

International Public Sector Accounting Standards

Implementation of Public Sector Accrual Accounting
Training of Trainers Course



MALAYSIAN INSTITUTE OF ACCOUNTANTS

Transparency and Accountability

...in managing public finances

- Expectations on good governance
- Demand for greater transparency and accountability
- Government-*Rakyat* trust could be established and reinforced through clear and comprehensive information regarding financial consequences of Government decisions:
 - Economic
 - Political
 - Social

Transparency and Accountability

...the effect towards debt crises

- Recent debt crises illustrates the inability of stakeholders to accurately monitor the financial position of governments due to lack of accurate and complete information
 - Maturity of debt unknown
 - Securitisation
 - Financial guarantees not disclosed
 - “Toxic assets” not tracked
 - Bailouts and nationalised entities

Transparency and Accountability

...is indeed a solution to many key issues affecting the public sector

- The accounting profession has the methods and concepts to improve transparency and accountability

Accrual Accounting

Accrual Accounting in the Public Sector

...for comprehensive and prudent fiscal management

- Prescribed as a policy measure in SRI 4 of the New Economic Model
- Sole reliance on cash accounting gives rise to significant risks stemming from inattention to asset-liability management
- The reported financial position of the Federal Consolidated Fund is too narrow to faithfully represent the resources controlled by, as well as the present obligations of, the Government

Comparing Cash vs Accrual

How different?

Modified Cash Basis

- Effects of transactions or events are recorded based on cash receipts and payments
- Unpaid supplies/services may be accrued if settled in January the following year
- No distinction of “future economic benefits” or “service potential”

Accrual Basis

- Effects of transactions or events are recognised as they occur
- Takes into regard:
 - Rights; and
 - Obligations
- “Future economic benefits” or “service potential” an important factor in determining the accounting for expenditure

Comparing Cash vs Accrual

Example #1

Date	Transaction / Event
9 September 2011	Govt issued purchase order to ABC Sdn Bhd for 50,000 small Malaysia flags
15 September 2011	ABC Sdn Bhd delivered 50,000 small Malaysia flags and invoiced the Govt RM150,000 (50,000 pcs x RM3)
16 September 2011	Flags distributed to all during Malaysia Day celebration at Dataran Merdeka
7 October 2011	Govt pays ABC Sdn Bhd RM150,000

Comparing Cash vs Accrual

Example #1

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9 September 2011	Govt issued purchase order to ABC Sdn Bhd for 50,000 small Malaysia flags
15 September 2011	ABC Sdn Bhd delivered 50,000 small Malaysia flags and invoiced the Govt RM150,000 (50,000 pcs x RM3)
16 September 2011	Flags distributed to all during Malaysia Day celebration at Dataran Merdeka
7 October 2011	Govt pays ABC Sdn Bhd RM150,000

Month	Modified Cash Basis	Accrual Basis
September 2011	Not accounted for	Expenses of RM150,000 recognised alongside the corresponding recognition of payables
October 2011	Expenses of RM150,000 recognised alongside the corresponding recognition of cash outflow	Recognition of cash outflow of RM150,000 alongside reversal of payables

Comparing Cash vs Accrual

Example #2

Date	Transaction / Event
9 September 2011	Govt issued purchase order to XYZ Sdn Bhd for 50 units of motorcycles
15 September 2011	XYZ Sdn Bhd delivered 50 units of motorcycles and invoiced the Govt RM500,000 (50 units x RM10,000)
1 October 2011	All 50 units of motorcycles have been deployed for use by PDRM
7 October 2011	Govt pays XYZ Sdn Bhd RM500,000

Comparing Cash vs Accrual

Example #2

Date	Transaction / Event
9 September 2011	Govt issued purchase order to XYZ Sdn Bhd for 50 units of motorcycles
15 September 2011	XYZ Sdn Bhd delivered 50 units of motorcycles and invoiced the Govt RM500,000 (50 units x RM10,000)
1 October 2011	All 50 units of motorcycles have been deployed for use by PDRM
7 October 2011	Govt pays XYZ Sdn Bhd RM500,000

Month	Modified Cash Basis
September 2011	Not accounted for
October 2011	Expenses of RM500,000 recognised alongside the corresponding recognition of cash outflow

Accrual Basis

- Asset is capitalised
- Carrying amount of the asset is systematically reduced and charged as expenses over its useful life (depreciation)
- Depreciation recognises the consumption of future economic benefits or service potential embodied in the asset
- More factors to consider (e.g. useful life, residual value)

