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Issues of practical implementation of international standards of accounting and reporting in the public and private sectors

Note by the UNCTAD secretariat

Executive summary

This note presents a review of practical implementation considerations with regard to the International Financial Reporting Standards and the International Public Sector Accounting Standards. It highlights practical implications of the International Financial Reporting Standards issued in recent years on topics such as financial instruments and revenue and for sectors such as leasing and insurance. In addition, it presents an overview of the current state of implementation of the International Public Sector Accounting Standards and practical implementation considerations related to regulatory, institutional and technical aspects.

Introduction

1. Member States of the United Nations noted at least four decades past the importance of a vibrant private sector in building productive capacities and 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 four decades, the United Nations has been contributing to the promotion of reliable and comparable financial and non-financial reporting by enterprises worldwide. To this end, the Economic and Social Council established the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting in October 1982.

2. The last two decades have been characterized by a proliferation of international standards in the areas of accounting and financial reporting in both the private and public sectors, auditing and assurance, as well as in the education and professional qualification of accountants. Through the Intergovernmental Working Group of Experts, UNCTAD has

contributed to a better understanding and more holistic and efficient implementation of such standards by member States.

3. With regard to the International Financial Reporting Standards, the Intergovernmental Working Group of Experts dedicated a series of annual sessions to deliberations focused on issues that arise in their practical implementation. The UNCTAD secretariat prepared background documentation and country case studies to facilitate better understanding and deliberations on such issues.[1] Furthermore, in recent years, the Intergovernmental Working Group of Experts has reviewed practical aspects of compliance monitoring and enforcement mechanisms with regard to corporate reporting requirements and issued guidance material.[2]

4. Over the years, delegates at annual sessions of the Intergovernmental Working Group of Experts have made successive requests for discussions on the practical implementation aspects of the International Public Sector Accounting Standards. The secretariat has accordingly organized a series of technical workshops on this topic.

5. This note aims to facilitate discussions at the thirty-fifth session of the Intergovernmental Working Group of Experts on issues of practical implementation of international standards of accounting and reporting in the public and private sectors. The first chapter addresses practical implementation aspects of the International Financial Reporting Standards, providing an overview of the International Accounting Standards Board and the current state of practical implementation worldwide. This is followed by a review of practical implementation considerations with regard to recently issued standards that will come into force in the current and subsequent financial reporting periods. The second chapter provides a brief background of the International Public Sector Accounting Standards and discusses practical implementation issues with regard to regulatory, institutional and technical aspects. The third chapter presents conclusions and questions that delegates may wish to consider.

I. Practical implementation of the International Financial Reporting Standards

A. Background

6. The accountancy profession has played a leading role with regard to the globalization of accounting standards. One of the early indications of a globalizing accountancy profession was the organization of the first World Congress of Accountants in 1904. The quadrennial Congress has continued to be held; the next Congress is scheduled to take place in November 2018. In 1973, 16 professional accountancy organizations established the International Accounting Standards Committee, which issued a number of International Accounting Standards until February 2001, and its Standing Interpretations Committee published interpretations of these standards. In 2001, the International Accounting Standards Committee was replaced by the International Accounting Standards Board, which adopted the standards that had been issued, along with the published interpretations; the Board called the full suite of standards and interpretations the International Financial Reporting Standards.

7. The current suite consists of 25 International Accounting Standards, 17 International Financial Reporting Standards and 18 Interpretations. Of 166 jurisdictions surveyed by the Board, 144 require the International Financial Reporting Standards to be applied by all or most domestic publicly accountable entities in their capital markets.[3] Among the

[1] UNCTAD, 2008, *Practical Implementation of International Financial Reporting Standards: Lessons Learned* (United Nations publication, Sales No. E.08.II.D.25, New York and Geneva).

[2] UNCTAD, 2017, *Monitoring of Compliance and Enforcement for High-Quality Corporate Reporting: Guidance on Good Practices* (United Nations publication, New York and Geneva).

[3] See www.ifrs.org/use-around-the-world/use-of-ifrs-standards-by-jurisdiction/#analysis
Note: All websites referred to in footnotes were accessed in August 2018.

49,000 companies listed on the 88 largest global securities exchanges, 27,000 use the International Financial Reporting Standards. The combined gross domestic product of countries applying the standards amounts to $46 trillion.[4]

B. Current and forthcoming practical implementation issues

8. The suite of International Financial Reporting Standards currently implemented represents an important change for virtually every company. It includes the widest reform ever to have taken place in accounting for insurance contracts, as well as major refinements in accounting for financial instruments and leases and the recognition and measurement of revenue. The significance of the current implementation programme is such that, in 2016, the International Organization of Securities Commissions issued the *Statement on the Implementation of New Accounting Standards*.[5] The statement emphasizes that early assessment of the impact of a new standard on a company's financial statements is desirable and that the disclosure of expected impacts is mandated under International Accounting Standard 8 on accounting policies, changes in estimates and errors. The International Organization of Securities Commissions suggests that listed companies should provide qualitative disclosures as early as possible, followed up quantitative disclosures once the issuer has advanced further in implementation assessment.

