



October 24, 2012

Mr. Phil Sinnett  
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**PUBLIC CONSULTATION ON THE PUBLIC EXPENDITURE AND FINANCIAL ACCOUNTABILITY  
(PEFA) GUIDANCE NOTE ON SEQUENCING PFM REFORMS**

Dear Mr. Sinnett:

The International Federation of Accountants (IFAC) values the opportunity to comment on the *Guidance Note on Sequencing PFM Reforms* (the “Guidance Note”). Through its membership, currently 167 professional accountancy bodies in 127 countries and jurisdictions, IFAC represents approximately 2.5 million accountants in public practice, industry and commerce, government, and education.

IFAC offers the following general comments and recommendations, with specific reference to paragraph 43 of the Guidance Note, which deals with “developing the accounting system.” Therefore, IFAC is not responding to the specific and example questions included in the separate page provided with the consultation.

**Importance of robust arrangements for public sector financial management, including financial reporting**

IFAC recommends that the Public Expenditure and Financial Accountability (PEFA) consider increasing the emphasis—in its framework, and therefore also in the Guidance Note—on the critical need for robust accounting arrangements and, in particular, the use of internationally accepted, high-quality standards such as IPSASs.<sup>1</sup> IFAC is of the view that the use of IPSASs promotes greater transparency and accountability in public sector finances and allows for enhanced monitoring of government debt and liabilities for their true economic implications.

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<sup>1</sup> IPSASs are standards written specifically with the public sector in mind, and are suitable for implementation by all types of governments and public sector entities. Although the accrual basis of the standards are based on the International Financial Reporting Standards (IFRSs), issued by the International Accounting Standards Board (IASB)—where the requirements of those Standards are applicable to the public sector—IPSASs also deal with public sector specific financial reporting issues that are not dealt with in IFRSs.



IFAC recognizes the importance of robust public sector financial management arrangements. An integral part of robust arrangements is high-quality financial reporting, which is critical for enhanced transparency and accountability.

The PEFA framework is an important tool for measuring and assessing the quality of public financial management (PFM). IFAC recognizes that the framework encourages those nations that are assessed to strive for ongoing improvement in the scores they achieve and, hence, in their PFM arrangements more generally.

However, IFAC believes that greater focus should be placed on the accounting systems and processes in the framework. The lack of focus on accounting systems is reflected in the Guidance Note, which includes relevant discussion in only one paragraph: paragraph 43.

In Policy Position Paper (PPP) 4, [Public Sector Financial Management Transparency and Accountability: The Use of International Public Sector Accounting Standards](#), IFAC states that:

*It is critical that governments work to establish greater trust between themselves and their constituents; this should be one of the highest priorities for national leaders and public officials. 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, and to reinforce their own credibility. This means providing clear and comprehensive information regarding the financial consequences of economic, political, and social decisions.*

*The type of information required can only be provided through a high-quality, robust, and effective accrual-based financial reporting system, which allows for government assets and liabilities (including debt) to be appropriately recorded, reported, and disclosed—and hence effectively monitored. The most globally accepted high-quality accrual-based financial reporting system is [International Public Sector Accounting Standards] IPSASs.*

### **Use of International Public Sector Accounting Standards (IPSASs) throughout the reform process**

IFAC recommends that PEFA consider revising the wording of the Guidance Note to ensure that, like Background Paper 1, it reflects the role that IPSASs can play throughout the PFM reform process.

Background Paper 1, *Guidelines for Sequencing PFM Reforms*, which is used as a key reference upon which the Guidance Note is based, highlights the use of IPSASs at all stages of reform. However, the Guidance Note suggests that IPSASs, or rather “IPSAS cash”, is only relevant for the intermediate accrual (modified accruals) stage of the reform process.

IFAC believes that the use of IPSASs should be considered throughout the entire reform process. By not identifying clearly the use of IPSASs throughout the process of PFM reform, including reference to the ultimate goal of adopting and implementing full, accrual-based IPSASs for financial reporting and budgeting, governments and politicians may not be suitably encouraged to ensure that the process of reform continues to completion, arguing that the progress they have made is sufficient.

To demonstrate the importance of IPSASs throughout the process, and how governments may transition from IPSAS cash-based accounting to full IPSAS accrual-based accounting, the International Public



Sector Accounting Standards Board (IPSASB) issued [\*Transition to the Accrual Basis of Accounting: Guidance for Public Sector Entities \(Third Edition\)\*](#) (January 2011), which, as the name suggests, provides guidance on the transition from the cash to the accrual basis, and is also useful for constituents reporting on an accrual basis (using other standards) and considering the adoption of IPSASs.

### **Implementing public sector financial management reforms**

IFAC recommends that in the Guidance Note, PEFA recognizes that not all jurisdictions require a staged approach to PFM reforms and that, in certain circumstances, it may be appropriate for jurisdictions to aim to move directly to implementing robust accrual-based accounting (financial reporting and budgeting) systems.

In PPP 4, IFAC notes that “*governments must implement the necessary institutional arrangements required to enhance public sector financial management transparency and accountability.*” These institutional arrangements form the foundations upon which PFM reforms can be implemented. IFAC recognizes the importance of laying these foundations before meaningful and enduring reforms can be introduced and, as such, believes that careful consideration should be given to the sequencing of reforms.

However, when building these foundations and implementing PFM reforms, IFAC judges it necessary for the process of reform to be considered on a country-by-country basis. A staged approach to PFM reform should not be seen as the only option. That is, while the staged (or stepped<sup>2</sup>) approach to PFM reform might be appropriate in a number of situations, it is important to identify those situations where jurisdictions can aim to move directly to (“leapfrog”) implementing robust accrual-based accounting (financial reporting and budgeting) systems.

While the Guidance Note refers to the considerable costs of introducing and maintaining a “full” accrual system, these costs must be considered in light of:

- the benefits of doing so; for example, full disclosure of position and performance, better decision making, and enhanced potential for high-quality assurance, and
- the costs of having a system in place that is less than adequate; for example, a system that is easier to manipulate by engaging in transactions that fail to get reported, and a system that enables politicians to focus on short-term decision making to the detriment of longer-term sustainability and future generations.

IFAC recognizes that to “leapfrog” when implementing PFM reforms requires considerable political will and support, and fully understands that the adoption and implementation of IPSASs in many countries involves a lengthy process. However, the considerable economic and social problems that have surfaced as a consequence of the current sovereign debt crisis highlight the potential significant risks of not acting now to improve the quality and transparency of public sector financial management arrangements.

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<sup>2</sup> The Chartered Institute of Public Finance and Accountancy publication *Stepping Stones on the Transition from Cash to Accrual Accounting* (March 2011) sets out a practical plan of how an entity might commence the transition process, and suggests a path toward full IPSAS implementation.



IFAC is committed to advancing stronger arrangements for public sector financial management throughout the world. One area where IFAC is working to build these foundations, including strengthening the accountancy profession more generally within emerging economies, is in its memorandum of understanding with the donor community. The [Memorandum of Understanding to Strengthen Accountancy and Improve Collaboration \(MOSAIC\)](#) sets out the basis for improving cooperation and collaboration between IFAC, international donors, and the international development community. MOSAIC will provide the foundations for increasing the capacity of professional accountancy organizations (PAOs) and improve the quality of financial management systems in emerging economies.

Please do not hesitate to contact us should you wish to discuss any of the matters raised in this letter, or require any further information.

Sincerely,

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

Ian Ball  
Chief Executive Officer