Comparing Cash vs Accrual

Example #2

Date	Transaction / Event
9 September 2011	Govt issued purchase order to XYZ Sdn Bhd for 50 units of motorcycles
15 September 2011	XYZ Sdn Bhd delivered 50 units of motorcycles and invoiced the Govt RM500,000 (50 units x RM10,000)
1 October 2011	All 50 units of motorcycles have been deployed for use by PDRM
7 October 2011	Govt pays XYZ Sdn Bhd RM500,000

Month	Modified Cash Basis	Accrual Basis
September 2011	Not accounted for	Capitalisation of RM500,000 worth of assets alongside the corresponding recognition of payables
October 2011	Expenses of RM500,000 recognised alongside the corresponding recognition of cash outflow	Recognition of cash outflow of RM500,000 alongside reversal of payables
Subsequently	No further accounting	Recognition of depreciation over the useful life

Advantages of Accrual Accounting

...for comprehensive and prudent fiscal management

- Transparency and comprehensiveness of disclosure
- Promotes greater fiscal discipline (*NEM Concluding Part Paragraph 4.5.1*)
- Facilitate costing of public goods and services for efficient resource allocation
- Facilitate infrastructure asset management to improve service delivery
- Meets international standards of public sector financial statements as journey towards developed status

Sounds comprehensive, but...



- Accrual accounting is merely a basis of accounting
- By itself, may not necessarily result in useful information
- Having a set of **high quality accrual-based accounting standards** is crucial



**Benchmark for the
future**

Accrual-basis IPSAS*

*issued by the International Public Sector Accounting Standards Board, an independent standard-setting board of the International Federation of Accountants

Today's Agenda

[A] Introducing Accrual-Basis IPSAS

[B] Scope of IPSAS and Reporting Entity Issues

[C] Revenue

[D] Capital Expenditure

[E] Employee Benefits

Part A

Introducing Accrual-Basis IPSAS



...an overview

- Conceptually similar with IFRS – no reinvention of view
 - *Note: full convergence between MASB's MFRS and IFRS by 1 January 2012*
- Maintained the original text of IFRS unless there is a significant public sector issue which warrants a departure
- 31 standards have been released
 - 28 standards substantially converged with IFRS
 - 3 standards – public sector specific (no IFRS equivalent)

IPSAS-IFRS Convergence



Current Status:

IPSAS as at 31 December 2010 is consistent with IFRS as at 31 December 2009

IPSAS-IFRS Convergence

Conceptually similar!

Financial Position

Financial Performance

Assets

Revenue

Liabilities

Expenses

Net Asset / Equity

Assets

...the definitions

- **IFRS**
 - resources controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity
- **IPSAS**
 - resources controlled by the entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity

Service Potential

...because the public sector's delivery of goods and services do not always generate direct net cash inflows.

Liabilities

...the definitions

- **IFRS**
 - present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits
- **IPSAS**
 - present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential

Net Asset / Equity

...the definitions

- **IFRS (Equity)**
 - the residual interest in the assets of the entity after deducting all its liabilities
- **IPSAS**
 - the residual interest in the assets of the entity after deducting all its liabilities



IPSAS-IFRS Convergence

Conceptually similar!

Financial Position

Financial Performance

Assets

Revenue

Liabilities

Expenses

Net Asset / Equity

Revenue

...the definitions

- **IFRS**
 - gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants
- **IPSAS**
 - gross inflow of economic benefits or service potential during the reporting period when those inflow result in an increase in net asset / equity, other than increases relating to contribution to owners

Expenses

...the definitions

- **IFRS**

- decreases in economic benefits during the accounting period in the form of outflows or depletion of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants

- **IPSAS**

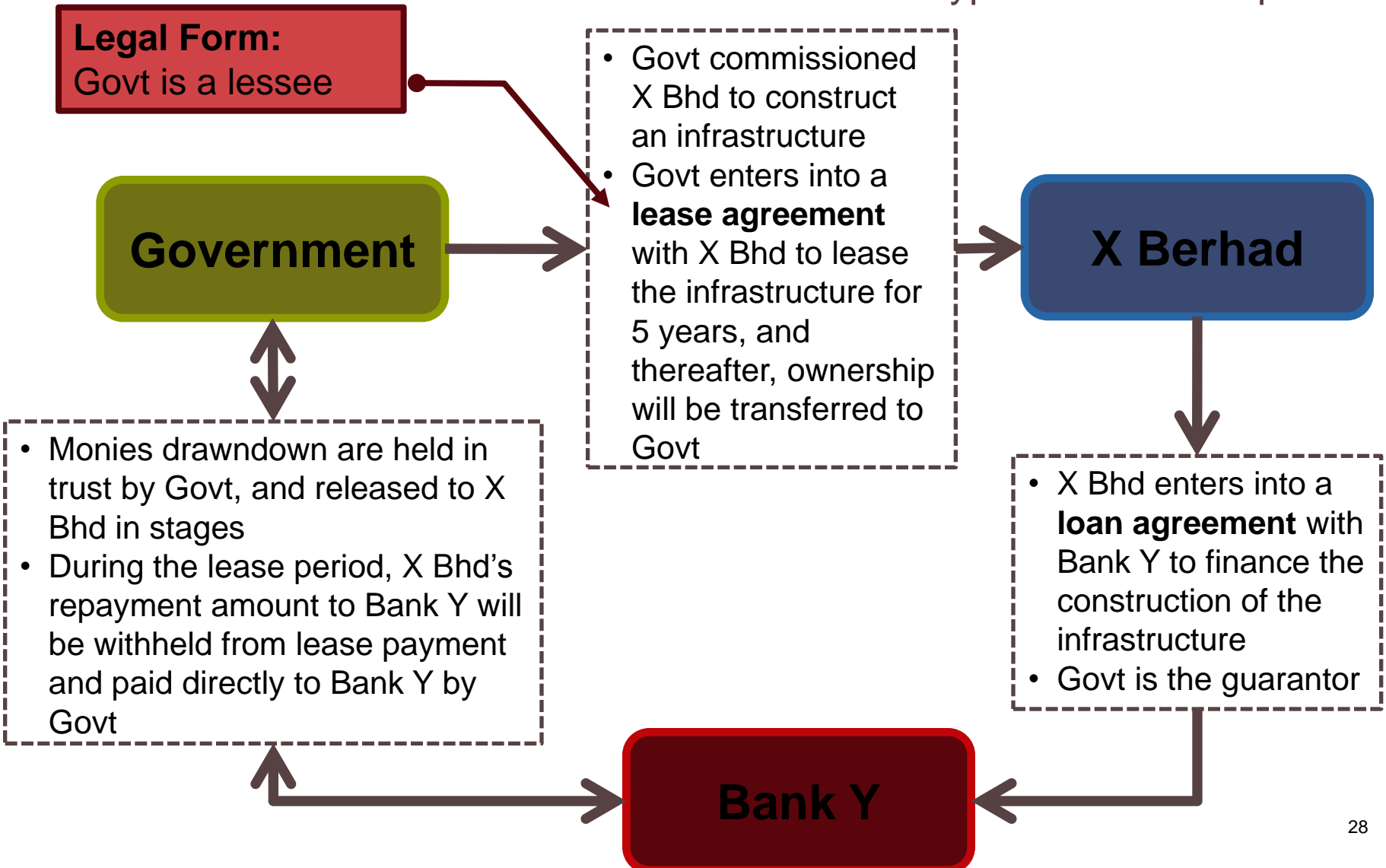
- decreases in economic benefits or service potential during the reporting period in the form of outflows or consumption of assets or incurrences of liabilities that result in decreases in net asset / equity, other than those relating to distribution to owners

Faithful Representation

- To be reliable, information must represent faithfully the transactions and other events it purports to represent
- Accounted for in accordance with their **substance** and **economic reality** (and not merely their legal form)

Substance over Legal Form

...hypothetical Example #1



Substance over Legal Form

...hypothetical Example #1

Substance:

- Govt borrows from Bank Y
- X Bhd is merely a contractor

Government

- Govt commissioned X Bhd to construct an infrastructure
- Govt enters into a **lease agreement** with X Bhd to lease the infrastructure for 5 years, and thereafter, ownership will be transferred to Govt