Standard 9: Financial instruments

9. Standard 9 replaces International Accounting Standard 39, which introduced fair value measurement requirements for many financial instruments. Standard 9 serves as the response by the International Accounting Standards Board to the financial crisis and to the need to replace Standard 39 with a more operationally workable standard. However, matters have been complicated by the fact that the standard has been issued in phases, with the classification and measurement part issued in 2009 and the standard completed in 2015 but without addressing macrohedging issues, for which Standard 39 remains in force. The phased publication was partly due to a decision that, as different aspects were completed, it would be better to make improved reporting available to constituents.

10. Early on during the financial crisis, a number of banks stated that using fair value as the measurement basis for financial instruments in a falling market had a catastrophic multiplier effect. Subsequent analysis has shown, however, that fair value accounting played little role in the crisis, yet a significant problem was that Standard 39 did not allow credit losses to be recognized until they had been incurred.[6] The effect of this was that banks were not signalling in advance that there was a deterioration in the quality of their loan portfolios. Their profit and loss accounts thus incurred large write-offs when losses occurred.

Expected credit loss allowance

11. The most radical change has arguably taken place in this area. Standard 9 introduces a three-stage approach to evaluating loans. In stage 1, the preparer measures the credit loss on the cohort of loans expected to occur in the next 12 months. A loan moves to stage 2 when a significant increase in credit risk is determined to have taken place for the entire 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 more detailed rules concerning specific types of instruments, such as those bought as credit impaired.

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[4] P Pacter, 2017, *Pocket Guide to International Financial Reporting Standards: The Global Financial Reporting Language* (International Financial Reporting Standards Foundation, London).

[5] See www.iasplus.com/en/news/2016/12/iosco.

[6] See, for example, ME Barth and WR Landsman, 2010, How did financial reporting contribute to the financial crisis? *European Accounting Review*, 19(3):399–423.

12. The approach involves considering expected losses, which is likely to be the most difficult area in implementation. Questions raised during 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 may include macroeconomic factors. A bank can use internal data, such as statistical trends, or external data. Historical data can be used if it has been corrected for any changes in circumstances.

13. This is an area that is challenging for banks, for their auditors and for regulatory and enforcement authorities. However, banks need to document their decision-making and the data on which it is based and make disclosures.

Classification and measurement

14. Standard 9 simplifies the approach to classification and measurement. It provides for three types of assets, each with a different measurement basis. The categories are determined with reference to the observable business model of the entity, as follows:

(a) Financial assets are held to maturity and solely interest and principal are collected. Assets are measured at amortized cost. There are rules to address complex instruments and determine whether the proceeds can be deemed interest and principal;

(b) Financial assets are held to 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 the part of their holdings that may be used for this purpose as distinct from permanent holdings. Assets are held at fair value in the balance sheet with changes in fair value reported under other comprehensive income.[7] There is a fair value option for use in the event of accounting mismatches;

(c) Financial assets that are not held in one of the other two business models. Such assets are measured at fair value through profit or loss. However, an exception is allowed when equity instruments are not held for trading. In such instances, they are still measured at fair value but under other comprehensive income instead of profit or loss. In such instances, dividends received are under profit or loss.

15. With regard to financial liabilities, the International Accounting Standards Board has indicated that constituents had not asked for any change to the requirements in Standard 39, which are largely maintained in Standard 9. One significant difference is that there is no longer a requirement to unbundle embedded derivatives.

Hedging

16. Standard 9 has simplified the accounting rules to address the hedging components of risk, such as hedging with crude oil futures against changes in aviation fuel prices, and the hedging of partial risk, such as 60 per cent of the currency risk on a financial instrument.[8] In addition, it introduces a new disclosure on the cost of hedging, designed to better inform users about gains and losses associated with hedging. Entities are required to disclose their risk management strategies and how these are likely to affect primary financial statements. Standard 9 does not address macrohedging. The International Accounting Standards Board had an ongoing project on this issue but its proposals were largely rejected and Standard 9

[7] Other comprehensive income contains “items of income and expense (including reclassification adjustments) that are not recognized in profit or loss as required or permitted by other International Financial Reporting Standards” (International Accounting Standard 1, paragraph 7).

[8] See, for example, International Financial Reporting Standards Foundation, 2014, [Board] completes reform of financial instrument accounting, Press release, 24 July, which states as follows: “[Standard] 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.”

has now been finalized.[9] The Board has continued to work on this issue and is expected to consult on an alternative proposal in due course.

