Introduction to IPSAS

The Handbook of International Public Sector Accounting Pronouncements is the primary authoritative source of international generally accepted accounting principles for public sector entities.

Agenda

- Introduction to IPSAS
- Introduction to Assets
- Introduction to Property, Plant and Equipment
- **Morning Break**
- Introduction to Liabilities
- Introduction to Revenue

Who is the IPSASB?

- Independent standard-setting board
- 18 members; international composition; meetings and materials public
- Objective:

  Strengthening public financial management and knowledge globally through increasing adoption of accrual-based IPSAS by:

  – Developing high-quality public sector financial reporting standards;

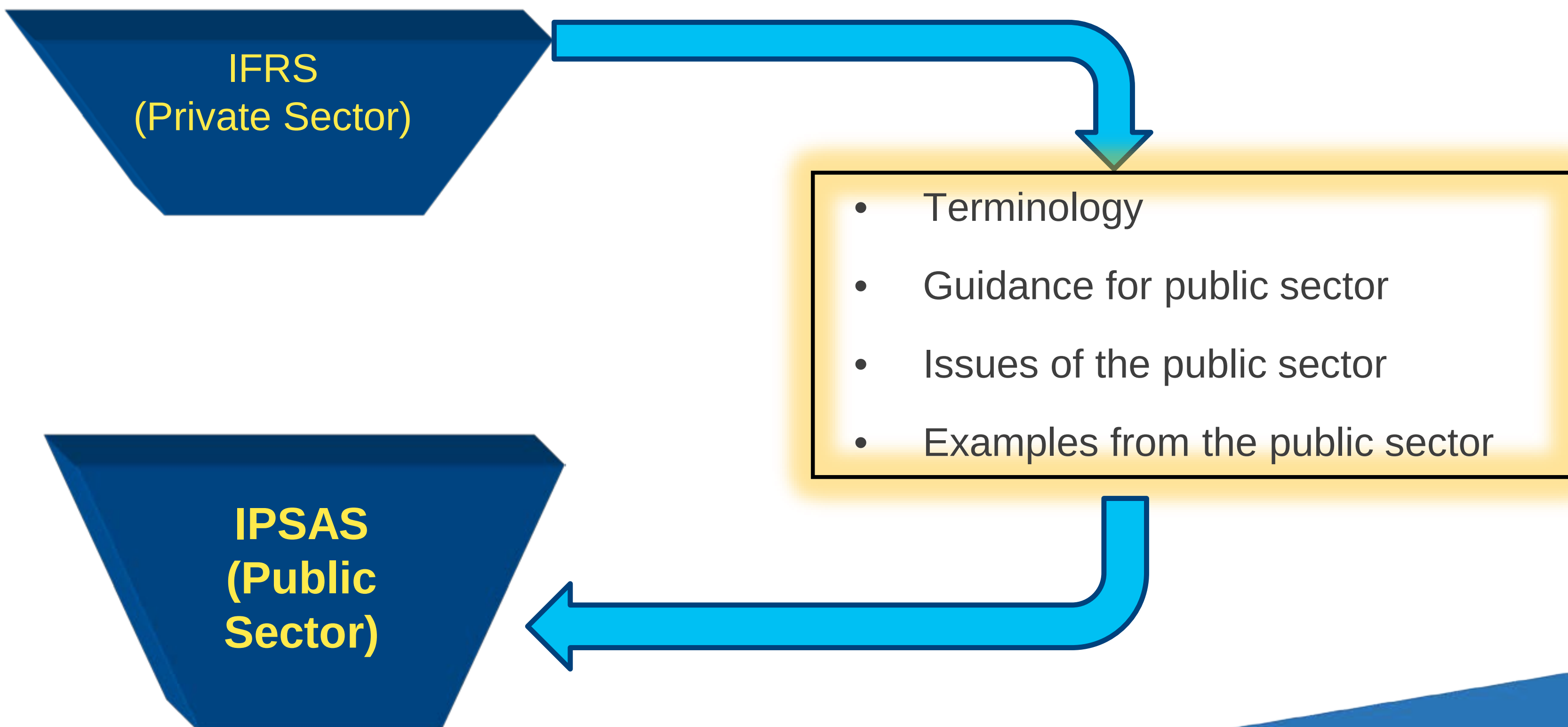
  – Developing other publications for the public sector; and

  – Raising awareness of IPSAS and the benefits of their adoption.