X Berhad

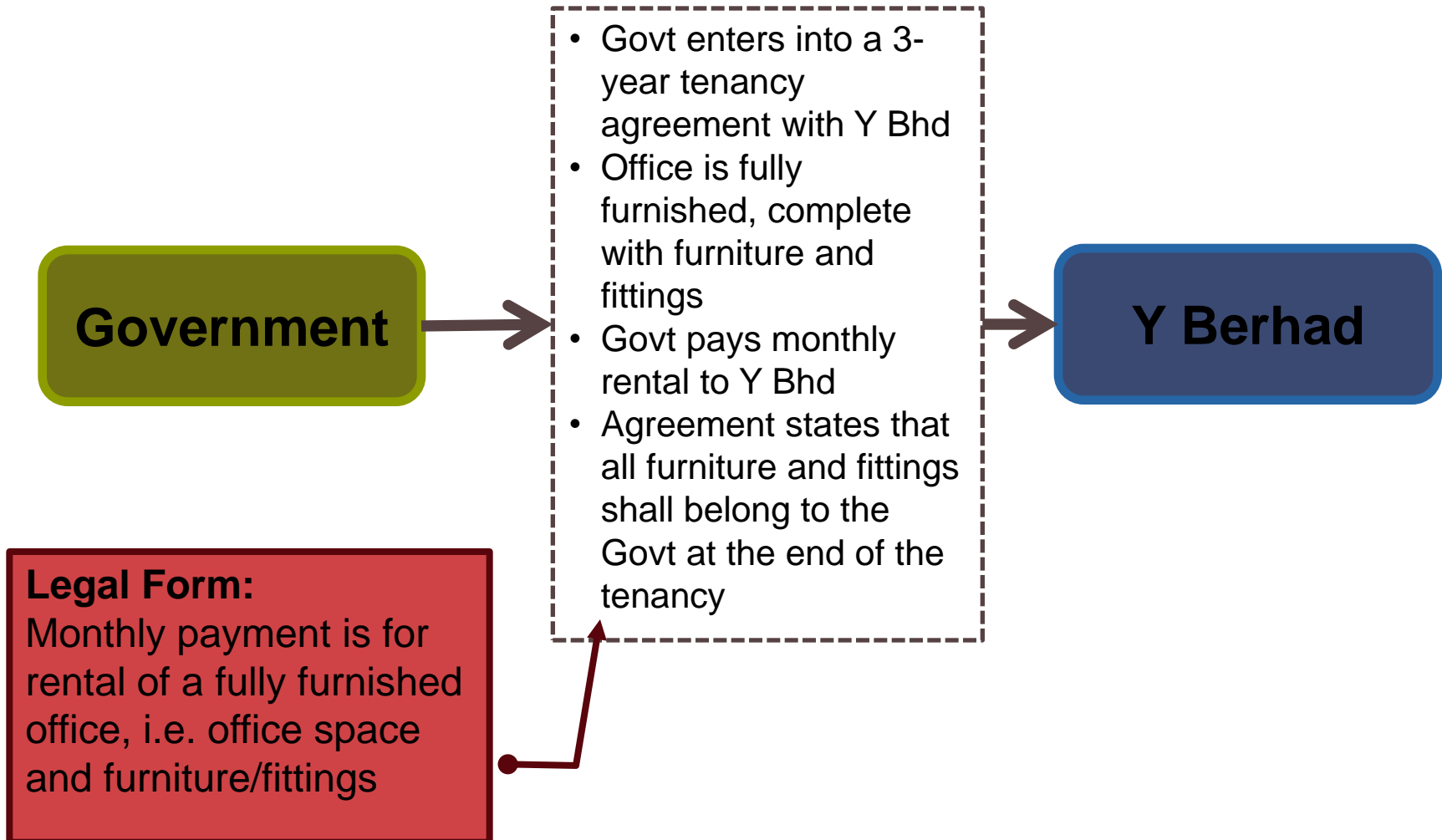
- Monies drawdown are held in trust by Govt, and released to X Bhd in stages
- During the lease period, X Bhd's repayment amount to Bank Y will be withheld from lease payment and paid directly to Bank Y by Govt

- X Bhd enters into a **loan agreement** with Bank Y to finance the construction of the infrastructure
- Govt is the guarantor

