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2018 Review

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ABBREVIATIONS

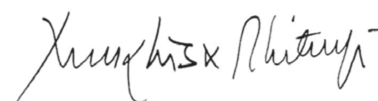
AASB	Australian Accounting Standards Board
ACCA	Association of Chartered Certified Accountants
ACRA	Accounting and Corporate Regulatory Authority
ADT	Accounting Development Tool
AICPA	American Institute of Certified Public Accountants
ASAF	Accounting Standards Advisory Forum
CFO	Chief Financial Officer
CFR	United States Code of Federal Regulations
EEG	Emerging Economies Group
ESMA	European Securities and Markets Authority
FASB	Financial Accounting Standards Board
FSB	Financial Stability Board
FSMA	Financial Services and Markets Authority
GAAP	Generally Accepted Accounting Principles
GFSM	Government Finance Statistics Manual
GPFR	General Purpose Financial Reports
GRAP	Generally Recognized Accounting Practices
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IPSAS	International Public Sector Accounting Standards
IPSASB	International Public Sector Accounting Standards Board
ISAR	Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting
OECD	Organization for Economic Cooperation and Development
PCAOB	Public Company Accounting Oversight Board
PLC	Public Limited Company
SAP	Systems, Applications and Products
SEC	Securities and Exchange Commission
SMEs	Small and Medium-sized Entities
US GAAP	United States Generally Accepted Accounting Principles

PREFACE

The positive role that a strong private sector could play in realizing the Sustainable Development Goals is clear. Large as well as small enterprises need to grow to effectively attain the Goals. The growth of enterprises requires financing from both domestic and foreign sources. Reliable and globally comparable reporting on both the financial and non-financial aspects of the economic performance and financial standing of enterprises is an essential part of the global financial infrastructure. With this in mind, Member States of the United Nations established the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting, to contribute to the global efforts aimed at promoting reliable and harmonized corporate reporting.

As the only intergovernmental body within the United Nations system tasked with carrying out such work, over the last 35 years, the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting has made significant contributions to this field. The annual open and neutral sessions of the Intergovernmental Working Group of Experts bring together policymakers, regulators, standard setters, academics and other interested stakeholders. Over the years, the Intergovernmental Working Group of Experts has addressed a variety of issues, dealing with financial reporting, environmental accounting and reporting, corporate governance and corporate social responsibility, and has pioneered tackling a number of topics, particularly with respect to environmental reporting. The Intergovernmental Working Group of Experts has also contributed to facilitating the financial inclusion of small and medium-sized enterprises by developing accounting and financial reporting guidance suitable for their needs. In recent years, the body developed the Accounting Development Tool – now also commonly known as the ADT. The Tool has enabled a number of Member States to assess their financial and non-financial reporting requirements for enterprises and to align them with global standards and codes in an efficient and integrated manner. Key components of the Tool include the International Financial Reporting Standards and the International Public Sector Accounting Standards.

I congratulate the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting on its thirty-fifth anniversary. It gives me great pleasure to present the 2018 volume of *International Accounting and Reporting Issues*, which provides a review of recent developments in Sustainable Development Goal reporting and of practical implementation aspects of both the International Financial Reporting Standards and the International Public Sector Accounting Standards.



Mukhisa Kituyi
Secretary-General of UNCTAD

INTRODUCTION

At least four decades ago, the Member States of the United Nations noted the importance of a vibrant private sector in building productive capacities, increasing the volume of trade and, ultimately, facilitating the attainment of economic and social development objectives. Enterprises need investment from domestic and international sources to grow their productive capacities and remain competitive in an increasingly integrating global market. Entities that provide reliable and comparable financial statements stand a greater chance of attracting investment. For over 40 years, the United Nations has been contributing to the promotion of reliable and comparable financial and non-financial reporting by enterprises worldwide. To this end, in October 1982, the Economic and Social Council established the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting as a standing body.

The adoption of the 2030 Agenda for Sustainable Development, as articulated in its 169 targets, has had significant implications for enterprises around the world regarding reporting on their performance towards achievement of these goals. In July 2016, during the fourteenth session of the United Nations Conference on Trade and Development, held in Nairobi, UNCTAD launched an initiative involving the selection of a limited number of core Sustainable Development Goal indicators for corporate reporting. Following a series of consultations with key experts in this field and intergovernmental deliberations, at the end of 2018, UNCTAD finalized guidance consisting of core indicators on the performance of enterprises relating to economic, environmental, social and institutional aspects.

In developing the guidance, the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting considered several recent developments, highlighted below, regarding sustainability reporting and the Sustainable Development Goals.

In June 2017, the Task Force on Climate-related Financial Disclosures, which was established by the Financial Stability Board at the request of the finance ministers and central bank governors of the Group of 20, published its final recommendations on forward-looking disclosures on the financial impact of climate change and on the transition to a global lower-carbon economy under the terms of the United Nations Framework Convention on Climate Change. In 2018, the Task Force was endorsed by stakeholders such as Governments, regulators, preparers, investors and professional accountancy organizations. In September 2018, the Task Force published a status report, in which it indicated that 457 companies with a combined market capitalization of US$7.9 trillion and 56 other organizations supported its recommendations on disclosures.

In January 2018, the European Union High-level Expert Group on Sustainable Finance published its final report. The Expert Group report was informed by an industry-led consultation process and included a proposal regarding the establishment of a sustainability taxonomy at the European Union level, integrating environmental, social and governance factors into financial decision-making and upgrading existing disclosure rules to better reflect sustainability risks. The Group recommended that the European Union should endorse the Task Force on Climate-related Financial Disclosures' guidelines as a way of supporting high-quality reporting standards globally, including through further work on sustainable finance at the United Nations.

In March 2018, the European Commission published an action plan on financing sustainable growth. The action plan, which is based on the recommendations of the High-level Expert Group, provides a fitness check of Directive 2014/95/EU on disclosure of non-financial and diversity information, with a view to ensuring its alignment with the recommendations. In the action plan, it is stated that steps will be taken to establish a sustainability taxonomy, beginning with climate change issues. Furthermore, the plan contains several actions on strengthening sustainability disclosure and accounting rule-making in this area, particularly the establishment of a European Corporate Reporting Lab to promote best practices in sustainability reporting, under the umbrella of the European Financial Reporting Advisory Group.

The International Integrated Reporting Council has been promoting the adoption of integrated reporting worldwide. In February 2018, the Africa Integrated Reporting Committee held its inaugural meeting, providing a forum for discussions on the adoption of integrated reporting in the African region, with support from regional and international stakeholders. This initiative, endorsed by stakeholders such as the World Bank and the International Federation of Accountants, provides an example of best practice in the promotion of sustainability reporting in developing countries.

The aim of the Action Platform for Reporting on the Sustainable Development Goals, which is based on continued cooperation between the Global Reporting Initiative and the United Nations Global Compact, is to provide a framework and methodology for companies to report on their Sustainable Development Goal-related performance. The UNCTAD secretariat, as a member of the Action Platform's Multi-stakeholder Advisory Committee, works closely with the Initiative and the Global Compact to ensure coordination and consistency with the UNCTAD project on core indicators, which focuses on a limited number of baseline universal indicators for companies in alignment with the Sustainable Development Goals statistical indicators at a macro level.

The World Business Council for Sustainable Development provides a forum where entities can discuss reporting on the Sustainable Development Goals. One important development that took place during the intersessional period of the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting was the launch of the Reporting Exchange, a tool for navigating the existing sustainability reporting requirements of over 60 countries, encompassing both mandatory and voluntary standards, as well as stock exchange listing requirements.

The World Benchmarking Alliance, which brings together reporting stakeholders and is backed by Aviva Investors, the United Nations Foundation, the Index Initiative and the Business and Sustainable Development Commission, seeks to identify and promote high-quality benchmarks for assessing and comparing the performance of companies regarding the Sustainable Development Goals. In June 2018, the Alliance concluded a consultation phase that covered all the continents and involved stakeholders from both developed and developing countries.

In addition, reports such as the Klynveld Peat Marwick Goerdeler Survey of Corporate Responsibility Reporting 2017, as well as research conducted by the World Business Council for Sustainable Development and the Climate Disclosure Standards Board, provide data insights into the current state of sustainability reporting, in particular regarding further work needed in this area. While most of the world's biggest companies integrate financial and non-financial data into their annual reports, many do not yet acknowledge climate change as a financial risk. The Survey highlights the growing resonance of the Sustainable Development Goals in entity reporting.

The last two decades have been characterized by a proliferation of international standards in the fields of accounting and financial reporting, in both the private and public sectors, auditing, assurance and training and professional qualifications for accountants. Through the Intergovernmental Working Group of Experts, UNCTAD has contributed to efforts to ensure that member States better understand such standards and implement them in a more holistic and efficient manner.

The Intergovernmental Working Group has dedicated a series of annual sessions to discussions on issues arising from the practical implementation of the International Financial Reporting Standards. The UNCTAD secretariat has prepared background documentation and country-case studies designed to facilitate better understanding of and deliberations on such issues. Furthermore, in recent years, the Intergovernmental Working Group has reviewed practical aspects of compliance-monitoring and enforcement mechanisms with regard to corporate reporting requirements and has issued guidance material.

Over the years, delegates at annual sessions of the Intergovernmental Working Group have made successive requests for discussions to be held on the practical implementation of the International Public Sector Accounting Standards. The secretariat accordingly organized a series of technical workshops on this topic. In October 2018, delegates at the thirty-fifth session of the Intergovernmental Working Group discussed issues arising from the practical implementation of international accounting and reporting standards in the public and private sectors.

The present report is comprised of two chapters, the first of which addresses aspects of the practical implementation of the International Financial Reporting Standards, providing an overview of the International Accounting Standards Board and the current state of practical implementation of the International Financial Reporting Standards worldwide. There then follows a review of practical implementation considerations with regard to recently issued standards that will come into force during the current and subsequent financial reporting periods. The second chapter provides a brief background of the International Public Sector Accounting Standards and contains discussion of practical implementation from the regulatory, institutional and technical perspectives.

CHAPTER I.
PRACTICAL ISSUES CONCERNING THE IMPLEMENTATION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS

A. INTRODUCTION

Overview of historical development

The accountancy profession has played a leading role in the globalization of accounting standards, organizing the first World Congress of Accountants in 1904. Ever since that time, the Congress has been held every four years at different locations across the world: most recently in November 2018, in Sydney, Australia. In 1973, sixteen professional accountancy bodies from Australia, Canada, France, Germany, Japan, Mexico, the Netherlands, the United Kingdom of Great Britain and Northern Ireland and the United States of America agreed to form the International Accounting Standards Committee. The Committee issued a number of International Accounting Standards (IAS), publishing interpretations thereof through its Standing Interpretations Committee until February 2001.

In 2001, the International Accounting Standards Committee was replaced by the International Accounting Standards Board (IASB), which adopted its predecessor's standards and published interpretations, renaming them the International Financial Reporting Standards (IFRS).

Prior to the formal establishment of IASB, and while the International Accounting Standards Committee members were voting on the reform of their body in 2000, the European Commission announced that it intended to adopt IFRS as the mandatory comprehensive accounting basis for companies listed on stock exchanges within the European Union. This development somewhat eclipsed the International Organization of Securities Commissions' secondary listing plan and other jurisdictions began to follow the European Union in adopting IFRS as their primary reporting basis.

This trend was given further impetus by the decision of the Securities and Exchange Commission in 2007 to recognize IFRS as equivalent to United States Generally Accepted Accounting Principles (US GAAP).[1] This meant that foreign companies using IFRS for their main financial statements and registered with the Securities and Exchange Commission for a secondary listing in the United States of America did not have to provide a reconciliation to US GAAP, thus saving a considerable amount of time and money. Currently, more than 500 IFRS-applying entities are registered with the Commission.[2]

Current state of International Financial Reporting Standards and their adoption around the world

The European Union adopted IFRS in 2005, rapidly followed by Australia, New Zealand and South Africa. Argentina, Brazil, Canada and the Republic of Korea have also done the same. Japan is slowly introducing the standards and certain companies already report voluntarily thereunder.[3] China has

[1] United States of America, Securities and Exchange Commission, 2007, Acceptance from foreign private issuers of financial statements prepared in accordance with international financial reporting standards without reconciliation to [United States Generally Accepted Accounting Principles] US GAAP, 17 [United States Code of Federal Regulations] CFR Parts 210, 230, 239 and 249, Final Rule, 21 December. Available at https://www.sec.gov/rules/final/2007/33-8879.pdf.

[2] Bricker W, Chief Accountant of the Securities and Exchange Commission, 2017, Statement in connection with the 2017 [American Institute of Certified Public Accountants] AICPA conference on current [Securities and Exchange Commission] SEC and [Public Company Accounting Oversight Board] PCAOB Developments, 4 December. In his statement, the Chief Accountant made the following observations: "Over 500 foreign private issuers, representing multi-trillions of dollars in aggregate market capitalization, report financial statement information to …the [Securities and Exchange Commission] SEC without reconciliation to US GAAP, which makes the United States one of the largest markets for the securities of [international financial reporting standards] IFRS-reporting issuers." Available at https://www.sec.gov/news/speech/bricker-2017-12-04 (accessed 15 January 2019).

[3] Van Mourik C and Katsuo Y, 2018, Articulation, profit or loss and [other comprehensive income] OCI in the [International Accounting Standards Board] IASB conceptual framework. Different shades of clean (or dirty) surplus, *Accounting in Europe,* 15(2): 167–192. The authors discuss conceptual differences regarding Japan and the International Financial Reporting Standards (IFRS). In particular, the Japanese would prefer to amortize goodwill and think that all profits and losses recognized in other comprehensive income should be recycled through profit or loss. This has restrained their movement towards full IFRS; Camfferman K and Zeff S,

issued its own financial reporting standards, which the IFRS Foundation considers to be virtually the same as its own.[4]

The current suite of IFRS consists of 25 IAS, 17 IFRS and 18 Interpretations. Of 166 jurisdictions surveyed by the Board, 144 require IFRS to be applied by all or most domestic publicly accountable entities in their capital markets.[5] Of the 49,000 companies listed on the 88 largest global securities exchanges, 27,000 use IFRS. The combined gross domestic product of the countries applying the standards amounts to US$46 trillion.[6]

Some of the key benefits arising from the global implementation of IFRS are: the enhanced comparability and improvement in quality of financial information; the empowerment of investors and other market participants to make informed economic decisions; increased reliability owing to the narrowing of the information gap between capital providers and the individuals to whom they have entrusted their money; the provision of information needed to hold management accountable; the ability to compare financial information on a global basis; the provision of vital information to regulators around the world; the creation of economic efficiency through moves to help investors to identify opportunities and risks across the world, thereby improving capital allocation; and the lowering of the cost of capital and of international reporting for preparers.

2015, *Aiming for Global Accounting Standards – the International Accounting Standards Board, 2001–2011,* Oxford University Press, Oxford: 517–527. The authors suggest that the halt in momentum towards domestic use of IFRS in the United States of America also put constraints on the adoption process; According to the Tokyo Stock Exchange, as at 31 March 2018, there were 147 listed companies using IFRS and 20 using US GAAP. The Tokyo Stock Exchange has confirmed that its website gives details of IFRS-user companies but not of US GAAP-user companies. See https://www.jpx.co.jp/english/listing/others/ifrs/ (accessed 6 February 2019).

4 Ministry of Finance of China and IFRS Foundation joint statement, Beijing, 18 November 2015, declaring that Chinese accounting standards were substantially converged with IFRS. Available at https://www.ifrs.org/-/media/feature/around-the-world/mous/2015-beijing-joint-statement.pdf?la=en (accessed 6 February 2019); See also Xu L, Zhang E and Cortese C, The role of accounting intellectuals in the emergence of Chinese accounting standards, *Accounting History* (forthcoming).

5 IFRS Foundation. Who uses IFRS standards? Available at www.ifrs.org/use-around-the-world/use-of-ifrs-standards-by-jurisdiction/#analysis (accessed 14 January 2019).

6 Pacter P, 2017, *Pocket Guide to IFRS Standards: The Global Financial Reporting Language,* IFRS Foundation, London, p. 4.

Beginning in 2002, IASB spent a decade working to achieve the convergence of its standards with those of the United States of America. That goal has been achieved in many areas, notably revenue recognition, business combinations, consolidation, accounting for share-based payment, operating segments and fair-value measurement. The new standards on revenue and leasing are products of those efforts, even though full convergence has not been achieved.

Institutional setting and funding

The institutional structure providing oversight for the standard-setting process, addressing funding, encouraging liaison with national standard setters and providing support in implementation has evolved greatly over the sixteen years since IASB formally began its work.

Initially, the IFRS Foundation trustees made up the core oversight mechanism and were also responsible for fund-raising and appointing the members of IASB and the Standing Interpretations Committee. Outside observers were critical of that arrangement, pointing out that the trustees were also responsible for their own appointment and were, therefore, a self-perpetuating body with no external accountability. Consequently, the core structure of the Foundation was expanded in 2009 to include a new top tier, the Monitoring Board, made up of representatives of the European Commission, Japan and the United States of America and two representatives of the International Organization of Securities Commissions.

In 2012, the Monitoring Board decided to expand its membership,[7] which now includes market authorities from Brazil, China and the Republic of Korea. Members are supposed to be drawn from countries that allow or require the use of IFRS within their jurisdiction. Some feel that this puts the United States of America in an awkward position. On the one hand, the Securities and Exchange Commission has more IFRS registrants than most other stock exchanges and is arguably the biggest financial market in the world and should, therefore, have a presence within the IFRS structure. On the other hand, companies of the United States of America are not permitted to use IFRS.

7 IFRS Foundation Monitoring Board, 2012, Final report of the review of the IFRS Foundation’s governance, 9 February, available at http://www.iosco.org/about/monitoring_board/pdf/Final%20Report%20on%20the%20Review%20of%20the%20IFRS%20Foundation’s%20Governance.pdf.

The 22 IFRS Foundation trustees are drawn from a variety of jurisdictions and have typically spent a lifetime working in areas linked to financial reporting. Over time, the Foundation has established several subcommittees, including the Nominating Committee, which identifies candidates for appointment to IASB, the IFRS Interpretations Committee, the Audit and Finance Committee and the Due Process Oversight Committee.

The 2016 IFRS Foundation Constitution specifies that IASB shall comprise a group of people representing the best available combination of technical expertise and diversity of international business and market experience, including auditors, preparers, users, academics and market and/or financial regulators.

The Board is made up of: (a) four members from the Asia–Oceania region; (b) four members from Europe; (c) four members from the Americas; (d) one member from Africa; and (e) one member appointed from any region, subject to requirements regarding the maintenance of overall geographical balance.

Funding continues to be an overwhelmingly difficult issue for the Foundation. Governments, stock markets and listed companies remain unwilling to pay for financial reporting standards. Consequently, the Foundation is underfunded, with countries such as France, Germany, Japan and the United Kingdom of Great Britain and Northern Ireland making significant contributions, while some other adopters pay nothing.

The trustees have developed a formula for calculating contributions from IFRS-using jurisdictions that is based on economic size and stock exchange activity. However, not all jurisdictions fully implement this method.

For example, within the European Union, the formula is used in countries such as France and the United Kingdom of Great Britain and Northern Ireland, where levies have been set for listed companies. However, not all European Union Member States contribute. The European Commission itself is now a significant contributor, paying £4.1 million in 2017. However, it contributed nothing at all until after the financial crisis of 2007 and 2008. The fact that the European Commission pays contributions is used as an argument by some European Union Member States, such as Austria, Denmark, Greece, Luxembourg and Sweden, to justify not making any national contributions.

Table 1
International Financial Reporting Standards Foundation 2017 results (simplified)

	£000	£000
Contributions		25,084
Publishing sales	6,612	
Less identified cost	-3,317	3,295
Other income		383
Total income		28,762
Operating costs		-20,939
Subtotal		7,823
Finance income	3,901	
Finance costs	-3,060	841
Net income before tax		8,664

The contributions can be analysed as follows:

	£000
International audit firms	8,707
Europe	8,312
Asia–Oceania	6,732
Latin America	229
North America	1,237
Middle East and Africa	
Others	152
Offset against	32
Subtotal	25,401
Costs (Tokyo office)	-317
Net total	25,084

Source: IFRS Foundation, 2017, Annual Report 2017, Financial Reporting for the World Economy, pp. 22–23.

International Financial Reporting Standards Interpretations Committee

The IFRS Interpretations Committee was set up to respond to queries regarding potentially conflicting standards and to requests for clarification. It was established by the International Accounting Standards Committee and increasingly plays a role in implementation. The Interpretations Committee is made up of experienced practitioners and is currently chaired by the Vice-Chair of IASB.

Where a request for an interpretation is submitted to the Interpretations Committee and, after analysing the topic, the Committee decides that clarification is required, an interpretation is issued, which goes to

IASB for endorsement and has the same authority as an IFRS.

Interpretations are generally rolled into the substantive standard should the standard be reopened for any reason. The Interpretations Committee reviews proposals submitted to it for inclusion on its agenda. Most proposals are turned down, but the refusal is accompanied by an explanation, and these "agenda decisions" are, in themselves, potentially useful sources of clarification, even if they do not constitute authoritative literature.

International Financial Reporting Standards Advisory Council

The other body carried forward from the International Accounting Standards Committee is the IFRS Advisory Council. The Council has about 50 members representing a diverse range of stakeholders. It meets twice a year for two days in London and currently focuses on strategic issues, although members are provided with a technical briefing.

International Financial Reporting Standards Accounting Standards Advisory Forum

Liaison on technical matters, more specifically with national standard setters, is carried out within the Accounting Standards Advisory Forum, created in 2013. This advisory group emerged to replace the IASB–Financial Accounting Standards Board (FASB) convergence process and meets four times a year. The Forum is a space within which standard setters can bring matters to the attention of IASB, which can get feedback on its ongoing work.

Currently, the four following regional groups representing national standard setters have seats in the Forum:

- The Asian-Oceanian Standard-Setters Group, representing standard setters from 26 economies, including Australia, China, Dubai, Iraq, Japan and the Syrian Arab Republic. The Group's secretariat is based in Tokyo, where the IFRS Foundation has its only office outside its London headquarters.
- The Americas Group, which includes the Group of Latin American Standard Setters, a body set up in 2011 that brings together fifteen members, including Argentina and Brazil.
- The Africa Group, which includes the recently formed Pan-African Federation of Accountants.
- The European Financial Reporting Advisory Group, which was set up in 2001 by a number of European organizations with an interest in accounting and which is the European Commission's adviser on IFRS. The Group liaises with national standard setters (who also hold half the seats on its Board) to represent Europe in the IASB standard-setting process and advises the European Commission on the endorsement of new IFRS. It therefore plays a more extensive role in the formal adoption process than the other regional groups. In addition to supporting national standard setters, the Group has a sizeable technical staff.

