ICGFM Ad Hoc Committee on Accounting Standards

Proposed changes to the Cash Basis Standard

March 3, 2015

Overview

It is our view that the Cash Basis standard is of great importance for two groups of users. Firstly, for sovereign governments will not implement accrual standards in the foreseeable future. The Cash Basis standard provides an international standard for such governments to publish IPSAS compliant General Purpose Financial Statements (GPFRS).

Secondly, for countries planning to transition to accrual, the Cash Basis standard provides a starting point and also a method of publishing IPSAS cash basis compliant GPFRS until full accrual is implemented.

A number of countries around the world have sought to publish GPFRS that are compliant with the Cash Basis standard. However, so far as it has been possible to determine, no country has been able to achieve full compliance (even though some claim to have done so). To be relevant the Cash Basis standard must be a feasibly achievable standard. The evidence is that at present this is not the case.

At the same time, if the Cash Basis standard is part of the overall IPSAS framework, then there needs to be a linkage between cash and accrual standards. This issue is addressed below.

1. Conceptual linkage between cash and accrual standards

The Conceptual Framework as developed by the International Public Sector Accounting Standards Board (IPSASB) does not address the issue of the relationship between the Cash Basis and Accrual Standards. We consider it important that the relationship is made explicit.

It is our view that the GPFRS as defined in the Cash Basis Standard should be envisaged as a sub-set of the GPFRS as defined in the accrual standards.

Under the Cash Basis standard the GPFRS contains three statements:

- Cash Flow statement (Statement of Receipts and Payments)
- Budget comparison (where appropriate)
- Notes and accounting policies.

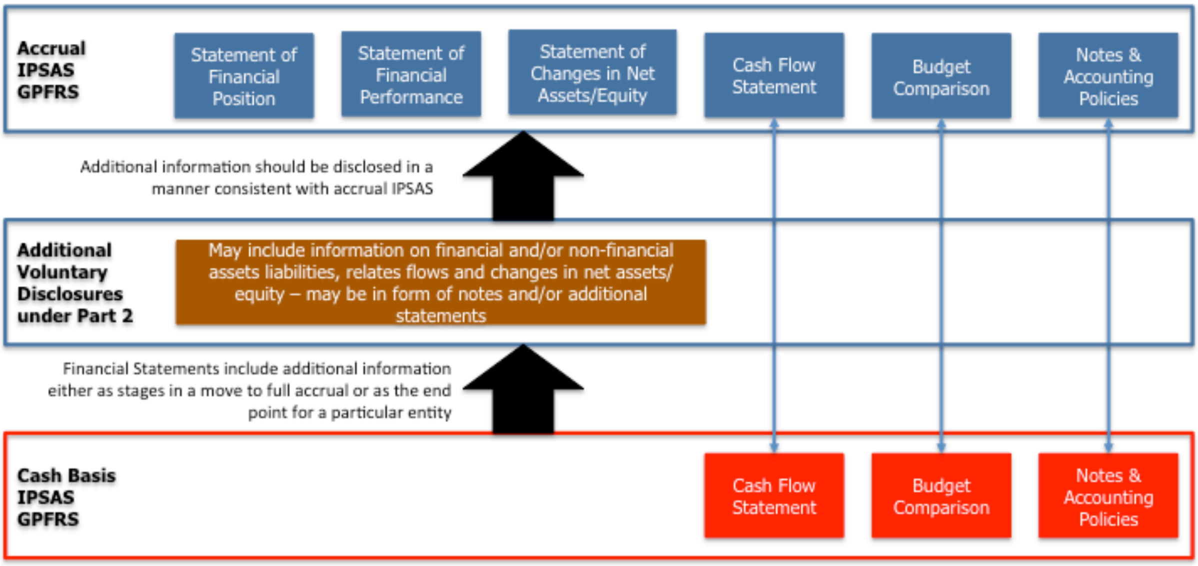
These three statements are just three out of six statements required by IPSAS 1 for accrual financial statements. The additional accrual IPSAS statements are:

- Statement of Financial Position (Balance sheet)

- Statement of Financial Performance (Operating statement)
- Statement of changes in net assets/equity

This relationship of the Cash Basis standard as a sub-set of the accrual IPSAS is summarised in Figure 1 below.

