ensure that those who have the most direct involvement in developing arrangements for enhanced reporting, transparency, and accountability within governments and the public sector—that is, Finance Ministers—receive our views directly on this important topic.



The recommendations in this letter are in line with IFAC's mission to contribute to the development, adoption, and implementation of high-quality international standards; and by doing so, contribute to the development of strong international economies. In responding to the problems created by the global financial crisis and ensuing sovereign debt crisis, it is critical that the G-20 strives for reporting of high-quality, internationally consistent, relevant, and reliable financial and non-financial information by all sectors, including the public sector. For the last ten years IFAC has consistently promoted the need for enhanced transparency and accountability in the public sector, noting in particular the risk that a lack of transparency and accountability presents to the efficiency of capital markets, global financial stability, and long term sustainability.

In March this year IFAC convened a seminar titled *The Sovereign Debt Crisis, a Matter of Urgency – from Lessons to Reform*, which included presentations, debates, and discussion involving key decision makers, politicians, and public sector finance management leaders¹. The outcomes from the seminar included the identification of the compelling and urgent need for governments to address seriously the quality of public sector financial management systems and institutions. There was a call for the adoption of accrual accounting and budgeting to better measure and manage fiscal positions; noting that the current crisis emphasized the deficiencies associated with cash-based arrangements. A common theme that emerged was that, in many countries, the risks associated with the poor fiscal measurement and management exposed by the sovereign debt crisis are amplified by the fiscal risks associated with the aging population.

Urgent and Fundamental Work is Needed to Determine the Nature of Institutional Change Required in Public Sector Financial Management, Transparency, and Accountability

Recommendation 1

IFAC recommends that the G-20 facilitate urgent and fundamental work, to be conducted or commissioned by the Financial Stability Board (FSB), to consider the nature of institutional changes that are needed in public sector financial management to protect the public and investors in government bonds.

Recommendation 2

IFAC encourages the G-20 to make explicit that the FSB's role encompasses public sector arrangements, as part of its aim "to coordinate at the international level the work of national financial authorities and international standard setting bodies and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies". In acknowledging the importance of the public sector as part of the FSB's role, IFAC encourages the establishment of a working group within the FSB architecture, which is specifically tasked with examining enhanced public sector financial reporting, transparency and accountability.

¹ www.ifac.org/news-events/2012-03/ifac-sovereign-debt-seminar-exposes-urgent-need-transformation-public-financial-



The sovereign debt crisis and related government debt issues, potentially affecting many countries around the world, have caused instability in the global financial system. They remain a significant threat to global financial stability and are a cause for major concern for the G-20. The failure of fiscal management in the public sector is widespread and has an economic impact that far exceeds the impact of losses incurred by corporate failures in the first decade of this century. This crisis demonstrates that the policies chosen to address the global financial crisis may inadvertently have changed the nature of the problem, moving it from the corporate to the government sector. In its most recent Insight Report on Global Risks, the World Economic Forum reported the results of a survey of 469 experts from industry, government, academia, and civil society, examining 50 global risks across five categories. It noted that the current most significant global economic risk is “chronic fiscal imbalances”².

However, the problems highlighted by the sovereign debt crisis include, but go much deeper than, the transparency and accountability of governments and poor public finance management and public sector financial reporting. The institutions for fiscal management are clearly deficient in many countries, and fail to create either the constraints or the incentives for governments to manage their finances in a manner that protects both the public interest and investors in government debt. Within most existing systems, it is assumed that poor fiscal management will lead to a change of government—this may occur, but incoming governments face the same incentives and constraints, which, not surprisingly, is likely to lead to similar behavior.

IFAC is of the view that what is needed is urgent and fundamental work to consider the nature of the institutional changes that are required to protect the public and to protect investors in government bonds. It strongly encourages the G-20 to initiate such work through the FSB, making it explicit that it is seen as a critical part of the FSB’s role. As such, a separate working group should be established within the FSB to specifically address public sector reporting and accounting matters.

In undertaking its work, the G-20 (and FSB) should look to the institutional arrangements for public finances in jurisdictions in which fiscal positions have been well managed, and should recognize that the problems that need to be addressed are ones in which governments are self-interested parties. As noted in IFAC’s 2010 submission to the G-20, arrangements that might be considered as part of this work include:

- High-quality and timely accrual-based financial reporting;
- Audited financial statements released within six months of year end;
- Budgeting, appropriations, and reporting on the same accrual basis;

² Refer: World Economic Forum, *Insight Report: Global Risks 2012, Seventh Edition*, An initiative of the Risk Response Network, 2012



- Full transparency in fiscal positions ahead of general elections, ensuring that voting is fully informed; and
- Limitations on deficit spending, or at least full transparency around the reasons for deficit spending and explanations of how, over an economic cycle, fiscal balance will be restored.

The Need for High-Quality and Timely Accrual-Based Financial Reporting in The Public Sector

Recommendation 3

IFAC recommends that the G-20 actively encourage and facilitate the adoption of accrual-based accounting by governments and public sector institutions, which promotes greater transparency and accountability in public sector finances, and allows for monitoring of government debt and liabilities for their true economic implications.

