International Public Sector Accounting Standards (IPSAS)

Impacts and Compliance Aspects

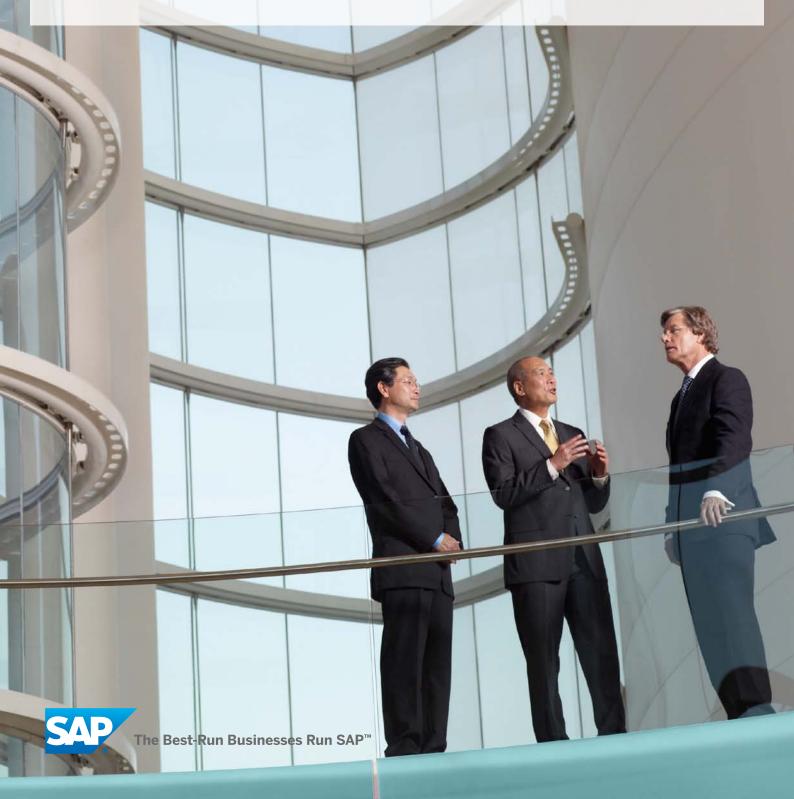




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Public Sector Accounting and Financial Reporting

Public sector organizations have long worked with a variety of financial reporting processes, principally cash-based accounting systems, and have faced the challenges posed by a lack of standardized international reporting practices. Many public sector entities are now adopting uniform standards and are experiencing new challenges.

Designed for use in preparing general-purpose financial statements, International Public Sector Accounting Standards (IPSAS) set uniform guidelines for accounting at public sector entities. The standards enable comparison of data across organizations and improve financial accounting transparency. Many countries have already introduced IPSAS or similar standards, and more have plans to adopt IPSAS in the future.

Public sector organizations face accounting challenges that stem from the use of cash-based accounting systems and a historical lack of standardized international reporting practices. Without a widely accepted set of rules, definitions, and guidelines, financial reporting data cannot be accurately compared among organizations around the world.

The problems associated with a lack of shared guidelines have long been recognized. In response to this situation, a recent trend is the development of uniform international accounting standards. Many public sector entities are in the process of adopting uniform standards, leading in turn to compliance issues. As the move to international standards continues, organizations are starting to come to terms with the challenges involved.

and reporting activities.

STANDARDS BOARDS AND FRAMEWORKS

Historically, local, state, and federal governments and other public sector entities have exercised jurisdictional powers to set individual standards for accounting, measurement, and financial reporting. Typically these frameworks are based on the principles of cash accounting.

A number of different public sector standards have evolved. Some standards are established at the national level, with countries developing their own set – or sets – of standards. For example, the following three boards operate in the United States: the Governmental Accounting Standards Board (GASB), the Federal Accounting Standards Advisory Board (FASAB), and the Financial Systems Integration Office (FSIO, formerly Joint Financial Management Improvement Program, or JFMIP).

Other national standard setters include the Public Sector Accounting Board (PSAB) in Canada and the Australian Accounting Standards Board. At another level, there are international standards included in the Government Finance Statistics Manual (GFSM), issued by the International Monetary Fund (IMF), and there are the International Public Sector Accounting Standards (IPSAS), which are discussed in this paper .¹



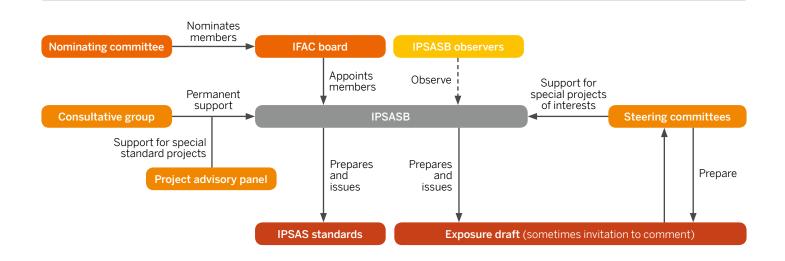
The Development of IPSAS

IPSAS is developed by the International Public Sector Accounting Standards Board (IPSASB), a private, independent standard-setting body under the auspices of the International Federation of Accountants (IFAC). See the figure for the organizational structure of the IPSASB.

