

EURO PEAN

PUBLIC SECTOR ACCOUNTING

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(EDS.)**

IMPRESA DA
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In the public sector there are a range of assets for which there is no market and so it is difficult to assign a value. These include heritage assets and infrastructure assets (such as roads and railways). In the case of many heritage assets the original cost price may also not be available.

10. Importance of public audit report

In the private sector, the audit process adds credibility to the financial statements indicating that they were subject to independent scrutiny. The stakeholders, primarily the shareholders, are given assurance that the financial statements, including a range estimates, provide a reasonable ('true and fair') view of the level of profit that has been earned.

In the public sector the audit report is probably more important than the financial statements, in terms of public accountability:

- it indicates where there have been budgetary or other irregularities;
- it may indicate other ways in which financial management has not been optimal – performance or value for money failures.

So the publication of public sector financial statements will rarely result in coverage in the media, but the publication of the annual and other reports of the Auditor-General may lead to some press coverage.

At least under the cash basis of accounting, public sector financial statements do not include any estimates. The amount of revenue received and the amounts paid to contractors for capital contracts should be known accurately, as long as the year-end cut-off regulations have been followed properly (this should be confirmed by the auditors). In contrast, comparable figures in private sector financial statements (or under the accrual basis of accounting) are based on estimates of, for example, the useful life of an asset being used to calculate the annual depreciation.

11. The problem of externalities

The government of each state has wider responsibilities than a private sector company and may have to deal with externalities created by the private sector, such as the following:

- inequality and unemployment;
- environmental pollution;
- dealing with major disasters and private sector failure;
- insurance responsibility of last resort.

As an example, the banking crisis of 2008 resulted in huge expenditures for many governments. This included supporting the banking sector and taking over some major banks including their liabilities. This had a significant impact on the finances of some governments and led to a period of austerity or reduced government expenditure which has now lasted over a decade. However, the liabilities that crystallised in 2008, had not been included in the balance sheets of the concerned governments. Even if they could have been foreseen, they could not have been estimated reliably and so could not have been included in the balance sheets.

In the private sector, in contrast, the liabilities of a company are known more accurately and so can be included in the balance sheet.

11.1. Heritage or Community Assets

Heritage or community assets are held and maintained principally for their contribution to knowledge and culture rather than for providing services. These may include ancient remains, museums, art galleries, national monuments, etc. These assets are held in trust for future generations. They do not have readily obtainable historic costs nor market values. In many cases they are unique and the government is not able to sell or dispose of the assets.

Private sector companies do not hold this type of asset so we cannot look to private sector accounting practice to determine how such assets should be accounted for.

Governments should perhaps report whether these assets have been properly maintained and indicate the cost of regular maintenance if this has not been undertaken.

11.2. Public goods

Another set of goods which are not found in the private sector is public goods. These are goods that are both non-excludable and non-rivalrous. Individuals cannot be effectively excluded from their use and use by one individual does not reduce availability to others. Thus it is not possible to charge directly for the use of such goods as no-one can be excluded from the benefits of such assets. Many public services have at least elements of being public goods. These include, for example, the police and army. Everyone benefits from these services and no-one can be excluded from this benefit.

Other public services may also be considered to be public goods and are underprovided if they were to be only provided by the private sector. This includes public education and health. There are wider benefits to these services than just the individuals who are being educated and treated. Society at large suffers if charges are made for such services and so their take-up is reduced. Public health campaigns and inoculations benefit the whole of the public and not just a few individuals.

So public goods should be provided universally and equitably to the whole of the public. It is not clear how private sector style financial statements can demonstrate these requirements and so public goods provide another challenge to the adoption of private sector approaches to financial reporting.

12. Conclusion

A leading British PSA academic summarised the differences between private and public sector accounting as follows:

The essential difference between the two sectors must be acknowledged. Public accountability is not well served by financial statements that focus on the interests of investors, and public sector assets frequently do not give rise to future cash inflows. On the other hand, fiscal control and compliance is important in the public sector, but is not in the commercial sector. Furthermore, the adoption of [private sector accounting approaches] emphasises financial accounting and external reporting to the neglect of budgeting and cost analysis that have traditionally been important aspects of public sector accountability.²⁷

The argument about whether the public sector should adopt private sector approaches to financial reporting has been taking place for hundreds of years. There has been a largely successful push by the professional accountancy profession (IFAC, national accountancy bodies and professional firms) for the adoption of accrual accounting over the last thirty years and they have benefited handsomely from the introduction of these reforms.

However, due to the differences between private sector and public sector accountabilities, private sector approaches to accounting have to be significantly adapted to be suitable for the public sector.

Rather than adopting private sector approaches, specific additional information could be provided within public sector financial statements to meet the particular public sector accountability requirements.

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Discussion topics

- As a citizen of your country, what types of information would you find it useful to find in the financial statements for your government?
- Why do you think that some governments have adopted the accrual basis of accounting (private sector approach) in the last couple of decades?
- How important do you think equity is? Should financial statements indicate the government's success in reducing inequality in a society? How important is intergenerational equity? Can this be demonstrated in government financial statements?
- Who do you think are the people who read public sector financial statements? When did you last review the financial statements of your government? What information should public sector financial statements include?
- Why do you think that most investors consider that Government debt is a very safe investment?
- Consider the above two diagrams indicating the processes for private and public sector entities. What are the key differences that may be important for accountability and financial reporting?
- How should we account for public sector externalities? To what extent do you think that public externalities should be included as liabilities in public sector balance sheets?
- What should the starting point be for the reform of public sector financial reporting? The financial statements developed for the private sector or what refinements are needed to provide useful information at reasonable cost?