What are IPSASs?

- Authoritative standards for preparation of general purpose financial statements
- Developed to apply to all public sector bodies
  - national, regional and local governments
  - component entities (other than commercial public sector entities)
  - International organizations (many apply IPSASs)

Converged with IFRSs



IPSAS Due Process

Required

- Research – relevant international and national standards and practices
- Develop and publish exposure draft – usually 4 month comment period
- Consider responses and amend draft standard as appropriate
- Final IPSAS

Public consultation paper may be issued before ED at IPSASB's discretion

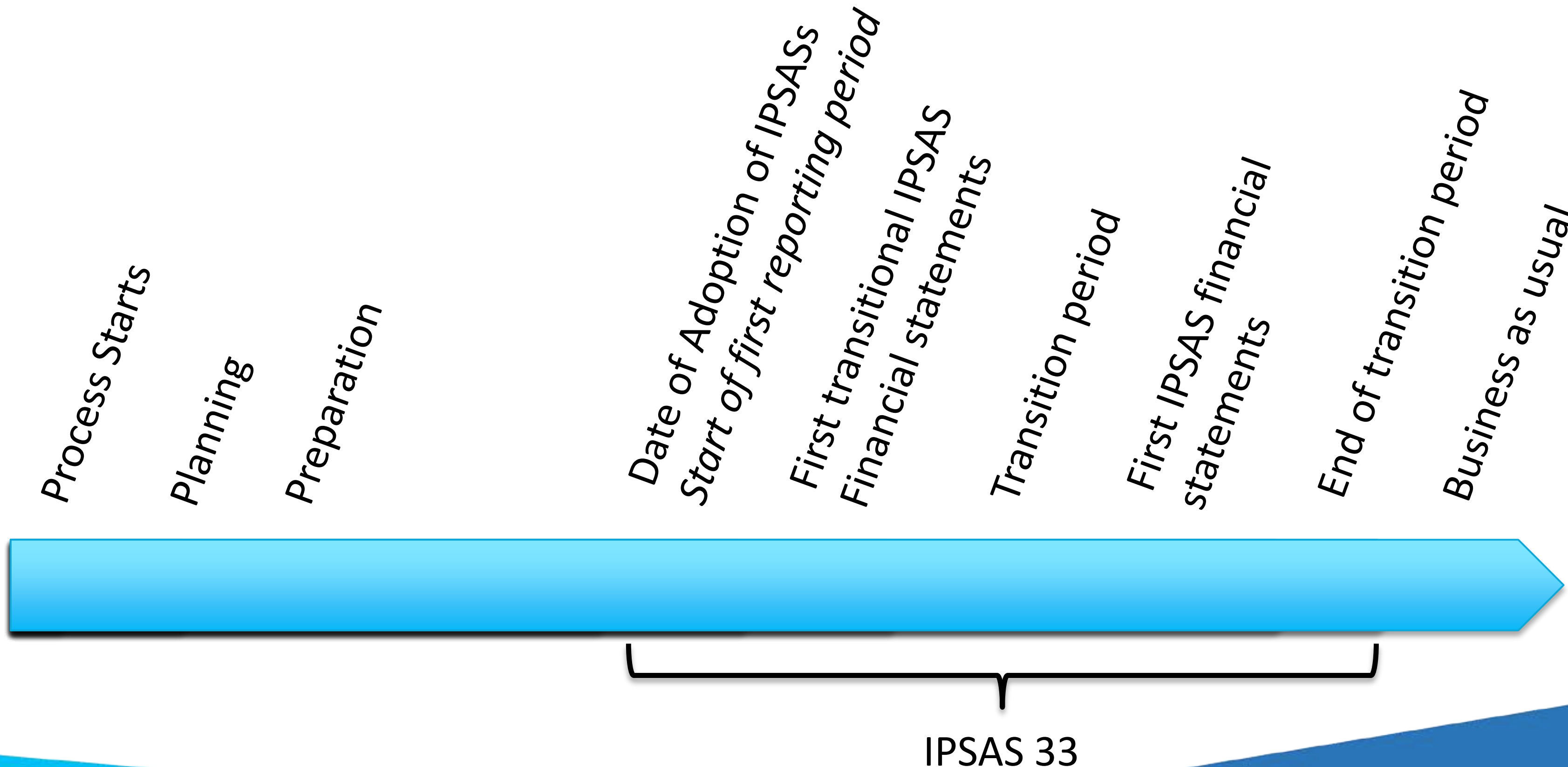
