Modernising Accounting in the Public Sector

Exchange of Experience

EC/FEE Conference 28 September 2006

Workshop A: Accounting Principles – Issues and challenges in the transposition of IPSAS into national and international public sector accounting

Chair of Workshop: Thomas Mueller-Marques Berger

Key Messages from the workshop

- Both the Commission and France had adopted IPSAS but have at times adapted certain standards to reflect their own circumstances. The UN is going to adopt IPSAS with no amendments.
- A significant impact of implementing accruals based financial statements in the EC was that this led to large net liabilities figure which needed to be explained clearly to the readers of the accounts. This was predominantly from accrued pension liabilities where the corresponding future member contributions based on Members States´ guarantees could not be recognised as an asset. Large year-end accruals relating to Agricultural spending also impacted here
- The Commission has based its accounting rule for employee benefits on IAS 19 but France has not, preferring to note pension commitments rather than recognise a liability. There was discussion over the applicability of IAS 19 to the public sector.
- On heritage assets it was felt that IPSAS 17 was not appropriate and needed updating. Particular problems covered when to recognise heritage assets on a consistent basis, how to value them when no market exists, and what additional disclosures might be appropriate.
- On service concessions, the workshop heard that currently there are 3 draft IFRIC Interpretations that address accounting from the operator's perspective only. A full Interpretation is likely to be issued by the end of the year. IPSASB is developing a project that will have grantors within its scope.

Summary of Workshop

The Chair opened the workshop at 14:30 and welcomed the speakers and delegates.

Derek Dunphy (Accounting Administrator, EC-DG Budget) was the first speaker. He spoke of the processes and challenges that the European Commission faced in implementing IPSAS into their first accruals based financial statements for 2005. Key points were:

- The Commission had taken IPSAS (or IFRS where there was no relevant IPSAS) and used them to develop 15 EC-specific accounting rules. These rules were then expanded into a more detailed Commission accounting manual. Derek also explained that the particular nature of Commission operations meant that certain IPSAS needed to be tailored in producing the EC rules.

- The Commission felt that IPSAS was a framework rather than detailed instructions, and to introduce accrual accounting standards and rules into the EC required a level of detail not present in IPSAS – hence the creation of the specific EC rules and manuals. The fact that the annual budget has been for so long and remains such a key element in the financial operations and reporting of the EC meant that much effort and training was needed to properly introduce accrual accounting to the staff who would be dealing with it.

- The main consequence of the move to accruals based financial statements was the presence of €62 billion net liabilities on the balance sheet. Derek explained that this was the amounts yet to be called from Member States through future budgets and therefore represented the difference between cash and accrual accounting. This needed to be clearly explained in the financial statements.

- A particular factor contributing to the net liabilities figure was the pension liability towards staff. This was calculated using actuarial valuation as required by IAS 19. However, the Commission does not operate a pension fund, instead Member States have guaranteed payment when pensions fall due. However, under the accounting rules such a guarantee is not an asset and therefore could not be recognised to offset the pension liability.

Lionel Vareille (Head of Accounting Standards, French Ministry of Economy, Finance and Industry) then spoke about the experience of France in implementing accruals based financial statements. Key points were:

- France has developed 13 accounting standards based on IPSAS but not replicas of IPSAS. It was felt that the starting point of some IPSASes was too Anglo-Saxon (shaped for particular administrative, juridical, and governmental structures), and that some important areas were not covered by IPSASes (tax, pensions, and subsidies) for the moment, even if this will change in the next future.

- They have therefore developed French standards which are relevant to French circumstances. As with the Commission, they often are more detailed than the IPSASes on which they are broadly based, but they can also be more general than some IPSASes, and their scope is generally different.

- Lionel then spoke about the treatment of pensions in the French accounts, in particular whether it was possible to apply IAS 19. Lionel said that IAS 19 requires a liability to be recorded on the basis of a contract. However, in France the public officials have civil service contracts and the State has the power to unilaterally vary the nature of the pension system. Hence it was felt IAS 19 could not be applied in France.

- In addition, there was discussion whether pension contributions represented an exchange or a non-exchange transaction. As the pension system could be varied it was felt that it was impossible to attach the benefit to the contribution and therefore it could be non-exchange.

- As a result in France they show the pension commitment in the accounts, but off-balance sheet. This commitment is of the order of €1,000 billion over 150 years. The commitment is discounted using the long term French government bonds discount rate. As the level of the commitment is very sensitive to movements in the discount rate there is no recognition of the movements in the commitment in the Statement of Performance.

John Stanford (Senior Technical Manager, IPSASB IFAC) then took a question from the Chair asking about the IPSASB position on pensions. John said that IPSASB will issue the Exposure Draft on Employee Benefits in late October. This would be based on IAS 19 as the IPSASB position was that IAS 19 could be adapted for the public sector. One particular adaptation would be that the discount rate should be a risk-free rate that would normally be based on market yields on government bonds rather than high quality corporate bonds.