CHAPTER 4

BUDGETS AND BUDGETARY ACCOUNTING

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SUMMARY

This chapter describes various approaches to budgeting, which is the traditional essence of public sector accounting. This includes budget planning and budget-linked accounting. The roles and functions of budgets are presented as well as the ideas and practices of both traditional budgets and modern variants such as output- and performance-based budgets.

KEYWORDS

Budget planning, budgetary accounting, budget models, types of appropriations

1. Introduction

In the public sector, the traditional core area of financial decision-making and management is related to budgeting and budget implementation. Elected representative bodies are the ultimate decision-makers in a democracy. One elementary part of this role is the budget power of the representative body.

The duty to be publicly accountable is more significant in government than in business financial reporting. As a consequence of the accountability of public administration to citizens and to their representative bodies (parliaments, councils, etc.), the principles of publicity and transparency are important in budgetary and financial reporting. This includes the lawful and regular behaviour of budget entities, compliance with the approved budget and striving to provide as much value as possible with the entrusted collective resources. Instead of the narrower profitability assessment in the private sector, in the public sector, the many-sided performance and value-for-money assessments are crucial.

Public sector budget structures and accounting conventions have been shaped by national practices. It is just lately that harmonisation pressures have emerged. Public sector accounting (PSA) is nowadays shaped more than ever before by international accounting standards, in addition to domestically developed accounting conventions. However, this international standardisation is more targeted to general-purpose financial statements than to budgets, and even this phenomenon is at an early stage in many countries.

In this Chapter 4 we first explain in Section 2 the budgetary accounting as one part of PSA. Section 3 is devoted to functions and principles of budgets such as the publicity and transparency principle. This is followed with a description of traditional annual budgets and modern variants such as budget appropriations in Section 4 and budget-linked budgetary accounting in Section 5. The last section gives a conclusion.

2. Budgetary accounting in the family of PSA systems

The **budgetary accounting** approach emerges from the agreed budget in the public sector. Bookkeeping must follow the logic and structure of the budget regarding the allocation of income and expenditure to the correct budget codes. If the budget is cash-based, then the follow-up bookkeeping must also be cash-based. If the budget is accrual-based, then the follow-up bookkeeping must also be accrual-based.

Cash-based budgeting and accounting can achieve money control purposes in the public sector. Accrual budgeting means spending measured on a cost basis rather than on a cash basis.¹ Accrual budgeting and accrual accounting also serve the need for management information with their steering and control functions.

Link between budgeting and accounting

The chart of accounts for budgetary accounting is derived from the budget structure. Budget entities may establish more detailed accounts as subaccounts to those accounts derived from the budget for management accounting and intra-organisational steering and control purposes.

If budgetary accounting and the financial accounting are on the same basis, these two accounting systems can be merged into one serving both budget reporting and financial statement reporting purposes. For instance, if the budget is on an accrual basis, the entries made during the year into the ledger make up a double-entry system that generates both the budget outturn reports (budget statements) and accrual based financial statements.

3. The functions and principles of budgets

Budgets in the public sector have several purposes. Annual legal budgets are normally supplemented with medium- to long-term strategic multi-year plans. These are typically less legally binding, but more strategic than annual budgets. They contain policy decisions regarding financing priorities, service provision priorities, etc.

Annual budget plans involve short-term planning by nature: they are financing and resource allocation tools for public sector entities. Available financing and resources are allocated to each department, unit and activity inside the organisation. Budgets contain not only allowed amounts

¹ Schick (2007), p. 118.

governmental accounting at federal and central state levels has been intended from 2010 onwards. However, the implementation of accrual accounting is challenging, as the Finance and Personnel Statistics Law requires cash-based information. States with accrual accounting systems thus have to report cash basis information for finance statistics purposes also. Currently, only three federal state governments (i.e. Bremen, Hamburg and Hessen) have implemented accrual-based accounting systems so far.⁹

Another reason for Germany's reluctance are high costs associated with the implementation of IPSAS (expected up to 2.3 billion Euro).¹⁰ Besides that, it is being criticised that IPSAS are not suitable for key functions of public sector accounting, for example, taxing and social welfare, and that they are too complex. German officials also question whether it makes sense to assess the value of unsaleable assets like streets or pedestrian ways.¹¹ Supporters of IPSAS are worried about Germany's restraint, as they argue that a powerful country like Germany could be a role model for other countries to implement IPSAS.

7. Empirical Studies on IPSAS adoption

A number of scholars have already investigated the emergence of international accounting harmonisation in the public sector. First, there are various papers having investigated why governments or organisations decide to adopt IPSAS. Referring to European countries, studies found that a government's decision to adopt IPSAS is influenced by a desire for *high-quality financial information*. For example, an international survey among accounting officials from American and European countries found that governments decide to adopt IPSAS due to *international comparability* and improved *quality of financial reporting systems*.¹² Findings from

⁹ Müller-Marqués Berger and Heiling (2015).

¹⁰ KPMG (2019).

¹¹ Deloitte (2012).

¹² Brusca and Martínez (2016).

another multi-country study indicate that accounting experts appreciate the facilitation of the *consolidation of financial statements*.¹³

Scholars have also examined why governments refuse to adopt IPSAS. Antipova and Bourmistrov (2013) explain a lack of accounting harmonisation by *path dependency* in accounting tradition. According to Oulasvirta (2014), Finland does not apply IPSAS due to a *lack of pressure to change*. Findings from Christiaens et al. (2015) indicate that the *fear of losing standard-setting authority* holds countries back from IPSAS adoption. *Costs* of implementation and adapting the national accounting standards to IPSAS are a further hampering factor.¹⁴

Second, studies have examined the effectiveness of IPSAS adoption. Based on survey data from 29 National Accounting Standard Setters (NASS) in Continental European, Anglo-American and Scandinavian countries, Bolívar and Galera (2016) conclude that fair value accounting (FVA) increases the usefulness of government financial statements for information users. Although the adoption of FVA is associated with higher costs, it improves government financial statements in terms of understandability, transparency, and accountability. In terms of harmonisation of public sector accounting in the EU, Pontoppidan and Brusca (2016) found that, instead of *international* accounting harmonisation, EU member states are prone to *regional* governance, meaning that European Public Sector Accounting Standards (EPSAS) are developed (for more details please see **Chapter 14**).