The Forum currently has twelve members, drawn from the following geographical regions:

- Africa – one member
- The Americas (North and South) – three members
- Asia–Oceania – three members
- Europe (including non-European Union) – three members
- The world at large, subject to requirements regarding the maintenance of overall geographical balance – two members

The current members are:

Africa:

- Pan-African Federation of Accountants

Asia–Oceania

- Asian-Oceanian Standard-Setters Group
- Accounting Standards Board of Japan
- Accounting Regulatory Department, Ministry of Finance, China
- Korea Accounting Standards Board

Europe (including one at large)

- European Financial Reporting Advisory Group
- Autorité des normes comptables, France
- Financial Reporting Council, United Kingdom of Great Britain and Northern Ireland
- Organismo Italiano di Contabilità, Italy

Americas

- Group of Latin American Standard Setters
- Canadian Accounting Standards Board
- Financial Accounting Standards Board, United States of America[8]

International Financial Reporting Standards Emerging Economies Group

The Emerging Economies Group is made up of 12 members, all of whom belong to the Group of 20, with the exception of Malaysia. The Foundation's implementation staff work with the Emerging Economies Group on technical issues and the Group's secretariat is based in Beijing. The Foundation also recently set up the Islamic Finance Consultative Group, which has around 20 members, including standard setters and other stakeholders with an interest in applying IFRS in an Islamic finance context.

Other advisory groups

The Foundation's list of standing advisory groups consists of the Capital Markets Advisory Committee, made up of financial analysts, the Global Preparers Forum, comprised of preparers of financial statements, the IFRS Taxonomy Advisory Group and the SME Implementation Group.

The Foundation has also set up several groups to both advise on individual standard-setting projects and address implementation issues, including the IFRS Transition Resource Groups for: Impairment of Financial Instruments; IFRS 15 Revenue from Contracts with Customers; and IFRS 17 Insurance Contracts. In addition, the Management Commentary Consultative Group and the Consultative Group for Rate Regulation were created to provide feedback regarding ongoing IASB projects.

Every year, the Foundation holds the World Standard-setters Conference. This event, which usually takes place in September or October, in London, provides national standard setters with an opportunity to hear technical presentations and to comment on the Foundation's work.

[8] IFRS Foundation, Accounting Standards Advisory Forum, available at https://www.ifrs.org/groups/accounting-standards-advisory-forum/#members (accessed 15 January 2019).

B. IMPLEMENTATION AND ENFORCEMENT

Regulatory and enforcement authorities, such as the European Securities and Markets Authority, occasionally publish information about priority areas for regulatory review prior to the implementation of a standard.[9] Audit firms advise preparers on the implementation of standards. In order to deal with practical implementation challenges, the Foundation has appointed a Director of Implementation and Adoption Activities and has been working to increase interaction with national standard setters.

International Financial Reporting Standards Foundation initiatives

The Director of Implementation and Adoption Activities is supported by other senior staff members and is responsible, among other things, for liaising with national standard setters. Implementation support is available both at the time of publication of new standards and following their implementation. When a standard is published the Foundation releases a summary and a market impact analysis thereof.

IASB conducts outreach activities both during the standard-setting process and immediately upon finalization of standards by the World Standard-setters Conference and the various regional groups of standard setters referred to above. Practitioners can contact the various transition resource groups concerning any issues that they may have encountered when preparing for transition regarding the major standards. Webinars are produced for dissemination through the Foundation's website.

The IFRS Interpretations Committee and the technical implementation team are also on hand to deal with any queries concerning post-implementation issues.

National standard setters

As a part of its outreach work, the Foundation produces material targeting national standard setters, who are, in turn, encouraged to conduct outreach with

[9] For example, European Securities and Markets Authority, 2016, Public statement. Issues for consideration in implementing IFRS 9 Financial Instruments (2016/ESMA/1563), 10 November. Available at https://www.esma.europa.eu/system/files_force/library/2016-1563_public_statement-issues_on_implementation_of_ifrs_9.pdf.

their own constituents. For such standard setters, the implementation process may include dealing with the translation of IFRS into the national language and their subsequent adoption and inclusion in the jurisdiction's legal framework.[10] National standard setters may, as in the case of the Republic of Korea, conduct public meetings, invite comment and encourage companies and auditors to engage with new standards. They may also have set up their own transition groups to help companies and to address national issues.

International audit firms

International audit firms are an important link in the financial reporting supply chain and play a significant role in implementation. Such firms typically keep preparers informed of international standard-setting developments through newsletters and provide advice to clients regarding impact assessment for standards.

Audit firms typically publish guidance on new standards and produce extensive handbooks on implementing IFRS. These "GAAP guides" are frequently updated and are developed from each firm's internal manual. They provide advice on implementing standards and take into account established practice, guidance and Interpretations Committee agenda decisions.

Through this process, audit firms aim to achieve the consistent application of IFRS across the world. Consequently, they would certainly be uncomfortable if clients in different parts of the world were given contrasting audit decisions by member firms of the same network from different countries.

Enforcers

In recent years, the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) has carried out a considerable amount of work in the field of enforcement. The Group has published guidance on monitoring of compliance and enforcement.[11] That guidance addresses the issue of the requirements for a monitoring, compliance and enforcement system and sets out a corresponding conceptual framework containing the following elements:

- Key definitions
- Defined objective and scope
- Key principles on which system is based
- Core activities and methodologies
- Availability of competent staff
- Reliable funding
- Monitoring and impact assessment mechanisms

In its 2014 annual review,[12] ISAR published case studies on compliance monitoring and enforcement from Australia, Belgium and Canada.

The Australian Securities and Investments Commission is in charge of monitoring and enforcement. It is responsible for around 2,000 companies, the 500 largest of which are, on average, reviewed every three years, and the smaller of which are reviewed at least every twelve years. Australia uses IFRS, which are reissued as national standards.

As a result of European Union membership, the structures of Belgium are influenced by the common requirements for stock exchange monitoring and enforcement established by the European Commission. These requirements were last reorganized in 2011, when the Financial Services and Markets Authority was created.

Canada is a federation of 13 provinces, each of which has its own securities regulator, the largest of which being the Ontario Securities Commission, which has oversight of the Toronto Stock Exchange. Although the regulators' activities are coordinated by the Canadian Securities Administrators, there are slight differences from one province to another. However, financial reporting rules are centralized through the Canadian Accounting Standards Board. The country uses IFRS but a number of Canadian companies also have a listing in the United States of America.

ISAR included enforcement cases studies from Germany and the United Kingdom of Great Britain and Northern Ireland in its 2015 annual review.[13] In both cases, enforcement of reporting by listed companies

[10] For example, Korean Accounting Institute, 2018, IFRS 9 implementation – Korean experience, 16 May, available at https://www.ifrs.org/-/media/feature/meetings/2018/may/eeg/ap8c-ifrs-9-implementation-experience-in-korea.pdf.

[11] UNCTAD, 2017a, *Monitoring of Compliance and Enforcement for High-quality Corporate Reporting*.

[12] UNCTAD, 2016a, *International Accounting and Reporting Issues: 2014 Review* (United Nations publications, UNCTAD/DIAE/ED/2015/2, New York and Geneva), pp. 15–60.

[13] UNCTAD, 2016b, *International Accounting and Reporting Issues: 2015 Review* (United Nations publications, UNCTAD/DIAE/ED/2015/3, New York and Geneva), pp. 1–51.

is carried out under the supervision of the European Securities and Markets Authority. Both national systems monitor compliance based on a sample of the total population of companies. Typically, this approach is based on a mixture of factors, including sectors of the economy felt to be particularly exposed and areas where financial reporting requirements have recently been changed. The market is divided up into different strata and checks are carried out on all companies from time to time. Generally, the larger and more economically significant the company, the more frequently it will be checked.

Monitoring and compliance work in the European Union is carried out by the institutions of individual Member States, under the supervision of the European Securities and Markets Authority. The Authority conducts regular coordination sessions with Member State regulators and publishes an updated synopsis of enforcement decisions. Such decisions, which are anonymized, are intended to provide feedback to the markets. The Authority also publishes an annual report containing analysis of enforcement decisions made by national regulators.

ISAR included a further enforcement case study in its 2016 annual review.[14] The case concerned Singapore, where oversight of financial reporting resides with the Accounting and Corporate Regulatory Authority. For the last few years, the Authority has been running its Financial Reporting Surveillance Programme, which is designed to monitor compliance and encourage better reporting. When selecting companies for monitoring, the Authority uses a risk-based system that takes into account the following factors: public interest risks based on size, number of employees, etc.; operations where accounting requires significant judgments; industries particularly affected by new accounting standards; and companies that have undergone a change in status or composition or with a modified audit report.

C. CURRENT AND UPCOMING IMPLEMENTATION ISSUES

The batch of IFRS currently being implemented represents an important change for virtually all companies. It includes the widest reform there has ever been of accounting for insurance contracts, as well as major refinements to accounting regarding financial instruments and leases and the recognition and measurement of revenue.

The significance of the current implementation programme is such that, in late 2016, the International Organization of Securities Commissions issued a statement[15] in which it emphasized that early assessment of the impact of a new standard on a company's financial statements is desirable and that disclosure of expected impact is mandated by IAS 8 – Accounting Policies, Changes in Accounting Estimates and Errors. In the statement, the Organization suggests that listed companies should provide qualitative disclosures as early as possible, followed by quantitative disclosures once the issuer has advanced further regarding the implementation assessment.

The Organization advises that implementation should include:

(a) Identifying system, process and any associated internal control changes needed to produce information required under the new standards, including the related disclosure, and developing system-implementation plans with appropriate accountability mechanisms;

(b) Determining the impact on compliance with financial condition requirements (for example, loan covenants and regulatory capital requirements), future tax liabilities, the ability to pay dividends and employee incentive schemes;

(c) Considering whether significant accounting judgments and estimates arising from the new standards are being developed and captured sufficiently during the implementation phase, as these may be required disclosures in the financial statements once the standards are adopted;

(d) Taking into consideration not only the new standards issued by IASB but also additional relevant resources, as provided by IASB.

The Organization also notes that changes in accounting policies are likely to affect the audit process and that

[14] UNCTAD, 2017b, *International Accounting and Reporting Issues: 2016 Review* (United Nations publications, UNCTAD/DIAE/ED/2017/1, New York and Geneva), pp. 17–31.

[15] The Board of the International Organization of Securities Commission, 2016, Statement on implementation of new accounting standards: Final report, December. Available at: https://www.iosco.org/library/pubdocs/pdf/IOSCOPD548.pdf.

auditors should review their procedures in the light of system changes.

In order to ensure a better understanding of the main issues involved in the adoption of the recently adopted IFRS, a short description of each of those standards is provided below.

1. Financial instruments

The subject of accounting for financial instruments has been one of the most controversial to arise in the last thirty years of standard setting. IFRS 9 – Financial Instruments replaces IAS 39 – Financial Instruments: Recognition and Measurement, which, despite considerable resistance on the part of many members of the financial reporting world, introduced fair-value measurement for many financial instruments.[16] In 2005, FASB and IASB agreed to give constituents time to become accustomed to working with fair value before beginning work to address application difficulties and eventually converging their approaches. This approach was, however, overtaken by events in the form of the financial crisis. The two Boards initially wished to work together to provide a new converged standard. However, while both standard setters ensured that they remained abreast of each other's work, their approaches differ, particularly regarding allowance for losses on loans.

IFRS 9 is the response of IASB to the financial crisis and to the need to replace IAS 39 with a more operationally workable standard. To further complicate matters, IFRS 9 has been issued in stages: the classification and measurement part was finalized in 2009, while the standard was completed only in 2015 and even then without addressing macrohedging issues for which IAS 39 remains in force. The phased publication was partly a response to pressure from the European Union in 2008 for quick action, and partly a decision that, as different aspects were completed, it was better to make the improved reporting available to constituents.

Early on in the financial crisis, a number of banks argued that using fair value as the measurement basis for financial instruments in a falling market had a catastrophic multiplier effect. The argument was that, as the market fell, so did balance sheet values, causing banks to sell assets to adjust their liquidity ratios. The sale of assets caused the market to fall further and triggered more reductions in balance sheet values, in a vicious circle. IAS 39 does not allow for the reclassification of assets and the European Union demanded that IASB amend it to allow European banks to reclassify some assets to amortized cost.[17]

Subsequent analysis has,[18] however, shown that fair value accounting played little role in the financial crisis, but that the fact that IAS 39 did not allow credit losses to be recognized until they had been incurred posed a serious problem. Consequently, banks were not signalling in advance that there had been a deterioration in the quality of their loan portfolios. Their profit and loss accounts would finally be hit by large write-offs when the losses actually occurred.

The Financial Stability Board has noted that: "credit losses are a key component of a bank's performance and financial position".[19] IFRS 9 brings a new approach to impairment that is based on expected, rather than incurred, credit losses. One benefit in this regard should be the systematic re-evaluation by banks of the credit worthiness of their loan portfolios and the transmission of that information to regulators and investors, who will have to reconsider how to draw conclusions from the new data. The Bank for International Settlements described IFRS 9 as the most important change in the history of financial reporting by banks.

It should also be noted that IAS 39 used an incurred loss approach as an anti-abuse device to prevent preparers from gaming their provisions. Returning to expected loss will mean that there is a high degree of estimation in the figures, resulting in more uncertainty, and that auditors and enforcers will be faced with assessing the accuracy of these estimates.

IFRS 9 introduces a simplified approach to the classification and measurement of financial instruments. Instruments may be held at amortized cost only if they are debt instruments and the cash flows received are principal and interest only. The standard also introduces

[16] Cairns D, 2006, The use of fair value in IFRS, in Walton P, ed., *The Routledge Companion to Fair Value and Financial Reporting* Routledge, Abingdon: 9–23.

[17] André P, Cazavan-Jeny A, Dick W, Richard C and Walton P, 2009, Fair value accounting and the banking crisis in 2008: Shooting the messenger, *Accounting in Europe* 6(1): 3–24.

[18] For example, Barth M and Landsman W, 2010, How did financial reporting contribute to the financial crisis? *European Accounting Review* 19(3): 399–423.

[19] Bank for International Settlements, 2015, Impact of expected credit loss approaches on bank risk disclosures. Report of the enhanced disclosure task force, 30 November, p. 3. Available at http://www.fsb.org/wp-content/uploads/Impact-of-expected-credit-loss-approaches-on-bank-risk-disclosures.pdf.

simplified hedging rules, which are more operational than IAS 39 and can be used more easily used for hedging non-financial contracts.

The standard addresses an application issue in relation to changes in own credit risk. IAS 39 required companies to adjust the carrying value of their own debt following market changes in its credit risk when companies elect the fair value option to measure their own debt. This has a counter-intuitive effect in that, if a company's credit-worthiness deteriorates, it registers a gain in profit or loss caused by reducing the carrying value of its debt. IFRS 9 recognizes this problem by requiring that the gain or loss be recognized in other comprehensive income.[20] Own credit loss must still be measured.

Expected credit loss allowance

This is arguably the area where the most radical change has taken place. IASB experimented with a number of quite complex models, with the idea of replicating credit management. These models accept that, in principle, some proportion of a cohort of similar loans is likely to default, and that this is compensated through the interest charged to that cohort. Schemes were trialled under which a certain amount of the interest was credited to a sort of sinking fund for impairment. In the end, having field-tested the approaches, the banking community concluded that they were too complex, and the IFRS 9 "three-bucket" (three-stage) approach was created.

During stage 1, the preparer measures the credit loss on the cohort of loans that is expected to occur in the next twelve months. A loan moves to stage 2 when a significant increase in credit risk is determined to have taken place for the whole cohort. An indicator of this is the presence of loans that are more than 30 days past due. This leads to recognition of an expected lifetime loss, discounted for the time value of money. Stage 3 is reached when an individual loan is deemed to be credit impaired. There are, of course, more detailed rules concerning specific types of instruments, such as those that are bought as credit impaired.

The approach involves looking forward to expected losses, and this is likely to be the most difficult area for implementation purposes. Questions raised during the drafting of the standard included: "What information does the bank use?" and "How far ahead does it look?". The standard requires banks to use "reasonable and supportable" information. This may be information specific to the borrower, such as diminishing financial performance, or it may be macroeconomic factors. A bank can use its own internal data, such as statistical trends, or external data. Historical data can be used as long as it has been corrected for any changes in circumstances.

This is an area that is challenging for banks, their auditors and regulatory and enforcement authorities. Nonetheless, banks will need to document their decision-making and the data on which it is based, as well as make disclosures. It should be remembered that what former SEC Chair Arthur Levitt described as "cookie jar reserves" were abused in the past in order to manage reported profit.[21] At the May 2018 meeting of the Emerging Economies Group, one member underlined the importance of banks agreeing their credit loss model with the banking regulator in their jurisdiction.[22]

Classification and measurement

IFRS 9 acknowledges the complexity of its predecessor and offers a simplified approach to classification and measurement. It provides for three types of assets (or buckets, as they have been described), each with a different measurement basis. The categories are determined with reference to the entity's observable business model:

- If the business model is to hold the financial asset to maturity and collect solely interest and principal, then it is measured at amortized cost. There are, of course, rules to address complex instruments and determine whether the proceeds can be deemed to be interest and principal.
- The second category is for financial assets under a business model that may be held to

[20] Other comprehensive income is an income category found only in US GAAP and IFRS. Historically, certain adjustments (to balance sheet values, for example) were permitted to be reported directly in equity. The Financial Accounting Standards Board (FASB) and IASB created a new section of the statement of comprehensive income, in which all such adjustments that had not passed through the profit or loss account should be recognized. In 2007, IASB introduced other comprehensive income as an amendment to International Accounting Standard (IAS) 1 – Presentation in Financial Statements.

[21] Levitt A and Dwyer P, 2003, *Take on the Street: How to Fight for your Financial Future*, Vintage Books, pp. 122.

[22] IFRS Foundation, 2018a, Report of the Emerging Economies Group meeting, May 2018 (Updated 22 October 2018), available at https://www.ifrs.org/-/media/feature/groups/eeg/eeg-report-may-2018.pdf.

maturity but may also be sold. This approach accepts that banks typically rebalance their portfolios on a day-to-day basis and therefore requires them to identify that part of their holdings that may be used for this purpose as distinct to "permanent" holdings. Assets in this category are held at fair value in the balance sheet, which changes in fair value reported in other comprehensive income.[23] There is a fair value option for this category, for use in the case of accounting mismatches.

- The third category is for financial assets that are not held in either of the two business models noted above. Such financial assets are measured at fair value through profit or loss. However, an exception is allowed when equity instruments are not held for trading. In this case, they will still be measured at fair value but through other comprehensive income instead of profit or loss. In such a case, dividends received go to profit or loss.

With respect to financial liabilities, IASB indicated that constituents had not asked for any change to the requirements in IAS 39, which are largely maintained in IFRS 9. One significant difference is that there is no longer a requirement to unbundle embedded derivatives.

Hedging

The approach to hedging in IAS 39 was frequently criticized as being rules-based and overly complex. The standard was difficult to apply in the case of hedging components of risk, and there were strict rules on "effectiveness" that might cause hedge accounting to be disallowed from period to period as the markets moved. The new standard has simplified the rules to address hedging components of risk (for example, hedging with crude oil futures against changes in aviation fuel price) and hedging of partial risk (for example, 60 per cent of the currency risk on a financial instrument).[24]

The standard also introduces a new disclosure of the cost of hedging, which is designed to better inform users about gains and losses associated with hedging. Entities are required to disclose both their risk management strategies and their likely impact on primary financial statements. As indicated above, the standard does not address macrohedging, which was much debated during the implementation of IAS 39 in Europe. IASB has had a project on this issue for a number of years but its proposals were largely rejected when presented: therefore IFRS 9 has been finalized without any further delay.[25] IASB has continued work in this regard and is expected to consult on an alternative proposal in due course.

Practical implementation

The National Australia Bank was an early adopter of IFRS 9 (Australian Accounting Standards Board (AASB) 9) and produced an investor briefing explaining the impact of the new standard. The Bank noted that it had had to increase its collective impairment provision by $A725 million (but this was adjusted against retained earnings). It produced data showing that the expected credit loss method of provisioning would cause impairment provisions to be recognized earlier than under IAS 39. The Bank also argued that the new categories of assets meant that a greater proportion of its loans would be at amortized cost and welcomed the ability to measure assets held to maturity or for sale at fair value through profit or loss.[26]

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[23] According to IAS 1 (7), other comprehensive income comprises: "items of income and expense (including reclassification adjustments) that are not recognized in profit or loss as required or permitted by other IFRS".

[24] See, for example, IFRS Foundation, 2014, press release, IASB completes reform of financial instrument accounting, 24 July. Available at https://www.ifrs.org/news-and-events/2014/07/iasb-completes-reform-of-financial-instruments-accounting/ (accessed 16 January 2019). In the press release, it is stated that: "IFRS 9 introduces a substantially reformed model for hedge accounting, with enhanced disclosures about risk management activity. The new model represents a significant overhaul of hedge accounting that aligns the accounting treatment with risk management activities, enabling entities to better reflect these activities in their financial statements."

[25] For a summary of the 2014 IASB discussion paper entitled "Accounting for dynamic risk management: a portfolio revaluation approach to macrohedging" and feedback from constituents, see IASB, Agenda Paper 4, May 2015. Available at http://archive.ifrs.org/Meetings/MeetingDocs/IASB/2015/May/AP04-Dynamic-Risk-Management.pdf.

[26] Australian Accounting Standards Board (AASB), 2017, *Review of Adoption of International Financial Reporting Standards in Australia, [Australian Accounting Standards Board] Research Report No. 4*, March. Available at https://www.aasb.gov.au/admin/file/content102/c3/AASB_Review_of_IFRS_research_report_03-17.pdf; and National Australia Bank, 2015, AASB 9 Financial Instruments. Analyst and investor presentation, 17 March. Available at https://www.nab.com.au/content/dam/nabrwd/documents/reports/corporate/aasb-9-analyst-and-investor-presentation-march-2015.pdf.

In the accounting policy notes to its 2017 financial statements, the Hongkong and Shanghai Banking Corporation Limited, an international bank based in the United Kingdom of Great Britain and Northern Ireland, states that: "The classification and measurement and impairment requirements are applied retrospectively by adjusting the opening balance sheet at the date of initial application, with no requirement to restate comparative periods. The Hongkong and Shanghai Banking Corporation Limited does not intend to restate comparatives. For the consolidated financial statements of the Corporation, adoption is expected to reduce net assets at 1 January 2018 by US$1.0 billion, with the classification and measurement changes increasing net assets by US$0.9 billion and impairment reducing net assets by US$2.2 billion, net of deferred tax of US$0.3 billion. As a consequence, common equity tier 1 capital is expected to increase by US$1.2 billion, applying regulatory transitional arrangements, and by US$0.2 billion on a fully loaded basis."[27]

At a meeting of the IFRS Foundation Emerging Economies Group held in Kuala Lumpur on 14–16 May 2018, the standard setters of the Republic of Korea[28] and Malaysia made presentations on the implementation of IFRS 9 in their countries. In his presentation,[29] Chan Hooi Lam of the Malaysian Accounting Standards Board identified the following challenges facing banks:

- Are the people sufficiently knowledgeable?
- Are the financial impacts, effect on capital requirements and other key performance indicators understood?
- Are the processes updated and the controls adequate?
- Are the systems ready?
- Have we managed stakeholder expectations?

At the meeting, the Korean Accounting Institute reported that it had set up a technical forum to provide implementation support in the Republic of Korea. Constituents had been invited to submit queries to this forum, which liaised continuously with the various organs of the IFRS Foundation and held public meetings to discuss issues. The Institute expected the total loss provision of banks of the Republic of Korea to increase by 16.3 per cent, or around US$1.0 billion, but the impact of this on equity was not expected to be significant. There was expected to be decreased volatility in profit and loss as a result of the mitigation of the effects of hedge accounting. Details of the implementation issues encountered were also provided.

