The role of public sector accounting standards (IPSAS) in supporting management and performance indicators

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Agenda

1. Introduction
2. Accounting reform
3. IPSAS: standards, reporting, evaluation
4. IPSAS and user needs
5. Results
6. Usefulness for management
7. Critical perspectives
8. Conclusions
1. Introduction

• Since years mid ‘80: worldwide governmental reforms (Hood, 1991 and 1995):

  ➔ New Public Management (NPM)
  - Output-oriented instead of input- or processing-oriented
  - Management techniques from enterprises
  - Quantifying service providing and performance measurement
  - Transparency
  - Efficiency and value-for-money audit

1. Introduction (2)

• Cornerstone of New Public Management:
  ➔ Reform of the accounting system and financial reporting

  ➔ Adoption of businesslike accrual accounting next to existing, traditional budgetary accounting (often wrongly named ‘cash accounting’; budgetary accounting is a system of authorizing budgets and recording encumbrances and finally receipts and disbursements to control the public purse whereas cash accounting is only recording receipts and disbursements)
2. Accounting reform

• Budgetary accounting:
  – Used to be the mainstream accounting and financial reporting system in the public sector
  – Still actively used in different governments / jurisdictions: recording of different phases: approval of budgets, appropriations, encumbrances, disbursements
  – Few information concerning liabilities and the future potential benefits of assets
  – Need for better accounting information

  ➔ Need for accrual accounting

2. Accounting reform (2)

• Accrual accounting:
  – Better suited for planning, financial management and decision-making;
  – Provides a greater (internal and external) accountability of the public resources;
  – Improves cost awareness (efficiency);
  – Facilitates asset & cash management;
  – Facilitates the recognition of risks and opportunities;
  – Supports the calculation of governmental fees and charges;
  – Better view on the (financial) impact of public policies;
  – …
3. IPSAS: standards

- International trend to adoption and implementation of accrual accounting in governments
- Since 2000: International Public Sector Accounting Standards (IPSAS)
  - Developed by IPSASBoard belonging to the International Federation of Accountants (IFAC)
  - Based on accrual accounting enterprises (IAS/IFRS)

3. IPSAS: standards (2)

- Not enforceable, but:
  - Widely adopted in international organisations (OECD, NATO, UN, European Commission, Interpol,…)
  - Different jurisdictions/countries apply IPSAS

- 31 accrual standards / 1 cash standard
  - IPSAS 1 and 2: Standards on Presentation of financial statements and accounting policies
  - IPSAS 3 to 31: Standards on Specific transactions and items (e.g. 12 Inventories; 17 Plant, property; …)
3. IPSAS: Reporting

- Statement of Financial Position (= balance sheet)
- Statement of Financial performance (= Profit and Loss Account)
- Statement of Changes in Net Assets
- Cashflow statement
- Notes

3. IPSAS: Evaluation

- + Worldwide accounting rules
- + In relationship with IAS/IFRS
- + Recognition two perspectives
  - Accrual accounting
  - Cash accounting
- - Lack of conceptual framework
- - Copied from IAS/IFRS assuming that accrual accounting is supreme
- - Denying budgetary accounting
3. IPSAS: evaluation (2)

- Respecting specific governmental characteristics
- Not compulsory
- Underestimation governmental context
- Lack of enforcement power IPSASB
- Lack of attention to 1st balance sheet
- No definition of the entity
- Non-exchange transactions

4. IPSAS and user needs

- Remarkable efforts of the IPSASB to promote accrual accounting in the public sector
- Much attention to reformed accounting rules, practices and reporting → BOTTOM UP
- However, less attention for the user needs financial reporting and applying accrual accounting in management perspective → TOP DOWN

→ “One is constantly paying attention to the kitchen of the restaurant without looking at the guests and their wishes”
4. IPSAS and user needs (2)

- What is the opinion of users (officials) and experts (practitioners, academics) regarding the usefulness of IPSAS?
- Field study in 17 European countries (IRAS 2010):
  - EU 15 - Luxembourg
    - + Lithuania (Eastern Europe)
    - + Norway (Scandinavia)
    - + Switzerland (leading roles of the Cantons)
  - In some countries: different jurisdictions (Bundesländer, Cantons,…)

4. IPSAS and user needs (3)

- Period: March 2008 – November 2008
- Response rate: 52.4% (academics 66.7% - officials 42.9% - consultants 47.6%)
- Completed questionnaire in 19 jurisdictions
### 5. Results: why IPSAS?