Current Consultations

- ED 59 – Amendments to IPSAS 25, *Employee Benefits*
  - (April 30, 2016)
- ED 60 – Public Sector Combinations
  - (June 30, 2016)
- ED 61 – Amendments to Financial Reporting under the Cash Basis of Accounting (the Cash Basis IPSAS)
  - (July 31, 2016)

Transitioning to Accrual Accounting

- Transition date
- IPSAS 1 – Comparative information in first IPSAS financial statements
- IPSAS 3 – Retrospective application when impracticable
- IPSAS 33 – Exceptions from other IPSASs during transition period
  - Transition period is up to three years

IPSAS 33 – Scope and Definitions



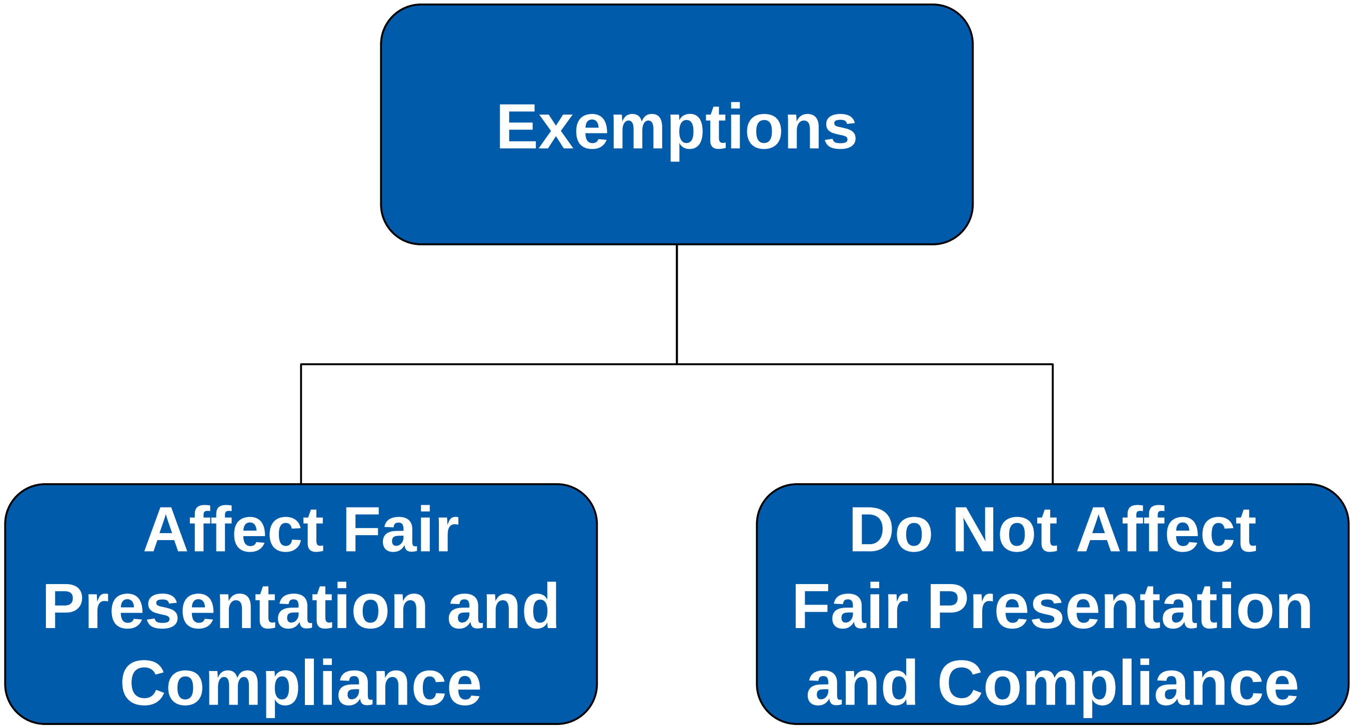
IPSAS 33 – Fair Presentation and Compliance with IPSASs