Derogations for insurers

The insurance community is faced with two major changes to its balance sheets: IFRS 9, in 2018, followed by IFRS 17 – Insurance Contracts, in 2021.[30] Insurers pointed out that there was a risk of the asset side of their balance sheets using fair values in 2018, while the liabilities side would not do so until 2021, thus importing to the balance sheet some accounting volatility arising from the accounting mismatch.[31]

In September 2016, IASB issued an amendment to the existing insurance standard, IFRS 4 – Insurance Contracts, to give insurers a choice of two derogations to handle the three-year transition. The insurer can either take to other comprehensive income any volatility arising from the mismatch during the three-year period (known as the overlay approach), or companies that are predominantly insurance can defer application of IFRS 9 until 2021 (deferral approach).

This facility has been hotly contested in Europe. Originally, IASB reluctantly took the view that there was no possibility of synchronizing the timing of the implementation of IFRS 9 and IFRS 17. To do so would have meant delaying implementation of IFRS 9, which is seen by banking regulators as an essential reform. Initially, the standard setter took the view that,

[27] Hongkong and Shanghai Banking Corporation Limited, 2018, *Annual Report and Accounts 2017*, p. 187, available at https://www.hsbc.com/investors/results-and-announcements/annual-report (accessed 16 January 2019).

[28] Korean Accounting Institute, 2018. IFRS 9 – Korean experience, 16 May, available at https://www.ifrs.org/-/media/feature/meetings/2018/may/eeg/ap8c-ifrs-9-implementation-experience-in-korea.pdf.

[29] Chan HL, IFRS 9 implementation – the Malaysian experience, p. 24, available at https://www.ifrs.org/-/media/feature/meetings/2018/may/eeg/ap8a-ifrs-9-implementation-the-malaysian-experience.pdf.

[30] At the IASB November 2018 meeting, it was proposed that the effective date of IFRS 17 be changed to January 2022.

[31] See, for example, [Chief Financial Officer] CFO Forum and Insurance Europe, 2016, Comments on IASB exposure draft on applying IFRS 9 – Financial Instruments with IFRS 4 – Insurance Contracts ("exposure draft"). Letter on deferral of IFRS 9 to the IASB Chair. 20 January 2016. Available at http://www.cfoforum.eu/letters/CFOF_IE_Comment_Letter_on_IFRS_9_Deferral.pdf.

if insurers were concerned about the mismatch, they should simply disclose the effects so that analysts could adjust their forecasts. This approach is supported by the Efficient Market Hypothesis that the share price compounds all publicly available information.

However, the European Financial Reporting Advisory Group, the European Commission's adviser on IFRS, took the view that insurers should be given a deferral.[32] The amendment to IFRS 4 was the result of the Advisory Group's intervention. Even then, the Advisory Group objected to the restriction of the deferral to entities that are predominantly insurers, and the European Union, in adopting the standard, extended the deferral to companies doing both banking and insurance. IASB had opposed this approach on the grounds that it didn't make sense to have one part of a group using IFRS 9 and another part using IAS 39, and indeed consolidation requires that a single set of accounting policies be used.

By way of examples of implementation of this derogation, Standard Life Aberdeen, a British life insurance company and asset manager, has claimed eligibility to defer application of IFRS 9 in its 2017 financial statements and will only implement the financial instruments standard in 2021, despite being a major fund manager. Standard Life Aberdeen has stated that: "The impact of the implementation of IFRS 9 will be dependent on the implementation of IFRS 17."[33]

In the accounting policy notes of the 2017 financial statements of the German insurer Allianz Group it is stated that: "due to the strong interaction between underlying assets held and the measurement of direct participating insurance contracts, the Allianz Group decided to use the option to defer the full implementation of IFRS 9 until IFRS 17 becomes effective on 1 January 2021".[34]

[32] European Financial Reporting Advisory Group Board, 2015, letter to Directorate General, Financial Stability, Financial Services and Capital Markets Union, European Commission giving endorsement advice on IFRS 9, 15 September. Available at http://www.eltia.eu/images/IFRS_9_Final_endorsement_advice.pdf.

[33] Standard Life Aberdeen, 2018, *Building a Diversified World-class Investment Company. Annual Report and Accounts 2017*, p. 155. Available at https://www.standardlifeaberdeen.com/_resources/documents/financial-reports/2018/SLA-plc-Annual-report-and-accounts-2017issue.pdf.

[34] Allianz Group, 2018, *Annual report 2017. Competence Change Future*, p. 94, available at http://financedocbox.com/Insurance/74448616-Competence-change-future.html (accessed 16 January 2019).

2. Revenue from contracts with customers

IFRS 15 – Revenue from Contracts with Customers came into force in January 2018. It is converged with Accounting Standards Codification 606 – Revenue from Contracts with Customers. Consequently, the top line of the income statement will look similar around the world. The previous US GAAP contains a great deal of detailed guidance for specific industries, while the relevant international standards, in the form of IAS 18 – Revenue and IAS 11 – Construction Contracts, provide very little detailed guidance. Adopting countries will therefore find IFRS 15 to be more prescriptive than its predecessors and this may generate implementation questions.

IFRS 15 is based on the identification of performance obligations.[35] The application of the standard presupposes that the preparer identifies contracts with customers and analyses performance obligations and allocates the overall contract price proportionately to each of them. Revenue is recognized when the performance obligation has been satisfied and is not dependent on the whole contract being satisfied. There is only a single performance obligation for many, if not most, transactions: the analysis process is therefore straightforward. Nevertheless, IFRS 15 provides that, where a contract includes an element of deferred settlement, the amount of the contract price should be split between the time value of money and the actual price of the goods or services delivered.

The application of the standard becomes more complex where there is more than one performance obligation. First, there may be difficulty in determining whether there is more than one performance obligation. For example, where a telephone handset might be sold with a minimum period of use of the supplier's telephone network, the customer is not usually charged a separate price for the handset. The contract does, however, contain two or more performance obligations under IFRS 15: the supply of the handset and access over time to the network.

Under IAS 18, there are no rules for determining how the separate parts of the contract are measured for

[35] According to IFRS 15, a performance obligation is a promise in a contract with a customer to transfer to the customer either: a good or service (or a bundle of goods or services) that is distinct; or a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

accounting purposes. IFRS 15 specifies that the contract price has to be allocated across the separate performance obligations in proportion to their retail price. This can cause implementation difficulties if no separate market price is discernible, or if the market prices give a significantly different allocation to that previously used.

Some telecommunications companies have historically not recognized the sale of the handset separately. Moreover, in the past, the market price of a handset without network access has been inflated. The result is a different pattern of recognition under IFRS 15. This is an implementation difference that will have an impact on analysts' runs of comparative data, but future years will be comparable with the new basis. The total revenue of each contract is unaffected.

The standard also addresses contracts that have variable consideration. It requires that an estimate of the variable element be recognized, but this is subject to a test as to whether it is highly probable that there will be an adjustment in a future period. Where a good estimate is possible, revenue should be recognized when the obligation to deliver is satisfied. Cases that could be affected include the licensing of intellectual property rights. Where a licence is granted for a period of time, revenue is allocated over the period for which the value of the intellectual property is dependent on the seller's continuing activity.

Another requirement is that the preparer is obliged to separately disclose impairments related to contracts with customers. Revenue from leases would be accounted for under IFRS 16 – Leases. This is an anti-abuse requirement that is designed to counter any risk of a preparer invoicing amounts that they know they cannot collect in order to inflate revenue in one period and then taking an impairment in the following period.

Practical implementation

In its 2017 annual report, the mobile telephone operator Vodafone Group Plc noted that: "The Transactions impacted by IFRS 15 are high in volume, value and complexity, therefore the Group is continuing to assess the impact of these and other accounting changes that will arise under IFRS 15 and cannot reasonably estimate the impact; however, the changes … will have a material impact on the consolidated income statement and consolidated statement of financial position … The Group expects to be in a position to estimate the impact of IFRS 15 early in the first quarter of the year commencing 1 April 2018".[36] It is further stated in the report that the amount of revenue allocated to equipment and recognized at contract inception will increase, and revenues recognized as services are delivered will reduce.[37] Incremental costs incurred in acquiring a contract will be deferred and amortized as revenue is recognized under the related contract, which will lead to later recognition of charges.

The German software company Systems, Applications and Products noted in the accounting policy notes to its 2017 statements that, since the issuance of IFRS 15, the group had adjusted revenue recognition policies and business processes. It identifies accounting for options for the purchase of additional copies of already licensed on-premises software as the "most notable revenue impact". Previously, the company applied US GAAP and did not recognize such options: IFRS 15 treats them as a separate performance obligation. The company states that it is phasing out this option from its business practices. It adds that the most notable impact of IFRS 15 on expenses relates to the cost of obtaining customer contracts. Previously, the company only recognized costs that were directly related and incremental, whereas, under IFRS 15, it will "capitalize all incremental costs of obtaining a customer contract that are expected to be recovered, regardless of whether they are direct or not".[38]

The Netherlands-based group Ahold Delhaize describes itself as one of the world's largest food retail groups, stating, in its 2017 annual report, that: "The Company currently recognizes revenue as control passes (to the customer) and the adoption of IFRS 15 will have no effect on when revenue is recognized". It adds that the standard will mandate additional disclosures surrounding its contracts with customers.[39]

[36] Vodafone Group Plc, 2018, *Connecting Everybody to Live a Better Today and Build a Better Tomorrow. Annual Report 2017*, p. 108. Available at https://www.vodafone.com/content/annualreport/annual_report17/downloads/Vodafone-full-annual-report-2017.pdf.

[37] Ibid., p. 107.

[38] Systems, Applications and Products, 2018, *[Systems, Applications and Products] SAP Integrated Report 2017. Intelligent Enterprise*, pp. 160–161. Available at https://www.sap.com/docs/download/investors/2017/sap-2017-integrated-report.pdf.

[39] Ahold Delahaize, 2018, *Better Together. Annual Report 2017*, pp. 143–144, available at https://www.aholddelhaize.com/media/6445/180302_aholddelhaize_annualreport_2017.pdf.

3. Leases

The new leasing IFRS 16 is due to be implemented in January 2019. It significantly changes the way in which lessees account for what were formerly operating leases but leaves lessor accounting largely unchanged. Lessees are expected to show altered balance sheets that will reflect both increased assets and increased liabilities: there are, however, practical exceptions. The standard was developed jointly with FASB and is largely but not completely converged.[40]

The central issue with lease accounting has always been that an entity can, through lease finance, obtain control of an asset without that fact being apparent in its financial statements. The cost of the exercise is reflected in operating, rather than financial, costs, and the economic gearing of the balance sheet is distorted. The company is contractually obliged to make future payments, sometimes for many years to come. The accepted wisdom in accounting is that a lease is comparable to purchasing an asset and borrowing to finance it, and the substance of that should be reflected in the accounting. The alternative view is that leasing is not the same as purchasing and that the legal rights and obligations are different and should be respected. An entity has many obligations to pay costs into the future, its existence depends on it: there is no reason to separate out lease contracts.

When the predecessor standard IAS 17 was issued in December 1997, it was hoped that that the new accounting that it brought about would significantly change balance sheets. Unfortunately, the main effect of the standard was to significantly change the way in which leases were written, causing them to cover shorter periods, to qualify as operating leases and to remain off-balance sheet. Such leases could be renewed so that lifetime use was obtained but in stages to avoid capitalization.

Standard setters have for a long time been aware of this abuse and the Securities and Exchange Commission also drew attention to it in a 2005 document on off-balance sheet financing by Securities and Exchange Commission registrants.[41] IASB and FASB agreed to undertake a joint project in this regard as part of their convergence programme. The starting point was a working paper, originally drafted by the G4+1 group of standard setters,[42] which suggested that all leases, however short, should be capitalized, and that lessor accounting should also be reformed to provide symmetry with the new lease accounting.

Over time, this position was modified in a number of ways. First, it was decided that lessor accounting was deemed to work effectively and the costs of changing it to make it mirror lessee accounting were likely to exceed the benefits. Consequently, it has been left largely untouched and still preserves the operating/finance lease distinction of IAS 17.

Second, it was decided that a robust definition of a service contract was required to enable leases to be distinguished from service contracts. Third, it was decided there should be derogations from the basic principle to avoid "undue cost or effort". Consequently, under IFRS 16, leases of under one-year duration and low-cost assets are excluded from capitalization.

Lessees are required to recognize both a leased asset and a lease obligation/liability in the balance sheet where they control the use of a more than insignificant asset for any period longer than twelve months. Under this new principles-based approach, virtually all leased assets and obligations arising from lease contracts are reflected on the balance sheet of the reporting entity. The asset may, however, be classified as an intangible "right of use" asset and be shown as a separate category on the balance sheet, or it may be classified with tangible, non-current assets, in line with the nature of the underlying asset, as was the case under the predecessor standard.

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[40] *World Accounting Report*, 19(1) "The IASB version differs from the FASB one in some details, especially the treatment of property rentals and mitigations for small leases." For comparisons of IFRS 16 with US GAAP, see IFRS Foundation, 2016, *Effects Analysis: International Financial Reporting Standard. IFRS 16 – Leases*, January 2016, pp. 67–70. Available at https://www.ifrs.org/-/media/project/leases/ifrs/published-documents/ifrs16-effects-analysis.pdf.

[41] SEC, 2005, Report and recommendations pursuant to section 401(c) of the Sarbanes-Oxley Act of 2002 on arrangements with off- balance sheet implications, special purpose entities and transparency of filings by issuers. Available at https://www.sec.gov/news/studies/soxoffbalancerpt.pdf.

[42] This informal grouping of standard setters originally consisted of representatives of members from the standard-setting organizations of Australia, Canada, United Kingdom of Great Britain and Northern Ireland and United States of America, who met occasionally with the International Accounting Standards Committee to discuss technical accounting issues from 1992. The group was wound down in 2001. For details, see Street D, 2006, The G4's role in the evolution of the international accounting standard-setting process and partnership with IASB, *Journal of International Accounting, Auditing and Taxation,* 15(1): 109–126.

In the profit or loss account, the asset is amortized, most likely on a straight-line basis reflecting the length of the lease, and the rental charge is split between a financing cost and reduction of the lease obligation. This means that, although the rental payment may be the same across the life of the lease, the charge to profit or loss is weighted towards the early life of the lease when the liability is greatest and the financing charge is therefore highest. This is significantly different from the US GAAP, under which the standard setters decided to allow a straight-line charge.

As discussed above, leases could be one of the main sources of off-balance sheet financing for businesses. In 2018, listed companies around the world had around US$3.3 trillion in leases. Under IAS 17 – Leases, the predecessor of IFRS 16, over 85 per cent of that amount would be categorized as operating leases and would not be accounted for in the balance sheet of the reporting entities understating their financial obligations or liabilities. During the financial crisis of 2007 and 2008, for example, some major retail chains became bankrupt because they were unable to quickly adjust to the new economic reality. They had significant long-term operating/leasing commitments on their stores and yet had deceptively lean balance sheets. In fact, their off-balance lease liabilities could have been up to fifty times more than the amounts they reported on their balance sheets. Thus, the accounting requirements applicable for leases at that time did not reflect the economic reality. To rectify this erroneous approach to accounting for leases, IASB and FASB decided to develop a new accounting standard for leases that eliminated the distinction between operating and finance leases, bringing all leases on to the balance sheet.

Implementation issues

The implementation of IFRS 16 will be more or less onerous, depending on the extent to which a given entity uses lease finance. However, all listed companies are likely to have an initial cost in determining what leases they have. Arrangements for central control of leasing vary from group to group. Subsidiaries may well have the right to enter into small leases without specific clearance from their central or main offices, in which case there might not be any central documentation of operating leases.

Large reporting entities will now need to reflect such leased assets in their balance sheet and to carry out fact-finding activities and make an initial assessment. Thereafter, they will need to update their information regularly and to change systems to enable that. They will also most likely want to change their internal control systems on leasing, so that any lease that would be reportable under IFRS 16 is cleared with the main office before a lease contract is signed.

The standard brings into sharper focus the issue of when a contract becomes a service contract rather than a lease. The IFRS Foundation published an effects analysis in 2016 that suggests that it is probable that some contracts that were previously regarded as leases may be reclassified. However, it has been suggested that leasing companies may review their policies and start to use classification as a service contract in order to avoid recognition of an asset and liability.

The definition of a service contract is one where the client does not obtain control over the asset. In debate, it was suggested that a service provider could write a contract for the supply of drinking water, as opposed to the rent of a particular water cooler. As long as the decision as to which water cooler to place on the client's premises rests with the service provider, it is not a lease. This is likely to lead to creative contract writing in areas such as car leases, where a provider may argue that, as long as the contract provides for provision of a vehicle, rather than a specific car, it is a service contract. Both auditors and enforcers may have difficulties in this area.

The exception for low-value assets may also be a source of difficulties. In conducting outreach on low-value assets, IASB suggested that these would be items that cost less than US$5,000 when new, such as personal computers.[43] However, this could potentially be another grey area for implementation from the perspective of preparers and for audit and enforcement by regulatory authorities.

The IFRS Foundation considers that there are many reasons to use lease finance other than the off-balance sheet possibilities. It notes that the old US GAAP and international accounting standards required lessees to disclose some information about contractual commitments to future lease payments. This information is used by analysts to adjust the

[43] IFRS Foundation, 2016, *Effects Analysis: International Financial Reporting Standard, IFRS 16 – Leases*, January 2016, p. 19. Available at https://www.ifrs.org/-/media/project/leases/ifrs/published-documents/ifrs16-effects-analysis.pdf.

balance sheet for the effects of leases. It argues that the accurate information about assets and liabilities provided under IFRS 16 will obviate the need for these necessarily imprecise estimates and should improve the accuracy of analysts' forecasts and share valuation.[44]

At the Emerging Economies Group Meeting in May 2018, members pointed out that the decision to maintain lessor accounting unchanged while reforming lessee accounting could mean that, for government statistical purposes, assets were counted twice, in both the lessor balance sheet and the lessee balance sheet. Members also raised the issue of how to implement the requirement to take account of options to extend a lease in cases where it was thought that the option would be exercised in the future.[45]

Implementation practice

The IFRS Foundation implementation support team made presentations to the Emerging Economies Group at its Kuala Lumpur meeting from 14 to 16 May 2018. One presentation looked at the difficulties involved in implementing IFRS 16.[46] As a part of a second presentation focusing on the impact on financial statements, it was noted that the implementation of IFRS 16 will change the financial metrics of companies that have what were previously classified as operating leases. In particular:

- balance sheet structure - liabilities and assets will increase, thereby increasing the debt/equity ratio.
- income statement - operating costs will reduce but financing costs will increase, so reducing the interest cover ratio.
- statement of cash flows: some operating cash flows will become financing cash flows.

The presentation also provides a staff analysis of possible effects by industry sector:[47]

Table 2
Long-term financial liabilities to equity ratio

	Reported on balance sheet (IAS 17) (Percentage)	If all leases on balance sheet (IFRS 16) (Percentage)	Increase (Percentage)
Airlines	123	251	1.28
Travel and leisure	118	191	0.73
Retailers	48	103	0.55
Transport	54	84	0.30
Telecommunications	79	96	0.17
Distributors	91	104	0.13

Source: IFRS Foundation, Emerging Economies Group, Business Implications of IFRS 16. Agenda paper 1B, May 2018, p. 6. Available at https://www.ifrs.org/-/media/feature/meetings/2018/may/eeg/ap1b-leases.pdf.

According to the 2017 financial statements for Norwegian Air Shuttle ASA: "There will be a material impact on the Group's income statement and statement of financial position from the adoption of IFRS 16. More than 80 per cent of the total impact is expected to arise from changed presentation of operational aircraft leases. In addition to the effects stemming from aircraft leases, there will be effects from the leasing of facilities, ground service equipment and other categories of equipment and machinery.

IFRS 16 allows for various adoption approaches, whereas the Group has not yet decided which approach to apply. The choice of adoption approach will have implications for the size of transitional effects recognized both in the income statement, the statement of financial position and equity.

As per now, the Group estimates that the total of assets and the total of equity and liabilities as per 1 January 2019 will increase with an amount in the range between 25 billion NKr and 28 billion NKr. The Group also estimates that, compared to current presentation in the income statement, in 2019, an amount of more than 4 billion NKr is expected to be

[44] Ibid., p. 39.

[45] IFRS Foundation, 2018a, Report of the Emerging Economies Group meeting, May (updated 22 October), available at https://www.ifrs.org/-/media/feature/groups/eeg/eeg-report-may-2018.pdf.

[46] IFRS Foundation, 2018b, Emerging Economies Group, Agenda paper 1A. IFRS 16 leases: drilling down, May. Available at https://www.ifrs.org/-/media/feature/meetings/2018/may/eeg/ap1a-leases-session-2.pdf.

[47] IFRS Foundation, 2018c, Emerging Economies Group. Agenda paper 1B, Business implications of IFRS 16, May, pp. 4 and 6. Available at https://www.ifrs.org/-/media/feature/meetings/2018/may/eeg/ap1b-leases.pdf. In the presentation, it is made clear that the figures contained therein are drawn from databases and relate to 1,022 IFRS or US GAAP users, with estimated operating lease liabilities of more than US$300 million. They are not intended to be a representative sample.

reclassified from lease expenses and into depreciation and interest expense. The net impact on the income statement and the equity, if any, cannot yet be reliably estimated."[48]

4. Insurance contracts

IFRS 17 – Insurance Contracts may turn out to be the most far-reaching standard ever produced by IASB. It introduces a single, comparable way of accounting for insurance contracts worldwide, at a time when there are many different views about how insurance companies should prepare financial statements and many national approaches that are not comparable with each other.

The advantages claimed for the new standard are that: the balance sheet will be based on current information; insurance profit will be released in line with the release from risk on the contract; investment income will be reported separately, so that analysts can see the performance in each of the two drivers of profit in insurance companies; and results and financial positions will be comparable across companies. This significant gain in transparency will only be achieved with very considerable pain. Nearly all insurers will have to completely rethink their financial systems, and analysts will take some time to accustom themselves to the new information.

IFRS 17 was issued in May 2017 and does not come into force until January 2022.[49] However, the standard has already been endorsed for implementation by many countries, including Australia, Canada, Malaysia, New Zealand, Singapore, South Africa and Switzerland. IFRS 17 is expected to generate significant benefits, by promoting more consistent accounting and reporting on insurance contracts, and higher-quality information, by providing better insight into recent insurance activities of reporting entities. The standard is expected to facilitate better investment decision-making and to support financial stability.

In 2018, 450 listed insurers, with total assets worth US$13 trillion, applied IFRS when preparing their financial statements. The significant lead time for implementation reflects the technical difficulties most companies may experience in applying IFRS 17. The IFRS Foundation has been running major implementation outreach since 2017 and has set up a transition resource group to address issues raised by constituents. IFRS 17 supersedes IFRS 4, which was issued as a temporary standard and which enabled insurers to continue to use the predecessor GAAP when their host jurisdiction switched to IFRS.

IFRS 17 addresses insurance contracts, rather than insurance companies' financial statements, covering all such contracts whether they are for one year (often referred to as property and casualty) or for longer periods (typically, life policies). The standard encompasses insurance contracts that have an investment element with a discretionary participation feature and addresses reinsurance. There are optional simplifications for contracts of one year or less.