While the IPSASB has no power to compel countries to adopt IPSAS, the standards do play an increasingly important role in the development and revision of national public sector accounting standards. IPSAS has taken on this important role because the standards reflect an accrual-based approach not found in most other public sector frameworks and provide universal standards that are not based on individual national laws.

Many countries have already introduced IPSAS or similar standards, and more countries have expressed plans to adopt IPSAS in the future. In addition, many supranational organizations including the European Commission, NATO, the Organization for Economic Co-operation and Development (OECD), and the United Nations currently use IPSAS-based financial accounting and reporting or have decided to do so in the near future.

Figure: Organizational Structure of the IPSASB²



Purpose and Content of IPSAS

Designed for use in preparing general-purpose financial statements, IPSAS sets forth requirements regarding recognition, measurement, presentation, and disclosure for transactions and events, such as payment of government taxes. The goal of the IPSASB in developing IPSAS was to set up uniform standards for accounting at public sector organizations around the world, thereby enabling comparison of data across organizations and improving financial accounting transparency.

BASIS AND APPLICABILITY

IPSAS is based mainly on International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) – frameworks put together by the International Accounting Standards Board (IASB). IAS and IFRS are concerned chiefly with financial reporting of private sector companies. Like IAS and IFRS, IPSAS is a framework for financial accounting, valuation, and financial statutory reporting. Some standards within IPSAS have no counterpart in IAS or IFRS, and are specifically addressed to the public sector.

IPSAS does not apply to government business enterprises such as public utilities and public transportation companies. These kinds of entities instead follow the IAS and IFRS frameworks.

DEVELOPMENT TO DATE

At present (since January 2011), IPSAS includes 31 standards that adhere to the principle of accrual-based accounting (see table). There is one additional standard that follows the cash basis principle. The preponderance of standards involving accrual-based accounting highlights the importance of this method in the IPSAS framework.

IPSAS COMPLIANCE

Simply put, IPSAS compliance calls for adherence to all applicable standards. As with private sector frameworks such as IAS, compliance is certified for an organization's or group's entire body of general-purpose financial statements only. In order to be in compliance, an organization must faithfully represent transactions, other events, and conditions in accordance with the requirements set out in IPSAS. During annual audits, auditors must determine that the accounting and reporting practices of the organization have been carried out in accordance with the requirements stated in the pertinent standards within IPSAS.

International Public Sector Accounting Standards³

IPSAS	Title	Basis
IPSAS 1	Presentation of Financial Statements	IAS 1
IPSAS 2	Cash Flow Statements	IAS 7
IPSAS 3	Net Surplus or Deficit for the Period, Fundamental Errors and Changes in Accounting Policies	IAS 8
IPSAS 4	The Effect of Changes in Foreign Exchange Rates	IAS 21
IPSAS 5	Borrowing Costs	IAS 23
IPSAS 6	Consolidated Financial Statements and Accounting for Controlled Entities	IAS 27
IPSAS 7	Accounting for Investments in Associates	IAS 28
IPSAS 8	Financial Reporting of Interests in Joint Ventures	IAS 31
IPSAS 9	Revenue from Exchange Transactions	IAS 18
IPSAS 10	Financial Reporting in Hyperinflationary Economies	IAS 29



Designed for use in preparing generalpurpose financial statements, International Public Sector Accounting Standards (IPSAS) set uniform guidelines for accounting at public sector entities.

International Public Sector Accounting Standards (continued)

IPSAS	Title	Basis
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	IAS 32
IPSAS 16	Investment Property	IAS 40
IPSAS 17	Property, Plant and Equipment	IAS 16
IPSAS 18	Segment Reporting	IAS 14
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	IAS 36
IPSAS 22	Disclosure of Financial Information About the General Government Sector	-
IPSAS 23	Revenue from Non-Exchange Transactions (Taxes and Transfers)	-
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: Disclosure	IFRS 7
IPSAS 31	Intangible Assets	IAS 38

IPSAS Compliance Support

In a joint study, financial software specialists from SAP and auditors from Ernst & Young AG performed an analysis in late 2007 to provide information on whether SAP® software can facilitate compliance with IPSAS. The objective of the study was to compare IPSAS and IAS with regard to additional or different implications regarding processing and reporting abilities of the SAP software. The compliant implementation of SAP financial software has already been well proven in contexts involving IAS. Therefore, the study focused on standards within IPSAS that have no counterpart in IAS, such as IPSAS 22, IPSAS 23, and IPSAS 24, and on certain areas where adaptations of IAS are specifically noted in IPSAS.