Figure 1: Relationship between Cash Basis and accrual IPSAS



Note that this model also illustrates how the Additional Voluntary Disclosures under Part 2 of the Cash Basis standard provide the link between cash and accrual GPFRS.

The model in Figure 1 is important for four reasons:

1. The model defines the conceptual linkage between the IPSAS Cash Basis and accrual GPFRS
2. If the Cash Basis standard is a sub-set of accrual IPSAS then this logically defines the requirements of the Cash Basis standard as being limited to those within accrual IPSAS requirements
3. The model indicates how the Cash Basis standard Part 2 Additional Voluntary Disclosures can be used to incorporate some elements of accrual information whilst remaining compliant with the Cash Basis standard.
4. Hence the model provides a route from cash to accrual GPFRS whilst retaining IPSAS compliance.

Points 2 through 4 above are expanded in the sub-sections below.

Point 2: the model of the relationship defines the Cash Basis standard requirements

Since the Cash Basis standard is a sub-set of the accrual IPSAS then the requirements of the Cash Basis standard must be consistent with, and not exceed, those of the accrual IPSAS. However, at present the Cash Basis standard contains requirements that are not reflected in accrual IPSAS. Such requirements are identified and further discussed below.

The relationship also means that if additional disclosures are made under Part 2 of the Cash Basis standard such disclosures should be consistent with the requirements of any relevant accrual IPSAS. For example, if information is provided on actual and contingent liabilities, then that information and presentation should be consistent with accrual IPSAS 19.

It is our view that the requirements of the Cash Basis standard should be limited to the requirements within accrual IPSAS. Furthermore, there should be a specific requirement that additional disclosures under Part 2 of the Cash Basis standard should be consistent with any relevant accrual IPSAS in terms recognition, measurement and presentation.

Point 3: the model indicates how Part 2 of the Cash Basis standard can be utilised

Many national governments publish GPFRS described as "modified cash" or "modified accrual". The IPSASB has declined to define such basis for the valid reason that the concept is too vague and application of modified cash or modified accrual varies between countries.

However, Part 2 of the Cash Basis standard allows a country to publish IPSAS compliant GPFRS whilst also allowing such additional "modified" accrual or cash information, and without any need to define such terms.

This option already exists under the Cash Basis standard but has never been formally recognised by IPSASB. An entity that publishes GPFRS that comply with Part 1 of the Cash Basis standard may be compliant with that standard. This compliance remains even if the notes contain extensive additional information in accordance with Part 2 of the Cash Basis standard, and even if such additional information in the Notes amounts to modified cash or accrual information.

This feature can be useful for countries in either of two situations:

1. A country that is transiting to accrual (see the next sub-section), or
2. A country that has decided not to move to full accrual but desires to publish more information that the mandatory information under the Cash Basis standard.

It is our view that the approach to using Part 2 of the Standard to provide some elements of accrual information should be specifically stated and explained in the Standard.

Point 4: the model provides a route from cash to accrual whilst continuing to publish IPSAS complaint GPFRS

As noted above, a country that is in transition to accrual accounting can continue to present GPFRS compliant with the Cash Basis standard whilst publishing an increasing range of accrual IPSAS information in the Notes.

This facility is especially important for national governments where the move to accrual accounting and GPFRS is being driven from a national level and there is likely to be a long period whilst groups of accrual IPSAS are sequentially adopted and implemented. In such countries the transition period may extend over decades. During the transition it is important that such a country commences and continues to publish IPSAS compliant GPFRS.

The IPSASB Study 14 "Transition to the Accrual Basis of Accounting: Guidance for Public Sector Entities" does not address the above problem. IPSAS 33 "First Time Adoption of Accrual Accounting" only deals with the issue once all of the accrual IPSAS have been adopted.

There are two approaches to the problem publishing GPFRS of an extended transition to full accrual:

1. A country progressively adopts national public sector accounting standards. The national standards may be based on IPSAS. Adoption is sequenced over time. Thus at any stage the government or other public sector entities can publish GPFRS that are compliant with adopted national standards. This is the approach adopted, for example, by Tajikistan.
2. An alternative approach is that during the transition the country and sub-national entities continue to publish Cash Basis compliant GPFRS, but with progressively more accrual information being published in the Notes. This is the approach adopted, for example, by Georgia.

It is our view that the Cash Basis standard should specifically refer to Option 2 above and explain how such an option can be applied.