However, IFRS 17 does not cover contracts such as warranties issued by manufacturers, retirement benefit obligations or insurance contracts in the hands of the beneficiary. Financial guarantee contracts may be accounted for under either IFRS 17 or IFRS 9 and fixed-service contracts under either IFRS 15 or IFRS 17. Distinct investment activities and some embedded derivatives are measured under IFRS 9. Any other non-insurance services supplied would come under IFRS 15.

The standard

Insurance works in the opposite way to most commercial operations: the insurer receives its revenue at the start and has to estimate the future expenses to arrive at a profit. In most other businesses, the costs are known and it is the revenue that is unpredictable. IFRS 17 defines an insurance contract as one where a specified risk is transferred to the insurer for a period in return for a premium. The aim of the standard is to ensure that revenue from the contract flows through to profit or loss during the period covered by the contract. The difficulty is that many claims against insurance contracts are made after the expiration of the period covered by the contract: there are many reasons for this, the main one being that evidence of damage is not immediately available.

As a consequence, even one-year contracts carry what is referred to as a "tail" of claims that may extend over several years. Insurers are therefore required to estimate, at each reporting date, claims not yet presented and deduct these from the contract revenue allocated.

[48] Norwegian Air Shuttle ASA, 2018, Annual report 2017, p. 26, available at https://www.norwegian.com/globalassets/ip/documents/investor-relations/annual-report-2017-interactive.pdf.

[49] As per the proposal of the IASB made at its November 2018 meeting.

IFRS 17 introduces the concept of "contract fulfilment cash flows", which form part of the insurance liability or asset. The standard also requires that this estimate include the future profit margin on the contracts and a risk adjustment. If this process suggests that the insurance contract is not profitable, it should be recognized immediately as an onerous contract.[50]

A key issue in this regard is the requirement for insurers to systematically update estimates and assumptions at each reporting date. This means that discount rates will reflect current market conditions and that the expectations about the future unwinding of the contracts will also be re-evaluated. According to the IFRS Foundation, if both assets and liabilities are at current values and are economically matched, the update should not import volatility into the financial statements.

Some contracts, particularly long-term ones, include an investment element in the premium. IFRS 17 requires that this be split out and accounted for separately. Some insurers take the view that, aside from specific, investment-oriented contracts, all insurance is based on the assumption that the insurer can boost profit on the insurance by investing the advance premium, with the profit being joint. However, according to the standard, this is a different kind of activity and should be reported separately.

Most companies will encounter difficulties when implementing the standard, which is why IASB has given a three-year lead time. The Foundation is providing support through an implementation transition resource group and other outreach. Technical staff have made implementation presentations to the World Standard-setters Conference, the Emerging Economies Group and the IFRS Advisory Council.

The impact of the standard will vary depending on the accounting principles previously used by each company and the mix of products it offers. Companies should already be carrying out evaluations in this regard and beginning to brief investors and regulators as to the likely impacts. Insurers are generally accustomed to estimating future cash flows on insurance products, but they will need to modify their approach to take account of the risk adjustment and expected profit elements when arriving at their insurance liability or asset. Auditors and enforcers will probably wish to scrutinize these elements early in the transition period.

The standard provides three approaches to handling the transition, with the preferred one being a full retrospective application, in line with IAS 8. However, standard setters are aware that relevant information may not be available in some cases. Where supportable information is available, a modified retrospective approach may be used: where it is not, there exists a third alternative in the form of the fair value approach. Clearly, full retrospective application provides the most useful information for investors.

The IFRS Foundation has stated that it anticipates relatively little change to the existing accounting for short-term contracts, but greater change for companies that issue long-term contracts.[51] It provides the following analysis of the location of listed insurance companies' head offices around the world:

Table 3
Listed insurance companies by region

Region	Number	Total Assets
Europe	95	8.6
Asia–Pacific	191	7.2
North America	110	5.8
Africa and Middle East	184	0.3
Latin America	46	0.2
	626	22.1

Source: IFRS Foundation, 2017. IFRS Standards Effects Analysis.

According to the Foundation, 449 of the above-mentioned 626 companies have total assets of US$13.3 trillion, use IFRS and will have to implement IFRS 17. The main exception is the United States of America, which has not converged with IFRS in this area. The Foundation also provides information on the types of insurance contract offered:

Table 4
Types of insurance contract on offer

Type	Number
Property and casualty	150
Life and health	96
Multiline	181
Reinsurance	22
	449

Source: IFRS Foundation, 2017. IFRS Standards Effects Analysis.

[50] The term "onerous contract" means any contract that is deemed ultimately to be loss-making. It applies to any contract running beyond the end of the reporting year: IFRS require that an estimate be made of the likely outcome of such contracts. Where it is expected that they will not make a profit, the full expected loss should be provided for in the current result (IAS 11, IAS 37 and IFRS 15).

[51] IFRS Foundation, 2017, *IFRS Standards Effects Analysis. IFRS 17 – Insurance Contracts*, May, p. 30, available at https://www.ifrs.org/-/media/project/insurance-contracts/ifrs-standard/ifrs-17-effects-analysis.pdf.

The Foundation reports that it does not expect banks to be affected by IFRS 17 unless they also act as insurers and that banks will have a choice of accounting under IFRS 9 or IFRS 17 for financial guarantees. It adds that it does not expect investment companies to use IFRS 17 but points out that future financial statements under IFRS 17 will be more directly comparable with those of investment companies.[52]

Insurance agents will not be affected, but companies that provide insurance cover services directly, even if ancillary to their main product (for example, airlines offering travel insurance) will have to account for them under IFRS 17. Manufacturers offering warranties will not have to account for them under IFRS 17, even though these products are similar to insurance contracts. However, other companies offering warranty insurance, for example, when buying a computer, independently, will need to apply IFRS 17.[53]

The Foundation notes that:

> "Quantifying the costs involved in implementing new accounting requirements is difficult, as they depend on specific circumstances and improvements that are made at the time of implementation.
>
> …
>
> The likely implementation costs of IFRS 17 that the International Accounting Standards Board has identified will be in:
>
> (a) project design and implementation;
>
> (b) systems set-up;
>
> (c) process changes;
>
> (d) education and communication."

In the Effects Analysis, it is stated that insurers are expected to set up project teams to implement IFRS 17. It is suggested that insurers' analysis of the changes needed will, in turn, lead to the design and subsequent implementation of new systems.[54] Each company will need to make a significant education effort, both internally and externally,[55] and liaise with insurance regulators.

Company assessments

At the time of writing, the 2017 financial statements of a number of companies were taken into account. Those companies all chose to defer application of IFRS 9 and stated that, although they were working on IFRS 17, it was too early to estimate its impact. The French insurer AXA, for example, devotes more than a page of its 2017 annual report to explaining the IFRS 17 requirements but comments that: "The method of implementation of IFRS 17 and its potential impact on the Group's consolidated financial statements are currently being examined."[56]

5. Initiatives in process

The new standards discussed in this paper have already had, or will have, a significant impact on financial reporting. IFRS 17 fills a significant gap in IFRS, while IFRS 9, IFRS 15 and IFRS 16 represent attempts to move to a second stage of elaboration in these areas and affect many companies. IASB has no plans regarding any further standard-setting projects of a similar dimension. However, IASB is currently working on a number of projects intended to improve financial reporting, which will lead to implementation requirements in the future. The main aim of these projects is to improve communication. There are also several projects intended to address relatively obscure gaps in IFRS or to make minor improvements to existing standards.

6. Better communication in financial reporting

This initiative encompasses several ongoing projects: its main focus is to shift the attention of preparers and auditors to communication issues, in addition to compliance. Investors have suggested that reports are overly long, contain much irrelevant material and do not present information in a coherent and organized way.

IASB has already made minor amendments to IAS 1 – Presentation of Financial Statements, with the intention of clarifying wording that might lead preparers and auditors to believe that specific disclosures, material

[52] Ibid., p. 27.

[53] Ibid., p. 28.

[54] Ibid., p. 59.

[55] Ibid., p. 61.

[56] AXA, 2018, *Registration Document. 2017 Annual Financial Report*, p. 200, available at https://www-axa-com.cdn.axa-contento-118412.eu/www-axa-com%2Fa3fd87ca-ce10-4c5a-8eab-dccc54d315c8_axa-ddr2017-en-pdf-e-accessible_02.pdf.

or otherwise, are required. The Board has worked on the concept of “materiality” to encourage preparers and auditors to exercise judgment and not simply to include information to protect themselves from accusations of non-compliance.

The Board has published a discussion paper in which principles of disclosure are established and which is relevant in this regard.[57]

The above-mentioned initiatives, which are designed to change the culture of disclosure, may not give rise to any significant implementation issues. However, if a change in culture is to take place, then the support of enforcers and regulators will be required.

In terms of changes to IFRS, IASB is working on a project entitled Primary Financial Statements, the aim of which is to enhance presentation in the profit or loss statement and the statement of cash flows. The underlying objective is to improve comparability, provide a better focus and address inconsistencies in current practice. This is unlikely to lead to costly technical changes but could have an impact on presentation.

The overall project also includes work to ensure that the IFRS taxonomy accurately reflects the standards and to encourage preparers to provide tagged data and regulators to develop electronic reporting.

Filling in the gaps

While IFRS 17 arguably dealt with the largest gap in the IFRS suite of standards, IASB is working on two other areas that are not addressed in the standards.

The term “rate-regulated activities” refers to a type of business situation that is encountered only in certain IFRS countries. In some jurisdictions, the prices charged to customers by commercial entities, such as public utilities, are regulated by a government agency. Normally, this mechanism is used to protect the public in a situation of monopoly supply. The regulator fixes rates in such a way that the supplier is able to make a specified rate of return but no more than that.

[57] IASB, 2017, *Discussion Paper: DP/2017/1. Disclosure Initiative–Principles of Disclosure*, March, available at https://www.ifrs.org/-/media/project/disclosure-initative/disclosure-initiative-principles-of-disclosure/discussion-paper/published-documents/discussion-paper-disclosure-initiative-principles-of-disclosure.pdf.

However, in practice, this leads to the need for period-to-period adjustments. For example, if the actual consumption of electricity is lower during a reporting period than anticipated when fixing the rate, the company may not make enough profit to reach the specified rate of return on capital employed. This will cause the regulator to increase the rate for the following period.

Traditionally, there has been an expectation that regulated entities will report a stable profit period-to-period, and this has been achieved by establishing a deferred asset or liability reflecting anticipated adjustments to the rate. As a part of this approach, a given entity establishes an asset for revenue to be caught up in the next period, which increases the profit in the reported period. In effect, this is a smoothing mechanism.

Nonetheless, not all standard setters currently accept this approach, nor do they agree that the rate adjustment can be recognized as an asset or liability under IFRS. They argue that the economic reality is that profits do fluctuate in such situations.

This method poses a problem in Brazil, but the country adopted IFRS and its regulated entities were obliged to remove such assets and liabilities. It also creates issues in Canada, a country that has grandfathered the use of these revenue adjustment assets and liabilities. IASB produced a discussion paper on rate regulation and has launched a project on accounting for rate-regulated activities. If a standard is produced, it is not yet clear whether existing IFRS adopters will be able to adopt the new accounting. The change may only apply to new adopters.

Another field with regard to which some constituents have been asking for years for rules to be introduced is that of business combinations. Since IASB abandoned merger accounting, the only way to account for a business combination has been as an acquisition, with the “acquired” company being restated to fair value on consolidation.

Business reorganizations may be affected by this development. For example, some jurisdictions require retail banks to be reorganized so that they do not include any investment banking activity. This may involve creating new subsidiaries or switching subsidiaries between group members. Under IFRS 3 – Business Combinations, this would involve revaluing to fair value, which some commentators think creates

an artificial change of accounting values within the consolidated statements.

Dynamic Risk Management is the title of a project to develop new rules for macrohedging by banks. This was a highly problematical area during the development of IAS 39 – Financial Instruments: Recognition and Measurement, under which hedging and similar activities were generally viewed with suspicion. This area concerns positions taken by banks on a day-to-day basis to balance or rebalance a given entity's exposure to financial risks. IASB developed a project to liberalize this area, but constituents found its proposals to be overly complex and its launch has been postponed pending further work. The project will eventually result in an amendment to IFRS 9, but that is probably several years away.

Maintenance

What IASB refers to as "maintenance projects" typically arise from submissions to the Interpretations Committee, or from post-implementation reviews. In both cases, the issues at hand are usually operational in nature and connected to standards that have a fundamental approach that is not in question. As such, they would not be expected to generate implementation difficulties, but this is not to suggest that they are necessarily insignificant.

One such project, entitled Financial Instruments with the Characteristics of Equity, focuses on the Board's research agenda and revisits the dividing line between debt and equity. That approach might seem to entail radical consequences, but the practical issue is to find a principled way of determining which complex financial instruments should count as equity and which should be classified as liabilities. The existing standard, IAS 32 – Financial Instruments: Presentation, is stigmatized as a collection of rules.[58] According to an analysis carried out by an IASB technical team, the standard draws on conflicting principles and a decision has to be made as to which to privilege. This is a project that has confounded both FASB and IASB for many years and that they have placed on and taken off their agendas multiple times. In the past, the European Financial Reporting Advisory Group has suggested that the dividing line is an artificial construct that creates, rather than solves, problems. The Advisory Group has proposed simply ranking instruments on the financing side of the balance sheet, based on their priority in bankruptcy, leaving analysts, lenders and others to decide where they make the cut, if a cut is necessary.

One project that is closer to completion is the amendment of the definition of a business contained in IFRS 3 – Business Combinations.[59] This amendment arises from a post-implementation review of the standard. IASB and FASB share the view that the original definition fails to clearly distinguish between the acquisition of a collection of assets and that of a business. This has implications for the way in which items are recognized and measured. If considered a business, items are consolidated as a subsidiary and valued at fair value. If classified as a collection of assets, they are measured at cost.

In the light of the above-mentioned post-implementation review, a number of constituents think that goodwill should still be amortized. Both FASB, in its rules for small businesses, and IASB, in its IFRS for SMEs, allow small businesses to amortize. Two questions arise in this regard: whether this practice should be extended to listed companies and whether the impairment approach could be simplified to make the application of the standard less onerous. IASB has tentatively decided not to reintroduce amortization and is looking at simplifications of the impairment test.

IASB has conducted post-implementation reviews regarding IFRS 13 – Fair Value and IFRS 8 – Segment Information. Both standards are thought to be working sufficiently well, although the disclosures linked to fair-value measurement mandated by IFRS 13 may be considered in the light of the Principles of Disclosure project.

International Accounting Standards Board agenda structure and future projects

IASB has difficulty limiting the number of items on its agenda in order to ensure that its efforts are focused on delivering projects efficiently. In recent years, the Board has attempted to resolve this issue and to address the call for evidence-based standard setting by splitting its activities into: (a) the standard-setting

[58] For a fuller discussion of this topic, see IASB, 2008, *Discussion Paper. Financial instruments with Characteristics of Equity: Invitation to Comment*, February, paras. 15–34. Available at https://www.ifrs.org/-/media/project/fice/discussion-paper/published-documents/dp-financial-instruments-characteristics-equity.pdf.

[59] IFRS, Definition of a business (amendments to IFRS 3), available at https://www.ifrs.org/projects/2018/definition-of-a-business/ (accessed 1 February 2019).

agenda; (b) the research agenda; and (c) projects in the research pipeline awaiting placement on the research agenda.

The research agenda is comprised of topics that constituents have highlighted (through the triennial agenda consultation) as being worthy of standard setting. Staff analyse the topics to see whether there is evidence of a financial reporting problem and whether there are any feasible solutions. Generally, a discussion paper is produced and the Board decides, based on feedback from the public, whether to move the topic to the standard-setting agenda.

The topics referred to in the preceding section are either on the standard-setting agenda or the research agenda. However, it is worth mentioning the following two items, which are currently in the research pipeline and which have the potential to generate significant issues:

- A project regarding the amendment of IAS 19 – Employee Benefits. In the view of most constituents, this standard is largely out of date: however, all attempts made since 2002 to amend it have proved to be largely unsuccessful.
- A project to revise the requirements for provisions subsequent to changes in the conceptual framework.

D. ISSUES FOR FIRST-TIME ADOPTERS

Given the high number of IFRS adopters, there is a reasonable amount of information available concerning the costs and benefits of adopting IFRS. Australia, Canada, the European Commission, Japan and the Republic of Korea have all conducted evaluations and made their results public. Generally, the extent of the costs and their nature depend on the type of GAAP ("predecessor GAAP") that the IFRS replaces. In a country such as the United Kingdom of Great Britain and Northern Ireland, where accounting requirements have historically been geared towards investor needs, the cost to preparers can be relatively small.

The main driver of cost seems to be the extent to which financial reporting is implicated in other legal issues. In the United States of America, litigation is a significant financial risk for corporations, and financial reporting is, to an extent, shaped by the need not to leave areas to the exercise of judgment that may be challenged expensively in the courts. In countries such as Germany or Switzerland, lawmakers have been concerned about preserving economic stability. Historically, reporting has been more oriented towards the perceived needs of the economy than investor information. In all jurisdictions, financial reporting has implications for taxation, although such implications vary significantly from one jurisdiction to another.

While there are many variants of national GAAP, the two main ones are the common law and the code law models. Broadly speaking, the common law model emerged in the second half of the nineteenth century as a function of the Industrial Revolution, with the arrival of the listed company having a significant effect. This model started with a minimal legal framework and significant elaboration of best practice rules by accounting professionals.

The code law model owes its origins to seventeenth-century France and a perceived need to impose accounting requirements on businesses to encourage stability in the economy and, in particular, to reduce the risk of bankruptcy. The French model was taken up in some German States and was eventually codified by France through the 1806 Commercial Code, which was used in several States temporarily controlled by Napoleon.

Certain theorists have suggested that national accounting models develop over time, partly through companies "borrowing" ideas and legislation from each other and partly through legislators responding to events in their own country.[60] In that sense, there is nothing new about the ever-wider adoption of IFRS: the practice of using rules developed elsewhere goes back to the beginning of accounting legislation. Accounting rules across the world have tended to be based on cultural, colonial and economic links and relate mostly to one or other of the two above-mentioned models.

Taxation is also part of this evolutionary process. In the United Kingdom of Great Britain and Northern Ireland, income tax was introduced in the late eighteenth century in order to finance the wars against France. As such, it predated the creation of national accounting requirements by at least 50 years. Consequently, an

[60] For example, see Baudot L and Walton P, 2013, Influences on the Standard-Setting and Regulatory Process, in van Mourik C and Walton P, eds., *The Routledge Companion to Accounting, Reporting and Regulation*, Routledge, Abingdon: 318–338.

entirely different stream of legislation and jurisprudence was developed in the United Kingdom of Great Britain and Northern Ireland. This situation should be contrasted with continental Europe, where taxation of this kind began to be considered only in the late nineteenth century and was given a major impetus by the First World War. In continental Europe, taxation arrived significantly later than, and was therefore built on, national accounting laws.

Problems related to the first-time adoption of IFRS are typically most severe where the predecessor GAAP is mostly heavily influenced by the code law model. Governments may well have to create an entirely new layer of legislation (as the European Union did) to take listed company reporting out of the private company framework that is embedded deeply in the law.

Published studies on first-time adoption of IFRS point to a number of issues. Japan has not yet adopted IFRS but permits listed companies to do so on a voluntary basis. In one survey of Japanese adopters,[61] it is noted that those most interested in adoption are entities with significant overseas operations, or significant foreign investors. In contrast, medium-sized companies in France with no activities outside the country have suggested that adoption only disrupts communication with their shareholders.[62]

The studies generally concur that first-time adoption involves significant transitional costs generated by the creation of a project team to manage the transition. Typically, new staff or outside consultants are hired to redesign internal systems to provide the information required for IFRS financial statements. In a steady state, first-time adopters will probably have higher reporting costs as a result of the need to recruit more highly qualified staff and to disseminate more information to investors. Their securities should, however, be more accurately priced in the market.

In terms of the technical content of the standards, the aim of IFRS 1 – First Time Adoption of International Financial Reporting Standards is to ensure that financial statements show a position as if the entity in question had always used IFRS. If the entity does not have long-lived assets and does not use financial instruments that need to be valued at fair value, the transition may not be too complicated. However, it is not always easy to establish the historical cost if company records are not structured in the right way, and IFRS lack any guidance on how to address less than extreme levels of inflation. Where fair value is required, IFRS do not permit the use of hindsight to establish past fair values and there may not be markets in every jurisdiction to establish reliable current values. The standards do, however, incorporate some exceptions and practical expedients to deal with most of these issues.

Member States continue to encounter challenges as a part of the process of implementing IFRS, including: a lack of regulatory backing; the weak nature, or absence of, institutions empowered to enforce implementation; the lack of a critical mass of professional accountants and experts in related fields, such as actuaries; and the scarcity of books and other training materials in languages other than English. Regional accounting standard setters face implementation challenges such as: member countries in their respective jurisdictions at varying stages in the implementation of IFRS; capital markets at different stages of development and with different information needs; and the lack of legal authority to promote the consistent implementation of IFRS on a regional basis.

E. INTERNATIONAL FINANCIAL REPORTING STANDARD FOR SMALL AND MEDIUM-SIZED ENTITIES

The IFRS for SMEs was first issued in 2009, with a slightly revised version coming into force in 2015. It is a stand-alone, comprehensive basis for accounting that does not involve any reference back to full IFRS, from which it differs in several ways. IASB has pledged to amend the standard only at intervals of at least three years, and then only to incorporate new IFRS that are already being implemented. Based on the Foundation's 166 jurisdiction profiles, the IFRS for SMEs is required or permitted in 86 countries.[63] The IFRS for SMEs is not, however, authorized for use in the European Union, not least because, in some regards, it does not comply with European Union Directive 2013/34/EU on

[61] Japan, Financial Services Agency, 2015, *IFRS Adoption Report*, 15 April, available at https://www.fsa.go.jp/en/news/2015/20151113-1/01.pdf.

[62] Masca E, 2012, Influence of cultural factors in adoption of the IFRS for SMEs, *Procedia Economics and Finance*, 3: 567–575. Available at https://tinyurl.com/ydafxsn8 (accessed 1 February 2019).

[63] IFRS Foundation, 2018d, IFRS Foundation updates jurisdiction profiles to reflect decision by 17 African countries to adopt IFRS standards from 2019, 29 January. Available at https://www.ifrs.org/news-and-events/2018/01/ifrs-foundation-updates-jurisdiction-profiles-to-reflect-decision-by-17-african-countries/ (accessed 17 January 2019).

the annual financial statements, consolidated financial statements and related reports of certain types of undertakings. The United Kingdom of Great Britain and Northern Ireland does, however, use a modified form of the standard for smaller companies.

The IFRS Foundation has made the IFRS for SMEs available in a large number of languages and the IFRS Education Initiative has been publishing support modules for each part of the IFRS for SMEs.[64]

First-time adoption

There is very little information available on the adoption of the IFRS for SMEs and no systematic professional studies would seem to have been carried out in that regard. However, there is a significant body of academic literature concerning potential adoption in Europe. This situation reflects the fact that, while there is a close relationship between tax rules and financial reporting by SMEs in many jurisdictions, the IFRS for SMEs specifically excludes the application of tax rules. In the literature, it is noted that the comparability of financial statements, which underpins full IFRS, is not so important for SMEs, although regulators suggest that use of the standard does help to encourage inward investment.

