IPSAS: Guidelines for Developing Countries

By

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1. Introduction

Nothing rankles like a good initiative extinguished in contact with bad implementation. History teaches that failure is not always the absence of ideas but the product of poor implementation.

From Luca Pacioli's *Summa de Arithmetica, Geometria, Proportioni et Proportionalità* to Floyd A. Beams' *Advanced Accounting;* the accountancy profession has come a long way. It continues to evolve; from basic bookkeeping to a tool for public accountability and social engagement.

The introduction of International Public Sector Accounting Standards (IPSAS) at the turn of the twenty-first century is a constant reminder that the evolution of accountancy is not relenting as man, ever restless, continues in the endless quest to improve his space in time. Rightly or wrongly, IPSAS has come to be accepted as the flagship accounting and reporting standards for the public sector. Globally, the acceptance and adoption rate is increasing by the day.

Governments across the world are starting to amend their Public Financial Management (PFM) laws in order to make express provisions that the financial statements of public sector entities be prepared in accordance with or based on IPSAS. Beyond governments, international organizations and independent non-governmental organizations are embracing IPSAS.

2. Objectives and key assumptions

This guidance note is by no means another "best practice" for IPSAS implementation. It is, on the contrary, an alternative perspective in the long list of IPSAS literature. It is meant to be a guide to some; provide an alternative approach to others and serve as a reference material to everyone. More importantly, it is intended to provoke discussion on IPSAS implementation.

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[1] This note has benefitted from the expert review of Messrs. Albert Hrabak and Andy Wynne.

The note makes four important assumptions. First, that readers already understand some IPSAS basics. Second, although this is hardly the case in all circumstances, that IPSAS is implemented using automated systems such as an Integrated Financial Management Information System (IFMIS). The third assumption is that necessary consultations have already been made and a decision taken to adopt and implement IPSAS by those vested with powers to do so. Lastly, that IPSAS is implemented as a continuum: from cash to accrual. It can therefore be applied to the implementation of both cash and accrual based IPSAS.

3. The Guidelines

3.1. Coordination with other PFM reforms

The PFM system is made up of Budget Preparation, Budget Execution, Accounting and Reporting, External Oversight and a range of cross cutting issues.[2] In many developing countries, IPSAS is but one of the activities of the overall PFM reform program falling under the Accounting and Reporting component. Because PFM is a unified system with multiple components, all PFM reforms activities must stay coordinated in order to maintain its organic integrity.

It is usually the case that an IFMIS is implemented to provide an automated environment for PFM reforms. As an integrated system, the IFMIS serves as a central repository for a common chart of accounts and budget classification codes (COA) as well as budget and accounting data. Nearly all reports - whether budgetary, management, statistical or financial - are expected to be generated from the IFMIS.

Unless there is proper coordination, it is not possible to rely on the IFMIS for generating IPSAS compliant financial statements. Implementing separate database and reporting software for IPSAS is not only an unnecessary and costly duplication of systems and effort, but also can create a chaotic and dysfunctional data fragmentation that often brings nothing but grief.

IPSAS implementation must therefore be well coordinated with other PFM reforms such as performance-based budgeting, cash management, procurement, audit modernization and payroll.

Countries should be aware that IPSASs are accounting standards, and do not provide guidance on a number of issues that they will have to deal with as part of a global PFM reform initiative. Therefore, effective coordination with other aspects of PFM reform projects will bring about synergies and ensure that IPSAS requirements as they relate to other PFM components are met.

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2 http://web.worldbank.org/WBSITE/EXTERNAL/PROJECTS/EXTFINANCIALMGMT/0,,contentMDK:21425372~menuPK:3914586~pagePK:210058~piPK:210062~theSitePK:313218,00.html

3.2. Structured implementation

Implementing IPSAS is an enormous and important task. For that reason, it must be implemented in a structured, orderly and deliberate manner.

The first steps in IPSAS implementation after obtaining the necessary approvals is the preparation of implementation strategy and setting up of project management structures. Whichever comes first will depend on the approach adopted. The absence of good project management structures and a quality implementation strategy are early warning signs that IPSAS implementation is in real and present danger.