2. Requirements in the Cash Basis standard that are more onerous than accrual IPSAS requirements

As indicated above if the Cash Basis standards are a subset of accrual IPSAS, then it follows that the Cash Basis mandatory disclosure requirements should never be more onerous than those in accrual IPSAS. Thus the accrual IPSAS define the parameters for the Cash Basis standard. Yet in two cases the Cash Basis standard requirements are significantly more onerous than those in accrual IPSAS, as indicated below.

2.1 Third party payments

The inclusion of third part payments is unique to the Cash Basis standard, though the term "third party payments" is used in relation to construction contracts in IPSAS 11. There is no general requirement for accrual GPFRS to show third party payments.

As indicated above, in our view the Cash Basis standard should not contain requirements that are more onerous than requirements in accrual IPSAS. Hence we consider that the requirement to provide information on third party payments should be moved to Part 2 of the Standard as an encouraged additional disclosure.

We do consider that disclosure of third party payment information should be encouraged, because the information is needed for fiscal control and resource allocation. The payments for goods and services by third parties are part of the fiscal resources available to government and disclosure should be encouraged. We would also wish to see such disclosure being required under an accrual IPSAS.

In addition, the Cash Basis Standard should provide additional information and examples to guide the identification and presentation of information on third party payments. The Cash

Basis Standard provides no guidance on the most important example of third party payments as described above.

A problem is that it is common practice of development partners to establish separate bank accounts for payments relating to a particular programme of assistance. There is a grey dividing line as to whether such bank accounts are in fact public money of the entity, or are bank accounts not controlled by the entity but used by the development partner for third party payments on behalf of the entity. Factors such as signatories on and control over the use of the bank account need to be taken into account. At present the Standard provides no guidance or examples on how to draw the dividing line.

We consider that the requirement to publish information on third party payments should be moved to Part 2 of the Standard as an encouraged additional disclosure. At the same time there should be improved guidance and examples of applying the concept of third part payments to national government GPFRS. Where appropriate, this requirement should also be included in the accrual IPSASs.

2.2 Information on external assistance

There are very specific requirements in Section 10 of Part 1 of the Cash Basis Standard on the disclosure of information about external assistance. Sections 64-93 in Part 2 of the Standard encourages yet more disclosure.

Accrual IPSAS 23 on Non-Exchange transactions refers to external assistance, but there are no specific disclosure requirements. The example in the implementation guidance to IPSAS 23 discloses information on a specific example of external assistance, but this is only under the general requirement to disclose major classes on non-exchange transactions. There is no general accrual IPSAS requirement to disclose information on external assistance.

Furthermore, the requirements for disclosure of information on external assistance are difficult to fulfil. This is one of the areas where Cash Basis GPFRS typically fail to fully comply with the Cash Basis Standard.

It is our view that the requirements for disclosure of information on external assistance should be moved to Part 2 of the Cash Basis Standard as an encouraged additional disclosure.

3. Issues making the Cash Basis standard difficult for full implementation by national governments

2.1 Consolidation

The Cash Basis Standard requires the preparation of consolidated statements for all controlled entities. For sovereign governments this will include some or all of:

- Not-for-profit entities, agencies and Funds that are under the control of central government

- Government Business Enterprises (GBEs, referred to as Public Corporations in the IMF Government Financial Statistics Manual (GFSM)) and their subsidiaries
- Sub-national levels of government if these fall within the definition of controlled entities, and in such cases entities, agencies, funds and GBEs controlled by sub-national levels of government.