A key issue for public sector financial reporting is that most governments still adhere to the cash basis of accounting, and therefore provide minimal disclosures relative to what the public, banks, investors, and credit providers generally expect of the private sector. Given the prominence of banks and private sector investors in holding government debt, it is of no surprise that there is a growing demand for the same level of financial transparency and accountability from the public sector as is expected from the private sector.

Greater transparency and accountability in public sector finances

In a time when sovereign debt issues are prominent, and the veracity of government reporting and transparency are being questioned, it is critical that governments work to establish—as a priority—greater trust between themselves and their constituents. To establish such trust, it is important that governments provide accurate and complete information on expenditures and transactions, in order to: demonstrate accountability and stewardship; reinforce their own credibility; and provide clear and comprehensive information regarding the financial consequences of economic, political, and social decisions.

This information must focus on both the short-term and longer-term impacts of decision making; the latter of which cannot be achieved through the reporting and disclosure of only cash flows. That is, the type of information required can only be provided through a high-quality, robust, and effective accrual-based financial reporting system.



Monitoring of government debt and liabilities for their true economic implications

The sovereign debt crisis, and the consequences that are being felt around the globe, illustrate the public sector balance sheet management failures by many governments, and highlight the inability of organizations such as global financial institutions, investors in government debt, and credit rating agencies to adequately monitor the financial positions of governments.

A major priority for all governments should be reducing economic uncertainties and the significant threats posed by inappropriately managed debt. However, it is important to recognize that government debt alone does not provide a comprehensive picture of fiscal soundness. The full disclosure of all assets, liabilities, and contingent liabilities is vital for assessing the true economic implications of public sector financial management. Furthermore, the disclosure of all liabilities, including the long-term obligations of government (e.g., pension obligations), may encourage government leaders to make decisions that focus on long-term sustainability, and which are not driven by short-term political incentives.

Only through a high-quality, robust, and effective accrual-based financial reporting system can all government assets and liabilities (including debt) be appropriately recorded, reported, and disclosed, and hence effectively monitored.

In making this recommendation, IFAC recognizes that the adoption of accrual-based accounting is not something which can be undertaken in a very short-term period in many jurisdictions. Indeed, the progress towards full accrual-based accounting is typically a long and demanding path. Furthermore, in some jurisdictions, the need to enhance professional accounting capacity and expertise in the public sector presents challenges to the adoption of accrual-based accounting. However, notwithstanding these issues, the imperative to address long-term sustainability and the welfare of future generations should compel governments to recognize and act, now and into the future, to enhance the reporting, transparency, accountability, and decision-making of the public sector.

Adoption and Implementation of International Public Sector Accounting Standards

Recommendation 4

IFAC recommends that the G-20 encourage the FSB to include International Public Sector Accounting Standards as a set of standards key for sound financial systems and deserving of timely implementation.

High-quality and timely accrual-based financial reporting in the public sector can be achieved through the adoption of globally-accepted, high-quality reporting standards developed specifically for the public sector, e.g., the International Public Sector Accounting Standards (IPSASs), issued by the International Public Sector Accounting Standards Board (IPSASB)³. They are designed to apply to the general purpose

³ www.ifac.org/public-sector



financial statements of all public sector entities, and are developed primarily for an accruals-based accounting context.

The inclusion of IPSASs as a set of key standards is consistent with the stated ambition of the FSB that *"The list of key standards will be periodically reviewed and updated by the FSB in light of policy developments at the international level."* The sovereign debt crisis is clearly an event that has given rise to a very significant number of policy developments at an international level.

The use of IPSASs by governments worldwide will improve the quality of financial information reported by public entities, which is critical for investors, taxpayers, and the general public to understand the full impact of decisions made by governments with respect to their financial performance, financial position, and cash flows. Global adoption of these standards will facilitate the comparability of such information on a global basis and assist in internal management decisions in resource allocation (planning and budgeting), monitoring, accountability, and long-term sustainability. As a universal set of public sector accounting standards, IPSASs would also provide better information regarding systemic risks associated with government liabilities, and would represent a significant step forward in achieving the financial transparency of national governments worldwide. Additionally, financial reporting using IPSASs supports the ability to conduct high-quality audits of governments' financial statements, as they provide a solid foundation and suitable criteria upon which auditors (in most cases, public sector auditors and supreme audit institutions) can undertake their work.

While the application of IPSASs alone would not solve the problems highlighted by the sovereign debt crisis, the appropriate use of financial information rendered from such standards would assist public officials and other groups in assessing the implications of fiscal decisions proposed or made by government. Indeed, it can be argued that without better reporting and enhanced transparency and accountability, the problems highlighted by the current sovereign debt crisis will never be truly and adequately resolved.

Please contact us should you require further information on any of the recommendations included in this letter. IFAC would welcome the opportunity to participate in, or contribute to, activities aimed at progressing these recommendations and to assist the G-20, and the FSB, in achieving their objectives.

Sincerely,

A handwritten signature in black ink, appearing to read 'Ian Ball', written in a cursive style.

Ian Ball
Chief Executive Officer