Project based IPSAS implementation with appropriate funding ensures that adequate structures and resources are put in place; that project scope is clearly defined and that there is a dedicated project team whose mandate is to deliver IPSAS.

It is the responsibility of the IPSAS professional project manager to ensure that the project is delivered on schedule, at minimal cost and in accordance with the implementation strategy. The implementation strategy will detail the sequence of steps that will be taken, in line with the chosen project management methodology, to actualize IPSAS from start to finish. Delineation of different implementation phases, milestones, timelines, responsibilities, and project governance structures, amongst others, may form part of the IPSAS implementation strategy paper. This document not only serves as reference material but also helps to define project boundaries lest IPSAS becomes a project *sans frontières.*

For the avoidance of doubt, it must be stated that an implementation strategy is not the same as a timetable of events or a periodic update of project status. Strategy documents are usually written by persons of sound technical competence and excellent writing skills. They are easily recognizable by their structure, presentation, technical depth and content.

IPSAS implementation should have only one primary goal: to deliver IPSAS compliant general purpose financial statements. Any other goal should be deemed secondary.

Ad hoc, unstructured and “on-the-fly” implementation is a serious project risk that must be avoided.

3.3. Take it one phase at time

Whether on a cash or accrual basis, IPSAS should be implemented in phases. This may sound intuitive but there is empirical evidence to suggest that some developing countries believe that it can be implemented all at once across all entities. This partly accounts for the short implementation timelines in some countries; the result being that timelines and targets are not met. This, in turn, leads to changing timelines, cost overrun and project failure.

In phasing IPSAS implementation, it is recommended that an assessment of the adequacy of the existing general purpose financial statements in relation to all applicable IPSAS is conducted. The assessment, itself, needs to be segregated into different categories taking into account the nature of individual economic entities. A typical segregation may involve three (or more) categories: budgetary, semi-autonomous budgetary and extra-budgetary entities.

In most developing countries, the last two categories traditionally report on an accrual basis while budgetary entities report on a cash basis. For this reason a uniform gap analysis tool cannot be used for all.

Also, different implementation timelines may apply to each category depending on the stage of its accounting and the identified gaps. For instance, while it may take, say, 3 years for budgetary units that are currently operating on a cash basis to comply with the cash-based IPSAS and another 3 years to comply with accrual-based IPSAS; the extra-budgetary units and GBEs may require about 3 or 4 years to migrate to a full accrual-based IPSAS. Achieving full consolidation at general government level may take upwards of 6 and 10 years in some countries for cash and accrual basis, respectively. As a limited number of countries have achieved such a consolidation as at today, it is however difficult to assess what is a standard timeframe for achieving this consolidation.[3]

The content of each phase will differ between countries; however, each phase must, in all cases, be broken into milestones. The milestones are further broken down into detailed activities with clearly defined responsibilities and timelines.

There is no hard and fast rule on what constitutes a phase. What is important is that each phase must have a clearly identified goal and attainment of proficiency must be met before moving toward the next goal.

For general government budgetary units that are presently on a cash basis, countries would be well advised to start from the cash-based IPSAS. Other units that are already on an accrual basis should start with the accrual-based IPSAS.

It should be borne in mind that even where different entities are operating on different basis of accounting, it is possible to prepare a consolidated cash flow statement for all controlled entities which is the only required general purpose financial statement under the cash based IPSAS.

[3] http://www.treasury.govt.nz/government/financialstatements/yearend/jun14/fsgnz-year-jun14-2.pdf

3.4. Chart of Accounts

In an automated environment, the Chart of Accounts (COA) provides the foundation upon which data tracking and reporting are built. In many countries, IFMIS is implemented to serve as a common ICT tool for all PFM processes. For this reason, the COA must be seen as a cross cutting activity that serves the purpose of all the PFM processes rather than IPSAS alone. It is therefore not advisable to assign COA design responsibilities exclusively to any of the PFM reform components.

If, for instance, the IPSAS implementation team is assigned the sole responsibility of COA design, the tendency is to focus on IPSAS requirements at the detriment of other components. Membership of the COA design team must therefore be representative of the various PFM reform activities and components.