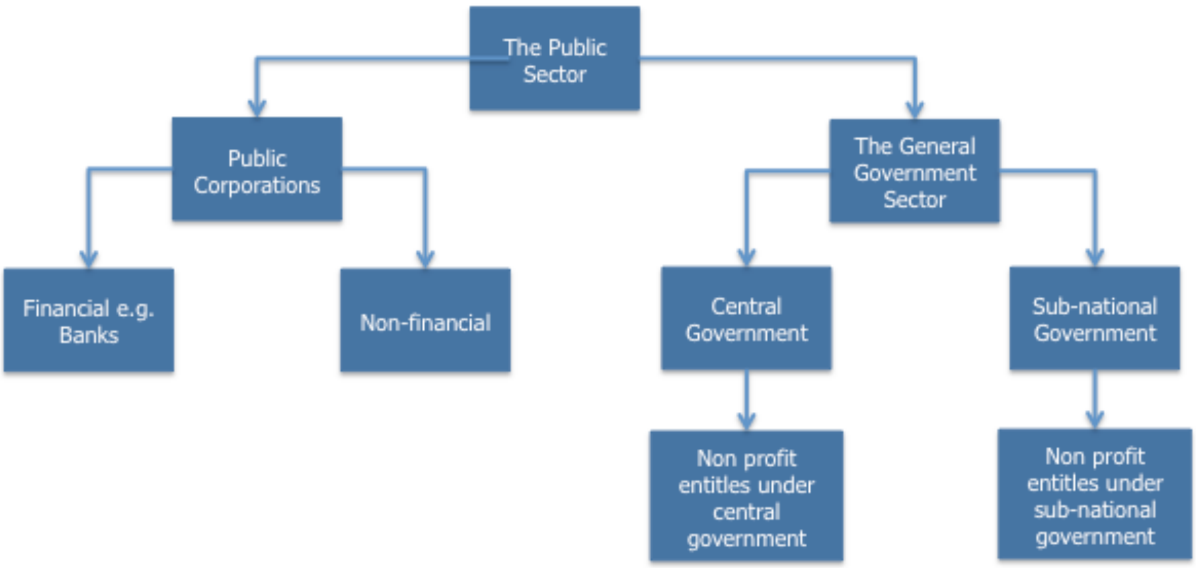
This Cash Basis consolidation requirement is consistent with the accrual IPSAS other than that it is based on IPSAS 6, which has now been replaced by IPSAS 35.

There are a number of reasons why implementing the consolidation requirements of the Cash Basis standard has proved so challenging:

1. It is technically difficult to consolidate entities that report in an accrual basis (as is likely to be the case with GBEs) with government entities that report on a cash basis. Published GPFRS of the GBEs will not provide a detailed analysis of cash flows in a format consistent with the government cash chart of accounts. Additional unpublished analysis of the cash flows may be difficult to obtain and will lack the reliability of audited GPFRS.
2. Countries reporting under the Cash Basis may not have the skills or resources to carry out technically complex consolidations and may doubt the value of allocating limited resources to this task.
3. The consolidation structure under the GFSM is simpler than the IPSAS structure, being based on administrative structures, and may take precedence over IPSAS consolidation in terms of government priorities.

The GFSM consolidation structure is summarised in Figure 2 below.

Figure 2: GFMS Consolidation Structure



Under accrual IPSAS 22 it is permitted to provide additional statements consolidating the General Government Sector (GGS) as defined in the GFSM. In fact for most countries reporting under the Cash Basis a GGS consolidation provides a more feasible option to consolidation based on control.

It is our view that the present Cash Basis standard consolidation requirements are so onerous that it is unlikely that most countries reporting under the Cash Basis standard will ever be able to meet the requirement. Making GGS consolidation an option would be more feasible, but then the Cash Basis Standard would not be consistent with the accrual IPSAS.

Hence it is our view that the whole of the consolidation requirement should be moved to Part 2 of the Standard as an encouraged disclosure. Furthermore, since Part 2 is more flexible, consolidation could be encouraged on either the control basis (as in IPSAS 35) or on the GGS basis (as in IPSAS 22).

3. Other issues

3.1 Format of the Receipts and Payments (cash flow) Statement

Paragraph 2.2.1 of the Cash Basis Standard states "*An entity which intends to migrate to the accrual basis of accounting is encouraged to present a statement of cash receipts and payments in the same format as that required by International Public Sector Accounting Standard (IPSAS 2), "Cash Flow Statements*". Presumably in other situations the format used in the examples in the Appendix to the Cash Basis standard is envisaged.

It is our view that the format of the presentation should always be in the IPSAS 2 cash flow statement format for the following reasons:

1. The model in Figure 1 above indicates the need for consistency between accrual IPSAS and Cash Basis Standard presentation as far as feasible
2. The cash flow statement format provides useful information for fiscal management - the traditional receipts and payments format is less useful
3. The cash flow format is largely consistent with GFSM cash flow statement format.

It is our view that instead of the existing paragraph 2.2.1 the Standard should more simply require presentation of the receipts and payments in a format consistent with IPSAS 2 cash flow statement.