UPDATE
PUBLIC SECTOR COMMITTEE
November 2000

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Introduction

The PSC's current activities are focussed on the development of International Public Sector Accounting Standards (IPSASs) for financial reporting by governments and other public sector entities (the Standards Project).

The PSC's Standards Project was established in late 1996. The objectives of the initial stage of the project are to develop by the end of November 2001: a background paper identifying current practices and issues in public sector financial reporting; a core set of IPSASs based (to the extent appropriate) on the International Accounting Standards (IASs) in place as at August 1997; an IPSAS on the cash basis of accounting; and guidance on the transition from the cash to the accrual basis of accounting.

To date, the PSC has issued the background paper, eight IPSASs, Exposure Drafts (EDs) of seven further proposed IPSASs and an Invitation to Comment dealing with the impairment of public sector assets. The Attachment to this Update summarizes the IPSASs issued to date and the exposure drafts currently on issue.

The outcome of the PSC's deliberations at its last meeting, in November 2000, is outlined below.

PSC Meeting, 6-9 November 2000

At this meeting the PSC approved for issue the following EDs:

- *Events After the Reporting Date*
- *Segment Reporting*
- *Financial Instruments: Disclosure and Presentation*

These EDs will now be finalized and are expected to be issued in late January 2001 for a 4 month exposure period.

The PSC also approved for issue an ED on *Investment Property* subject to agreement by rotary resolution of the final amendments identified at the meeting. It is intended that this ED will be issued in late January 2001 with those identified above.

The major features of these EDs are outlined below.

ED *Events After the Reporting Date*
(to be issued in late January 2001)

The ED is based on IAS 10, *Events After the Balance Sheet Date* (revised 1999). The ED establishes criteria for deciding whether the financial statements should be adjusted for an event occurring after reporting date. It distinguishes between adjusting events (those that provide evidence of conditions that existed at reporting date) and non-adjusting events (those that are indicative of conditions that arose after reporting date). The ED also:

- includes discussion of how to determine the date of authorization of financial statements for issue within the public sector;
- notes the need to consider whether announced government intentions meet the definition of non-adjusting or adjusting events; and
- explains the application of the going concern concept within the public sector, including an acknowledgement that the assessment of going concern is likely to be of relevance for individual entities rather than a government as a whole.

ED *Segment Reporting*
(to be issued in late January 2001)

The ED is based on IAS 14 *Segment Reporting* and requires similar disclosures to those required by IAS 14. However, the ED requires that the segments adopted for external financial reporting should be the same as those adopted for reporting internally to senior management. This differs from IAS 14 which requires certain disclosures to be made about business and geographic segments, and defines these segments by reference to different risks and returns.

The PSC is of the view that defining segments by reference to risks and returns is not appropriate for public sector entities which do not operate in a competitive market with the objective of generating a profit. However, the PSC notes that for accountability, performance assessment and decision making purposes the governing body and senior management of public sector entities will require disaggregated financial information which identifies such matters as:

- the extent to which the entity's major service delivery objectives have been achieved;
- the resources devoted to, and the costs incurred in, their achievement; and
- the sources of funding and cost recoveries to support the achievement of those major objectives.

The PSC is of the view that the disclosure in general purpose (external) financial statements of certain information about the major segments reported to senior management is a cost efficient mechanism of enhancing the transparency of financial reporting by public sector entities. It will support the discharge of accountability by public sector entities and provide information useful to users as input for decision making purposes. This approach will allow segments to reflect activities, programs, outputs, ministries or portfolios consistent with the basis of reporting to the governing body and senior management. At the whole of government level segments may be identified consistent with government functional classifications used for government finance statistical (GFS) reporting purposes, thus supporting the harmonization of accounting and statistical bases of reporting.

ED *Financial Instruments: Disclosure and Presentation*

(to be issued in late January 2001)

The PSC agreed an exposure draft with substantially the same requirements as those in International Accounting Standard IAS 32, *Financial Instruments: Disclosure and Presentation*. The ED proposes a number of disclosures for both recognized and off-balance sheet (statement of financial position) instruments. Proposals are also included on the classification of financial instruments by the issuer, including the separate identification of equity and liability components.

The PSC recognises that entities in the public sector use financial instruments and should be subject to the same presentation and disclosure requirements as those for entities in the private sector. This is because there is no compelling reason to justify a different approach for the public sector. While the PSC's view is that the proposed Standard should apply to all entities in the public sector the ED invites comment on this issue. The PSC notes that it is not common for public sector entities to issue equity instruments and invites respondents to the ED to comment on whether the liability/equity classification requirements proposed in the ED are relevant for public sector entities in their jurisdiction. The ED also seeks comment on financial instruments used in Islamic countries that may not have been specifically dealt with by the proposals in the ED.