<table>
<thead>
<tr>
<th>Reasons to link the accrual accounting legislation to IPSAS</th>
<th>A</th>
<th>B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Useless to reinvent the wheel, more efficient to use IPSAS</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>To enhance (inter)national comparability of financial information</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>To be in accordance with international organizations</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>To facilitate the consolidation of financial statements</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>To improve public/private comparability</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>The IPSAS are developed by qualified persons</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>For financing purposes</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

- A = local governments
- B = central governments

### 5. Results: why not IPSAS?

<table>
<thead>
<tr>
<th>Reasons to not link the (planned) accrual accounting legislation to IPSAS</th>
<th>A</th>
<th>B</th>
</tr>
</thead>
<tbody>
<tr>
<td>The accounting legislation is based on local business accounting rules</td>
<td>8</td>
<td>3</td>
</tr>
<tr>
<td>The IPSAS are rather unknown in my jurisdiction</td>
<td>5</td>
<td>3</td>
</tr>
<tr>
<td>There is a fear of losing the standard setting authority</td>
<td>4</td>
<td>2</td>
</tr>
<tr>
<td>There is few experience in implementing the IPSAS</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>The IPSAS do not consider budgetary accounting</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>The IPSAS are based on IFRS/IAS</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>The IPSAS are mainly inspired by Anglo-Saxon accounting legislation</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>The IPSASB has limited legislative power</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Not all relevant accounting issues are covered by the IPSAS</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>The IPSAS are not government-specific enough</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>The IPSAS are not in harmony with the ESA 95 standards</td>
<td>0</td>
<td>1</td>
</tr>
</tbody>
</table>
5. Results: why accrual accounting?

<table>
<thead>
<tr>
<th>Reasons to adopt accrual accounting</th>
<th>A</th>
<th>B</th>
</tr>
</thead>
<tbody>
<tr>
<td>To improve cost awareness and efficiency</td>
<td>14</td>
<td>11</td>
</tr>
<tr>
<td>To improve external accountability and oversight control</td>
<td>14</td>
<td>7</td>
</tr>
<tr>
<td>To support performance management (growing need for accounting information)</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>To support asset and cash management</td>
<td>9</td>
<td>6</td>
</tr>
<tr>
<td>To facilitate decision-making</td>
<td>8</td>
<td>4</td>
</tr>
<tr>
<td>To support the calculation of governmental fees and charges</td>
<td>7</td>
<td>2</td>
</tr>
<tr>
<td>To better see the impact of public policies on public organizations’ financial position</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>To facilitate the recognition of risks and opportunities</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>To measure intergenerational equity</td>
<td>4</td>
<td>0</td>
</tr>
<tr>
<td>To be able to give reliable financial information to the capital markets</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

5. Results: why not accrual accounting?

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</tr>
</thead>
<tbody>
<tr>
<td>Balance sheets and profit/loss calculations are of less importance in the public sector</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Cash accounting systems complement better with budgetary accounting systems</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>An accounting reform will lead to considerable costs</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>The current cash accounting system meets all requirements</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>A cash based system fits the characteristics of a public sector organization</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>The accounting system was only just changed to a modified cash accounting system</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Local governments resist against an accounting reform</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Some public sector efforts cannot be accounted for</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Former accounting reforms have shown significant implementation problems</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>Accrual accounting has limited potential to support political decision making</td>
<td>0</td>
<td>1</td>
</tr>
</tbody>
</table>
6. Usefulness for management

• Balance sheet
  → ‘Facilities’ management
  → Investments in capital assets
  → Accounts receivable and accounts payable administration
  → Debt position, financial health (net working capital)
  → Management of bank accounts and cash at hand
  → …

• Profit / Loss Account
  → Cost accounting (determining prices, management control)
  → Profitability follow-up
  → Transfer pricing systems
  → Subsidy management
  → …
7. Critical perspectives

1) **Effectiveness** = “Outcomes” / output → “outcomes” very difficult to measure in governments

2) “Output” levels often difficult to measure: eg. cost per km road maintenance, health care cost per patient, … (GASB, SEA June 2010 p. 5). → Consequences to **Efficiency** = output / input

3) **Economy** = Input / cost of the input; mostly easy to measure and to control

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7. Critical perspectives (2)

4) P/L Account shows ‘incomplete’ overview (JC, JR FAM 2008)

<table>
<thead>
<tr>
<th>6</th>
<th>7</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economische inputs</td>
<td>Economische benefits</td>
</tr>
</tbody>
</table>

Social inputs    Social benefits
7. Critical perspectives (3)

5) Definition of the reporting entity: 4 types (CICA 1985)
   • juridical entity
   • controlled entity
   • economic entity
   • ‘political accountability’ entity

Accrual accounting systems (particularly IPSAS) often only consider the juridical entity concept and in addition the consolidation (IPSAS 6 and 22)

7. Critical perspectives (4)

6) Indicators of financial health (‘sustainability, flexibility, vulnerability CICA 1997) often apply macroeconomic variables, such as “Debt / National Income”, “Foreign Debt / GDP (= gross domestic product)”, … in this context role of IPSAS is very limited and e.g. disregards potential tax levying

7) Analogously: limited relationship IPSAS with standards such as “European System of Integrated Economic Accounts” (ESA 95), “Government Finance Statistics Manual” (IMF), …?
8. Conclusions

• No good-bad story: obviously, IPSAS and other similar accrual accounting systems clearly offer strengths and opportunities to management, but…
• They are not alone:
  → Need for harmonisation with budgetary accounting
  → Accrual accounting useful for ‘businesslike’ entities or segments vs. typical ‘governmental’ entities or segments where budgetary accounting appropriate (see GASB US)
  → Harmonisation – integration defined by user needs: external stakeholders, ‘internal’ stakeholders (politicians, managers)