- A first-time adopter's first IPSAS financial statements shall fairly present: the financial position, financial performance, and cash flows of the entity

- Some exemptions affect fair presentation and compliance with IPSASs
  - If using these exemptions, prepare transitional IPSAS financial statements

- Consider materiality in assessing fair presentation and compliance

IPSAS 33 – Optional Exemptions



Three year transition period

IPSAS 33 – Exemptions affecting Fair Presentation and Compliance

- Three year exemption for recognizing and/or measuring assets and liabilities:
  - Inventories
  - Investment property
  - Property, plant and equipment
  - Defined benefit plans and other long-term employee benefits
  - Biological assets and agricultural produce
  - Intangible assets
  - Service concession assets and related liabilities
  - Financial instruments

IPSAS 33 – Exemptions affecting Fair Presentation and Compliance

- Three year exemption for recognizing and measuring non-exchange revenue
- Exemptions where related assets / liabilities not recognized or measured
  - Borrowing costs
  - Leases
  - Provisions, contingent liabilities and contingent assets
- Related party disclosures
- Interests in other entities

Application of materiality

- IPSASs need not be applied when the effect of applying them is immaterial
- An item is material if it’s omission from or misstatement in the financial statements could influence the discharge of accountability by the entity or the decisions that users make on the basis of the financial statements
- The concept of materiality is considered in deciding
  - Whether items need to be recognized
  - The application of a particular accounting policy
  - What items should be disclosed in notes

Introduction to Assets

Typical public sector assets

- Financial assets (monetary assets)
  - Cash and cash equivalents
  - Revenues receivable
  - Loans and advances receivable
- Non-financial assets
  - Physical assets (non-monetary assets)
    - Inventories
    - Property, plant and equipment
  - Intangible assets
    - Computer software

Definition of an Asset

- A resource **presently controlled** by the entity as a result of a **past event**.

As set out in ED of public sector conceptual framework

Asset Recognition of Criteria

An item that meets the definition of an asset should be recognized if:

- It is probable that any future service potential or economic benefit associated with the asset will flow to the entity; and
- The cost or fair value of the item can be measured reliably

Is a road an asset?

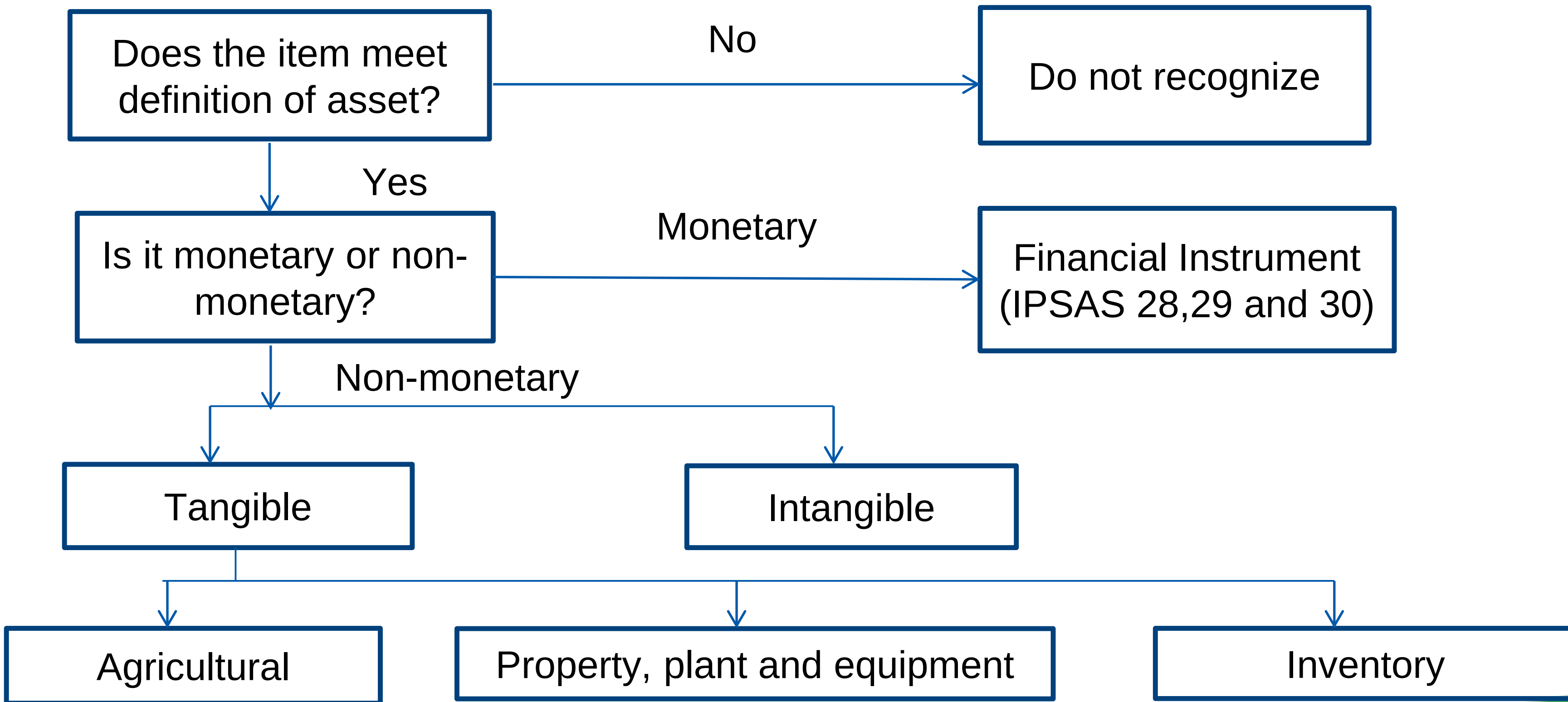
- A public sector entity owns and maintains a network of roads in its jurisdiction.
- The residents and general public have access to the roads for their general use.
- Are the roads an asset of the public sector entity? Why or why not?