ED *Investment Property*

(to be issued in late January 2001)

ED *Investment Property* is based on IAS 40, *Investment Property* and requires either a cost or fair value model to be adopted. The ED:

- makes it clear that property held to deliver a social service is not an investment property even though it may also generate some cash inflows. Such property is accounted for in accordance with ED 14 *Property, Plant and Equipment*;
- proposes that investment property initially be measured at cost or where the item's cost can not be determined reliably or is not relevant at its fair value as at the date it is first recognized. This differs from IAS 40 which requires investment property to be initially measured at cost – however, it reflects the requirements proposed in ED 14; and
- clarifies that on initial adoption of the accrual basis of accounting any change in the carrying value of an investment property arising on a move from the cost model to the fair value model be recognized in net assets/equity.

Work in Progress

ED *Related Party Disclosures*

The PSC considered a draft ED based on IAS 24 *Related Party Disclosures* but with a focus on disclosure of transactions not conducted at arm's length. In contrast to IAS 24, the draft ED did not exempt wholly owned controlled entities domiciled within the same country as the controlling entity from disclosure of related party transactions. The PSC determined that the draft ED should be revised to require disclosure of:

- transactions between the controlling entity and the controlled entity (in the controlled entity's financial statements); and
- remuneration of key management personnel.

The Committee will consider a revised draft at its next meeting.

ED *Provisions, Contingent Liabilities and Contingent Assets*

The PSC considered a draft ED based on IAS 37, *Provisions, Contingent Liabilities and Contingent Assets.* IAS 37 defines provisions as liabilities of uncertain timing or amount and includes requirements relating to the recognition of provisions and onerous contracts. IAS 37 also requires the disclosure of information about contingent assets and contingent liabilities. The draft ED proposed that the Standard should:

- apply to the public policy obligations of governments; and
- in respect of onerous contracts, be limited to apply to only those contracts that were entered into with the expectation that the contract would provide approximately equal value to both parties.

The PSC determined that it was necessary to limit the scope of the ED to exclude liabilities associated with welfare payments and contingent assets associated with non-exchange revenues. The Committee noted that this change in scope would also require a review of the application of the ED to onerous contracts. The Committee will consider a revised draft at its next meeting.

ED *Entity Combinations*

The PSC considered a draft ED based on IAS 22, *Business Combinations*, which deals with the acquisition of entities and the uniting of interests. The draft ED proposed substantially the same requirements as those in IAS 22.

The PSC agreed to defer the development of a Standard dealing with entity combinations until it has completed its core Standards. The PSC considered that the development of a Standard on entity combinations would not have broad application in the public sector and, therefore, was not a priority for the current work program.

Transitional Guidance

The Committee continued to develop guidance to assist entities moving from the cash basis to the accrual basis of accounting. At this meeting the PSC considered initial drafts of guidance on a range of issues to be dealt with by the Transitional Guidance. Issues discussed at the meeting included the most appropriate way of presenting material for those entities seeking guidance on issues associated with implementation of the cash basis (as outlined in ED 9 *Financial Reporting under the Cash Basis of Accounting*) and the nature of examples to be used.

The PSC also considered mechanisms to better leverage off the experience of members and observers and their member organizations. Work on the Transitional Guidance will continue.

Framework for Public Sector Financial Reporting

The PSC considered and concurred with comments it had received that it should develop a framework to support its core Standards. It noted that it had already undertaken considerable work, through its Studies, in exploring the various elements of a framework. Accordingly, it would be well placed to commence work on a framework once it has finalized its core Standards.

The PSC agreed to include the development of a framework for financial reporting on its future work program and that it would initially look at the objective of financial reporting in the public sector and the reporting entity concept. Depending on its existing commitments, the PSC may commence some preliminary scoping work on these projects in 2001.

Non Standards Projects

In addition to work on the Standards Project the PSC also deals with other matters as time allows. At this meeting these matters included:

- Proposed Study *Corporate Governance in the Public Sector;*
- Submissions to the International Accounting Standards Committee on proposed International Accounting Standards; and
- Occasional papers.

At the November meeting the PSC agreed to publish an occasional paper prepared by the French delegation on the PSC. The paper entitled *An Original Method of Public Administration: Delegated Public Service* will be available early next year.