Practical implementation

17. The National Australia Bank was an early adopter of Standard 9 (Australian Accounting Standards Board 9). The Bank produced an investor briefing to explain the impact of Standard 9 and noted that it had had to increase its collective impairment provision by $A 725 million, although this was adjusted against retained earnings. Data showed that the expected credit loss method of provisioning would cause impairment provisions to be recognized earlier than under Standard 39. The Bank stated that the new categories of assets meant that a greater proportion of its loans would be at an amortized cost and welcomed the ability to measure assets held to maturity or for sale at fair value through profit or loss.

Derogations for insurers

18. The insurance community faces two major changes to its balance sheets, namely Standard 9 in 2018 and Standard 17 on insurance contracts in 2021. Insurers have noted that there is a risk that the asset side of balance sheets will use fair values in 2018 while the liabilities side will not use fair values until 2021, thereby importing some accounting volatility to balance sheets arising from the accounting mismatch.[10]

19. In September 2016, the International Accounting Standards Board issued an amendment to the existing insurance standard, Standard 4 on insurance contracts, to allow insurers a choice of two derogations to handle the three-year transition. Insurers can either move under other comprehensive income any volatility arising from the mismatch during the period, known as the overlay approach, or companies that are predominantly insurance-related can defer application of Standard 9 until 2021, known as the deferral approach.

Standard 15: Revenue from contracts with customers

20. Standard 15 came into force in January 2018. There was little detailed guidance on the relevant predecessor standards, namely International Accounting Standards 11 on construction contracts and 18 on revenue. Countries that have adopted the International Financial Reporting Standards may note that Standard 15 is more prescriptive than its predecessors and this may generate implementation questions.

21. Standard 15 is built on the identification of performance obligations.[11] Its application presupposes that preparers identify contracts with customers, analyse performance obligations and allocate the overall contract price proportionately to each obligation. Revenue is recognized when a performance obligation has been satisfied, and is not dependent on the entire contract being satisfied.

22. For many, probably most, transactions, there is only a single performance obligation, and this analysis is therefore straightforward. The application of Standard 15 becomes more complex when there is more than one obligation, and there may be difficulty in determining whether there is more than one obligation. For example, if a telephone handset is sold with a required 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 Standard 15, namely supply

[9] For a summary of a discussion paper on this issue and feedback from constituents, see International Accounting Standards Board, 2015, Accounting for dynamic risk management: A portfolio revaluation approach to macrohedging, Agenda paper 4.

[10] See, for example, the correspondence of 20 January 2016 from the Chief Financial Officers Forum and Insurance Europe to the chair of the International Accounting Standards Board, available at www.cfoforum.eu/letters/CFOF_IE_Comment_Letter_on_IFRS_9_Deferral.pdf.

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

of the handset and access over time to the network. Standard 15 specifies that a contract price must be allocated across performance obligations in proportion to the retail price of the separate obligations.

Standard 16: Leases

23. Standard 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 reflect both increased assets and increased liabilities, but there are practical exceptions. Standard 16 was developed jointly with the Financial Accounting Standards Board in the United States of America and is largely but not completely converged.[12]

24. When the predecessor standard, International Accounting Standard 17, was issued in December 1997, it was expected that the new accounting and reporting brought about would significantly change balance sheets. However, its main effect was to significantly change the way leases were written, causing them to cover shorter periods, to qualify as operating leases and remain off balance sheets. Such leases could be renewed, so that lifetime use was obtained, but in stages, to avoid capitalization.

25. Under Standard 16, a lessee is required to recognize both a leased asset and a lease obligation and/or liability in the balance sheet when they control the use of a more than insignificant asset for any period longer than 12 months. The asset may, however, be classified as an intangible right-of-use asset and be shown as a separate category in the balance sheet or may be classified with tangible non-current assets in line with the nature of the underlying asset, as had been required under Standard 17. 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-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 more towards the early life of the lease when the liability is greatest and the financing charge therefore the highest. This is a significant difference to the generally accepted accounting principles in the United States, under which standard setters decided to allow a straight-line charge.

Implementation issues

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

27. Standard 16 puts into sharper focus the issue of when a contract becomes a service contract and not a lease. This is a boundary issue that may cause enforcement problems. The exception for low-value assets may also be a source of difficulties. The effects analysis of the International Accounting Standards Board on Standard 16 reports that in conducting outreach on low-value assets, the Board suggested that these would be items that cost less than $5,000 when new, such as personal computers. However, this could potentially be a grey area for implementation and for audit and enforcement by regulatory authorities.