Is the convention center an asset?

A senior level of government maintains a convention center within the boundaries of a local government. The local government benefits from the economic activity generated by the center through increased property assessments and higher tax revenues .

Should the local government report the convention center as an asset? Why or why not?

Decision Tree



Property, Plant and Equipment
IPSAS 17

Definition of PP&E

- PP&E are tangible items that:
  - Are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
  - Are expected to be used during more than one reporting period.
- Specialist military equipment and infrastructure assets meet the definition

Recognition Principle

- The cost of an item of property, plant, and equipment recognized as an asset if:
  - It is probable that future service potential or economic benefits associated with the item will flow to the entity; and
  - The cost or fair value of the item can be measured reliably.

Initial Measurement

- An item of PP&E that qualifies for recognition as an asset is measured at its cost
- Elements of cost includes
  - Purchase price (including import duties/taxes net of trade discounts and rebates)
  - Costs directly attributable
  - Estimate of obligations associated with retirement, disposal or abandonment
- Cost of an item acquired in a non-exchange transaction is its fair value at acquisition date

Measurement Example

A municipality has acquired land and a building to be develop into a parking structure. The building is to be demolished.

- How would the acquisition be accounted for? Explain

The property is used temporarily for surface parking pending construction.

- Is the surface parking operation part of the cost of the new parking structure? Explain

Measurement after Initial Recognition

- **Cost model** - property, plant, and equipment is carried at its cost, less any accumulated depreciation and any accumulated impairment losses.

- **Revaluation model** - property, plant, and equipment is carried at a revalued amount, being its fair value less any subsequent accumulated depreciation, and subsequent accumulated impairment losses.

Comparison of Models

	Cost Model	Revaluation Model
Initial recognition	Cash price or equivalent or fair value at date of acquisition	
Subsequent	Original cost	Fair value at date of revaluation
Carrying Amount	Original cost less accumulated depreciation and impairment losses since recognition	Revalued amount less accumulated depreciation based on revalued amount and impairment losses subsequent to revaluation date

Depreciation

- All PP&E except land is subject to depreciation
- The depreciable amount of an asset is expensed on a systematic basis over its useful life to surplus or deficit for each period unless it is used in carrying amount another asset
- Depreciation begins when an asset is in operation
- Reviewed at each annual reporting date
- Each significant component is depreciated separately

Depreciation Example

A government has a water treatment facility with the following components:

Component	Cost (CU)	Expected Life
Building envelop	2,000,000	40 yrs
Roof	500,000	15 yrs
Pumps	1,000,000	10 yrs
HVAC System	500,000	15 yrs

Assuming was in service Jan 1, 20x0, no residual value and straight line depreciation, what is depreciation for year ended of Dec 31, 20x0?