The COA is designed top down: from the general purpose financial statements (starting with the Statement of Financial Position) through the notes, sub-notes and details. This ensures that the reporting needs are fully met in line with structured query language (SQL) design and reporting principles.[4]

Failure to follow SQL principles in COA design will make it impossible to map individual transactions to the general purpose financial statements, notes and sub-notes. This failure is largely responsible for the inability of many IFMIS applications to generate standard reports in the desired formats.

In order to support IPSAS compliant GPFS, the COA must take into account all IPSAS reporting requirements. To ensure that the COA fully supports IPSAS reporting requirements, a checklist of all IPSAS reporting requirements should be made and their relationships to transaction data established. Revenue, Expenses, Assets and Liabilities are grouped into related classes that are progressively granulated for detailed data tracking and reporting.

Entities are classified starting from the Public Sector, General government (central, state and local governments) down to individual economic entities. In doing this, care is taken to ensure that IPSAS required entity control relationships are maintained in order to comply with IPSAS segment reporting and consolidation requirements.

[4] SQL is a special-purpose programming language designed for managing data held in relational database management systems. It has been a standard of the International Organization of Standardization (ISO) since 1987.

In keeping with SQL principles, values that are calculated from other records should not be assigned codes. Such items include balancing items like cash balances, profit or loss on disposal of assets, depreciation and impairment of non-financial assets.[5]

It is often assumed that the inclusion of non-financial assets and inventories in the COA automatically makes it IPSAS accrual compliant. This is a wrong assumption. Without question, the most important difference between cash and accrual basis of accounting lies in the timing of recognition of economic events. Most times, timing differences are addressed through the recognition of accruals and prepayments as well as accounts payables and accounts receivables.

3.5. Focus on Economic Entities

A common mistake in IPSAS implementation is the undue emphasis on consolidation and the near neglect of the economic entity as the starting point. IPSAS apply first to public sector units called economic entities except, of course, Government Business Enterprises to which IFRS apply.[6]

Always bear in mind: an economic entity is a single reporting unit. IPSAS 1, to which the rest of the IPSAS are but feeders and amplifiers, is built around the economic entity. Paragraph 43 of IPSAS 6 on Consolidated and Separate Financial Statements provides further guide: "In preparing consolidated financial statements, an entity combines the financial statements of the controlling entity and its controlled entities line by line, by adding together like items of assets, liabilities, net assets/equity, revenue, and expenses". This does mean that consolidation is preceded by the preparation of IPSAS compliant financial statements of the controlled and controlling entities to be consolidated

In phasing IPSAS implementation, enough time should be dedicated to achieving compliance at the economic entity level while consolidation follows after the entities to be consolidated have fully complied with IPSAS. How much time is allotted depends on the prevailing circumstance in every jurisdiction.

3.6. Keep an eye -- or two -- on cost

Make no mistake about it; implementation of IPSAS is a costly endeavour. The question is, how much is a reasonable cost? Put differently, agreed that IPSAS holds a lot of benefits, should a country break the bank in order to enjoy those benefits? The obvious answer is no. Here are a few reasons why cost is a big factor in implementing IPSAS.

First, it is really difficult to measure the benefits accruing from IPSAS. Second, excessive cost could be a deterrent to adopting IPSAS. Third, it creates sustainability risks. And

[5] Other experts and IFMIS applications may see this differently. The bottom line, however, is that the objectives are met and that IPSAS compliant reports are generated.
[6] IPSASB has just issued a consultation paper on the applicability of IPSAS to GBEs https://www.ifac.org/sites/default/files/publications/files/IPSASB-GBE-Consultation-Paper-At-a-Glance_0.pdf

lastly, if the IPSAS implementation turns out to be a huge budget undertaking, it risks becoming an avenue for corruption thereby defeating the accountability goal; one of its most advertised and persuasive benefits.

Cost is particularly a big factor in the decision to transit to accrual based IPSAS. In the 1920s, the British government attempted and rejected accrual based accounting and reporting at the central government level (local authorities had already introduced accrual accounting) because the associated benefits were considered insignificant in comparison with the associated costs.[7] Accrual accounting was introduced in 1919 amongst other reasons, to enable accounting officers (commanders in World War 1) "attain economic control of the units under their command."