8. Conclusion

With the aim of harmonising public sector accounting at a global level, the IPSASB has been developing International Public Sector Accounting Standards, shortly IPSAS, from 2004 onwards. The application of a common set of public sector accounting standards by public sector entities

¹³ Christiaens et al. (2015).

¹⁴ Brusca and Martínez (2016).

aims at implementating an accrual-based accounting system, achieving comparability and consistency of financial information both among countries and across government levels, and improving accounting information for better decision-making. Applying IPSAS is associated with a higher level of transparency in government accounting and financial reporting that in turn positively relates to accountability and oversight control. Due to higher quality of financial information, decision-making processes and assets and liability management is assumed to be improved. Enhanced government financial statistical information further benefits the recognition of risks, opportunities, cost awareness and efficiency.

Next to various benefits associated with the evolution of a common set of public sector accounting standards at a global level, numerous challenges should not be neglected. Implementing IPSAS is associated with an organisational change so that innovation barriers such as negative attitudes toward change (e.g., resistance to change), a lack of tangible resources including IT platforms or financial capacities, and insufficient task knowledge and experience on how to implement a new accounting system can challenge a successful adoption. Nevertheless, international reporting on basis of IPSAS provides an opportunity to increase the quality of financial reporting results, enhance international comparability and improve decision making by government.

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Discussion topics

- What is the nature of the harmonisation of accrual accounting?
- What are the benefits of IPSAS?
- How to cope with organisational reluctance in applying IPSAS?

CHAPTER 8
IPSAS CONCEPTUAL FRAMEWORK AND
VIEWS ON SELECTED NATIONAL FRAMEWORKS

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SUMMARY

This chapter is about conceptual frameworks in public sector accounting, particularly addressing the IPSAS conceptual framework. While taking this as a reference, the chapter also offers brief views on selected national frameworks from a group of European countries—namely the UK, Finland, Austria, Germany and Portugal—, as illustrative examples of how conceptual frameworks can approximate or diverge from that of IPSASB.

The explanations enable an understanding of the role of a conceptual framework underlying public sector accounting standards, as well as the main issues normally included in it.

KEYWORDS

financial information, users, qualitative characteristics, elements of financial statements, measurement criteria

1. Introduction

The beginnings of accounting conceptual frameworks (CFs) may be found in the 1930s in the USA, originating in the accounting profession. A clear attempt to reach an accounting theory was the American Accounting Association 1966 “*A Statement of Basic Accounting Theory*” (ASOBAT)¹. However, it was not before 1973, with the creation of the Financial Accounting Standards Board (FASB), that accounting conceptual frameworks began to be discussed and developed across countries, starting from the Anglo-Saxon world.

FASB’s CF, started in 1973, was the major and most complete one, comprising several statements on a wide range of financial accounting and reporting matters (e.g., objectives of financial reporting, qualitative characteristics of accounting information, elements of financial statements, recognition and measurement in financial statements, and presentation of financial statements). This work has inspired others, such as those from the Accounting Standards Committee in UK, and more recently, that from the International Accounting Standards Board (IASB).

As to public sector accounting (PSA), the origins of its CFs come from the USA as well, being derived from those of business accounting, at least in the last forty years. Separating between federal accounting and governmental accounting for state and local level, the latter followed, since the 1930s, principles and standards issued by a national council (currently the Governmental Accounting Standards Board – GASB). However, at the beginning of the 1980s, FASB, which was concerned explicitly with business organizations, started to concern itself with nonbusiness organizations too, issuing a statement on the objectives of financial reporting by nonbusiness organizations, conflicting with GASB’s responsibilities². Nowadays, GASB focuses on state and local government accounting, including non-for-profit public sector units. Since its establishment in 1984, GASB has initiated its own CF, starting from the FASB’s framework; currently, some important

¹ Jones (1992).

² Jones (1992).

pronouncements are GASB Concept Statements no. 1 (1987), no. 4 (2007) and no. 6 (2014). At the federal level, there is the Federal Accounting Standards Advisory Board (FASAB) *Handbook of Federal Accounting Standards and Other Pronouncements* (2012), including the Statements of Federal Financial Accounting Concepts no.1 to no.7.

While, in principle, there should be only one commonly accepted (financial) accounting theory, historically derived from practice, it is acknowledged that, even within business accounting, developing a single generally accepted accounting CF is not easy. Additionally, considering that accounting is to be a purposive activity, aimed at producing and reporting information that must be useful for somebody to do something,³ the development of accounting CFs has been based on approaches considering the users of financial accounting reports and their needs,⁴ which, in turn, are determined by the context where they act. Environment is deemed to determine the objectives of accounting information and consequently other dimensions of the accounting CF.⁵

This explains why, although based on business accounting, specific CFs (as standards) have been especially derived and developed for PSA. Even those who argue for ‘one single world of accounting’ recognize that there might be context specifics determining PSA particularities, hence requiring its CF to reflect differences (e.g., different concepts and different interpretations of principles), at least at a detailed level, from the one for financial accounting overall.

Accordingly, though deriving from the IASB’s CF, the IPSASB (2014) published a specific CF for PSA, considering the following public sector specific characteristics⁶:

- The primary objective of delivering public services – rather than to make profits and generate a return on equity for investors; requires

³ Jones and Pendlebury (2010).