Derecognition

- The carrying amount of PP&E is derecognized:
  - On disposal
  - When no future service potential or economic benefits is expected from its use

– Gain or loss on derecognition is included in surplus or deficit

– A replaced component is derecognized

PP&E Primary Disclosures

- For each class
  - The measurement bases
  - The depreciation methods
  - The useful lives or the depreciation rates used
  - Gross carrying amount and accumulated depreciations at beginning and end
  - Reconciliation of opening and closing balances
- Specific disclosures for the revaluation model
- Other disclosures e.g. restrictions on title, contractual commitments etc.

Borrowing Costs – IPSAS 5

- “Benchmark treatment” - borrowing costs expensed in the period incurred
- “Allowed alternative treatment” - borrowing costs directly attributable to acquisition of qualifying asset included in cost
- Qualifying asset is one that takes a substantial period of time to get ready for its intended use (PP&E, some inventories, intangible assets)
- Guidance provided on which costs are eligible

Impairment – IPSAS 21 and IPSAS 26

- A loss in future economic benefits or service potential in excess of depreciation
- Assessed at each reporting date
- IPSAS 21, *Impairment of Non-Cash Generating Assets* or IPSAS 26, *Impairment of Cash Generating Assets*
  - A cash -generating asset is held with the primary objective of generating commercial return
  - Non-cash-generating assets are all other assets
- Asset is written down to recoverable amount if impaired

Indicators of Impairment

Technological, legal, or policy changes

Obsolescence/physical damage

Change in use

Cessation of construction

Poor economic/service performance

Non-Cash Generating

No demand/need for services

Cash Generating

Decline in market value

Increased market interest rates

Liabilities

Typical Liabilities

- Accounts payable and accrued expenses
- Long term debt
- Provisions
- Pensions and other employee benefits
- Unearned revenues
- Transfer payments payable
- Lease obligations
- Bank loans, and other short term debt

Liability Definition

- A **present obligation** of the entity for an **outflow of resources** that results from a **past event**.

As set out in ED of public sector conceptual framework

Liability Recognition Criteria

An item that meets the definition of a liability should be recognized if

a) it is probable that there will be an outflow of service potential or economic benefits from the entity

b) the item has a cost or fair value that can be measured with reliability

Provisions – Definitions and Recognition

Provisions – liabilities of uncertain timing or amount

Contingent liabilities – possible obligations to be confirmed by occurrence of future events

Accounts Payable	Accruals	Provisions	Contingent Liability
Recognize liability	Recognize liability	Recognize liability	Disclose

↔ Certainty Continuum ↔

Illustrative Example

At the reporting date legal proceedings have been commenced seeking property and punitive damages from a municipality for injuries from an accident. It is alleged the municipality was negligent in maintenance of the road. Legal counsel advises there is a 30% probability that the municipality will be held liable.

- Should the entity recognize a provision or disclose a contingent liability ? Explain
- Does the answer change if, at the next period end, the probability is assessed as (a) remote or (b) 60% ? Explain

Measurement of Provisions

- Amount recognized is best estimate of the expenditure required to settle the present obligation at the reporting date
- Best estimate is the amount an entity would rationally pay to settle the obligation or to transfer it to a third party at reporting date
- Uncertainty is dealt with by various methods
  - Expected value
  - Individual most likely outcome

Illustrative Example

A government has a legal obligation to remediate a contaminated site. A site assessment has determined two options. The most likely outcome is containment. There is a chance that contamination will have to be removed and treated. Possible outcomes are in the table.