Implementation practices

28. At a meeting of the Emerging Economies Group in Kuala Lumpur in May 2018, the implementation support team of the International Financial Reporting Standards Foundation gave a presentation on the implementation difficulties with regard to Standard 16 and a

[12] The International Accounting Standards Board version differs from that of the Financial Accounting Standards Board in some details, in particular the treatment of property rentals and mitigations for small leases (World Accounting Report, February 2016). For comparisons with the generally accepted accounting principles in the United States, see International Financial Reporting Standards Foundation, 2016, Effects Analysis: Standard 16.

presentation on the business implications of Standard 16.[13] The latter noted that implementation would change the financial metrics of companies with what were previously classified as operating leases, as follows:

(a) Balance sheet structure: liabilities and assets will increase, thereby increasing the debt-to-equity ratio;

(b) Income statement: operating costs will reduce but financing costs will increase, thereby reducing the interest coverage ratio;

(c) Statement of cash flows: some operating cash flows will become financing cash flows.

Standard 17: Insurance contracts

29. Standard 17 may turn out to be the most far-reaching standard that the International Accounting Standards Board has produced to date. It introduces a single, comparable way of accounting for insurance contracts worldwide in a context in which there are many different views about how insurance companies should prepare financial statements and many national approaches that are not comparable. Standard 17 was issued in May 2017 and does not come into force until January 2021. The significant time gap reflects the technical difficulty most companies may experience in applying this standard.

30. Standard 17 defines an insurance contract as one in which 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 period of a contract. In 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. Standard 17 introduces the term “contract fulfilment cash flows”, which form part of the insurance liability or asset. Standard 17 requires that this estimate also include the future profit margin on the contract and a risk adjustment. If this process suggests that the contract is not profitable, it should be immediately recognized as an onerous contract.[14] A key issue in this regard is that an insurer is required to update the estimates and assumptions systematically at each reporting date. This means that discount rates will reflect current market conditions and the expectations about the future unwinding of the contract will also be re-evaluated. Some contracts, in particular long-term contracts, include an investment element in the premium. Standard 17 requires this to be split and accounted for separately.

31. Implementation of Standard 17 will be difficult for most companies, and the International Accounting Standards Board has therefore provided a three-year lead period. The International Financial Reporting Standards Foundation provides support through a transition resource group on implementation and other outreach activities. Technical staff have given presentations on implementation at meetings of the World Standard-setters, the Emerging Economies Group and the International Financial Reporting Standards Advisory Council.

Initiatives in progress

32. The new standards discussed in the present note have already had or will have a significant impact on financial reporting. The International Accounting Standards Board currently does not have other standard-setting projects of a similar dimension in view, but has a number of projects in progress intended to improve financial reporting, which will lead to implementation requirements in the future. The main aim of these projects is to

[13] See www.ifrs.org/groups/emerging-economies-group/#meetings.

[14] Onerous contract refers to any contract deemed ultimately to be loss-making, and applies to any contract running beyond the end of the reporting year. The International Financial Reporting Standards require an estimate to be made of the likely outcomes of such contracts and, if they are not expected to make a profit, state that the full expected loss should be provided for in the current result (Standard 15 and International Accounting Standard 37).

improve communications; several other projects are intended to address relatively obscure lacunae in the International Financial Reporting Standards and others are intended to make minor improvements in existing standards.

Standards for small and medium-sized entities

33. The International Financial Reporting Standards for Small and Medium-sized Entities of the International Accounting Standards Board were first issued in 2009 and a slightly revised version came into force in 2015. The standards are a stand-alone comprehensive basis of accounting that do not involve any reference to the full suite of International Financial Reporting Standards and differ from the full suite in a number of ways. The Board aims to amend the standards at intervals of at least three years and then only to incorporate new International Financial Reporting Standards already being implemented. According to the International Financial Reporting Standards Foundation and based on its profiles of 166 jurisdictions, the International Financial Reporting Standards for Small and Medium-sized Entities are required or permitted in 86 countries.

34. An update is not currently planned; in 2016, the International Accounting Standards Board voted to start the next update process in early 2019. The new International Financial Reporting Standards discussed in this chapter will normally be candidates for review by the Implementation Group of the International Financial Reporting Standards for Small and Medium-sized Entities prior to the update in 2020. However, as financial institutions and insurance companies are not permitted to use the International Financial Reporting Standards for Small and Medium-sized Entities, these standards should not be impacted by Standard 17. The existing standards include limited guidance on financial instruments used by commercial companies, and these may change slightly as a result of the finalization of Standard 9. Standard 15 and Standard 16 normally apply in some form to small and medium-sized enterprises and, as such enterprises may be significant users of lease finance, they may be more affected by the implementation of Standard 16 than many larger companies. The determination of a material leased asset may differ in the context of such an enterprise in comparison with that of a listed company.