⁴ Jones (1992).

⁵ Vela Bargues (1992).

⁶ See IPSASB (2014, preface).

- information beyond financial position, financial performance and cash flows, to properly evaluate the performance of public sector entities;
- Non-exchange transactions (e.g., taxes and grants) – the involuntary and compulsory nature of major contributions makes accountability an overriding purpose of GPFs;
 - A budget to be accomplished – considering the budget as an instrument of public policy and a law, GPFs must report on the budget (public policies) accomplishment;
 - Nature of the programs and longevity of the public sector – financial statements have to be complemented with information allowing the assessment of sustainability in the long run, and the going concern principle cannot be assessed only by the net financial position;
 - Nature and purpose of public sector assets and liabilities – there are infrastructure and other public domain assets (e.g., heritage, military assets) difficult to measure and with no market; entities assume certain liabilities in order to provide a public service (e.g., the provision of social benefits);
 - The regulatory role of public sector entities – in order to safeguard public interest or bring the market to function; judgment is required to evaluate whether the regulatory role creates assets or liabilities;
 - Relationship to statistical reporting – public sector accounts, namely concerning the General Government Sector, are input for the National Accounts and Government Financial Statistics – convergence is needed but differences remain.

In the European context, some diversity can be found regarding public sector accounting CFs. While the UK is IFRS-based (e.g., *The Government Financial Reporting Manual – FreM*, revised on an annual basis), in Continental countries there are some IPSASB's adopters (e.g., Spain, Portugal, France and Austria), whereas others are based on deeply-rooted national traditions, even though some concepts of the IPSASB's might be adopted (e.g., Germany and Finland).

This chapter continues discussing the definition and role of a CF and the authority of the IPSASB's CF over the standards or recommended

a revaluation is to be done annually. If insignificant annual changes occur, then a revaluation every 3-5 years is sufficient. Even if using the revaluation model, items with a definite useful life still need to be depreciated. Also, it needs to be stressed that the revaluation model applies to the entire class of PPE to which the revalued asset belongs (IPSAS 17.51, with the exception of impairments under IPSAS 21 and 26). Thus, a simultaneous revaluation of all assets in that class of PPE has to be undertaken. Also, the adjustment of the accumulated depreciation after revaluation is to be done for the entire class of assets (IPSAS 17.50).

The accounting treatment of the revaluation method can be a sophisticated matter. An example is shown in Figure 10.2 with the reporting periods depicted on the abscissa and the carrying amount on the ordinate axis.

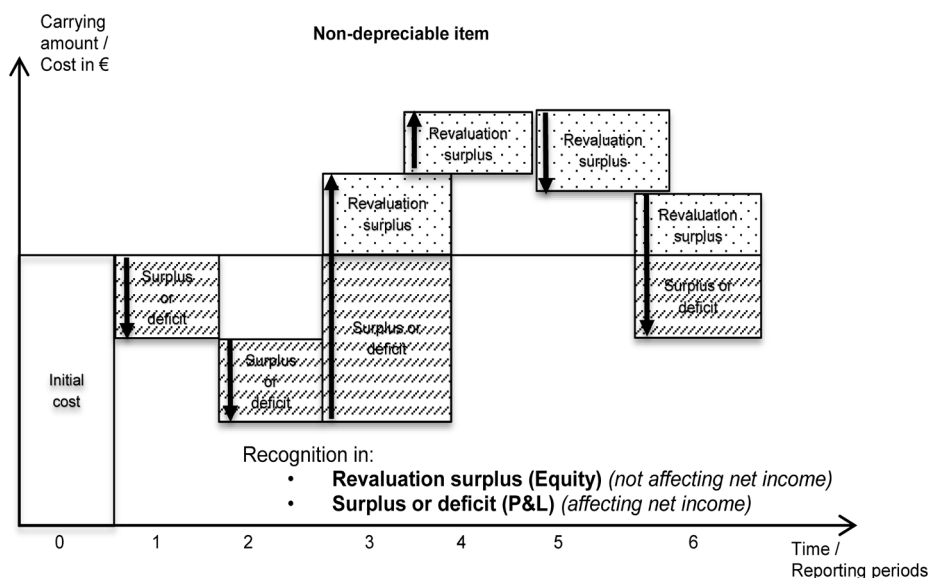


Figure 10.2: Revaluation model: Accounting treatment of revaluation surpluses / deficits

For reasons of simplicity, an example of a non-depreciable item is drawn, which might be, e.g., a piece of land, as land has an unlimited useful life. The graph shows revaluation amounts that have to be accounted for directly in equity without changing net income in the dotted areas (“Revaluation

surplus”). The diagonally striped areas depict revaluation amounts that are accounted for through “surplus or deficit” (i.e. profit and loss), and thus will change net income. In this example, after initial recognition in the first two reporting reports, the revalued amount lies below the initial cost of the item, i.e. there is an impairment loss. In this case, the revaluation decrease shall be recognized in the surplus or deficit, leading to a reduction in the net income of the public entity in these years. In years 3 and 4, the value of the item increases, so that the revalued amount even lies above the initial cost. In this case the revaluation surplus has to be split. First, to the extent that the revaluation reverses a revaluation decrease (i.e. impairment loss) previously recognised in surplus or deficit, it has to be recognized in surplus or deficit. The remaining amount, i.e. the difference, that exceeds the initial cost is to be recognized directly in net assets. Here, the reverse of revaluation even does not only refer to one specific asset, but to the entire class of assets (IPSAS 17.54). If in year 5 the revalued amount goes down below the initial cost again, first the revaluation surplus is to be reversed, and second the remaining amount is to be recognized in surplus or deficit.