Next PSC meeting April 29 – May 3, 2001

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ATTACHMENT

Summary of PSC Standards Project Documents

BACKGROUND PAPER
IFAC PSC Study11 *Governmental Accounting Issues and Practices* aims to assist governments in the preparation of their financial reports and contains a detailed description of the common bases of accounting used by governments: cash accounting (including modified cash accounting) and accrual accounting (including modified accrual accounting). The Study also provides examples of actual financial statements prepared under each basis.

INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS (IPSASs)
IPSAS 1 *Presentation of Financial Statements* sets out the overall considerations for the presentation of financial statements, guidance for the structure of those statements and minimum requirements for their content under the accrual basis of accounting.

IPSAS 2 *Cash Flow Statements* requires the provision of information about the changes in cash and cash equivalents during the period from operating, investing and financing activities.

IPSAS 3 *Net Surplus or Deficit for the Period, Fundamental Errors and Changes in Accounting Policies* specifies the accounting treatment for changes in accounting estimates, changes in accounting policies and the correction of fundamental errors, defines extraordinary items and requires the separate disclosure of certain items in the financial statements.

IPSAS 4 *The Effect of Changes in Foreign Exchange Rates* deals with accounting for foreign currency transactions and foreign operations. IPSAS 4 sets out the requirements for determining which exchange rate to use for the recognition of certain transactions and balances and how to recognize in the financial statements the financial effect of changes in exchange rates.

IPSAS 5 *Borrowing Costs* prescribes the accounting treatment for borrowing costs and requires either the immediate expensing of borrowing costs or, as an allowed alternative treatment, the capitalization of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset.

IPSAS 6 *Consolidated Financial Statements and Accounting for Controlled Entities* requires all controlling entities to prepare consolidated financial statements which consolidate all controlled entities on a line by line basis. The Standard also contains a detailed discussion of the concept of control as it applies in the public sector and guidance on determining whether control exists for financial reporting purposes.

IPSAS 7 *Accounting for Investments in Associates* requires all investments in associate to be accounted for in the consolidated financial statements using the equity method of accounting, except when the investment is acquired and held exclusively with a view to its disposal in the near future in which case the cost method is required.

IPSAS 8 *Financial Reporting of Interests in Joint Ventures* requires proportionate consolidation to be adopted as the benchmark treatment for accounting for such joint venturers entered into by public sector entities. However, IPSAS 8 also permits – as an allowed alternative – joint ventures to be accounted for using the equity method of accounting.

EXPOSURE DRAFTS CURRENTLY ON ISSUE FOR COMMENT
ED 9 *Financial Reporting Under the Cash Basis of Accounting* proposes requirements for the preparation and presentation of the cash flow statement and supporting accounting policy notes under the cash basis of accounting. It includes requirements relating to the identification of the reporting entity and the structure and the minimum content of the cash flow statement. ***Comment deadline: November 30, 2000***.

ED 10 *Revenue from Exchange Transactions* proposes requirements for the accounting treatment of revenue arising from exchange transactions and addresses the issue of revenue recognition for these transactions. ***Comment deadline: November 30, 2000.***

ED 11 ***Inventories*** proposes the accounting treatment for inventories under the historical cost system. ***Comment deadline: November 30, 2000.***

ED 12 ***Construction Contracts*** proposes requirements for the accounting treatment of revenue and costs associated with construction contracts. ***Comment deadline: November 30, 2000.***

ED 13 ***Financial Reporting in Hyperinflationary Economies*** proposes requirements for financial reporting under conditions of hyperinflation. ***Comment deadline: November 30, 2000.***

ED 14 ***Property, Plant and Equipment*** proposes the accounting treatment for property, plant and equipment, including the basis and timing of their initial recognition, and the determination of their ongoing carrying amounts and related depreciation. ***Comment deadline: January 30, 2001.***

ED 15 ***Leases*** proposes requirements for the accounting treatment of leasing transactions. ***Comment deadline: January 30, 2001.***

ITC ***Impairment of Assets*** **–** In addition to these exposure drafts the PSC has published an Invitation to Comment (ITC) on *Impairment of Assets*. The purpose of the ITC is to seek comments on the appropriate accounting treatment for the impairment of assets. It reflects the tentative position of the PSC that an impairment test should be applied to all assets but that the cash flow test required by IAS 36 *Impairment of Assets* is not appropriate for assets held by public sector entities for the delivery of goods and services rather than the generation of positive cash flows for the entity. ***The comment deadline for the ITC is January 30, 2001***.

Copies of these documents are available at www.ifac.org