The main implementation cost is seen as being the training of accounting staff and the use of experts to improve systems and, potentially, to retain some separate tax-related records. Such training drives up accounting costs and owners of SMEs are generally reluctant to allocate resources thereto.

The next revision of the International Financial Reporting Standard for Small and Medium-sized Entities

There is no update currently in the pipeline. In 2016, IASB voted to begin the next update process early in 2019. The work plan envisages a call for information in 2019 and the issue of a new update in 2020 for subsequent implementation. There is an SME Implementation Group, which very occasionally issues question-and-answer material to clarify the standard and which will handle the next update. The updating process generally consists of an initial call for information (comparable to the post-implementation review process) from constituents to identify any operational difficulties. The feedback in this regard is analysed, along with the changes in full IFRS that have taken place since the last update, and the Implementation Group then makes recommendations to IASB. IASB due process is subsequently followed, with proposed changes being made available for comment prior to the issue of a new standard.

The standards referred to in section C of this chapter will normally be candidates for review by the Implementation Group as a part of the 2020 update. However, financial institutions and insurance companies are not allowed to use the IFRS for SMEs, so it should not be affected by IFRS 17. The existing IFRS for SMEs includes limited guidance on financial instruments as used by commercial companies, and this may change slightly as a result of the finalization of IFRS 9.

However, IFRS 15 and IFRS 16 would normally apply in some form to SMEs. SMEs would be expected to be significant users of lease finance, and they may be more affected by IFRS 16 than many larger companies. What constitutes a material leased asset may differ depending on the given context (SMEs or listed companies).

F. CONCLUSIONS

As highlighted in this chapter, preparers, auditors and users of financial statements are facing what is probably their most difficult transition since adopting IFRS. The international standard setter has issued four major standards that may require a significant reorganization of systems and may change primary financial statements for some companies. Insurance companies are confronted with the biggest challenge of all, with the vast majority having to deal with a wholesale change in the way they report insurance contracts: preparation in this regard will be intensive and probably expensive.

Both insurance companies and financial institutions also face an overhaul of the way they account for financial instruments. The requirements of IFRS 9 will bring not only simplification and greater flexibility but also a radical change to credit-loss provisioning. The need to forecast credit loss will be a challenge for all participants, preparers, auditors and users in the field of bank financial reporting.

[64] IFRS, 2018, September 2018 IFRS for SMEs update, available at https://www.ifrs.org/supporting-implementation/supporting-materials-for-the-ifrs-for-smes/ifrs-for-smes/september-2018-ifrs-for-smes-update/ (accessed 1 February 2019).

Virtually all companies are affected by IFRS 15: those with contracts that cover more than one component may have to change their systems and there may be a transitional affect. IFRS 16 is not likely to change lessor accounting, but those companies that lease assets may well find that the leases will come on to the balance sheet.

The IFRS Foundation is assisting with implementation by conducting numerous presentations, webinars and other outreach activities, and has set up transition resource groups regarding the major issues. Some enforcers have also published guidance. In particular, the International Organization of Securities Commissions has published its 2016 Statement on Implementation of New Accounting Standards. The Statement highlights the need both to assess the potential impact of standards and to alert stakeholders to their likely effects on individual companies' future financial positions and results and issues that should be considered in implementation, disclosure and audit.

National standard setters may well find it worthwhile to create special working groups to liaise with the IFRS Foundation implementation team and to help handle the implementation of these major new standards in their own jurisdiction. Most will need to work with preparers and auditors to ensure that the local language version of the standards is accurate and that entities have identified any potential problems and sought solutions thereto. Businesses may well have significant system changes and these need to be addressed early on in the implementation process. Once the standards are in use, there may be a need to communicate with enforcers and users of financial statements to help ensure a smooth transition.

This group of standards represents the last of the major reforms arising from the project to improve both the IFRS and convergence with FASB in the United States of America. Once these reforms have been absorbed, the international standard setter's programme for the immediate future will be oriented more towards the maintenance and improvement of existing standards. IASB is focused on improving communication and filling in gaps.

CHAPTER II. REVIEW OF THE PRACTICAL IMPLEMENTATION OF INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS

This chapter contains a summary of recent developments regarding the international public sector accounting standards (IPSAS) and a review of the process of their adoption around the world. In addition, this chapter highlights forthcoming standards, progress concerning accrual-based IPSAS globally and selected key practical issues that may arise during implementation. Practical challenges may emerge with regard to regulatory context, institutional arrangements, changes in and updating of information technology (IT), technical accounting and financial reporting issues and challenges arising from the broader development of the public sector accounting profession, in particular skills development.

IPSAS are designed for application by national, regional and local Governments and related government entities. Convergence of accounting practices and systems across borders should establish a largely homogenous basis for underlying assumptions regarding accounting and financial reporting.[65] IPSAS serve as a mechanism that allows for more homogenous public sector financial reporting across different countries. In addition, IPSAS can also be a tool for establishing homogeneity in accounting and financial reporting within a country, for example between municipal and central government reporting levels.

A. BACKGROUND TO INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS

International harmonization and convergence in the area of public sector accounting is currently driven through the adoption of IPSAS at the national level. In public sector accounting research, "adoption" has been described as a process involving the incorporation of the requirements of international standards, such as IPSAS, into local regulations.[66] Adoption may entail the coexistence of different sets of standards: for example, IPSAS requirements may be embedded in local regulations. Over time, a convergence process may see accounting requirements "converging" towards the same principles. The process of convergence may be carried out through a step-by-step implementation of changes of international standards in a local context. Convergence may take place between IPSAS and local accounting and financial reporting requirements within the public sector or between various levels of reporting, for example, central Government and municipalities within a single country.

The basis of proper sequencing is a proper understanding of the existing financial management system in a given local context.[67] Local variables and conditions influence the IPSAS implementation process. Nevertheless, the adoption of the standards by countries across the globe has increasing brought them to the attention of other States.[68]

Over the last two decades, the International Public Sector Accounting Standards Board (IPSASB) and its IPSAS have increasingly become a point of reference for international standardization within the field of public sector accounting. IPSASB is an independent standard-setting board that operates under the auspices of the International Federation of Accountants (IFAC).

In its early stages, during the 1980s, harmonization in the area of public sector accounting was undertaken because of rising concern that scant financial data

[65] Brusca I and Martínez JC, 2015, Adopting International Public Sector Accounting Standards: A challenge for modernizing and harmonizing public sector accounting, International Review of Administrative Sciences, 82(4): 724–744.

[66] See for example, Pacter P, 2005, What exactly is convergence? International Journal of Accounting, Auditing and Performance Evaluation, 2(1–2): 67–83. Available at https://www.iasplus.com/en/binary/resource/2005ijaape.pdf.

[67] Bietenhader D and Bergmann A, 2010, Principles for sequencing public financial reforms in developing countries, International Public Management Review, 11(1): 52–66. Available at http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.881.4488&rep=rep1&type=pdf.

[68] See, for example, Association of Certified Chartered Accountants (ACCA), 2017, [International Public Sector Accounting Standards] IPSAS implementation: current status and challenges. Available at https://www.accaglobal.com/content/dam/ACCA_Global/Technical/pubsect/pi-IPSAS-implementation-current-status-and-challenges.pdf; and Brusca I and Martínez JC, 2015, Adopting international public sector accounting standards: A challenge for modernizing and harmonizing public sector accounting, *International Review of Administrative Sciences*, 82(4): 724–744.

existed for public sector entities and government organizations. An increasing awareness of the large amounts of funds held and managed in the public sector resulted in a growing need for better financial accountability within the public sector.[69] Improving accounting practices became an integral part of the new public management[70] movement from the 1990s onwards.[71]

Since 1997, IPSASB has developed and issued a suite of accrual-based IPSAS[72] and a cash-basis IPSAS.[73] The IPSAS Handbook of Pronouncements can be downloaded from the Board's website.[74] The first IPSAS were published in May 2000. They were primarily based on IAS and incorporated the accrual method of accounting. The Organization for Economic Cooperation and Development (OECD)[75] was an early adopter of IPSAS, issuing its first set of IPSAS-compliant financial statements in 2000. Another early IPSAS adopter was the Swiss Federal Government, which implemented them in around 2007.[76] Moreover, Geneva and Zurich had almost completed IPSAS implementation by that time.[77]

In addition to financial reporting standards, IPSASB has developed three recommended practice guidelines on: reporting on the long-term sustainability of an entity's finances; financial statement discussion and analysis; and reporting service performance information.

Since 2004, IPSASB has been operating as an independent standard-setting board, dedicated to developing high-quality IPSAS, guidance papers and other resources for use by public sector entities around the world for general purpose financial reporting. In October 2014, IPSASB issued the first global conceptual framework for public sector entities. The framework underpins IPSASB standard-setting and guidance development activities. General purpose financial reporting standards are defined in the IPSASB conceptual framework as financial reports intended to meet the information needs of users who are unable to require the preparation of financial reports tailored to meet their specific information needs.[78]

The key strategic objective of the 2015 IPSASB forward strategy[79] is to strengthen public financial management and knowledge globally through the increased adoption of accrual-based IPSAS.

Current International Public Sector Accounting Standard-development process

IPSASB follows a certain due process and certain working procedures in promulgating IPSAS. When developing such standards, IPSASB adheres to very structured and public due process. This process provides the opportunity for all those interested in financial reporting in the public sector, including those preparers and users directly affected by IPSAS, to make their views known to IPSASB and to consequently have them considered as a part of the standard-setting development process.

Exposure drafts of all proposed IPSAS are developed, usually with input from a task force or project advisory panel and are available for download from the IPSASB website. Comments received through the exposure draft process are considered by IPSASB and are publicly available on its website. At a more general level, agenda papers, including issues papers and draft international standards, are posted online in advance of each IPSASB meeting, along with,

69 See, for example, Aggestam Pontoppidan C and Andernack I, 2016, *Interpretation and Application of IPSAS*, Wiley.

70 The term "new public management" was established in the late 1980s to denote a new emphasis on the importance of management and "production engineering" in public service delivery, often linked to principles of economic rationalism. See Hood C, 1989, Public administration and public policy: Intellectual challenges for the 1990s, *Australian Journal of Public Administration*. 48(4): 346–358.

71 Hood C, 1995, The "new public management" in the 1980s: Variations on a theme, *Accounting, Organizations and Society*, 20(2/3): 93–109.

72 For the full set of IPSAS, see International Public Sector Accounting Standards Board (IPSASB), Publications and resources. Available at https://www.ipsasb.org/publications-resources (accessed 17 January 2019).

73 See IPSASB, Revised cash-basis IPSAS.

74 IFAC, 2017, *Handbook of International Public Sector Accounting Pronouncements*.

75 The 2016 set of Organization for Economic Cooperation and Development (OECD) IPSAS-compliant financial statements is available at http://www.oecd.org/about/budget/external-auditor-financial-statements-2016.pdf.

76 Bergmann A, 2012, The influence of the nature of government accounting and reporting in decision-making: Evidence from Switzerland, *Public Money and Management,* 32(1): 15–20.

77 Ibid.

78 IPSASB, 2014, The conceptual framework for general purpose financial reporting by public sector entities. Final pronouncement, October 2014, para. 1.4.

79 IPSASB, 2015, The IPSASB's strategy for 2015 Forward: Leading through change, 17 September.

following approval by IPSASB, the minutes of the immediately preceding meeting.[80]

International Public Sector Accounting Standards Board institutional arrangements and standing

Over the last few decades, IPSASB has undergone various reforms. Its predecessor, the IFAC Public Sector Committee, held its first meeting back in 1987. The Committee became IPSASB in 2004,[81] with revised terms of reference, reflecting the fact that the IPSASB mandate would focus on developing and issuing IPSAS.[82]

In order to strengthen IPSASB governance arrangements, an IPSASB Governance Review Group was formed to propose future internal governance and oversight arrangements.[83] Subsequently, a governance review of IPSASB was carried out in 2014,[84] providing recommendations that strengthened IPSASB governance arrangements in a timely, cost-effective and expeditious manner.[85]

As a result of those recommendations, the Public Interest Committee was established in 2015 and is responsible for providing assurance that IPSASB standard-setting activities are in the public interest. The minutes of the Committee's past, and the dates of its upcoming, meetings are available to the public.[86]

Another outcome of the IPSASB governance review was the establishment of a separate Consultative Advisory Group.[87] The role of the Advisory Group is to enable IPSASB to receive direct feedback from interested public and private sector institutions, especially those engaged in the preparation, audit or evaluation of public sector financial statements, on their strategy, work programme and standard-setting activities. The Public Interest Committee oversees the work of the Advisory Group, with which IPSASB must consult regarding the identification and prioritization of future projects.

Brief review of current and upcoming International Public Sector Accounting Standards

IPSASB has been developing and issuing its suite of accrual-based IPSAS since 1997. As noted above, in October 2014, IPSASB issued the first global conceptual framework for public sector entities. This framework underpins IPSASB standard-setting and guidance-development activities. In addition to IPSAS and the recommended practice guidelines, IPSASB also publishes other documents. The present section contains a review of IPSASB work published during the period 2017–2018.

In April 2018, IPSASB issued its Exposure Draft 65 – Improvements to IPSAS, 2018. The document contains proposals for both general improvements to IPSAS, designed to address issues raised by stakeholders, and IFRS convergence amendments. Furthermore, in 2018, IPSASB published a consultation document on its Proposed Strategy and Work Plan 2019–2023. As a part of the Strategy, the importance of IPSAS for public financial management is emphasized and the following strategic objective is proposed: "Strengthening public financial management … globally through increasing adoption of accrual-based IPSAS." In the consultation document, it is stated that this approach should be supported through the two following main areas of activity, both of which have a public interest focus: (a) developing IPSAS and

[80] Meetings and agenda papers are in English, the official working language of IPSASB.

[81] For a history of IPSASB governance review, see IPSASB Governance Review Group, 2014a, The future governance of the International Public Sector Accounting Standards Board (IPSASB). Public consultation, January. Available at http://www.oecd.org/gov/budgeting/IPSASB-Consultation-Paper.pdf.

[82] See, for example, Aggestam Pontoppidan C and Andernack I, 2016, *Interpretation and Application of IPSAS*, Wiley.

[83] IPSASB Governance Review Group, 2014a, The future governance of the International Public Sector Accounting Standards Board (IPSASB). Public consultation, January, p. ii. Available at http://www.oecd.org/governance/budgeting/IPSASB-Consultation-Paper.pdf.

[84] OECD, Public consultation on the International Public Sector Accounting Standards Board (IPSASB), available at http://www.oecd.org/gov/budgeting/IPSASB-Governance-Review.htm (accessed 17 January 2019).

[85] IPSASB Governance Review Group, 2014b, The future governance of the International Public Sector Accounting Standards Board (IPSASB). IPSASB Governance Review Group – recommendations. Available at http://www.oecd.org/gov/budgeting/IPSASB-Governance-Review-Group-Recommendations.pdf.

[86] See OECD, Public Interest Committee, available at http://www.oecd.org/gov/budgeting/pic.htm (accessed 17 January 2019).

[87] See IPSASB, Consultative Advisory Group, available at https://www.ipsasb.org/cag (accessed 17 January 2019).

other high-quality financial reporting guidance for the public sector; and (b) raising awareness of IPSAS and the benefits of accrual adoption.[88] The consultation process provides an opportunity for stakeholders to comment on the IPSASB strategic objective, supporting themes and work plan priorities for the period 2019–2023.[89] During the period 2017–2018, in addition to the consultation document, IPSASB issued new IPSAS and exposure drafts. This section focuses on introducing those recent publications.

At the end of 2017, IPSASB issued a revised IPSAS – Financial Reporting under the Cash Basis of Accounting, which enters into force on 1 January 2019 and with regard to which early adoption is encouraged. The amendments contained therein seek to address some of the main barriers that had been observed regarding the adoption of this standard. The proposals contained in Exposure Draft 61 – Amendments to Financial Reporting under the Cash Basis of Accounting are implemented through the revised Cash Basis IPSAS.[90]

IPSAS 40 – Public Sector Combinations was issued in 2017, providing the first international accounting requirements that specifically address the needs of the public sector when accounting for combinations of entities and operations. The standard classifies public sector combinations as either amalgamations or acquisitions.

In June 2018, IPSASB approved IPSAS 41 – Financial Instruments, which embraces a new, simplified classification and measurement requirements for financial assets, a forward-looking impairment model and a flexible, principle-based hedge- accounting model. IPSAS 41 seeks to align accounting for financial instruments with IFRS 9[91] and includes proposals for public sector-specific modifications. This approach builds on public and private sector best practice, while seeking to address specific public sector features.

Exposure Draft 64 – Leases was issued in January 2018. The aim of the IPSASB Leases project is to achieve convergence with IFRS 16 – Leases. In developing Exposure Draft 64, IPSASB applied its policy paper on the process for reviewing and modifying IASB documents. Drawing on this process, IPSASB proposes the adoption of the IFRS 16 right-of-use model for lessees. However, with regard to lessors, IPSASB decided not to adopt the IFRS 16 risks and rewards incidental to ownership model, opting instead for the right-of-use model. IPSASB also proposes new, public sector-specific guidance on concessionary leases for both lessors and lessees.

Exposure Draft 63 – Social Benefits was also released in 2017. The Draft focuses on accounting for the delivery of social benefits, such as retirement, unemployment and disability, and is designed to improve consistency, transparency and reporting by public sector entities of social benefit schemes, which account for a large portion of government expenditure in most jurisdictions.

Finally, during the 2017–2018 period, IPSASB issued two consultation papers, one on accounting for revenue and non-exchange expenses and the other on financial reporting for heritage in the public sector. The first of those papers contains discussion of the two following potential approaches to recognition of revenue for transactions that have performance obligations or stipulations:

(a) The exchange/non-exchange approach, which maintains the principles contained in IPSAS 23 – Revenue from Non-exchange Transactions (Taxes and Transfers)[92] but which identifies five options for updating IPSAS 23;

(b) The public sector performance obligation approach for revenue, as a part of which revenue is recognized when identified performance obligations have been met.

The consultation paper also focuses on two potential approaches for recognition of non-exchange expenses:

(a) The extended obligating event approach, which relies on the IPSASB Conceptual Framework

[88] IPSASB, 2018, *IPSASB Proposed Strategy and Work Plan 2019–2023. Consultation, January 2018*, p. 7, available at https://www.ifac.org/system/files/publications/files/IPSASB-Strategy-and-Work-Plan-2019-2023-Consultation.pdf.

[89] Ibid.

[90] IPSASB, 2016, *Exposure Draft 61. Amendments to Financial Reporting under the Cash Basis of Accounting (the Cash-Basis IPSAS)*, February. Available at https://www.ifac.org/system/files/publications/files/IPSASB-Exposure-Draft-61-Cash-Basis-IPSAS.pdf.

[91] IFRS, IFRS 9 – Financial instruments, available at https://www.ifrs.org/issued-standards/list-of-standards/ifrs-9-financial-instruments/ (accessed 17 January 2019).

[92] IPSASB, 2017a, *Consultation Paper. Accounting for Revenue and Non-exchange Expenses*, August, available at https://www.ifac.org/system/files/publications/files/Accounting-for-Revenue-and-Non-Exchange-Expenses-Consultation-Paper.pdf.

to determine when a resource provider has a liability and an expense;

(b) The public sector performance obligation approach for expenses, which mirrors the equivalent revenue approach but adapted for non-exchange expenses.

In addition, the consultation paper covers: (a) implementation issues regarding recognition of revenue from capital grants and services in-kind; (b) initial and subsequent measurement of non-contractual receivables; (c) subsequent measurement of non-contractual payables.

In the consultation paper on financial reporting for heritage in the public sector,[93] it is argued that:

- Heritage items' special characteristics do not prevent them from being assets for the purposes of financial reporting.
- Heritage items should be recognized in the statement of financial position if they meet the recognition criteria contained in the Conceptual Framework.
- In many cases, it will be possible to assign a monetary value to heritage assets.

Heritage items are defined as those items that are intended to be held indefinitely and preserved for the benefit of present and future generations because of their rarity and/or significance. The consultation paper also discusses:

- Initial and subsequent measurement of heritage assets.
- Whether heritage preservation responsibilities could involve present obligations for entities, which should be recognized as liabilities in the financial statements.
- Presentation of information for heritage in general purpose financial reports.

Lastly, the IPSASB staff have issued a document [94] summarizing the existing IPSAS provisions concerning materiality.

B. REVIEW OF CURRENT STATE OF PRACTICAL IMPLEMENTATION OF INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS

This section contains a review of the current state of practical implementation of IPSAS globally, drawing on recent key publications.[95] The International Monetary Fund (IMF) has highlighted that: "at the macrofiscal level, the importance of accrual accounting for macroeconomic policy arises from the fact that it measures assets and liabilities that are relevant to the overall stance of fiscal policy and fiscal sustainability, but [that] are not measured by cash accounting." More specifically, IMF has stated that: "whereas cash accounting measures only conventional debt, accrual accounting measures other quasi-debt liabilities, such as accounts payable for the receipt of goods and services and employee liabilities".[96]

Countries can opt to first implement the cash-basis IPSAS and then to develop a route for the transition

[93] IPSASB, 2017b, *Financial Reporting for Heritage in the Public Sector*, April, available at https://www.ifac.org/system/files/publications/files/IPSASB-Consultation-Paper-Financial-Reporting-for-Heritage-in-the-Public-Sector.pdf.

[94] IPSASB, 2017c, IPSASB staff questions and answers on materiality, 21 June, available at http://www.hesabras.com/Content/media/filepool3/2017/7/555.pdf; and IPSASB, IPSASB staff podcast on materiality, available at http://www.ifac.org/news-events/2017-06/ipsasb-staff-podcast-materiality (accessed 18 January 2019).

[95] The publications include, but are not limited to: ACCA, 2017, IPSAS implementation: Current status and challenges, available at http://www.accaglobal.com/content/dam/ACCA_Global/Technical/pubsect/pi-IPSAS-implementation-current-status-and-challenges.pdf; Ernst and Young, 2012, Overview and comparison of public accounting and auditing practices in the 27 [European Union] EU Member States. Prepared for Eurostat. Available at https://ec.europa.eu/eurostat/documents/1015035/4261806/study-on-public-accounting-and-auditing-2012.pdf; IFAC, 2017, *International Standards: 2017 Global Status Report*, available at https://www.ifac.org/system/files/publications/files/International-Standards-2017-Global-Status-Report.pdf; Cavanagh J, Flynn S and Moretti D, 2016, *Implementing Accrual Accounting in the Public Sector*, International Monetary Fund (IMF), Fiscal Affairs Department, Washington, D.C. Available at https://www.imf.org/external/pubs/ft/tnm/2016/tnm1606.pdf; OECD and IFAC, 2017, *Accrual Practices and Reform Experiences in OECD Countries*, Paris, available at https://read.oecd-ilibrary.org/governance/accrual-practices-and-reform-experiences-in-oecd-countries_9789264270572-en#page1 (accessed 18 January 2019); PricewaterhouseCoopers, 2014, *Collection of Information Related to the Potential Impact, including Costs, of Implementing Accrual Accounting in the Public Sector and Technical Analysis of the Suitability of Individual IPSAS Standards*. Available at https://ec.europa.eu/eurostat/documents/1015035/4261806/EPSAS-study-final-PwC-report.pdf; and PricewaterhouseCoopers, 2015, PricewaterhouseCoopers global survey on accounting and reporting by central Governments: 2nd edition. Towards a new era in Government accounting and reporting. Available at https://www.pwc.com/rw/en/assets/pdf/second-edition-global-survey-government.pdf.