II. Practical implementation of the International Public Sector Accounting Standards

A. Background

35. The International Public Sector Accounting Standards are a tool that can be applied to support the modernization of government accounting and many countries have made efforts to adopt them. The first International Public Sector Accounting Standards were published in May 2000. This chapter highlights key practical issues that can arise during the implementation process. Practical challenges can emerge in areas such as regulatory set-up, institutional arrangements, technical accounting and financial reporting, along with issues and challenges with regard to the broader development of the public sector accounting profession. The standards are developed by the International Public Sector Accounting Standards Board for application by local, regional and national governments and related government entities and serve as a mechanism for enabling the increased homogeneity of public sector financial reporting in different countries.[15]

36. The adoption of the standards by countries worldwide has gained increasing attention among member States.[16] At the same time, policymakers, regulators and

[15] I Brusca and JC Martínez, 2016, Adopting International Public Sector Accounting Standards: A challenge for modernizing and harmonizing public sector accounting, *International Review of Administrative Sciences,* 82(4):724–744.

[16] Ibid. Also see, for example, Association of Chartered Certified Accountants, 2017, International Public Sector Accounting Standards implementation: Current status and challenges, available at www.accaglobal.com/uk/en/professional-insights/global-profession/ipsas-implementation-current-status-and-challenges.html.

academics are increasingly devoting attention to recent developments in the global convergence of public sector accounting and reporting. In debates on local, regional and global convergences of public sector accounting practices, accountability and transparency often stand out as critical components in driving the convergence agenda. In the last two decades, the International Public Sector Accounting Standards Board and the standards it establishes have increasingly become a focal point for international standardization and reference within the area of public sector accounting. The Board is an independent standard-setting board and its operations are facilitated by the International Federation of Accountants. Since 1997, the Board has developed and issued a suite of accrual-based and cash-based International Public Sector Accounting Standards.[17] In addition, the Board 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.

37. The strategy of the Board since 2015 has had as its key strategic objective to strengthen public financial management and knowledge globally through the increased adoption of accrual-based International Public Sector Accounting Standards by:[18]

(a) Developing high-quality public sector financial reporting standards;

(b) Developing other publications for the public sector;

(c) Raising awareness of the International Public Sector Accounting Standards and the benefits of their adoption.

38. The Board adopts a certain due process and working procedures in promulgating the International Public Sector Accounting Standards. In developing the standards, the Board follows a structured and public process that provides an opportunity for stakeholders in financial reporting in the public sector, including preparers and users directly affected by the standards, to make their views known and have them considered by the Board.

B. Overview of current and forthcoming standards

39. In 2017, the Board issued Exposure Draft 62 on financial instruments, which proposes new, simplified classification and measurement requirements for financial assets, a forward-looking impairment model and a flexible principle-based hedge accounting model. Exposure Draft 62 seeks to align accounting for financial instruments with Standard 9 on financial instruments and includes suggested public sector-specific modifications.[19] This approach builds on public and private sector best practices while seeking to address public sector-specific features.

40. In addition in 2017, the Board issued Exposure Draft 63 on social benefits, which addresses accounting for the delivery of social benefits, such as retirement, unemployment and disability benefits, aimed at improving consistency, transparency and reporting by public sector entities of social benefit schemes, which account for a large portion of government expenditure in most jurisdictions. Exposure Draft 63 defines social benefits and proposes requirements for the recognition and measurement of social benefit schemes.

41. At the end of 2017, the Board issued revised International Public Sector Accounting Standards on financial reporting under the cash basis of accounting, which take effect on 1 January 2019, with earlier adoption encouraged. The amendments seek to address some of the main barriers that had been observed with regard to the adoption of this standard. In addition, the Board issued Standard 40 on public sector combinations, providing the first international accounting requirements that specifically address the needs of the public sector when accounting for combinations of entities and operations. Standard 40 classifies public sector combinations as either amalgamations or acquisitions.

[17] See www.ipsasb.org/publications-resources and www.ifac.org/publications-resources/revised-cash-basis-ipsas.

[18] www.ifac.org/publications-resources/ipsasbs-strategy-2015-forward-leading-through-change.

[19] www.ifrs.org/issued-standards/list-of-standards/ifrs-9-financial-instruments/. The Board approved Standard 41 on financial instruments in June 2018.

42. In January 2018, the Board issued Exposure Draft 64 on leases. The leases project of the Board is a convergence project with Standard 16 on leases. In developing Exposure Draft 64, the Board applied its policy paper on the process for reviewing and modifying International Accounting Standards Board documents. Drawing on this process, the International Public Sector Accounting Standards Board proposes adopting the Standard 16 right-of-use model for lessees. However, the Board decided not to adopt the Standard 16 risks and rewards incidental-to-ownership model for lessors and instead decided to opt for the right-of-use model for lessors as well. The Board also proposes new public sector-specific guidance on concessionary leases for both lessors and lessees.