To summarize subsequent measurement so far, for both assets with a definite useful life and those with an indefinite useful life, there is the option to choose between the cost model or the revaluation model. Regardless of the approach for subsequent measurement selected, for assets with a definite useful life, a scheduled depreciation has to be accounted for. When using the revaluation method, for both assets with a definite useful life and those with an indefinite useful life, a revaluation depending in the determined frequency has to take place.

In addition, to each of these variants regardless of the useful life of an asset, it has to be tested for impairment, i.e. whether there is a loss in the future economic benefits or service potential of an asset, over and above the systematic recognition of the loss of the assets depreciation. With respect to impairment. IPSAS 17.79 distinguishes between cash generating and non-cash generating assets and this differentiation is a public sector specific one, because IFRSs do not regard such situations. Cash generating assets are held by the public entity with the intention to generate cash inflows independent of other assets (IPSAS 21.16). Therefore, the asset is presented like by a

profit-oriented company, such as rented buildings or managed forests. For impairment of these assets IPSAS 26 has to be applied. Non-cash generating assets are all assets other than cash generating assets (IPSAS 21.14), as these are acquired with the intention to deliver services to the public (IPSAS 21.18): e.g., streets, public buildings, and fire trucks. Specifically, for the impairment of non-cash generating assets, IPSAS 21 has been developed by the IPSASB, as there was no comparable IFRS to be referenced to.

The general procedure of testing for impairment is basically the same under IPSAS 21 and 26. In a first step, at the reporting date, a check for an indication of impairment has to be done. Accordingly, external and internal sources of information are listed in IPSAS 21.27 and 26.25¹⁰. The check for such indications is not to be conducted for intangible assets with indefinite useful lives or intangible assets not yet available for use or goodwill, as for these assets there is an obligation for an impairment test once a year. Secondly, if there is any indication of impairment, the impairment test is initiated by measuring the recoverable service amount (IPSAS 21) or the recoverable amount (IPSAS 26), respectively. Thirdly, the recoverable (service) amount is compared with the carrying amount of the asset: if the recoverable (service) amount lies below the carrying amount, an impairment is to be recognized.

For non-cash generating assets under IPSAS 21, the recoverable service amount is the highest of the fair value less costs to sell and the value in use. If one of the amounts exceeds the asset's carrying amount, the other does not need to be calculated (IPSAS 21.36). For the fair value less costs to sell, the best evidence would be the asset's price in a binding sale agreement in an arm's length transaction, or current bid price at an active market. As this will hardly be measurable for typical public sector assets, an alternative is a disposal amount, e.g. recent transactions for similar assets not within a forced sale. The value in use, i.e. the present value of an asset's service potential, can, according to IPSAS 21 be determined by using one of three methods:

¹⁰ Including the respective Implementation Guidance (IG).

- 1) Depreciated replacement cost approach:** Cost to replace the asset's gross service potential, which is determined as the lower of the reproduction or replacement cost (less accumulated depreciation) (IPSAS 21.45 ff.);
- 2) Restoration cost approach:** Cost of restoring the service potential to its pre-impaired level, which is determined by subtracting the estimated restoration cost of the asset from the current cost of replacing the remaining service potential of the asset before impairment (IPSAS 21.48);
- 3) Service units approach:** Value of the reduced number of service units from the asset in its impaired state, determined by reducing the current cost of the remaining service potential of the asset before the impairment to conform with the reduced number of service units expected from the asset in its impaired state (IPSAS 21.49).

For cash generating assets under IPSAS 26, the recoverable amount is the highest of the fair value less costs to sell (comparable to the IPSAS 21 definition) and the value in use. The value in use is determined by an estimation of the future cash in- and outflows expected to be derived from the use of the asset and its ultimate disposal. Here the appropriate discount rate to those future cash flows has to be applied, which is a sophisticated issue (IPSAS 26.AG3).

If the (accumulated) impairment loss of the previous period has decreased in the next period, a reversal of impairment is to be recognized (IPSAS 21.67/26.102). However, the maximum of reversal is the amount as if no impairment loss existed (IPSAS 21.68, IPSAS 26.106). A reversal of impairment is to be recognized in surplus or deficit (IPSAS 21.68, 26.108). Also the depreciation charge needs to be adjusted afterwards.

Examples of how to handle the accounting treatment for PPE under IPSAS 17, 21 and 26 are provided in chapter 11.

4. Accounting for revenue from non-exchange transactions

IPSAS 23 addresses accounting for revenue from non-exchange transactions, which is a specific public sector matter. Whereas in the private sector, the majority of transactions has an exchange character, the public sector mainly finances its activities by means of taxes or transfers,¹¹ i.e. by non-exchange transactions. Due to this reason, there is no IFRS that deals with this type of transactions and therefore the IPSASB developed an own standard as the accounting treatment of revenue from non-exchange transactions is not trivial. Also, recently, IPSAS 42 ‘Social benefits’, i.e. a specific form of expenses from non-exchange transactions, has been published. In addition, an IPSASB project on further expenses from non-exchange transactions (collective and individual services and emergency relief) is currently ongoing. Furthermore, as Müller-Marques Berger and Wirtz (2018) highlight, concessionary loans and public guarantees are partially addressed in IPSAS 28, 29 and 41.

4.1. Definition of non-exchange transactions

The scope of IPSAS 23 and the corresponding definitions are provided in IPSAS 23.5-23.7. Here, non-exchange transactions are defined as transactions in which a public entity receives/pays resources and provides/receives no or nominal consideration (IPSAS 23.9). Nominal costs are either insignificant or symbolic. The scope of IPSAS 23 covers (1) taxes and (2) transfers. **(1) Taxes** are economic benefits or service potential compulsorily paid or payable to the public entity other than fines or other penalties (IPSAS 23.7). Taxes represent revenues to the public sector entities. **(2) Transfers** are inflows from non-exchange transactions, other than taxes, such as cash or non-cash assets, debt forgiveness, bequests, donations, goods and services in-kind (IPSAS 23.7).