Bank Y

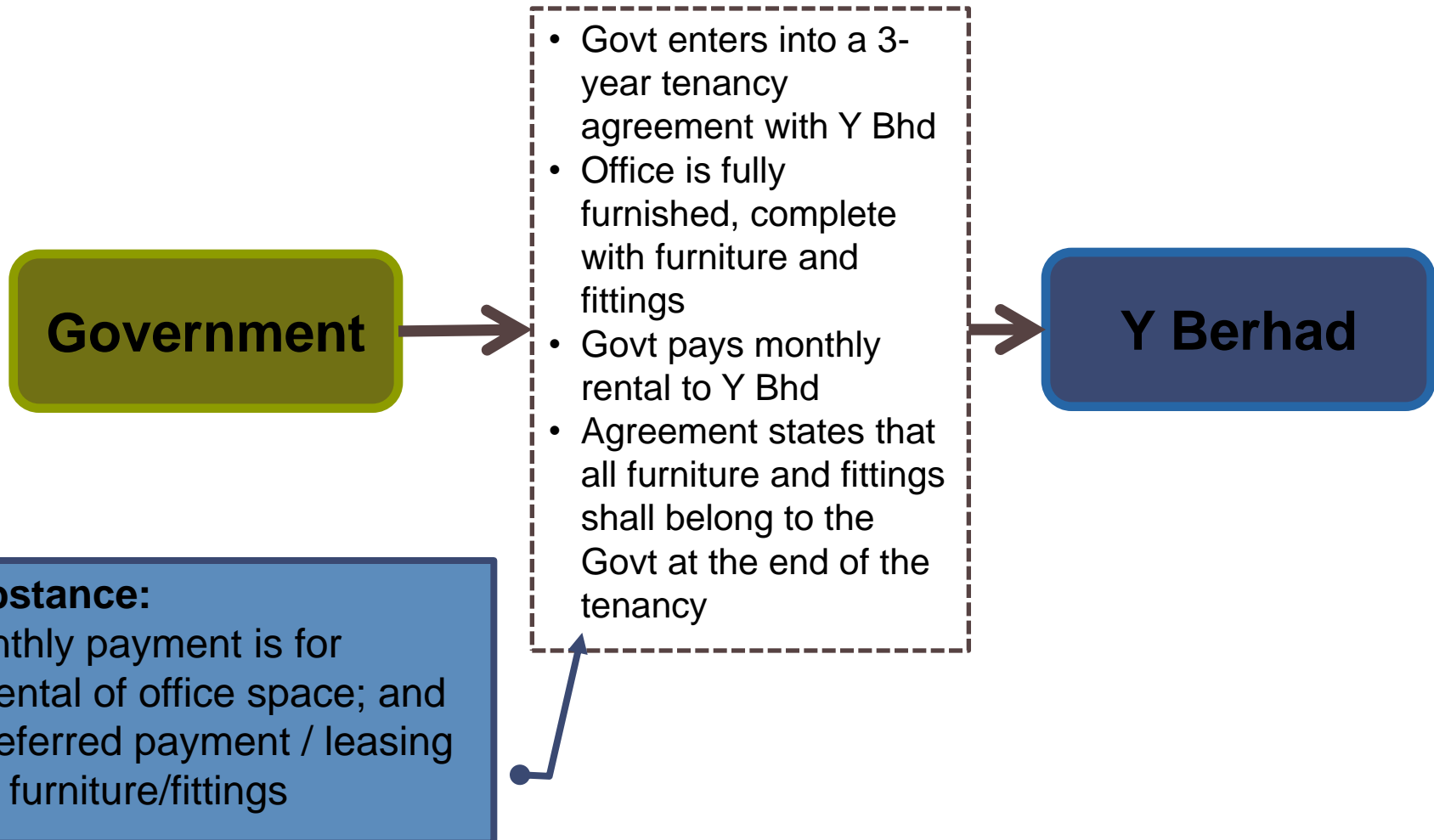
Substance over Legal Form

...hypothetical Example #2



Substance over Legal Form

...hypothetical Example #2



- IPSAS is principle-based
- Requires the use of judgement
- Examples:
 - Classification of financial assets (e.g. FGS, Crown Agents)
 - held for trading?
 - held to maturity?
 - available for sale?
 - Extent of control by the Government over statutory bodies and business enterprises
 - Expenditure – to capitalise or to expense?

- Determining the carrying amounts of some assets and liabilities requires estimation of the effects of uncertain future events
- Example:
 - Useful lives of property, plant and equipment
 - Impairment of assets
 - Pension liabilities (this is in fact most significant in the public sector)

- IPSAS specify the required accounting treatment for certain transactions and events.
- In the absence of specific guidance, to develop policies that results in relevant and reliable information:
 - requirements in IPSAS dealing in similar and related issue;
 - recent pronouncement of other standard-setting bodies (e.g. IFRS)
- Subject to materiality

Part B

Scope of IPSAS and Reporting Entity Issues



- Designed to apply to the general purpose financial statements of all public sector entities
- IPSAS do not apply to Government Business Enterprises (“GBE”)

Government Business Enterprise

An entity that has all the following characteristics:

- Is an entity with the power to contract in its own name
- Has been assigned the financial and operational authority to carry on a business
- Sells goods and services, in the normal course of its business, to other entities at a profit or full cost recovery
- Is not reliant on continuing government funding to be a going concern (other than purchases of output at arm's length)
- Is controlled by a public sector entity

IPSAS 6

Government Business Enterprise

...shall apply IFRS



- Incorporated under Companies Act, 1965
- Mandatory to use MASB's FRS



IPSAS is meant for...



IPSAS is meant for...