Questions were then taken on the first two presentations:

- Andy Wynne (UK ACCA) said that in his opinion IAS 19 could not be applied to the public sector and that he, therefore, preferred the French approach of having no pension liability on the balance sheet. Derek Dunphy replied that as the EC had decided (as a key element of its accrual accounting project) that it would follow IPSAS (or IFRS where there was no relevant IPSAS) in creating its accounting rules, it must base itself on IAS 19, in advance of the future IPSAS on the subject.
- Another question asked whether future tax revenues could be included in the notes to financial statements. John Stanford replied that in the US there are 75-year forecasts for costs and revenues for medicare and social security programs and that these fall within the scope of the auditor's opinion. There are no current plans to introduce this as part of IPSASB's development of an IPSAS on social policy obligations although it is possible that IPSASB may initiate a project on fiscal sustainability reporting in the future.

Jayantilal Karia (Director of Accounts Division, United Nations) then spoke on the implementation of IPSAS for the United Nations system of organisations. Key points included:

- The UN is a very diverse set of organisations. In the past the UN has developed and applied its own accounting standards. From July 2006 the UN system has decided to adopt IPSAS. Implementation will in a phased manner where some Organizations plan to adopt IPSAS by 2008 and the whole system should adopt by 2010.
- The decision is for full adoption of IPSAS, or IFRS where there is no applicable IPSAS. There will be no exemptions or overrides. Jay explained that this decision was to ensure consistency of approach across the UN system Organisations.
- The transition will involve the move to full accruals, and also from reporting every two years to annual financial statements. Many UN Organisations will also need to replace ERP systems.
- A particular challenge is that the balance sheet will show considerable net liabilities due to unfunded after service health insurance programmes and accrued annual leave (for the UN system , the pension scheme is funded and not in deficit). A further challenge is that some funding could be at risk if a qualified auditor's opinion is received, therefore it is important that implementation of IPSAS is done right the first time.

John Stanford then spoke about developments in IPSASB regarding heritage assets and service concessions. Key points on heritage assets were:

- IPSASB issued a consultation paper, incorporating a discussion paper issued by the UK Accounting Standards Board,(UK ASB), asking for submissions by 30 June 2006. Thirty-seven replies were received. IPSASB will review its approach to heritage assets at is forthcoming meeting in November 2006 and will decide whether to issue a further consultation paper or move to development of an Exposure Draft (ED) on heritage assets or and ED of amendments to IPSAS 17 in respect of heritage assets.

- One issue raised by the UK ASB was the relevance of the purpose of the reporting entity to whether an item meets the definition of a heritage asset. Some feel that only items controlled by heritage bodies can meet the definition, but the majority consider that the purpose of the entity is not relevant to whether an item mets the definition of a heritage asset.

- There are starkly different views on whether heritage assets should be recognised. Some argue that valuation is impracticable on an ongoing basis and that the cost of valuing huge collections exceeds any benefits to users. If you permit entities not to recognize there are audit issues in evaluating “practicality” and “cost-benefit”.

- In recognising and measuring heritage assets should cost, fair value or current value be used? There is no existing market for a variety of heritage assets so fair values may be difficult to obtain. Cost may not be a useful attribute of very old assets.

- How far should any standard vary from IPSAS 17? There is an argument for treating heritage assets on the same basis as other items of property, plant and equipment, but with perhaps a relaxation of the rules, or further explanatory guidance, on revaluation, depreciation and impairment.

- The overall challenge described was that obtaining a global consensus on accounting for heritage assets is very difficult. Should an IPSAS permit a number of options. In this context it was noted that, in the private sector, the IASB was seeking to eliminate options in many areas..

Key points on service concessions were:

- IFRIC issued 3 draft interpretations on accounting for service concessions in March 2005. The IFRIC approach is based primarily on the concept of “control” rather than “risks / rewards”, and only looks at the accounting treatment from the operator’s perspective. As the public sector is often the grantor (purchaser) the Interpretations do not directly address the circumstances of many public sector entities.

- IFRIC have revisited and revised the Interpretations and it is likely that a full Interpretation will be issued before the end of the year. The fundamental approach is unlikely to change very much from that in the 3 draft Interpretations. It is very unlikely that there will be a full IASB standard in this area.

- As the public sector is largely outside the scope of the IFRIC Interpretation, the IPSASB is looking to develop guidance in a public sector context. This will focus on the grantor’s perspective. treatment.

Questions were then invited on the final two presentations.

- Harald Brandsas asked Jay Karia how the UN could help developing and smaller nations with the implementation of IPSAS, based on the UN’s experience. Jay replied that whilst the UN was not funded for such assistance they would look to publish some guidance to assist those countries looking to make the transition, such as Uganda.

- Johan Chistaens asked about the recognition of heritage assets. He suggested that if the asset was used in a business-like way and provided economic benefits then it should be recognised. If not (for example those assets used for cultural reasons) then the financial benefit is zero and they should not be recognised. John Stanford replied that if IPSASB went down this route it would require countries to de-recognise some assets which are already recognised on balance sheets.

- The Chair asked John Stanford if IPSASB could consider offering a choice of recognition and measurement criteria for heritage assets. John replied that IPSASB is currently looking for convergence in the guidance that it offers and that it would therefore prefer not to offer choice. However, he conceded that in this special case it may be the only workable solution.

- An IPSASB member asked if the UN and the European Commission planned to move to accruals budgeting in the near future. Derek Dunphy replied that currently their focus was on the discharge and follow-up of the first accrual based financial statements (2005), so there were no plans for the Commission to make such a move in the short-term. Jay Karia said that this is under discussion at the UN but is a medium term goal. It would mean that the unfunded liabilities would need to be funded from member contributions.

The Chair closed the workshop at 16:15.