43. In April 2018, the Board issued Exposure Draft 65 on improvements to the International Public Sector Accounting Standards, which proposes general improvements to address issues raised by stakeholders, and convergence amendments with regard to the International Financial Reporting Standards. In addition, the Board published a consultation document on its proposed strategy and work plan for 2019–2023 that emphasizes the importance of the International Public Sector Accounting Standards in public financial management reforms and proposes as a strategic objective the strengthening of public financial management globally through the increased adoption of accrual-based standards.

44. Finally, in 2017, the Board issued a consultation paper on heritage items and in 2018, issued a consultation paper on accounting for revenue and non-exchange expenses. Board staff have issued a staff questions and answers document on the application of materiality to preparing financial statements, which summarizes existing provisions in the International Public Sector Accounting Standards on materiality.[20]

C. Practical implementation

45. The *International Standards: 2017 Global Status Report* of the International Federation of Accountants[21] highlights that the process towards providing high-quality public financial information begins with Governments committing to the implementation of internationally recognized financial reporting standards. The report states that financial reporting standards such as the International Public Sector Accounting Standards support a comprehensive capture of the financial performance and position of reporting entities. In addition, the International Federation of Accountants emphasizes that this process is driven by national priorities, resources and relevance. Member organizations must determine the appropriate level and type of actions they should take to promote and support the adoption of the standards, and the International Federation of Accountants assists them by providing guidance on developing road maps to promote and support adoption.

46. The PricewaterhouseCoopers survey on accounting and reporting by Governments, *Towards a New Era in Government Accounting and Reporting*, second edition, states that the greatest 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.[22]

Africa

47. Over the years, many countries in Africa have adopted International Public Sector Accounting Standards, with several countries intending to formally adopt the standards as part of financial management reform programmes. Some of the incentives and programmes for their adoption in Africa have been funded by donors. The PricewaterhouseCoopers survey highlighted that 17 countries in Africa indicated their intention to move to accrual accounting.

[20] For a related podcast, see www.ifac.org/news-events/2017-06/ipsasb-staff-podcast-materiality.
[21] www.ifac.org/publications-resources/international-standards-2017-global-status-report.
[22] www.pwc.com/rw/en/publications/pw-ipsas-survey.html.

Asia and the Pacific

48. Following the crisis in the late 1990s, countries in South Asia embarked on financial management reforms in the private and public sectors. Some of the countries most affected by the crisis were Indonesia, the Republic of Korea and Thailand, and other countries affected included Malaysia and the Philippines. Funding from donors such as the International Monetary Fund and the World Bank required public finance management reforms, including the adoption of accrual accounting standards based on the International Public Sector Accounting Standards. Bangladesh, India, Nepal and Pakistan adopted standards aligned to cash-based International Public Sector Accounting Standards.[23]

Eastern Europe

49. Countries in Eastern Europe have embarked on adoption processes with regard to the International Public Sector Accounting Standards. However, publications on their implementation processes are not as widely available as those of other regions.

Latin America and the Caribbean

50. Many countries in South America are moving towards the adoption of the International Public Sector Accounting Standards, included as part of financial management reform programmes promoted and funded by donors.[24] Chile and Peru have taken the lead, with other countries looking to adopt the standards by 2021. The International Public Sector Accounting Standards Board states that national Governments, bodies and organizations in the following countries in South America have adopted or plan to adopt the standards; Brazil, Colombia, Costa Rica, Panama and Peru.[25]

Western Europe

51. A survey of financial reporting practices in selected countries carried out in 2017 by the Organization for Economic Cooperation and Development in collaboration with the International Federation of Accountants and the Accountability Now initiative was sent to the ministries of finance and equivalent bodies of all 34 member countries.[26] The results showed that most member countries had reformed and modernized their financial reporting practices in the last decades.

D. Practical implementation challenges

52. This section addresses the role of legal and regulatory aspects in the context of adopting accrual-based International Public Sector Accounting Standards, including institutional issues that may emerge during adoption, as well as a review of selected technical issues. Finally, the section addresses the role of statistical reporting and budget-based reporting with regard to accrual-based financial reporting under the standards, skills development and cost aspects of implementation.

Legal and regulatory aspects

53. Public sector accounting is firmly embedded in the political, economic, legal and social contexts in which it is practiced. The political system and legal framework therefore have a significant influence on the adoption and implementation of government accounting standards in general. The implementation of the International Public Sector Accounting

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23 Association of Chartered Certified Accountants, 2017.

24 Ibid.

25 www.ifac.org/system/files/uploads/IPSASB/IPSASB-Fact-Sheet-June-2016-2.pdf.