	Estimate	Probability
Option A - Containment	CU 2 million	70%
Option B – Removal	CU 10 million	30%

What is the amount of the provision? Explain

Present Value

- Estimate based on the present value when time value of money is material
- The discount rate used reflects
  - current market assessments
  - risks specific to the liability
- Does **not** reflect risks for which future cash flow estimates adjusted
- Increase in PV due to passage of time is recognized as an interest expense

Future Events

- The estimate of the provision should reflect expected future events
- Future events may be
  - inflation
  - changes in technology
  - cost reductions due to experience
  - new legislation

Other Measurement Issues

- Gains from disposal of assets not considered in estimate of provision
- Reimbursements by another party
  - a separate asset (not offset against liability)
  - not to exceed provision
  - expense may be presented net

Changes in Provisions

- Provisions reviewed at each reporting date
  - adjusted to reflect current best estimate
  - reversed if not probable settlement required
- Change in provision is change in estimate made prospectively (current year result)

Illustrative Example

On January 1, 20X0, an entity puts a nuclear power generation plant in service at cost CU 100 million. There is a legal obligation for decommissioning the plant at the end of its useful life and ongoing management of contaminated material from operations. The plant is depreciated over 40 years on straight line basis.

a) Should the entity recognize a provision? Why or why not?

b) If yes, what should the basis of measurement be? Why?

Disclosures

For each class of provision

a) Opening and closing carrying amount
b) Additional provisions or increases in provisions
c) Amounts used
d) Amounts reversed
e) Increase in present value from the passage of time
f) Effect of a change in the discount rate
g) Description of nature and timing
h) Uncertainties and major assumptions
i) Expected reimbursements

Revenue: Introduction

Learning Objective

- IPSAS 9, *Revenue from Exchange Transactions*
- IPSAS 23, *Revenue from Non-Exchange Transactions*
- At the end of this session you are able to
  - distinguish between exchange and non-exchange revenues
  - apply the requirements for identification, recognition and measurement of revenues
  - apply the presentation and disclosure requirements for reporting revenues

Definition of Revenue

- **Increases** in the **net financial position** of the entity, ***other than*** increases arising from **ownership contributions**.
- All items of revenue included in surplus or deficit for the period
- Excludes amounts collected as an agent and financing inflows
- When collection not probable expense recognized

Illustrative Example

A municipality collects property taxes on behalf of the state. During the year it billed residential and commercial property taxes of CU 1,116,644 million. Of that amount, CU 527,442 was billed on behalf of the state.

How much would it report as revenue? Explain

1. CU 1,116,644
2. CU 589,202

Types of Revenue

Revenue

- Exchange Transactions - one entity receives assets or services, or has liabilities extinguished, and directly gives equal value to another entity
- Non-Exchange Transactions - one entity gives/receives value from another without directly getting/getting equal value in exchange
  - Taxes
  - Transfers

Recognizing Non-Exchange Transactions

- Analyze non-exchange transactions
  - Do resource inflows meet definition and criteria for recognition of an asset
  - Is there a performance obligation that requires recognition of a liability
- Measured at the amount of increase in net assets
- Inflow is probable and fair value measurable
- Outflow is probable and amount estimable

Accounting for Announcement

A senior level of government has made an announcement that it will include additional operating funds in its next budget for local housing authorities to allow them to increase subsidies to low income families.

Do local housing authorities have an inflow of resources that meet the definition of an asset as a result of the announcement? Explain

Accounting for Transfers

Stipulations
Expectation/understanding on how resource to be used

Conditions	**Restrictions**
Consume as specified or return	Consume as specified

- The timing of revenue recognition is determined by the nature of the stipulations and their settlement.

Characteristics of Conditions

- An outflow of resources will be probable, and performance against the condition is required and is able to be assessed
- Condition enforceable and in cases of breaches, it would be enforced
- Performance is assessable and monitored - specifies
  - the goods and services to be provided or assets to be acquired
  - the periods within which performance is to occur

Illustrative Example

A national government provides funds to a provincial government entity subject to the stipulation that the entity raise a matching contribution. The funds are returnable to the national government if it fails to raise the matching contribution.

Is the stipulation a condition that would result in recognition of a liability?

Accounting for Taxes

- Entity that imposes taxes recognizes the assets when
  - taxable event occurs
  - recognition criteria satisfied
- Taxable event – event subject to taxation
- Assets measured at fair value at acquisition date - best estimate of the inflow taking into account
  - probability resources will flow
  - fair value of resultant assets
- Revisions accounted for in current period

Illustrative Example

A national government levies a tax on the income of individuals. The fiscal period of the government and the tax year end is December 31. Taxpayers have until April 30 of the following year to file their tax return, and until June 30 to pay any outstanding taxes.

Does the national government recognize an asset and revenue at the fiscal period end? Why?

Questions and Discussion

- Visit the IPSASB webpage
  http://www.ifac.org/PublicSector/