¹¹ IPSASB (2018) Preface to the IPSASs, 10.(b).

4.2. Recognition of elements to be recorded in non-exchange transactions

In order to account for revenue from non-exchange transactions, the following flowchart can be applied as shown in Figure 10.3¹².

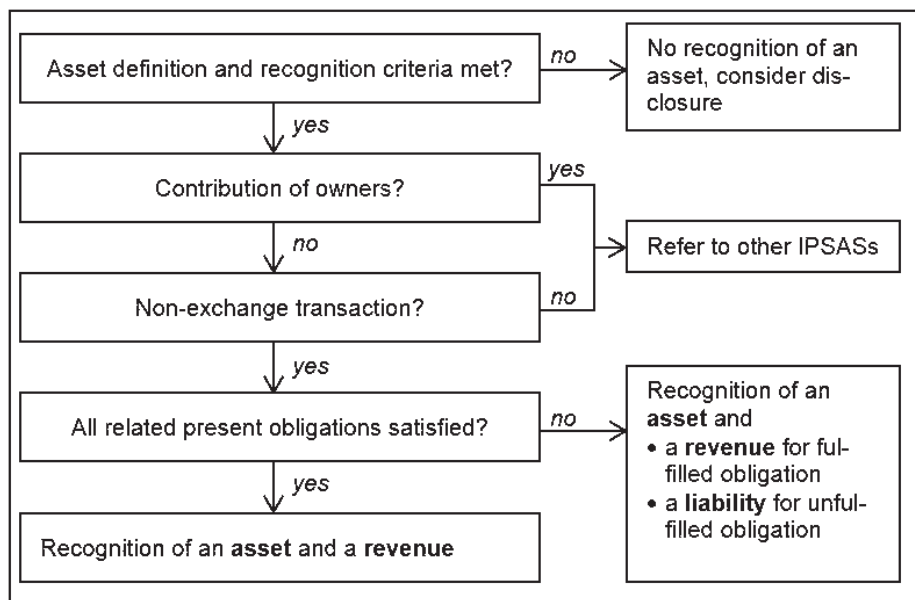


Figure 10.3: Flowchart of accounting for non-exchange transactions (IPSAS 23)

First, an assessment is needed, whether for the item acquired the asset definition (IPSAS 1.7) and recognition criteria (IPSAS 23.31) are met. If this is not the case, an asset is not recognized, but maybe a disclosure is to be done. If an asset was acquired, it needs to be verified whether it was a contribution of owners (IPSAS 23.37) as defined in IPSAS 1.7. If so, other IPSASs are referred to. In the other case, it is to be checked whether it was a non-exchange transaction as otherwise other IPSASs apply. If the transaction meets the definition of a non-exchange transaction (IPSAS 23.9-10), the next question is whether all related obligations to the transaction

¹² See also IPSAS 23.29 and Müller-Marques Berger and Wirtz (2018) in Adam (2018), p. 398.

have been fulfilled, i.e. if there are not any conditions on the transferred asset (IPSAS 23.17). If there are no conditions, i.e. no present obligations, an asset and a revenue in the surplus or deficit is to be recognized (IPSAS 23.44). Otherwise, an asset and a revenue for the fulfilled obligation and a liability for unfulfilled obligations are to be recorded. In fact, a liability is a deferred revenue, i.e. a revenue with conditions. It becomes revenue in the surplus or deficit as the obligations are accomplished.

A specific question with respect to recognition is the point of time in which to recognize particular taxes. According to IPSAS 23.34, taxes are to be recognized at the taxable event, i.e. the event that the public entity has determined to be subject to taxation (IPSAS 23.7). This is, e.g., the event of earning of assessable income during taxation period for income tax, undertaking of a taxable activity during a taxation period for the value added tax, the movement of dutiable goods across customs boundary for customs duty, or passing of the date on or for which the tax is levied for property tax. As the taxable event and the payment of taxes often take place at different points in time, in the statement of financial position, also advance receipts – revenue deferrals (for prepayments) and tax receivables – revenue accruals (for subsequent payments) need to be considered (IPSAS 23.27-28).

4.3. Measurement of the elements to be recorded in non-exchange transactions

The asset is to be initially measured when the public entity gains control over the asset (substance over form), at fair value. For subsequent measurement, other IPSASs, e.g., IPSAS 17 (PPE) or 16 (Investment property) apply. The revenue is to be measured at the amount of the increase in net assets (also fair value). The liability is recognized if its definition and recognition criteria are fulfilled; it is measured at the amount to settle the obligation as of the reporting date.

5. Accounting for service concession arrangements: Grantor

IPSAS 32 is a further standard developed for the specific use by public sector entities that act as the grantor in such constellations.¹³

5.1. Definition of service concession arrangements and assets

A service concession arrangement is defined as a binding agreement between a grantor and an operator, whereby the operator uses an asset to provide a public service on behalf of the grantor for a specified period of time, and the operator is compensated over the service concession period (IPSAS 32.8). Thereby, the so called service concession asset can alternatively either be a) provided by the operator, who constructs, develops or acquires the asset for the grantor or an existing asset of the operator, or b) provided by the grantor as an existing asset of the grantor or an upgrade to such an asset (IPSAS 32.8).

Table 10.1 provides an overview of examples of service concession agreements and assets based on IPSAS 32.

Agreements	Assets
Provision of toll roads	Roads, bridges, tunnels, etc.
Hospital operation	Hospitals (land & buildings, etc.)
Facility management, e.g. cleaning services	Machines as cleaning facilities, etc.
Transportation services	Busses, trains, etc.
Utilities, e.g. water supply, telecommunication services	Water pipe lines, telecommunication networks

Table 10.1: Examples for service concession arrangements (IPSAS 32 IE)

¹³ Still, it mirrors IFRIC 12 for the private sector and the operators.