26 www.ifac.org/publications-resources/accrual-practices-and-reform-experiences-oecd-countries; member countries are Australia, Austria, Belgium, Canada, Chile, Czechia, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, the Republic of Korea, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, Slovakia, Slovenia, Spain, Sweden, Switzerland, Turkey, the United Kingdom of Great Britain and Northern Ireland and the United States.

Standards may imply legal changes, as well as new regulations and governance practices. These may be complex and time consuming and vary between countries. With regard to the standards, the governance of accounting practices may be conducted at various levels of government and these levels may vary between countries. A typical division of such levels includes the local government, state government and central government. If a country decides to adopt the standards, it may need to decide on the scope of adoption, namely whether it will be at the local, state or central level of government. In addition, with regard to regulatory aspects, the country may need to consider legal and standard-setting complexities.

Institutional arrangements

54. In the public sector, the legal and regulatory setting is often greatly intertwined with institutional arrangements. There is a growing emphasis in countries and by Governments on the challenges involved in implementing the International Public Sector Accounting Standards in local contexts. An important starting point when embarking on the adoption of the standards could therefore be to ensure that an assessment of the relative complexity of the institutional arrangements for accounting is carried out. The complexity of the accounting arrangement in a country could be driven by the number of accounting laws, rules and standards applied in the national context. The higher the number of accounting laws applicable, the more likely that the national accounting arrangements will be complex.[27] The levels of government can affect the complexity of the institutional arrangements. For example, a European Union-wide study found that member States with a state government-level subsector were the countries with the most complex accounting arrangements.[28] Some countries choose to implement a reform of the institutional arrangements within a broader financial reform that goes beyond the adoption of the International Public Sector Accounting Standards. The institutional arrangement for financial audits also needs to be considered when considering adopting the standards.

Levels of implementation

55. Studies have shown that government accounting arrangements are greatly heterogeneous. The existence of different levels of government has implications for the adoption of the International Public Sector Accounting Standards. Countries with state-level governments have been noted as having the most complex accounting arrangements. Governments need to determine the scope of implementation of the standards by taking into account the different levels of government.

Technical challenges

56. Countries embarking on the adoption of the International Public Sector Accounting Standards are likely to experience technical challenges in diverse areas. One of the first challenges to arise may be with regard to establishing the approach to adoption. The International Monetary Fund has developed a model for a phased transition from cash-based to accrual accounting.[29] Understanding that there are different approaches and methods for phasing the adoption of the standards could facilitate the understanding of technical standard-level implementation challenges. Drawing on existing studies and reports, the key technical challenges in adopting the standards can be grouped into those related to statements of financial performance and statements of financial position, as well as broader challenges in preparing financial statements, including the reconciliation of budget reporting and accrual-based financial reporting, as well as consolidated financial reports. In addition to specific technical challenges, there are overall challenges with regard to the quality of data used to support accrual-based financial reporting and to ensuring the timeliness of reporting.

[27] Ernst and Young, 2012, *Overview and Comparison of Public Accounting and Auditing Practices in the 27 [European Union] Member States* (London).

[28] Ibid.

[29] International Monetary Fund, 2016, *Implementing Accrual Accounting in the Public Sector* (Washington, D.C.).

57. Preparing a statement of financial performance that is in compliance with the standards could imply specific challenges with regard to revenue recognition. Accounting for revenue is highlighted as one of the main challenges by the Association of Chartered Certified Accountants.[30] Preparing a statement of financial position that is in compliance with the standards entails challenges related to the detailed contents of the statement. The results of the Organization for Economic Cooperation and Development, International Federation of Accountants and Accountability Now survey show that countries have progressed at different rates in preparing balance sheets due to challenges in this area.

Links to statistical reporting

58. Government finance statistics provide the basis for fiscal monitoring. The *Government Finance Statistics Manual 2014* is part of a series of international guidelines on statistical methodologies issued by the International Monetary Fund.[31] In addition, the International Public Sector Accounting Standards Board initiated a project in 2012 aimed at reducing the differences between International Public Sector Accounting Standards and reporting guidelines for public sector government finance statistics.[32] The Board noted that significant benefits could be gained from using a single integrated financial information system to generate both financial statements under the International Public Sector Accounting Standards and government finance statistics reports. Such an approach would reduce the preparation time and costs of the latter, as well as the efforts required, while improvements could be expected in the source data for the reports, with flow-on benefits with regard to report quality, including timeliness. Improvements in the understandability and credibility of both types of reports are also likely to result.