[96] Khan A and Mayes S, 2009, *Transition to Accrual Accounting*, IMF, p. 3, available at https://www.imf.org/external/pubs/ft/tnm/2009/tnm0902.pdf.

to accrual accounting.[97] Such a route has also been echoed by the International Consortium on Governmental Financial Management.[98]

In a 2017 report, IFAC highlighted that the journey towards high-quality public financial information begins with Governments committing to the implementation of internationally recognized financial reporting standards, such as IPSAS, that support a comprehensive capture of their financial performance and position. Furthermore, in the report, it is stated that: "Based on national priorities, resources and relevance, member organizations have to determine the appropriate level and type of actions they should take to promote and support the adoption of IPSAS. IFAC is assisting member organizations by providing guidance in developing roadmaps to promote and support adoption."[99]

Overview of implementation

This section provides an overview of IPSAS implementation status and a number of examples of implementation in selected countries.[100] In its 2015 report, PricewaterhouseCoopers notes[101] that the biggest shift in financial reporting practices is expected in Africa and Latin America, followed by Asia, with many Governments undertaking such a project as part of a wider public finance management reform, often funded by international institutional donors.

1. Africa

Africa has been at the forefront of IPSAS adoption, with several countries intending to formally adopt the standards as part of financial management reform programmes. Some of the incentives and programmes for IPSAS adoption in Africa have been funded by donors. In the 2015 PricewaterhouseCoopers report, it was highlighted that 17 countries in Africa have indicated their intention to move to accrual accounting.

2. Asia–Pacific

Following the Asia crisis of the late 1990s, countries in South Asia embarked on financial management reforms in the private and public sectors. Some of countries most affected by the crisis were Indonesia, the Republic of Korea and Thailand. Other countries were also affected, including Malaysia and the Philippines. Funding from donors such as IMF and the World Bank required public finance management reforms, including the adoption of accrual accounting standards based on IPSAS. Bangladesh, India, Nepal and Pakistan adopted standards aligned with cash-based IPSAS.[102]

3. Eastern Europe

A number of countries in Eastern Europe have embarked upon the journey towards IPSAS adoption. Little has been published on IPSAS implementation processes within the region. However, to provide one example,[103] the Government of Armenia made a decision to adopt accrual-based IPSAS. The Ministry of Finance translated the IPSAS into Armenian in 2009 and then again in 2012. The 2012 translation of the IPSAS served as a reference for the development of the Armenian Public Sector Accounting Standards. According to the World Bank, the Armenian standards are now being piloted in a number of government organizations and a trainer-training programme is planned.[104] Another example is the Russian Federation, which has finalized proposals for the adoption of national accounting rules based on IPSAS, with the aim of increasing the efficiency and

[97] See, for example, Brusca I, Gómez-Villegas M and Montesinos V, 2016, Public financial management reforms: The role of IPSAS in Latin America, *Public Administration and Development*, 36(1): 51–64; and Bietenhader D and Bergmann A, 2010, Principles for sequencing public financial reforms in developing countries, *International Public Management Review,* 11(1): 52–66. Available at http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.881.4488&rep=rep1&type=pdf.

[98] Hughes J, 2013, A compilation and certification programme for developing countries, *International Journal of Government Financial Management*. XIII(1): 1–14. Available at https://www.icgfm.org/wp-content/uploads/2017/06/1-7.pdf.

[99] IFAC, 2017, *International Standards: 2017 Global Status Report*, p. 25, available at https://www.ifac.org/system/files/publications/files/International-Standards-2017-Global-Status-Report.pdf.

[100] For a very high-level overview of adoption information per country, see IFAC, Financial reporting standards adoption by country. Available at https://www.ifac.org/system/files/Standards-Adoption-by-Country.pdf.

[101] PricewaterhouseCoopers, 2015, PricewaterhouseCoopers global survey on accounting and reporting by central Governments: 2nd edition. Towards a new era in Government accounting and reporting. Available at https://www.pwc.com/rw/en/assets/pdf/second-edition-global-survey-government.pdf.

[102] ACCA, 2017, IPSAS implementation: Current status and challenges.

[103] Please note that many other countries in this region are also going ahead with IPSAS adoptions.

[104] See IFAC, Armenia, available at https://www.ifac.org/about-ifac/membership/country/armenia (accessed 18 January 2019).

effectiveness of government spending. In the 2015 PricewaterhouseCoopers report, it is noted that: "The process to change the local accounting standards in the public sector to standards that are broadly consistent with IPSAS has already been initiated."[105] The initiative, which is being run under the World Bank Treasury Development Project, aims to improve the governance of the public finances of the Russian Federation by presenting more complete, true and fair financial information.[106] It should be noted that the Russian Federation has applied accruals-based accounting to all public sector entities since 2006.[107]

4. Latin America and the Caribbean

Much of Latin America is moving towards adopting IPSAS, including as a part of financial management reform programmes promoted and funded by donors.[108] Chile, Colombia and Peru have taken the lead, having adopted IPSAS in 2018. IPSASB states that national Governments, bodies and organizations in Brazil, Costa Rica, Ecuador and Panama have partially adopted, or plan to adopt, IPSAS in the near future.[109]

5. Western Europe and Others

The 2016 OECD Accruals Survey on selected financial reporting practices in all OECD countries was carried out in collaboration with the IFAC "Accountability. Now." initiative[110] and was sent to the Ministries of Finance and equivalent bodies of all 34 OECD countries.[111] Answers from all 34 Ministries were collected from November 2015 to June 2016. The results of the survey[112] show that most OECD countries have reformed and modernized their financial reporting practices over the last few decades.

The European Commission is currently working to establish and implement uniform and comparable accruals-based accounting practices for all sectors of general Government in European Union Member States. In that regard, Eurostat launched a public consultation on the suitability of IPSAS for European Union Member States in February 2012. This consultation on the suitability of IPSAS and harmonized, accruals-based European Union public sector accounting standards was considered to be an important part of efforts to build trust across the public sector.[113] The overall conclusion arising from the public consultation process was that European Union Member States[114] did not think it appropriate for the European Union to adopt IPSAS, preferring instead to see the development of European Public Sector Accounting Standards (EPSAS). However, if formally adopted, EPSAS will be closely coupled with IPSAS. Following the first consultation process, and the subsequent decision to develop EPSAS,

[105] PricewaterhouseCoopers, 2015, PricewaterhouseCoopers global survey on accounting and reporting by central Governments: 2nd edition. Towards a new era in Government accounting and reporting. Available at https://www.pwc.com/rw/en/assets/pdf/second-edition-global-survey-government.pdf.

[106] Legenkova M, 2016, International public sector accounting standards implementation in the Russian Federation, *International Journal of Economics and Financial Issues,* 6(4): 1304–1309. Available at http://www.econjournals.com/index.php/ijefi/article/view/2593/pdf.

[107] Mann N, 2013, Russia set to introduce "IPSAS-based" accounting standards, 7 February, available at http://www.publicfinanceinternational.org/news/2013/02/russia-set-introduce-%E2%80%98ipsas-based%E2%80%99-accounting-standards (accessed 18 January 2019).

[108] ACCA, 2017, IPSAS implementation: Current status and challenges.

[109] Brusca I et al., 2016, Public financial management reforms: The role of IPSAS in Latin America; ACCA, 2017, IPSAS implementation: Current status and challenges; Araya-Leandro C, Caba-Pérez MdC and López-Hernandez AM, 2016, The convergence of the Central American countries to international accounting standards, *Revista de Administração Pública*, 50(2), Rio de Janeiro, March/April. Available at http://www.scielo.br/scielo.php?script=sci_arttext&pid=S0034-76122016000200265 (accessed 18 January 2019); and IPSASAB, 2016, International Public Sector Accounting Standards Board fact sheet, June. Available at https://www.ifac.org/system/files/uploads/IPSASB/IPSASB-Fact-Sheet-June-2016-2.pdf.

[110] IFAC, Accountability. Now. Available at https://www.ifac.org/about-ifac/accountability-now (accessed 18 January 2019).

[111] Australia, Austria, Belgium, Canada, Chile, Czechia, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Republic of Korea, Slovakia, Slovenia, Spain, Sweden, Switzerland, Turkey, United Kingdom of Great Britain and Northern Ireland and United States of America.

[112] OECD and IFAC, 2017, *Accrual Practices and Reform Experiences in OECD Countries*, Paris, available at https://read.oecd-ilibrary.org/governance/accrual-practices-and-reform-experiences-in-oecd-countries_9789264270572-en#page1 (accessed 18 January 2019).

[113] Aggestam Pontoppidan C and Brusca I, 2016, The first steps towards harmonizing public sector accounting for European Union Member States: Strategies and perspectives, *Public Money and Management*, 36(3): 181–188.

[114] European Commission, 2012, Public consultation - Assessment of the suitability of the international public sector accounting standards for the Member States. Available at https://ec.europa.eu/eurostat/documents/10186/752720/D4_2012-EN.PDF.

the European Commission held a second public consultation on EPSAS governance in November 2013.

6. International organizations

OECD was an early adopter of IPSAS (issuing its first set of IPSAS-compliant financial statements in 2000). In addition, the European Organization for Nuclear Research[115] and the United Nations system organizations have adopted IPSAS. Examples of increased transparency can be found in the financial statements of public sector entities that have adopted IPSAS. One example of strengthened transparency can be found in the following quote, taken from the first set of IPSAS-compliant financial statements of the World Food Programme: "Under IPSAS, all purchases of food commodities and in-kind donations are added to inventory, together with the cost of transportation to the country where the food becomes distributable and any other relevant costs, such as milling or bagging. In 2008, the value of food and associated costs added to existing stock of US$0.5 billion was US$2.7 billion. When commodities are issued for beneficiaries, the value of the inventory issued is expensed through the statement of financial performance. In 2008, the total value of food commodities issued was US$2.2 billion. At the year end, the inventory in warehouses controlled by the [the World Food Programme] was valued at US$1.0 billion and has been reported in the financial statements for the first time. This new information gives the Board visibility on the value of inventories."[116]

C. PRACTICAL IMPLEMENTATION CHALLENGES

This section addresses the role of legal and regulatory requirements in the context of adopting accrual-based IPSAS, before then turning to institutional issues that may emerge when adopting IPSAS. Subsequently, there is a review of selected technical (standard-by-standard) issues that may pose a challenge when adopting IPSAS. Lastly, the section focuses on the role of statistical reporting and budget reporting vis-à-vis accrual-based IPSAS financial reporting, cost aspects of implementation and skills development.

1. Legal and regulatory aspects

Public sector accounting is firmly embedded in the political, economic, legal and social contexts in which it is practised. Therefore, political systems and legal frameworks have significant influence on the adoption and implementation of government accounting standards in general. Legal changes are required, as well as new regulations and governance practices: these may be complex and time-consuming and will vary from country to country.

In most IFAC member organization jurisdictions, the Government has the authority to set public sector accounting standards, usually within the Ministry of Finance or the Treasury. IFAC explains that this is evidenced by the high number of IFAC member organizations (92 per cent) with no direct responsibility in the IPSAS adoption process. In all, 5 per cent of IFAC member organizations share responsibility with their Government for the establishment of public sector accounting standards and play an advisory role concerning public financial management matters. Only 3 per cent of IFAC member organizations have direct responsibility for IPSAS adoption.[117] Consequently, it can be concluded that the adoption of IPSAS in countries across the world is carried out under the auspices of Governments and government entities.

Another level of complexity emerges in the context of considering legal and regulatory aspects of IPSAS adoption. Namely that governance of accounting practices may be carried out at various levels of Government.

A typical division of levels of Government can include central, State and local Government. The 2014 Government Finance Statistics Manual states that, for example, a country may have one central Government, several State, provincial or regional Governments and many local Governments. In addition, there may also be non-profit institutions under government control. Not all countries have all the above-mentioned levels of Government: some may have only a central Government, or a central Government and

[115] For European Organization for Nuclear Research financial statements, see https://fap-dep.web.cern.ch/content/reports (accessed 18 January 2019).

[116] World Food Programme, 2009, Audited annual accounts 2008, 11 May, p. 74, available at http://one.wfp.org/eb/docs/2009/wfp200450~2.pdf.

[117] IFAC, 2017, *International Standards: 2017 Global Status Report*, pp. 24–25, available at https://www.ifac.org/system/files/publications/files/International-Standards-2017-Global-Status-Report.pdf.

a single subordinate level of Government. The 2014 Government Finance Statistics Manual [118] and a 2012 report prepared for Eurostat by Ernst and Young[119] provide further information in this regard.

Central Government is typically defined as consisting of the institutional unit or units of the central Government, plus central Government-controlled non-market non-profit institutions.[120] The political authority of the central Government extends over the entire territory of the country. The central Government can impose taxes on all resident institutional units and on non-resident units engaged in economic activities within the country. The central Government subsector in most countries is large and complex. It is generally composed of a central group of departments or ministries that make up a single institutional unit, plus, in many countries, other units operating under the authority of the central Government, with a separate legal identity and enough autonomy to form additional government units.

State Governments typically consist of institutional units exercising some of the functions of Government at a level below that of central Government and above that of local-level government institutional units.[121] States may be described using other terms, such as provinces, cantons, republics, prefectures or administrative entities. A State Government's principal departments and ministries constitute a single institutional unit in a manner similar to the core unit of the central Government. In addition, there may be agencies operating under the authority of a State Government, with a separate legal identity and sufficient autonomy to form additional institutional units.

Local Governments are typically institutional units with fiscal, legislative and executive authority that extends over the smallest geographical areas distinguished for administrative and political purposes.[122] The scope of a local Government's authority is generally much more limited than that of a central or State Government, and local Governments may or may not be entitled to levy taxes on institutional units or economic activities taking place in their areas. According to the 2014 Government Finance Statistics Manual, local Governments are typically involved in:

- Educational establishments.
- Hospitals and social welfare establishments, such as kindergartens, nurseries and welfare homes.
- Public sanitation and related entities, such as water purification systems and plants, refuse collection and disposal agencies, cemeteries and crematoriums.
- Culture, leisure and sports facilities, such as theatres, concerts, music halls, museums, art galleries, libraries, parks and open spaces.[123]

According to a report covering all European Union Member States and prepared for Eurostat in 2012, local Governments are more likely than their central counterparts to use an accrual accounting model.[124]

When a country chooses to adopt IPSAS, it must decide on the scope of adoption (central, State and local Government). In addition, on the regulatory side, countries need to consider legal and standard-setting complexities.

The Ministry of Finance is the standard-setting authority in about half the OECD countries. The level of guidance on accounting principles and standards stipulated in the law varies from country to country. Where the legal framework defines only general principles, the Ministry of Finance is, in most cases, tasked with setting the accounting standards, either directly (32 per cent of countries) or in consultation with an advisory board (18 per cent of countries). Independent national standard-setting boards are responsible for standard setting in a further 24 per cent of countries (Australia, Canada, France, Israel, Mexico, New Zealand and the United States of America).[125]

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[118] De Clerk S, ed., 2014, *Government Finance Statistics Manual 2014*, IMF, Washington, D.C., available at https://www.imf.org/external/Pubs/FT/GFS/Manual/2014/gfsfinal.pdf.

[119] Ernst and Young, 2012, Overview and comparison of public accounting and auditing practices in the 27 [European Union] EU Member States.

[120] De Clerk S, ed., 2014, *Government Finance Statistics Manual 2014*, p. 24.

[121] Ibid., p. 25.

[122] Ibid., p. 26.

[123] De Clerk S, ed., 2014, *Government Finance Statistics Manual 2014*, p. 26.

[124] Ernst and Young, 2012, Overview and comparison of public accounting and auditing practices in the 27 [European Union] EU Member States. p. 21.

[125] Moretti D, 2016, Accrual practices and reform experiences in OECD countries – results of the 2016 OECD Accruals Survey, *OECD Journal on Budgeting*, 16(1): 9–28. Available at: https://tinyurl.com/yamgsrm4 (accessed 18 January 2019).

Argentina and Brazil provide examples of the different paths taken when incorporating IPSAS into local legal and standard-setting processes. Argentina uses public sector accounting standards set by the federal Government. IPSAS have not been adopted, but the National Accounting Office has begun to develop public sector accounting standards that are harmonized with accrual-basis IPSAS, although there is no clear time frame for doing so.[126] In 2009, Brazil enacted a transparency law on the convergence of the country's accounting standards with IPSAS.[127] The national chart of accounts was issued in 2014,[128] with gradual and full implementation of IPSAS scheduled by 2020.[129] As a part of the process, several different implementation challenges have been encountered that arose, in part, from the size and complex nature of Brazil. The country has a federal Government, 26 States and 5,564 local authorities, making it difficult to achieve the consistent application of standards by a given date.[130]

The various levels of Governments are reflected in the legal setting on a country-by-country basis. The levels of Government and the legal system have implications for regulatory change processes, such as changes in accounting standards. It is important to clearly review the interlinkages between the legal and regulatory frameworks in place for statistical reporting and budget reporting, an issue that is addressed further on in this report.

Legal and regulatory factors also have an impact on institutional issues that may emerge when adopting IPSAS. Many studies have highlighted the fact that institutional arrangements may create challenges at the national level when adopting IPSAS.

2. Institutional arrangements

This subsection considers institutional arrangements and their role in the adoption of IPSAS. Within the public sector, the legal and regulatory setting is often closely intertwined with such arrangements.

There is a growing emphasis across countries and Governments on the challenges involved in implementing IPSAS in a local context. Thus, in any given country, when embarking on the adoption of IPSAS, it is important to assess the relative complexity of the accounting institutional arrangements. When carrying out this task, account must be taken of the number of accounting laws, rules and standards applied in the country context. The larger the number of accounting laws in place, the more complex the domestic accounting arrangements will be.[131] The levels of Government (central, State and local) can have an effect on the level of complexity of institutional arrangements. For example, a European Union-wide study found that those European Union Member States with a State Government subsector have the most complex accounting arrangements.[132]

Historically, in many jurisdictions, accounting standards in the public sector have been set by the Ministry of Finance. According to a 2016 IMF report, this is at odds with the need for objectivity, independence and integrity in government financial reporting. In the report, it is stated that some countries introducing accrual accounting based on international accounting standards have taken the opportunity to revise their institutional arrangements and externalize the setting of accounting standards for the public sector. For example, countries can opt to establish independent boards designed to advise the Government on the adoption or adaptation of international accounting standards (France and the United Kingdom of Great Britain and Northern Ireland) or to vest responsibility for determination of public sector accounting standards

[126] Brusca I et al., 2016, Public financial management reforms: The role of IPSAS in Latin America; ACCA, 2017, IPSAS implementation: Current status and challenges; Araya-Leandro C et al., 2016, The convergence of the Central American countries to international accounting standards.

[127] Lopes Cardoso R, Busanelli de Aquino AC and Magrini Pigatto JA, 2014, Brazilian governmental accounting reforms: IPSAS and accrual accounting adoption, 11 July. Available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2466484 (accessed 21 January 2019).

[128] Brazil, National Treasury, The move to accrual accounting and IPSASs adoption in Brazil: Challenges and perspectives. Available at https://www.ipsasb.org/system/files/meetings/files/IPSAS%20Adoption%20in%20Brazil.pdf

[129] Ernst and Young, 2015, IPSAS outlook: IPSAS issues for public finance management executives, December, p. 4. Available at https://www.ey.com/Publication/vwLUAssets/EY-ipsas-outlook-december-2015/$FILE/EY-ipsas-outlook-december-2015.pdf.

[130] Brazil, National Treasury, The move to accrual accounting and IPSASs adoption in Brazil: Challenges and perspectives. Available at https://www.ipsasb.org/system/files/meetings/files/IPSAS%20Adoption%20in%20Brazil.pdf.

[131] Ernst and Young, 2012, Overview and comparison of public accounting and auditing practices in the 27 [European Union] EU Member States.

[132] Ibid.

in an independent national body (Australia, Canada, New Zealand and South Africa).[133]

The above-mentioned examples highlight the importance of institutional coordination at the national level when embarking on the adoption of international standards. At the national level, countries need to recognize the need for coordination of legislative requirements related to or affected by IPSAS adoption. The implementation of IPSAS can have implications for a number of legislative and regulatory areas. The more complex the regulatory framework in a country, the more effort is required to achieve coherence among these requirements at the national level.

It is also important to clearly review the interlinkages between regulations on statistical reporting and budget reporting and, taking this process into account, define the role and authority of IPSAS-based financial reporting in relation to other regulatory reporting requirements that may exist in a given jurisdiction. It is also essential to have a coordination mechanism at a national level to ensure that such issues are taken into account.

One example from the European Union illustrates how certain institutional arrangements have been handled. Article 3 of Council Directive 2011/85/EU requires Member States to "have in place public accounting systems comprehensively and consistently covering all subsectors of general Government and containing the information needed to generate accrual data with a view to preparing data based on the European System of Accounts 95 standard".[134] The Directive thereby acknowledges the essential incoherence between those public sector accounts, which only record cash flows, and the fact that European Union budgetary surveillance is based on European System of Accounts 95 accruals data. This means that cash data have to be converted into accruals through approximations and adjustments involving macro-based estimates. Moreover, where accruals accounts do not exist at the micro level, financial transactions and balance sheets have to be derived from a variety of different sources, leading to a "statistical discrepancy" between the deficit compiled via non-financial accounts and that compiled via financial accounts.

In 2013, the European Commission drew attention to the fact that the quality of European-level statistical information was highly dependent on the appropriateness of the entire production process. Eurostat therefore promotes a system of harmonized accruals-based accounting standards, consistent with the European System of Accounts, for all government sector entities.[135]

Another example that highlights some of the complexities of institutional arrangements in a national setting is the Malta IPSAS-adoption process. In Malta, domestic legislation empowers the Minister of Finance to issue accounting standards with a legal notice that does not require parliamentary approval. Moreover, there is no external government external body that issues guidelines on government accounting in the country. After 2004, however, the number of circulars concerning accrual accounting dwindled to zero, and European Union directives had to be transposed into national legislation. As the Maltese authorities were awaiting instructions from the European Union in order to proceed, especially with regards to government accounting standards, the legal system could have effectively acted as a negative factor. In Malta, an Accrual Accounting Task Force was established to support implementation: with time, responsibilities were spread across the Ministry of Finance.[136] There are no accounting standard-setting bodies in Malta. The central Government is in the process of switching from a traditional, budget-oriented, cash-based accounting system to a more informative one: a process that began in 1999.[137] The decision to adopt IPSAS was taken in 2011, but the process appears to have stalled, with the national authorities awaiting guidance from the European Union.

[133] Cavanagh J et al., 2016, *Implementing Accrual Accounting in the Public Sector*, p. 6.

[134] Council of the European Union, 2011, Council directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States, 21 November, p. 44. Available at https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:306:0041:0047:EN:PDF.

[135] European Commission, 2012, Public consultation - Assessment of the suitability of the international public sector accounting standards for the Member States. Available at https://ec.europa.eu/eurostat/documents/10186/752720/D4_2012-EN.PDF.