5.2. Recognition of elements to be recorded in service concession arrangements

The service concession arrangement has to be recognized by the grantor if the following conditions are cumulatively fulfilled (IPSAS 32.9). The grantor controls or regulates which services are provided, to whom these are provided, and what is the price of delivery. In addition, the grantor must control any significant residual interest in the asset, at the end of the term of the arrangement. In addition, a liability is recognized together with a new service concession asset, except for cases in which the service concession is an existing asset of the grantor, therefore only needing reclassification (IPSAS 32.14).

5.3. Measurement of elements to be recorded in service concession arrangements

Initial measurement of the service concession asset is at fair value at the time of recognition (IPSAS 32.11), except for cases in which an existing asset of the grantor is only reclassified (IPSAS 32.12). For its subsequent measurement, the IPSAS relevant for the specific asset are to be applied, namely IPSAS 17 for PPE or IPSAS 31 for intangible assets.

The liability is initially measured at the same amount as the asset. For subsequent measurement, depending on the type of compensation is obligation of the grantor to pay, two alternative models have to be distinguished: (1) the financial liability model, and (2) the grant of a right to the operator model. In the following, the models¹⁴ are explained and two examples are drawn to highlight the differences in accounting treatment for the grantor, i.e. a public entity.

(1) The **financial liability model** is prevalent if the grantor has an unconditional obligation to pay for the construction, development,

¹⁴ Also, a mixed model by dividing the agreement is possible (IPSAS 32.27). However, this is not explained in this chapter.

acquisition or upgrade of the asset (IPSAS 32.18). As such, the operator is compensated for the asset by a payment of the grantor, and not by the parties who receive the service delivered with the asset. The subsequent measurement is recorded as follows: when the financial liability model is applied, the payment of the grantor is distinguished between an asset component, which also leads to a reduction of the liability, a finance charge, i.e. the cost of capital and a service component, which covers the charge for delivering the service (IPSAS 23.21). Finance charge and service component are accounted for as expenses (IPSAS 23.22). If the service charge and the finance charge are not separately identifiable, the payment is to be allocated relative to the fair values of the asset and the revenues (IPSAS 23.23). Applying this model approximates the recognition of a financial leasing contract.

An example

A private operator provides transportation services on behalf of a public entity, using busses controlled by the public entity. The operator receives fixed payments from the public entity, which prescribes the services and prices. As such the financial liability model is prevalent and the asset and a liability have to be recognized. The initial measurement of the asset, i.e. the busses, takes place at fair value of the busses, whereas for subsequent measurement, according to IPSAS 17, there is the option to choose between the cost or the revaluation model. The busses are assets with a definite useful life, so these are to be depreciated and regularly assessed for indications of impairment. Correspondingly to the asset, also the liability is to be initially measured at the fair value of the busses. In each reporting period, the payment to the operator is divided into an asset component and a service component (plus interest), whereas the asset component annually reduces the liability.

(2) For the **grant of a right to the operator model**, there is no unconditional obligation to pay by the grantor to the operator. Instead, the operator is given the right to earn revenue from third-party users or another asset (IPSAS 32.24). Thereby the transaction, a revenue is earned by the operator. Together with the asset and a liability (which is a deferred revenue) at the initial recognition, a revenue is afterwards also

Money measurement: The common accounting convention is to measure transactions with (constant) monetary terms.	125
Multi-year budget: An approved budget for more than one year. It excludes published forward estimates or projections for periods beyond the budget period.	97
Net assets/equity consolidation: Consolidation task to offset (eliminate) the carrying amount of the controlling entity's investment in a controlled entity and the controlling entity's portion of the net assets/equity of the controlled entity.	327, 358
New Public Management: The approach to public sector management adopted by some governments in recent decades that emphasises efficiency, encourages privatisation and outsourcing and the adoption of private sector style management tools by public sector entities.	48, 65, 75, 83
Non-controlling interest (NCI): Also referred to as minority interest. Specifically used in relation to controlled entities included in consolidated financial statements to specify the interest in net assets that is held by outside investors rather than the controlling entity preparing the consolidated financial statements. The outside investor's share of ownership in net assets gives them no influence on how the company is run. The outside investor's portion of the surplus or deficit and net assets/equity of a controlled entity has to be disclose separately.	232, 313 ff., 351 f.
Non-exchange transactions: Transactions in which a public entity receives/pays resources and provides/receives no or nominal consideration (IPSAS 23.9).	80, 172, 258, 266, 294
Notes: Additional financial and non-financial information that complements the financial statements within GPFR, helping users to better understand, interpret and place in context the information reported in the different financial statements (e.g. statement of financial position or of cash flows). They should include also a summary of the main accounting policies.	239, 254
Original budget: The initial approved budget for the budget period.	110
Periodicity: This means that the life of an accounting entity must be divided into constant periods, usually into one-year periods, for reporting purposes.	125

Power: Consists of existing rights that give the current ability to direct the relevant activities of another entity (IPSAS 35.14). 311, 314, 343

Private sector accounting: The style of external financial accounting adopted by not state-owned for profit companies that includes a profit and loss accounting indicating the annual profit earned by the company and a balance sheet that indicates how its debts will be funded in cases of bankruptcy or insolvency. The private sector might encompass charities and non-profit organisations. 30, 75, 79 f., 145

Property, plant and equipment: Tangible (i.e. physical) assets for the purposes of production or supply of goods or services, administrative purposes or rental to others, which are expected to be used during more than one reporting period (i.e. as non-current assets) (IPSAS 17.13). 255 ff., 278 ff.