Budget-based versus accrual-based reporting

59. 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. Adopting accrual-based financial reporting 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, as noted in the *Government Finance Statistics Manual 2014*, the accumulation of experience in accrual accounting and the availability of accrual-based historical data during this period is likely to contribute to a smoother eventual transition to accrual budgeting. In handling budgetary reporting and annual financial reporting, a challenge could arise if there are timing differences in the introduction of accrual accounting and budgeting. In such a situation, the capacity to generate suitable cash-based reports will need to be maintained in the interim period until a full transition to accrual budgeting has been achieved.

Skills capacity

60. Governments and public sector organizations may not have the skills, competence and staffing levels required for the implementation of the International Public Sector Accounting Standards. This has been a challenge in many countries. Implementation requires a programme of training to raise skills levels, and there are additional pressures to recruit and retain staff that are skilled in and focus on the standards. This challenge goes beyond a lack of core knowledge and understanding of the standards; related challenges may include the translation of the standards and guidance materials. Skills gaps identified by the Association of Chartered Certified Accountants include some reporting areas, in particular in the narrative reporting accompanying financial statements to clarify what the financial data implies for users.[33] Adoption of the standards may imply not only a steep increase in skills requirements but also a change in the finance culture and mindset, to make full use of the opportunities presented by professional accountants, to drive value. In

[30] Association of Chartered Certified Accountants, 2017.
[31] www.imf.org/external/np/sta/gfsm/.
[32] www.ifac.org/publications-resources/ipsass-and-government-finance-statistics-reporting-guidelines.
[33] Association of Chartered Certified Accountants, 2017.

addition to the technical skills required, there may be country-specific linguistic challenges to be addressed. For example, in Abu Dhabi, the Government requires financial statements to be presented in Arabic.[34] Overall accountancy capacity in a country will impact the ability to recruit and retain qualified staff in the public sector and implementation will require the upgrading of skills. This may lead to staff leaving an organization after acquiring such skills. Such challenges may also be viewed as opportunities to develop the capacities of existing staff. A consideration in this regard should be to achieve a good balance between using internal staff and external resources such as consultants.

Implementation costs

61. The costs of implementing the International Public Sector Accounting Standards should not be underestimated, whether from the financial reporting or the audit perspective.[35] Costs will be incurred in training, in using specialized external consultants, in upgrading information technology and in developing appropriate guidance and translation tools. Adequate financial resources should also be devoted to targeted stakeholder engagement and to other engagement and awareness activities. Most countries reviewed by the Association of Chartered Certified Accountants had adopted the International Public Sector Accounting Standards in conjunction with wider public financial management improvement programmes, which required additional investments.

62. In the last decades, many countries have undertaken significant reforms in public accounting and, therefore, in the financial reporting of information by public entities. The new accounting systems respond not only to concerns with regard to legitimacy, lawfulness and compliance with regulations, through budgetary cash-based information, but also the availability of information concerning the efficient use and supply of public resources. The reforms introduced in public sector accounting aim to improve financial reporting for decision makers and for accountability purposes in general.

63. Practical challenges in adopting the International Public Sector Accounting Standards can emerge in areas such as regulatory set-up, institutional arrangements, technical accounting and financial reporting, along with issues and challenges with regard to the broader development of the public sector accounting profession. In the coming years, further studies may need to be conducted on addressing country-specific implementation issues.

III. Conclusion and the way forward

64. This note reviews practical implementation considerations with regard to the International Financial Reporting Standards, highlighting the implications of standards issued in recent years, and the International Public Sector Accounting Standards, presenting an overview of the current state of implementation of the standards.

65. With regard to the International Financial Reporting Standards, delegates at the thirty-fifth session of the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting may wish to consider the following issues:

(a) What is the current state of implementation of the International Financial Reporting Standards worldwide?

(b) Are the standards being implemented in a comparable and consistent manner?

(c) Are monitoring, compliance and enforcement authorities conducting their work in a consistent and comparable manner worldwide?

(d) What are some of the key benefits that have been derived as a result of the global implementation of the standards?

[34] Ibid.

[35] Ibid.

(e) Some large jurisdictions worldwide have not yet implemented the standards as issued by the International Accounting Standards Board. What are the prospects for these jurisdictions to implement the standards in the coming years?

(f) What are some of the main challenges that countries and enterprises encounter in implementing the standards?

(g) What needs to be done at the global level to promote the further implementation of the standards in additional jurisdictions, in particular in developing countries and countries with economies in transition?

66. With regard to the International Public Sector Accounting Standards, delegates may wish to consider the following issues:

(a) What is the current state of implementation of the International Public Sector Accounting Standards worldwide?

(b) What are some of the main challenges that have been encountered in implementing the standards?

(c) Are there clearly defined and globally recognized assurance standards intended for financial reports prepared by public sector entities?

(d) What needs to be done to facilitate the sharing of experiences among member States with regard to the implementation of the standards?