[136] Jones R and Caruana J, 2015, Governmental accounting in Malta towards IPSAS within the context of the European Union, *International Review of Administrative Sciences*, 82(4): 745–762.

[137] See Malta, Treasury Department, International public sector accounting standards (IPSASs) in Malta, available at https://treasury.gov.mt/en/Pages/Government_Accounts_Directorate/IPSAS/IPSAS_In_Malta.aspx (accessed 21 January 2019).

Some countries chose to overhaul institutional arrangements through broader financial reform.

Institutional arrangement concerning financial audits also need to be considered when adopting IPSAS. Within the European Union, for example, a very limited number of countries do not conduct financial audits. Auditing arrangements appear to be less heterogeneous than accounting arrangements. Most public entities are subject to financial audit where the auditing standards applied are International Standards on Auditing or similar. It has been noted that one impact of the adoption by the European Union of EPSAS would be the enhancement of the institutional arrangements for audit and internal control.[138]

3. Levels of implementation: central, State and local Government

Studies have indicated that government accounting arrangements are extremely heterogeneous. The existence of different levels of Government (central, State and local) has implications for the adoption of IPSAS. Countries that have a level of State Government have been observed to have the most complex accounting arrangements. State Governments usually follow their own accounting standards, mainly for reasons linked to independence: those standards can vary greatly from one State to another, creating significant accounting heterogeneity within a given country. Indeed, some State Governments in the same country may follow accrual-based accounting, whereas others use cash-based accounting.[139]

Thus, the accounting complexity introduced by the presence of a State Government appears to be more significant than the simple inclusion of an additional layer of Government. According to a 2012 study of European Union Member States, State Government standards showed little resemblance to IPSAS.[140] There is a need to determine the scope of implementation in terms of the levels of Government in a given country.

By way of an example, Nigeria implemented IPSAS at the level of the federal Government as of January 2016,[141] while each of the country's 36 federal States will determine its own implementation period. South Africa has drawn on IPSAS to develop its own accrual accounting standards, known as Generally Recognized Accounting Practices,[142] which are applied by municipalities and municipal entities.[143] The central Government, in the form of the National Treasury, has adopted a modified cash basis of accounting framework. However, the National Treasury has developed a roadmap to implement the accrual accounting framework in terms of Generally Recognized Accounting Practices at central Government level.[144]

4. Technical challenges

This section addresses some of the key technical challenges faced by IPSAS-adopting countries, first of all focusing on a model for a phased transition from cash to accrual accounting. Awareness that there are different approaches to and methods regarding the phased adoption of IPSAS improves understanding of technical, standard-level, IPAS-implementation challenges. The above-mentioned challenges are organized into the following groups: statements of financial performance, statements of financial position and broader challenges regarding the preparation of financial statements (reconciliation between budget reporting and accrual-based financial reporting and

[138] PricewaterhouseCoopers, 2014, *Collection of Information Related to the Potential Impact, including Costs, of Implementing Accrual Accounting in the Public Sector and Technical Analysis of the Suitability of Individual IPSAS Standards*. Available at https://ec.europa.eu/eurostat/documents/1015035/4261806/EPSAS-study-final-PwC-report.pdf.

[139] Ernst and Young, 2012, Overview and comparison of public accounting and auditing practices in the 27 [European Union] EU Member States.

[140] Ibid.

[141] Ugwumadu J, 2015, Nigeria to start IPSAS implementation in January, 14 August, available at https://www.publicfinanceinternational.org/news/2015/08/nigeria-start-ipsas-implementation-january (accessed 21 January 2019);

See also Ajayi R, 2018, Nigeria's financial statement in compliance with IPSASA-AGF, available at https://prnigeria.com/2018/01/23/nigerias-financial-statement-compliance-ipsas-agf/ (accessed 21 January 2019).

[142] See, for example, South African Institute of Chartered Accountants, 2008, Government to implement accounting standards designed to enhance delivery, 15 July. Available at https://www.saica.co.za/tabid/695/itemid/109/Government-to-implement-accounting-standards-desig.aspx (accessed 21 January 2019).

[143] South Africa, National Treasury, 2012, Application of the [generally recognized accounting practices] GRAP reporting framework. Available at https://oag.treasury.gov.za/Publications/01.%20Annual%20Financial%20Statements/05.%20For%20Local%20Government/For%20fin.%20year%20ending%2030-06-2012/Application%20of%20the%20GRAP%20Reporting%20Framework%202011%202012%20Municipalities.pdf.

[144] See Accountancy South Africa, 2016, Overview of 2014–2015 local government audit outcomes, 1 September, available at https://www.accountancysa.org.za/special-feature-public-sector/ (accessed 23 January 2019).

consolidation). The list of technical issues considered herein is far from exhaustive. The section summarizes certain key challenges and provides examples of use to countries that are about to embark upon, or have initiated, the IPSAS adoption process.

In addition to specific technical challenges, there are overall challenges pertaining to ensuring timeliness of reporting and the quality of data supporting accrual financial reporting. For example, Bangladesh experienced challenges with respect to the timeliness of reporting: that is to say, the delayed production of documents and their late submission to the relevant authorities. In addition, the quality of financial data has been compromised by the limitations of separate accounting systems. The experience of Bangladesh, and of many other countries, is that IPSAS implementation challenges will take a number of years to overcome.[145]

Phasing for the transition from cash to accrual accounting

IMF has studied international experiences of transition regarding accounting practices and reporting in the public sector and, based on that work, has suggested an indicative phasing for the transition from cash to accrual accounting in the public sector. As a part of this approach, the transition to accrual accounting entails reforms in three parallel dimensions of fiscal reporting. In reviewing technical (standard-level) IPSAS-adoption challenges, the model created by IMF, which consists of the three following key dimensions, provides a helpful framework (see also Table 5 below):[146]

Recording of stocks in the balance sheet, beginning with a financial balance sheet and with the ultimate goal of publishing a comprehensive balance sheet of the Government's financial and non-financial assets and liabilities valued in accordance with international standards;

Recognition of flows in the operating statement, with the ultimate goal of recording all transactions at the time economic value is transferred (rather than at the point cash payments are made) as well as other economic flows that affect the Government's net worth (such as changes in the value of government asset holdings);

Consolidation of institutions, with the ultimate goal of including all institutional units under effective

[145] See Government of Bangladesh, 2016, *Public Financial Management Reform Strategy 2016–2021*, June, available at http://mof.portal.gov.bd/sites/default/files/files/mof.portal.gov.bd/page/710cb4b9_e331_4036_812e_8fb8e36cb2a0/PFM%20Reform%20Strategy%202016-21%20Final.pdf.

[146] Cavanagh J et al., 2016, *Implementing Accrual Accounting in the Public Sector*.

Table 5
Transition to accrual accounting

	Balance sheet		Operating statement		
	Assets	**Liabilities**	**Revenues**	**Expenses**	**Other Flows**
Phase 0: Cash accounting	Cash balances	Bank overdrafts Debt	Cash receipts	Cash payments	None
Phase 1: Elementary accrual accounting	Trade receivables Prepayments	Trade payables	Accrued trade revenue	Accrued expenses excluding depreciation	None
Phase 2: Advanced accrual accounting	Equity Investments	Other financial liabilities Long-term liabilities (for example, pensions)	Accrued non-tax receivables	None	Valuation changes in financial assets and liabilities Provisions
Phase 3: Full accrual accounting	Fixed and intangible assets Inventories Tax receivables	Monetary financial instruments	Accrued receivables	Depreciation	Valuation changes in non-financial assets

Source: Cavanagh J et al., 2016, Implementing Accrual Accounting in the Public Sector, IMF, Washington, D.C., p. 11. Adjusted.

government control in fiscal reports, regardless of their constitutional status or legal form.

This framework points to the fact that the technical, standard-level challenges experienced by Governments and public sector entities will depend on the level of accounting practices at the point in time when the transition process is initiated.

The present chapter focuses on outlining key technical challenges related to the adoption of IPSAS (phases 2 and 3 together). For Phase 0, public sector entities can turn to cash-basis IPSAS.

The way in which implementation is embraced differs from country to country. In Botswana, where the Government is the public sector accounting standard setter, the Financial Reporting Act 2010 requires adherence to IPSAS.[147] The Botswana Institute of Charted Accountants states that the Government has adopted modified cash-basis IPSAS and intends to transition to accrual-basis IPSAS.[148] Ghana has adopted IPSAS for all public sector accounts, beginning in 2016.[149] However, in recognition of the complexities involved, a step-by-step approach to implementation, spanning a five-year period from 2016 onwards, has been promoted.[150]

Preparing International Public Sector Accounting Standard-compliant statements of financial performance

IPSAS 23 – Revenue from Non-Exchange Transactions (Taxes and Transfers) creates implementation challenges for many Governments. The standard requires that revenue arising from non-exchange transactions be recognized on the basis of the value of the asset/benefit received, less any obligations (conditions) that may still need to be met in terms of the particular arrangement. The amount of the benefit relating to the condition is recognized as a liability until the condition is met, at which point it is realized as revenue.

It can be difficult to distinguish between restrictions and conditions and, consequently, to determine when revenue should be recognized in the statement of financial performance (although IPSAS 23 provides extensive guidance on this area of judgement). Tax revenue, on the other hand, should be recorded when the event generating a legal right to receive a tax has occurred and the revenue can be measured reliably. IPSAS 23 provides guidance on the triggering event for recording typical tax streams.[151]

Accounting for revenue is listed as a challenge for a number of countries in the 2017 Association of Chartered Certified Accountants report on IPSAS adoptions.[152] Specific accounting issues identified relate to infrastructure assets, intangible assets, financial instruments, social benefits and revenue from non-exchange transactions.[153] In another example, in 2016, the Auditor-General of South Africa stated that:[154]

> "I was unable to obtain sufficient appropriate audit evidence for revenue from non-exchange transactions totalling R7.7 billion (2014–15: R8.6 billion) because some entities did not maintain proper accounting records of and adequate control over assessment revenue. These entities' records did not permit the application of alternative auditing procedures. Consequently, I was unable to determine whether any further adjustments to revenue from non-exchange transactions were necessary."

[147] Please note that, at the time of writing, it was unclear whether this requirement had come into force.

[148] See IFAC, Botswana, available at https://www.ifac.org/about-ifac/membership/country/botswana.

[149] See Government of Ghana, Ghana adopts international public sector accounting standards (IPSAS) for the public sector. Available at http://www.ghana.gov.gh/index.php/media-center/news/1114-ghana-adopts-international-public-sector-accounting-standards-ipsass-for-the-public-sector%202016 (accessed 8 February 2019).

[150] See also International Bank for Reconstruction and Development and World Bank, 2014, Republic of Ghana. Report on the observance of standards and codes – accounting and auditing. Available at http://documents.worldbank.org/curated/en/434281479709115757/pdf/ACS116080WP0P1486140Box385409B00OUO090.pdf.

[151] Under IPSAS 23, the taxable event is decisive and is defined as: "the event that the Government, legislature or other authority has determined will be subject to taxation". This may be different from an event generating a legal right to receive a tax.

[152] ACCA, 2017, IPSAS implementation: Current status and challenges.

[153] Lopes Cardoso R et al., 2014, Brazilian governmental accounting reforms: IPSAS and accrual accounting adoption.

[154] South Africa, Department: National Treasury, 2016, *Consolidated Financial Statements 2016. For the Year Ended 31 March 2016*. Available at https://oag.treasury.gov.za/Publications/04.%20Consolidated%20Financial%20Statements/13.%20For%20fin.%20year%20ending%2031-03-2016/Consolidated%20Financial%20Statements%202016.pdf, p. 149 (accessed 21 January 2019).

To take another example, the authorities in Barbados noted that the change towards IPSAS in terms of non-exchange revenue led to the establishment of a central revenue authority to collect income tax, value added tax, licence income and land tax.[155]

With regard to Zambia, where cash-basis IPSAS are applied, failure to collect and account for revenue and a lack of information on expenditure, assets and liabilities have been identified as consistent problems.[156]

Preparing International Public Sector Accounting Standard-compliant statements of financial position

Accounting for assets in general, and the application of IPSAS 17 – Property, Plant and Equipment in particular, pose challenges for numerous adopters. IPSAS 17 provides guidance on accounting treatment for tangible assets. The loss of future economic benefit or service potential over and above systematic depreciation, or impairment, is recognized under IPSAS 21 – Impairment of Non-cash-generating Assets and IPSAS 26 – Impairment of Cash-generating Assets. All physical assets, including land, buildings, plant and equipment, infrastructure, subsoil and heritage assets, would normally be evaluated at cost, including all the costs associated with their acquisition and preparation for use, or, where possible, at current value.

By way of an example illustrating that populating the financial statement of position does entail challenges, in a 2017 joint OECD and IFAC report, it is noted that countries have progressed differently in populating their balance sheets.[157] Most countries that have implemented accrual accounting reforms report a large range of assets, including land and buildings, defence equipment and infrastructure. However, certain liabilities, such as debt related to public-private partnerships and civil service pensions, are not reported by a significant number of countries. Natural resources are reported and measured by a minority of countries. In an OECD and IFAC survey, it was found that the rationale for this situation varies depending on the country. As a part of the survey, some countries referred to technical difficulties relating to the inventorying of assets and the evaluation of liabilities, while others indicated that these items are not reported due to the lack of international consensus on the appropriate accounting treatment.[158]

To accommodate some of the challenges linked to the adoption of IPSAS 17, IMF has developed some guidance on the standard, particularly on developing accounting policies for tangible assets, which includes the following recommendations:[159]

- "A capitalization threshold should be used for inclusion of physical and intangible assets in the balance sheet, since low value items will not affect the interpretation of the asset balances.
- Information provided in the balance sheet and disclosures should be detailed enough to provide a complete and relevant picture of all public assets. This may involve identifying different categories within Governments' infrastructure, buildings, equipment, or natural resources, such as: roads, airports, schools, hospitals, prisons, office buildings, military equipment, national security equipment, agricultural products held by the Government, proven oil or gas reserves, etc.
- Governments should report on assets they control, and not just the assets that they own. [Similarly, Governments should not recognize assets if they do not control them, even if they do legally own them.] Control is the power to govern the use of an asset, to benefit or to bear the risks from its use.
- Accounting policies therefore need to elaborate on how this principle should be interpreted, by setting control criteria or indicators for the main categories of assets;
- The valuation methods for assets will typically be an initial recognition at cost, and a subsequent one at amortized cost, market

[155] IFAC, 2017, *Accrual Practices and Reform Expectations in the Caribbean. Public Sector Financial Accountability Survey Findings*, 15 March.

[156] Zambia, Office of the Auditor General, 2017, *Report of the Auditor General on the Accounts of the Republic. For the Year Ended 31 December 2016*. Available at http://www.ago.gov.zm/reports/Special/REPORTOF.pdf.

[157] Moretti D, 2016, Accrual practices and reform experiences in OECD countries – results of the 2016 OECD Accruals Survey, *OECD Journal on Budgeting*, 16(1): 9–28. Available at: https://www.oecd-ilibrary.org/docserver/budget-16-5jlv2jx2mtzq.pdf?expires=1547050153&id=id&accname=ocid195767&checksum=C75D7653DADDCF601D913C36E2BBFFF2 (accessed 21 January 2019).

[158] See OECD and IFAC, 2017, *Accrual Practices and Reform Experiences in OECD Countries*, Paris.

[159] Cavanagh J et al., 2016, *Implementing Accrual Accounting in the Public Sector*, pp. 43–44.

value, or replacement cost. For assets that are measured at amortized cost, a useful life needs to be determined appropriately in the accounting policies, based on information provided by [the entities] that supply or maintain these assets. Where initial recognition at cost or market value is not possible, because supporting information is not available, or there is no observable market price, accounting policies may authorize simplified methods, such as statistical estimations."

Accounting for physical assets provides perhaps the greatest practical challenges in this last phase of the transition.[160] Some specific operational implications that emerge in the process of adopting IPSAS 17 relate to, for example, the establishment of asset and inventory records. According to one source: "A significant effort may be needed to bring asset records up to date, to verify the existence and condition of such assets, and to determine initial valuations. Lists of assets owned or controlled by public sector entities need to be maintained, in the form of asset registers. Asset registers may be a simple spreadsheet or database, but, ideally, they should be maintained in an information system that interfaces directly with the general ledger. Governments transitioning to accruals may not have such information readily available and will have to undertake an initial inventory of their physical and intangible assets, together with evidence of physical verification."[161]

The Abu Dhabi Accountability Authority issued an unqualified audit report on all government financial statements for 2016.[162] However, challenges were encountered at the level of individual entities, where issues included: the impairment testing of goodwill and intangible assets; revenue recognition; depreciation of assets over their useful lives; preparation of consolidated financial statements; the accounting treatment of finance and operating leases; approved spending of annual budgets; asset recognition; the presentation in financial statements of government contributions; the estimation of fair value of investment properties; the payment of annual bonuses and staff incentives; assessment of the likelihood of recovery of financial facilities and loans; profit recognition, including of foreign investments; and comparisons between budget and actual spend.

Additional challenges linked to the preparation of an IPSAS-compliant statement of financial position may include the varying interpretations of "componentization" of assets, referring to the requirement in IPSAS 17 to separately account for significant components of assets. This is especially challenging when recognizing and measuring infrastructure assets, which may not have been previously recognized under the cash basis of accounting or may have previously only been accounted for collectively as a bundle of related assets.[163]

The liabilities side of the statement of financial position may also pose certain challenges for IPSAS adopters. Accounting for post-employment benefits can be challenging. National public pension and social security systems are established by law and can differ greatly. Systems may be funded or unfunded, mandatory or voluntary. In most countries, different types of pension and social security schemes may coexist. Typically, these include: (a) national pension or social security schemes, to which private and public sector employees are required to contribute; (b) a public servants pension scheme; and (c) some benefits or pension schemes for specific categories of employees (such as military or teacher pension schemes).[164]

As pointed out in a 2016 IMF report, special accounting treatment is required for post-employment benefits that are usually earned on a continuing basis, but that may not be paid directly or until sometime in the future. Governments that are involved in such arrangements should therefore develop accounting policies that define how to estimate government obligations. The treatment of long-term pensions and similar benefits is complex because of the timescales and uncertainties attached to them.[165]

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160 Ibid.

161 Ibid., p. 47.

162 Abu Dhabi Accountability Authority, 2017, *Accountability Report 2017*, pp. 36–37, available at http://www.adaa.abudhabi.ae/En/Publications/Pages/Publications.aspx?code=accountability_reports (accessed 23 January 2019).

163 Ernst and Young, 2015, Common IPSAS adoption issues, p. 2.

164 See for example, Ponds E, Severinson C and Yermo J, 2011, Funding in public sector pension plans: International evidence, *OECD Working Papers on Finance, Insurance and Private Pensions*, 8, OECD Publishing, Paris. Available at http://dx.doi.org/10.1787/5kgcfnm8rgmp-en (accessed 21 January 2019).

165 Cavanagh J et al., 2016, *Implementing Accrual Accounting in the Public Sector*, pp. 32–33.

In the 2016 IMF report, it is stated that:

"Differences in pension systems and/or differences in accounting rules can lead to differing outcomes in the financial accounts. The financial statements of the Governments of Australia, Canada, New Zealand, the United Kingdom of Great Britain and Northern Ireland and the United States of America include liabilities in relation to the pensions of government employees. In these countries, as well as in, … for example, France and Spain…, the Governments also provide payments to private-sector employees or to all citizens of a certain age, but these payments are not treated as creating liabilities for the Government since they are viewed as ongoing social benefits. Part of the reason is that the Government does not have a contractual obligation to make these payments, and it could reduce them by changing the law – though, from a practical point of view, the Government's room for manoeuvre may be very limited. Where these payments are funded by ordinary taxes, there is also a concern that to record a liability for them would not make sense unless an asset was also recorded in relation to the taxes."[166]

One example of a more specific challenge in the context of defined benefit plans can be found in Tanzania. The country adopted IPSAS in 2012/13 for the entire Government. The National Audit Office of Tanzania has noted a number of implementation problems, including the fact that the Government lacked actuarial valuation of defined benefits plans for government retirees, contrary to IPSAS 25 (today IPSAS 39). Without performing actuarial valuations, the Government was unable to report the initial liability for the defined benefit plans, the amount of actuarial gains and losses, past and current service, or the interest cost of the defined benefit plan.[167]

Lastly, it should be noted that, in addition to the recognition of assets and liabilities, transitioning to IPSAS entails the recognition of financial liabilities and financial assets in the balance sheet, recording changes in the value of those stocks in the operating statement. Recording financial liabilities, such as pensions or debt related to public-private partnerships, and disclosing financial contingent liabilities also allows internal and external stakeholders to have a better understanding of the long-term financial impact of government decisions and commitments.[168]

Additional high-level technical challenges of preparing International Public Sector Accounting Standard-compliant financial statements

IPSAS-based financial statements produced include the full set of statements required under accrual accounting. This includes a cash-flow statement, a statement of financial position (including all assets and liabilities), a statement of financial performance and a statement of changes in net assets/equity.[169] In addition, if the public sector entity has a publicly available budget then a reconciliation against the accrual accounts is required (refer to budget section).

IPSAS does not assume that the accrual basis will be used in budgeting. Specifically, IPSAS 24 – Presentation of Budget Information in Financial Statements provides the option of using any other basis than accrual basis. Under IPSAS 24, entities that make their budget publicly available are asked to present a comparison of the budget amounts and the actual amounts. IPSAS 24 offers two alternatives for disclosing the comparison between the actual figures and the budget: either a separate statement ("statement of comparison of budget and actual amounts"), or an additional column in the financial statements.

The main difficulty public sector entities appear to encounter when applying this standard is the determination of a "comparable actual amount". This refers to "the requirement to convert the actual results presented in the statement of financial performance and statement of financial position back into a form that is consistent with the basis on which the budget was originally prepared and approved. This is purely to ensure comparability between the two sets of information". Applying IPSAS 24 "can be complex and time consuming, particularly since the reconciliation

[166] Ibid., footnote 35.

[167] ACCA, 2017, IPSAS implementation: Current status and challenges, pp. 15–16.

[168] Cavanagh J et al., 2016, *Implementing Accrual Accounting in the Public Sector*, pp. 29–30.

[169] Some valuation changes are not shown in the statement of changes in net assets/equity. Also, the statement of changes in net assets/equity does not only present valuation changes, but also other movements recognized directly in equity.

between the two sets of information needs to also be disclosed".[170]

Consolidation is another area that may pose challenges to implementers of IPSAS (IPSAS 35 – Consolidated Financial Statements). "While Governments will learn from the experience gained during the first phase of the transition to accrual for undertaking this task, consolidating the financial statements of subnational Governments may prove a lengthy process. This is because in some countries: (i) the Constitution, laws or regulations defining the accountability requirements and responsibilities of the subnational Government may not be harmonized; (ii) accounting and systems capacity may be weaker at the subnational government level; (iii) accounting standards may have been developed at subnational level under a different basis of accounting and charts of account; and (iv) subnational Government may have different reporting cycles than central Government." However, it is also important to highlight that consolidated financial statements of central Government only include subnational Governments if the former controls the latter, which, in many countries, may not be the case.