Prudence principle: Two notions exist. Cautious prudence means care in e.g. estimating budget incomes so that they are not exaggerated and care in estimating budget expenditures so that they are not underestimated. Asymmetric prudence means that e.g. unrealized losses are recognized, but not unrealized gains. Asymmetric prudence is one of the core principles for preparing financial statements in Germany, whereas the cautious prudence notion prevails in IPSAS financial statements. 99, 131

Public sector accounting: The means by which governments, ministries, departments and agencies record, analyse and report their economic transactions. It depends on the system of accounting and accounting technique used. In some jurisdictions, it includes a comparison of cash receipts and payments actually undertaken in comparison with the annual budget approved by parliament. 48, 75, 164

Public sector: All institutional units, resident in the economy that are controlled by government, including social security funds (ESA 1.35). 30

Qualitative characteristics: Attributes financial information must fit the main objectives of accounting. Qualitative characteristics are principles that might interact and must be outweighed against each other. Qualitative characteristics of elements of IPSAS financial statements should ensure for usefulness of the information provided for several users, namely for the purposes of accountability and decision making. Examples are neutrality, comparability and timeliness. 124, 182, 185, 194 ff., 201, 209

Realisation: Refers to the initial recognition of revenue. Revenues can only be realised after they have been earned. They are earned and only recognized e.g. in sales transactions in that point or period in time, when the underlying goods associated with the revenues have been delivered or the services have been provided.	128, 131, 328 f.
Recognition criteria: Features to be accomplished by an item in a transaction, in order to include that item in the financial statements. Usually, recognition criteria relate to the definition of an element in the financial statements, such as asset, liability, revenue or expense. In order to be included as such, the definition and recognition criteria must be fulfilled. The latter include the reliability of the measurement.	155, 207 ff.
Regularity auditing: A type of auditing in a government or public sector entity, aiming at assessing conformity with legal form, assuring propriety and probity (explicit in the law) of records of transactions, and transactions themselves. Regularity audits also include assessing whether transactions conform with the budget or not. They are generally carried out by Supreme Audit Institutions (SAI), following rules from the International Organization of SAI (INTOSAI).	246 f.
Replacement cost: The price that would be paid to acquire an asset with equivalent ability to generate economic benefit or service potential in an orderly market transaction at the measurement date.	34, 127, 137
Reporting entity: A government or other public sector organization, program or identifiable area of activity of the public sector, that prepares GPFs; it might not have juridical/legal personality (IPSASB CF 4.1, 4.4).	34, 146, 155, 217 ff.
Reporting unit: The entity, formally or informally existent, that produces reporting.	154, 337
Resource: An item with service potential or the ability to generate economic benefit (IPSAS CF 5.7).	196 ff., 220 f., 254, 294
Separate financial statements (SFS): Financial statements presented in addition to consolidated financial statements or in addition to financial statements by an investor that does not have controlled entities but has investments in associates or joint ventures (IPSAS 34.7).	337

Service concession arrangement: Binding agreement between a grantor and an operator, whereby the operator uses an asset to provide a public service on behalf of the grantor for a specified period of time; and the operator is compensated over the service concession period (IPSAS 32.8).	270, 297
Service concession asset: Asset which is alternatively either a) provided by an operator, who constructs, develops or acquires the asset for the grantor or an existing asset of the operator or b) provided by the grantor as an existing asset of the grantor or an upgrade to an existing asset of the grantor (IPSAS 32.8).	270, 297
Service potential: An asset's capacity to provide services that contribute to an entity's objectives (without necessarily generating net cash inflows) (IPSAS CF 5.8).	198 ff., 203, 256
Settlement amount: This is the amount at which an asset could be realised or a liability could be liquidated with the counterparty, other than in an active market.	134, 136
Significant influence: Power to participate in the financial and operating policy decisions of another entity but, is not control or joint control of these policies (IPSAS 38.8).	312, 345
Single entry bookkeeping: Simple bookkeeping technique, in which each transaction is only recorded once, with no counterpart entry; generally associated to the cash-basis accounting regime, in single entry only cash inflows and cash outflows are recorded.	39, 123
Stakeholders: The key groups of people that a private sector company or a public sector entity are accountable to for the quality of their management.	81 f., 88
Sustainability Reporting: Process of delivering an overview of an economic, environmental and social performance of an organization consisting of financial and non-financial information, but in contrast to Integrated Reporting. The Global Reporting Initiative (GRI) is a global de facto standard setter for sustainability reports.	34

Taxation: The main source of public sector or government income; mandatory payments to be made on the receipt of income by a person or company or for a variety of other reasons including purchase or ownership of land or property.	48, 51, 54, 86 f., 268
Taxes: Economic benefits or service potential compulsorily paid or payable to a public sector entity other than fines or other penalties (IPSAS 23.7), but such as the receipt of income by or for a variety of other reasons.	51, 268
Transfers: Inflows from non-exchange transactions other than taxes such as cash or non-cash assets, debt forgiveness, bequests, donations, and goods and services in-kind (IPSAS 23.7).	266
Transparency: Unfettered access by the public to timely and reliable information on decisions and performance in a reporting entity.	144, 164, 224 ff., 245, 378
Treasurer: The government official who is responsible for the Treasury, may be the most senior financial official in a government or the Ministry of Finance.	48, 50
Treasury: The central department in the Ministry of Finance which is responsible for collection of receipts, making payments, recording these transactions and ensuring liquidity and taking care of financial planning.	48, 50, 58 f.
Users of GPFR: Several addressees of the financial reporting in a broad sense, who usually do not have the power to require (individually tailored) specific purpose reporting to satisfy their financial information needs. They are, e.g., citizens, the Parliament, investors in markets, national statistics institutes and the media.	132, 190, 245

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