In 1925, six years after the introduction and production of accrual based financial statements, "the Army Council, with the support of the parliamentary Public Accounts Committee, decided that this approach required additional costs of at least £200,000 a year (and twice that amount for the first year), but that "the experiment had not led to commensurate economies in administration and seemed unlikely ever to do so". With this adverse verdict, the accrual accounting experiment was terminated.

In 1950 a Parliamentary Committee also undertook a careful review of the evidence for the general adoption of accrual accounting and concluded that: "We agree with the principle that the main Exchequer Accounts and the framework of both Estimates and Appropriation Accounts must remain on a cash basis." Furthermore, the Parliamentary Committee also concluded that the adoption of the accrual basis would: "necessitate the valuation of all existing assets and an estimate of the probable remaining useful life of each – a gigantic task requiring the listing of figures many of which could be no more than guess work."

Whatever relief that advancement in technology, improved access to information and new skills provided with respect to implementation complications and difficulties in asset valuation are vitiated by the astronomical increase in the size and geographical spread of national assets.

IPSAS implementation must be properly planned and the estimated cost determined from the start. In deciding whether a country or an entity should adopt IPSAS, the political leadership or governing board of the entity must be availed of all necessary details, including total estimated cost implementation, as part of the initial proposal.

4. The role of auditors

Auditors make the final call on whether a general purpose financial statement is IPSAS compliant through their audit opinion. They must therefore be part of the

[7] https://www.linkedin.com/groups/Accrual-Accounting-Tested-Rejected-British-4254659.S.5844450157965381633?qid=c07ae9e6-c48b-40cd-8a1d-4814ea8c53b7&goback=%2Egmr_4254659

implementation process. They need to understand IPSAS in order to be in the right position to tell when a GPFS is IPSAS compliant.

It is noted that the IPSAS implementation process in many developing countries is undertaken with the active involvement of the Supreme Audit Institutions (SAIs). However, in many countries like Nigeria, semi-autonomous and extra-budgetary units are statutorily audited by private sector auditors - not the SAI.

A readiness assessment of the private sector audit community in performing their roles under IPSAS should be undertaken and steps taken to fill any identified capacity and integrity gaps.

In concluding this section, Ernst and Young has compiled and published a very useful checklist that can be used to determine whether general purpose financial statements are IPSAS compliant. Auditors will find the checklist very useful in assessing financial statements' compliance with IPSAS.[8]

5. Conclusion

To borrow from a popular cliché, IPSAS has come to stay. But it is too early in the day to tell if it will live up to its rating. A whole lot will depend on those on whose shoulders the responsibility for implementing IPSAS rests.

Amongst the few PFM experts who have summoned the courage to criticize IPSAS, the most common concerns have centered on ease of implementation, cost of implementation and understandability of IPSAS financial statements. It is recommended that those charged with implementing IPSAS pay sufficient attention to those concerns well in advance and decide proactively how to address them in the course of implementation.

In a blog post published in March 2013, Matt Andrews of Harvard Kennedy School took a rather unflattering view of PFM reforms in general. According to him, "Official reports…show that up to 100 countries have adopted IPSAS, for instance, and many of these adopters are in the developing world… Such a high level of adoption sounds like a good story. But we should not be congratulating ourselves too fast. More often than not, what you see is not what you get with these new PFM practices; they are adopted as signals to garner external legitimacy but often cannot be implemented and seldom provide real solutions to the PFM problems of different countries."[9]

In the final analysis, the success or otherwise of IPSAS as well as its public perception will depend on their ability to deliver cost-effective improved accountability which

[8] http://www.ey.com/Publication/vwLUAssets/EY_-_International_Public_Sector_Accounting_Standards_Disclosure_Checklist_-_September_2012_Edition/$FILE/EY-IPSAS-Ctools-%20Disclosurechecklist-Sept2012.pdf
[9] http://opinion.publicfinanceinternational.org/2013/03/pfm-reform-signal-failure/#more-990

results in better decision making by management, governance, and other interested parties.

While the passion of many IPSAS implementers is salutary, it needs to be recognized that neither passion nor hype can take the place of diligent and faithful implementation. It remains to be seen whether Africa and the developing world will make a success of IPSAS. Or whether it will be, in the words of Andrews, another “signal failure”.