It is, therefore, particularly beneficial that a gap analysis be undertaken for both central and subnational Governments to identify the differences between the targeted and the existing accounting frameworks. The analysis can then allow both central and local Governments to define an action plan to close the gap. Ideally, this should be done before the transition starts.[171]

The Association of Chartered Certified Accountants commissioned two studies, one on the use of whole of government accounts[172] and one on the use of consolidated government accounts,[173] comparing consolidation practices in five different countries (Australia, Canada, New Zealand, Sweden and the United Kingdom of Great Britain and Northern Ireland). According to the studies, the federated structures of Government found in Australia, Canada and Sweden consolidate on the basis of jurisdiction, reflecting political notions of control and accountability boundaries. The United Kingdom of Great Britain and Northern Ireland, on the other hand, adopts more expansive models of consolidation, with a macroeconomic emphasis on usability (for government policy-making, rather than public accountability).

The studies show that, in order for consolidated government accounting reform programmes to bring about the use of consolidated whole of government accounts for their intended purpose, politicians and key government officials must display significant commitment. Such coordinated political action, however, is hard to achieve and remains the most significant challenge for any accounting-based reform. Currently, there are no real political incentives to switch in large numbers to using consolidated government accounting systems for policymaking in most of the countries analysed in the Association of Certified Chartered Accountants (ACCA) studies, with New Zealand being the exception.

To make such reforms more relevant to users and useful for decision-making purposes, consideration needs to be given to incorporating government budgeting functions and perhaps convergence with an international statistics framework, rather than just compliance reporting for accountability purposes. From the perspective of the United Kingdom of Great Britain and Northern Ireland, there is also a need to include mechanisms to ensure that recommendations by parliamentary committees scrutinizing whole of government accounts are followed up.

The studies further showed that, in Canada, there is a persistent need for the integration of various financial (as well as statistical) information systems, in order to enhance the comparability, continuity, timeliness and usefulness of information, not only for financial reporting, but also for planning, decision-making and accountability purposes. In Sweden, it took a long time for the Government and other institutions to develop an appropriate model that represented the way in which the country is being managed. This could indicate that, to get it right, rather than rushing, careful consideration should be given to how consolidation should aid management of the country, and that politicians should make the case for a more deliberative and long-term approach to reforming government financial reporting.

[170] See for example, Ernst and Young, 2015, Common IPSAS adoption issues, p. 2.

[171] Cavanagh J et al., 2016, *Implementing Accrual Accounting in the Public Sector*, p. 38.

[172] ACCA, 2014, Whole of government accounts: Who is using them? Available at http://www.accaglobal.com/content/dam/acca/global/PDF-technical/public-sector/tech-tp-woga-whole-of-government.pdf.

[173] ACCA, 2015, Consolidated government accounts: How are they used? Available at http://www.accaglobal.com/content/dam/ACCA_Global/Technical/pubsect/ea-consolidated-government-accounts-v4.pdf.

5. Link to statistical reporting

Statistical reporting, including government finance statistics and the European System of Accounts, provide the basis for fiscal monitoring. The Government Finance Statistics Manual 2014 is part of a series of international guidelines on statistical methodologies that have been issued by IMF. The 2014 Manual is an update of its 2001 predecessor and is the third edition of a publication that describes a specialized macroeconomic statistical framework, the government finance statistics framework, designed to support fiscal analysis. In the 2014 Manual, it is stated that: "The Government Financial Statistics Manual 2014 recommends disseminating fully integrated flows and stock positions, recorded on an accrual basis, while maintaining cash-flow data to allow an assessment of the liquidity constraints of Government. It is recognized that the implementation of the fully integrated system described in the Manual will take some time and will need to progress at a pace determined by the differing needs and circumstances of the country involved. In particular, many countries will need to revise their underlying accounting systems to reflect the accrual basis of recording and revised classifications."[174]

Within the European Union, the European System of Accounts[175] provides a macro-level statistical accounting framework for government and non-government sectors in the European Union and is accruals based. European System of Accounts-based government debt and deficit data for excessive deficit procedure purposes are the result of the consolidation of the individual accounts of general government entities in the Member States and are defined by European Union legislation. In the context of European Union fiscal monitoring and the excessive deficit procedure, the European Commission, in accordance with article 126 of the Treaty on the Functioning of the European Union, has the task of regularly assessing the quality both of actual data reported by Member States and of the underlying government sector accounts, compiled according to the European System of Accounts. Recent developments, in particular incidents of inappropriate financial reporting by some European Union Member States, have demonstrated that the system for fiscal statistics has not sufficiently mitigated the risk of substandard quality data being notified to Eurostat. Furthermore, the impact of the economic and financial crisis has highlighted the need to strengthen the economic governance structure for the euro zone and the European Union as a whole. The European Commission responded on 29 September 2010 by adopting a package of legislative proposals, the "European economic governance package" (referred to as the "six pack"), which was adopted by the European Parliament and the Council of the European Union on 16 November 2011. This package seeks to extend and improve the monitoring of fiscal policies, macroeconomic policies and structural reforms, in order to remedy the shortcomings found in existing legislation. New enforcement mechanisms are planned in the event of non-compliance by European Union Member States. It is clear that these mechanisms must rely on high-quality statistical information, produced on the basis of robust and harmonized accounting standards adapted to the European public sector.

In 2012, IPSASB initiated a project designed to reduce the differences between IPSAS and public sector government finance statistics reporting guidelines.

According to IPSASB: "Significant benefits can be gained from using a single integrated financial information system to generate both IPSAS financial statements and government finance statistics reports. This will reduce government finance statistics report preparation time, costs and effort, while improvements can be expected in the source data for these reports, with flow-on benefits in terms of report quality, including timeliness. Improvements to the understandability and credibility of both types of reports are also likely to result."[176]

…

"Differences between IPSAS and government finance statistics reporting guidelines are of two main types: (a) underlying conceptual differences, and (b) presentation and terminology differences."[177]

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[174] De Clerk S, ed., 2014, *Government Finance Statistics Manual 2014*, p. xxi.

[175] European Commission, European system of national and regional accounts, available at http://ec.europa.eu/eurostat/statistics-explained/index.php/European_system_of_national_and_regional_accounts_-_ESA_2010 (accessed 21 January 2019).

[176] IPSASB, 2012a, At a glance: Consultation paper, IPSASs and government finance statistics reporting guidelines, October, pp. 1–2. Available at https://tinyurl.com/y8e6wea7 (accessed 21 January 2019)

[177] IPSASB, 2012b, *IPSASs and Government Statistics Reporting Guidelines*, October, p. 10, available at https://www.ifac.org/system/files/publications/files/IPSASs%20and%20GFS%20Guidelines%20FINAL%20October%2016%20

6. Budget versus accrual reporting

The authors of one 2009 report on transitioning to accrual accounting addressed a number of issues relating to alignment of accrual accounting and budgeting, stating that: “it is sometimes argued that accounting and budgeting regimes should be closely aligned so that there is a clear and transparent basis for comparing, in financial terms, the Government’s planned and actual financial outcomes”.[178]

Governments may decide to adopt accrual accounting as a first step before embarking on the more complex task of introducing accrual budgeting. Most Governments operate on a cash basis.

According to one 2017 study on accrual practices and reform in the Caribbean, the current budget recognition basis in the region is as follows: Nine economies (Anguilla, Aruba, the Bahamas, Belize, the British Virgin Islands, Guyana, Jamaica, Montserrat and Trinidad and Tobago), or 60 per cent, prepare their budget on a cash basis; Four economies (Antigua and Barbuda, Saint Lucia, Saint Vincent and the Grenadines and the Turks and Caicos Islands) are transitioning from a cash to an accrual basis; and two economies (Barbados and the Cayman Islands) prepare their budget on an accrual basis.[179]

This may give rise to a temporary incongruity between ex ante and ex post information (for example, financial statements would include accrual-based expenses, while the budget would continue to be based on cash expenditure). However, the accumulation of accrual accounting experience and the availability of accrual-based historical data during this period are likely to contribute to a smoother eventual transition to accrual budgeting. [180]

One challenge when handling budgetary reporting and annual financial reporting is that, where there are timing differences in the introduction of accrual accounting and budgeting, there will be a need to maintain the capacity to generate suitable cash-based reports in the interim.

Accrual-based budgets seek to show the estimated full resource, rather than just the cash, implications of planned government activities. Thus, budgeted financial statements show the accrual-based budgeted revenues and expenses, budgeted cash receipts and payments and the estimated impact of the planned activities on the assets and liabilities of the Government.

A budget classification sets out the way in which budgeted revenues, expenditures and financing items would be categorized and presented in the budget. Under a cash-budgeting system, the budget classification would not include stocks of assets or liabilities. A chart of accounts is a logical coding framework that forms the basis of recording accounting transactions and balances (flows and stocks) in the general ledger, the principal accounting record of an entity. In a properly designed system, the chart of accounts should incorporate the budget classification. This means that, in addition to all the accounts specified in the budget classification, the chart of accounts will include other accounts required for accounting and reporting purposes. For example, a chart will have accounts for assets and liabilities that would not normally be included in a cash-based budget classification. In addition, a chart would normally also include information about particular revenues and expenses at a more detailed level than required for the budget classification.

According to a 2014 IMF report, “The Government of Iceland has decided to reform its legal framework for budgeting by introducing a new organic budget law… The proposed organic budget law is designed to improve fiscal discipline, codify existing good practices, support sustainable fiscal policy and put Iceland at the forefront of international budget practice. In particular, the proposed organic budget law requires improvement of the fiscal reporting framework consistent with internationally accepted standards.

…

The alignment between the budget and the financial statements must be maintained. One of the strengths of the existing legal framework is this alignment and the proposed organic budget law also stresses the importance of this feature. First, budget documents

2012.pdf. See p. 11 of same document for a detailed list of differences between IPSAS and government finance statistics reporting guidelines.

[178] Khan A and Mayes S, 2009, *Transition to Accrual Accounting*, IMF, September, p. 7, available at https://www.imf.org/external/pubs/ft/tnm/2009/tnm0902.pdf.

[179] IFAC, 2017, *Accrual Practices and Reform Expectations in the Caribbean. Public Sector Financial Accountability Survey Findings*, March, p. 14.

[180] Khan A and Mayes S, 2009*, Transition to Accrual Accounting*, pp. 7–8.

should include a full set of projected or estimated financial statements for each of the budget and forward years that are fully comparable to the ex post financial statements. Second, although the budget would focus on Government Finance Statistics Manual 2001 indicators, such as net lending/borrowing, and IPSAS statements usually focus on surplus or deficit – also referred to as operating result – a common harmonized presentation of the operating statement should be adopted for both budgets and accounts.

The budget should recognize depreciation as an expense but need not appropriate for depreciation at this stage. The budgeted operating statement should include depreciation as an expense to determine the operating result. Although depreciation could also be appropriated, it is suggested that, in order to avoid complexities, this should be deferred. Instead, appropriation should continue to be for accrual-based expenses (excluding depreciation) and capital expenditure. This issue should be revisited after the implementation of IPSAS for ex post reporting has been completed and some expertise has been developed in dealing with depreciation, particularly estimating depreciation for budget and future years."[181]

Another example can be found in Brazil. According to ACCA: "Brazil has needed to improve public financial management processes alongside the implementation of IPSAS and increase resources and expand staff capacity. The country's budget is cash based, but financial statements are accrual based, requiring a dual ledger to serve budget reporting and accrual accounting."[182]

7. Information technology

Many countries may find that existing IT will not necessarily support the adoption of accrual-based IPSAS. Thus, IPSAS adoption is likely to require the replacement or adaptation of some existing IT systems, data structures and charts of accounts. Reporting systems and structures may need to be updated as part of the transition process. A change in IT systems can be costly and will require expert advice.[183]

8. Skills capacity

Governments and public sector organizations may not have the skills, competence and staffing levels needed to cope with the adoption of IPSAS: a process that has posed a challenge in many countries. Implementation requires a programme of training to raise skills and there will be additional pressures to recruit and retain IPSAS-focused and skilled staff. The skills challenge goes beyond a lack of core knowledge and understanding of IPSAS, encompassing other issues, such as the translation of standards and guidance materials. Skill gaps identified include some reporting areas, particularly the narrative reporting accompanying the financial statements to clarify what the financial data is telling the users.[184] IPSAS adoption requires not only a paradigm shift in skills, but also a change in finance culture and mindset to exploit the opportunities presented by professional accountants to drive value. In addition to the technical skills required, country-specific language challenges may need to be addressed. For example, in Abu Dhabi, there was an additional issue of the need to present financial statements in Arabic, as required by the Government.[185] The overall accountancy capacity within a country will have an impact on its ability to recruit and retain qualified staff within Government, and implementation will require upskilling. This may lead to trained staff leaving a given organization but can also be viewed as an opportunity to develop existing staff. A consideration here should be the balance between internal and external resources.

ACCA notes that, in order to ensure that the appropriate knowledge transfer to internal staff takes place in the longer term, external consultants should be used with care. Lengthy implementation timescales mean that entities must consider how to retain institutional memory and tacit organizational knowledge throughout the process, as staff may not be involved for the duration. Implementation will also require new business models and charts of accounts.

[181] IMF, 2014, *Country Report No. 14/353, Iceland: Technical Assistance Report – IPSAS in Iceland – Towards Enhanced Fiscal Transparency,* December 2014, Washington, D.C., pp. 1–8. Available at https://www.imf.org/external/pubs/ft/scr/2014/cr14353.pdf.

[182] ACCA, 2017, IPSAS implementation: Current status and challenges, p. 18.

[183] See, for example, OECD and IFAC, 2017, *Accrual Practices and Reform Experiences in OECD Countries*, Paris; and ACCA, 2017, IPSAS implementation: Current status and challenges.

[184] ACCA, 2017, IPSAS implementation: Current status and challenges.

[185] Ibid.

Skills-related challenges were observed in Austria when implementing accrual accounting:[186] education and training requirements that were identified included:

- Education and training on a whole new system (not just IT but workflows as well).
- Only a small team involved in designing the training contents.
- The large number of employees in all ministries to be trained.
- The need to find appropriate trainers who identify t with the reform (trainer-training).
- The need to educate and train within a tight timetable.

Training activities thus included:

- Double-entry booking and accrual budgeting and accounting systems (asset management, treasury, transaction management, etc.).
- Different types of seminars of differing intensity on the new regulations.
- E-learning programme comprehending the basics of the reform.
- Special seminars on performance budgeting and gender budgeting.
- Seminars on technical implementation.

Working in partnership with PricewaterhouseCoopers, the University of Ghana rolled out a three-month training course on IPSAS for staff in key university administrative functions. The course was designed to enable staff to acquire the knowledge and skills required to present transparent and accountable financial statements that meet international financial standards.[187]

Another recent project in the area of IPSAS education is the establishment of an online course on European public sector accounting. The project is the result of cooperation between five European universities. Students and professionals are introduced to different public sector accounting approaches and traditions drawn from selected European Union Member States. The course includes lectures on IPSAS and keeps track of the harmonization of European public sector accounting and the respective EPSAS. The work was funded by the European Commission.[188]

Furthermore, significant efforts are needed to educate all users of IPSAS-based information, given that, depending on the jurisdiction, public sector IPSAS-based reports may differ significantly from reports prepared under the previous accounting standards.[189]

9. Cost of implementation

From both a finance and an audit perspective, the costs of implementation (both financial and resource-based) should not be underestimated.[190] Costs will be incurred for training, the use of specialized external consultants, IT upgrades and the development of appropriate guidance and translation tools. There are also significant costs associated with assembling the set of information (for example, asset records) necessary for accrual reporting but absent in a cash-based environment. In this respect, the lower the quality of the existing set of information, the more the move to accrual reporting will cost.

Adequate financial resources should also be allocated to targeted stakeholder engagement and to other engagement and awareness activities. Most of the countries included in a recent ACCA study adopted IPSAS in conjunction with a wider public financial management improvement programme, which requires additional investment.

Technology should be considered as a part of cost. It can be expensive and expert advice and consultancy is required to support configuration, user training and transfer to business as usual. Adoption is likely to require the replacement or adaptation of some existing IT systems, data structures and charts of accounts. Reporting systems and structures may need to be updated as part of the transition process.

[186] See, for example, http://www.rgs.mef.gov.it/_Documenti/VERSIONE-I/Comunicazione/Workshop-e-convegni/Seminario_2017-02-9_10/5_Accrual_Accounting_Reform_and_Opening_Balance_Sheet_-_February_2017_-_B_Schatz.pdf.

[187] See University of Ghana, 2016, University of Ghana commits to IPSAS conversion project, 14 September, available at https://www.ug.edu.gh/news/university-ghana-commits-ipsas-conversion-project (accessed 21 January 2019).

[188] University of Rostock, Online course: European public sector accounting, available at http://offene.uni-rostock.de/online-course-european-public-sector-accounting/ (accessed 21 January 2019).

[189] Please note that the reporting will, on the other hand, become more comparable to that seen in the private sector.

[190] ACCA, 2017, IPSAS implementation: Current status and challenges.

The Malaysian authorities decided to adopt the standards for all entities on the same date: consequently, there was a lack of resources and initial consultancy costs were high. The lack of skills in accrual accounting also caused difficulty in producing timely and credible financial statements.[191]

IMF[192] has suggested that, once the above-mentioned gap analysis has been completed, Governments should estimate the costs of reform to determine whether they are outweighed by the potential benefits, and secure budgetary resources for the implementation of the reform, which may be phased or involve partial adoption. Recent experience indicates that financial and other costs of reforms can vary significantly depending on the state of accounting practices, the quality of financial information available at the time, the degree of ambition and links with other financial management reforms.

The potential costs of implementing harmonized, accrual-based, government accounting standards in European Union Member States constitute a topic of discussion.[193] Such costs must be set against the potential benefits. Based on information made available by countries that have moved to accruals accounting, the European Commission has estimated, in very broad terms, what the costs for the Member States might be. The costs are likely to be significant and are strongly influenced by the scale and pace of accruals implementation, the size and complexity of the government sector in question and the completeness and reliability of existing systems. In addition, European Union Member States might find it appropriate to modernize their public financial management systems when implementing the new accounting standards.

As an order of magnitude and based on the experience of those countries for which cost data are available, the possible cost for a medium-sized European Union Member State of moving from a cash-based accounting system to an accruals-based accounting system, for central Government but no other layers of Government, could be up to €50 million. This amount would include, for example, the expense of putting in place the new standards and the associated central IT accounting tools, but not the costs associated with a complete reform of the financial reporting system. The costs could be much higher for larger European Union Member States that have systems of autonomous regional Government or more complex government systems and those that have not made progress on accruals accounting. This is particularly the case if the transition to a harmonized accruals system is combined with wider reforms of accounting and financial reporting practices. For example, the cost of the accruals and budgeting reforms in France over the last decade was put at €1,500 million. For a smaller European Union Member State, with national accruals accounting systems already in place, the costs might be less than €50 million. All of the cost estimates collected fall within the range of 0.02–0.1 per cent of gross domestic product. In addition, the implementation of harmonized accruals accounting for European Union Member States would also require significant investment by the European Commission in terms of leadership, expertise and resources.

Within the European Union, it is believed that harmonization will bring about a reduction in bureaucracy and costs that, in the medium to long-term, would far outweigh the expected investment. Furthermore, the real and significant expected financial costs can be weighed against the potential benefits, not least those of better governance, accountability, better public sector management and the transparency needed for the proper functioning of markets.

D. CONCLUSIONS

Over the past few decades, many countries have introduced significant reforms regarding public accounting and, consequently, the financial reporting of information by public entities. The new accounting systems respond not only to the legitimacy and lawfulness of, and need to comply with, regulations, through budgetary cash-based information, but also to the availability of information concerning the efficient use and supply of public resources. The aim of the reforms is to improve financial reporting for decision makers and for accountability purposes in general.

[191] Ibid, p. 11.

[192] Cavanagh J et al., 2016, *Implementing Accrual Accounting in the Public Sector*.

[193] This section is based on European Commission, 2013, Report from the Commission to the Council and the European Parliament: Towards implementing harmonized public sector accounting standards in Member States The suitability of IPSAS for the Member States. Available at https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=celex%3A52013DC0114 (accessed 21 January 2019).

This chapter describes upcoming IPSAS, the advancement of accrual-based IPSAS globally, as well as key practical issues that can arise during the implementation process. Practical challenges may emerge in areas such as regulatory set-up and institutional arrangements, or in the form of technical accounting and financial reporting issues and problems regarding the broader development of the public sector accounting profession. During the coming decades, more attention should be paid to country-specific issues, including the education and training of government accountants. Governments should strive to make accrual accounting and IPSAS a reality in the public sector globally.

Annex

List of International Public Sector Accounting Standards*

IPSAS	Title	Underlying IFRS
IPSAS 1	Presentation of Financial Statements	IAS 1
IPSAS 2	Cash Flow Statements	IAS 7
IPSAS 3	Accounting Policies, Changes in Accounting Estimates and Errors	IAS 8
IPSAS 4	The Effects of Changes in Foreign Exchange Rates	IAS 21
IPSAS 5	Borrowing Costs	IAS 23
IPSAS 9	Revenue from Exchange Transactions	IAS 18
IPSAS 10	Financial Reporting in Hyperinflationary Economies	IAS 29
IPSAS 11	Construction Contracts	IAS 11
IPSAS 12	Inventories	IAS 2
IPSAS 13	Leases	IAS 17
IPSAS 14	Events After the Reporting Date	IAS 10
IPSAS 15	Financial Instruments: Disclosure and Presentation IPSAS 15 has been replaced by IPSAS 28,29 and 30	IAS 32
IPSAS 16	Investment Property	IAS 40
IPSAS 17	Property, Plant and Equipment	IAS 16
IPSAS 18	Segment Reporting	IAS 14/IFRS 8
IPSAS 19	Provisions, Contingent Liabilities and Contingent Assets	IAS 37
IPSAS 20	Related Party Disclosures	IAS 24
IPSAS 21	Impairment of Non–Cash-Generating Assets	
IPSAS 22	Disclosure of Information about the General Government Sector	
IPSAS 23	Revenue from Non-Exchange Transactions (Taxes and Transfers)	

* Based on IPSASB, 2018, *Handbook of International Public Sector Accounting Pronouncements*, 2018 Edition, vols. I–III.

IPSAS	Title	Underlying IFRS
IPSAS 24	Presentation of Budget Information in Financial Statements	
IPSAS 25	Employee Benefits	IAS 19
IPSAS 26	Impairment of Cash-Generating Assets	IAS 36
IPSAS 27	Agriculture	IAS 41
IPSAS 28	Financial instruments: Presentation	IAS 32
IPSAS 29	Financial Instruments: Recognition and Measurement	IAS 39
IPSAS 30	Financial Instruments: Disclosures	IFRS 7
IPSAS 31	Intangible Assets	IAS 36
IPSAS 32	Service Concession Arrangements	IFRIC 12
IPSAS 33	First-time Adoption of Accrual Basis IPSASs	IFRS 1
IPSAS 34	Separate Financial Statements	IAS 27
IPSAS 35	Consolidated Financial Statements	IFRS 10
IPSAS 36	Investments in Associates and Joint Ventures	IAS 28
IPSAS 37	Joint Arrangements	IFRS 11
IPSAS 38	Disclosure of Interests in Other Entities	IFRS 12
IPSAS 39	Employee Benefits	IAS 19
IPSAS 40	Public Sector Combinations	
IPSAS 41	Financial Instruments	IFRS 9

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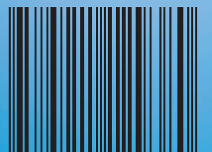

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