The study found that in most cases there were no material differences between IAS and IPSAS that would affect the ability of public sector organizations to implement SAP software including the SAP ERP application and SAP for Public Sector solutions, and to facilitate compliance with IPSAS. The study also found that as with IAS, IPSAS focuses strongly on rules to determine valuation and provide the level of detail required for a presentation of financial statements.

To comply with IPSAS, a company's business processes must align properly with the requirements. Implementation partners must ensure and document compliant implementation, and auditing support is required.

IPSAS 1 lays out the types of financial classifications necessary for the statement of financial position (as defined in IPSAS 1.88) and for the statement of financial performance (as defined in IPSAS 1.102f). These classifications are the basis for the development of an IPSAS-specific chart of accounts, a list of all accounts to be tracked by an organization. Developing a chart of accounts is key to any IPSAS project. This can be new territory for some public sector organizations that are not familiar with the requirement of a chart of accounts to perform accrual-based accounting practices. Support from internal and external auditing and implementation partners is needed to develop a compliant chart of accounts.

Feedback from organizations using accrual accounting based on IPSAS showed that their previously existing accounting procedures had to undergo certain, sometimes significant changes to deliver IPSAS-compliant information. However, these changes are readily achievable through a joint effort by accountants, auditors, and management to define the starting point for implementing SAP for Public Sector solutions, working together with the consultants performing the implementation.

The current release of the SAP ERP application enables organizations to create cash flow statements using the indirect method. In addition, the cash ledger functionality of the application enables the creation of cash flow statements using the direct method.



A Look at Some Specific Standards Within IPSAS

The remainder of this paper focuses on several standards within IPSAS that are of particular importance and that differ substantially from the corresponding standards within IAS. SAP experience has shown that although implementation activities may present some challenges, SAP software can indeed be used effectively to enable compliance with these standards.

IPSAS 1: "PRESENTATION OF FINANCIAL STATEMENTS"

IPSAS 1 describes the elements required for general-purpose financial statements to be IPSAS compliant. The study found there are two main areas of difference between IPSAS 1 and IAS 1.

One area of difference is as follows: IPSAS 1.21e states that when a public sector organization makes its approved budget public, the organization must also provide a comparison of budgeted and actual amounts, either as a separate statement or included as a column in the budget itself. The requirements for budget reporting are detailed in IPSAS 24 (as discussed later in this paper) and have no counterpart in IAS. Organizations can use the SAP for Public Sector solution portfolio to integrate budget management and execution (funds management) activities with financial accounting and reporting activities. Enabled by this integration, public sector organizations can achieve compliance with IPSAS 1.

The second area is this: According to IPSAS 1.109, to achieve compliance, public sector organizations must provide an analysis of their expenses and include this analysis in the statement of financial performance itself, or in the notes. Organizations may choose which of two forms of analysis they prefer to employ. The first form of analysis is based on the nature of the expenses incurred. The second form of analysis is based on the function of the expenses within the entity (as detailed in IPSAS 1.113f), classifying expenses according to the program or purpose for which they were incurred. Data for performing expense analysis according to function can be retrieved using the funds management tools of SAP for Public Sector solutions.

IPSAS 2: "CASH FLOW STATEMENT"

IPSAS 2 calls for an organization to provide information regarding historical changes in the organization's cash and cash equivalents. The required information must identify the sources of cash inflows, the items on which cash was expended during the period, and the cash balance as of the reporting date. This cash flow information reveals how the public sector entity raised cash to fund activities and how, specifically, the cash was spent.

A cash flow statement that is in compliance with IPSAS needs to analyze changes in cash and cash equivalents during a given period. The statement should classify activities as operating, investing, or financing activities. Two methods for compiling the statement are allowed: the direct method (recommended), and the indirect method. The current release of the SAP ERP application enables organizations to create cash flow statements using the indirect method. In addition, the cash ledger functionality of the application enables the creation of cash flow statements using the direct method.

IPSAS 18: "SEGMENT REPORTING"

IPSAS 18 sets rules for reporting financial information by segments to enable insight into an organization's historical performance. To comply with this standard, organizations must report on a basis that supports the accurate assessment of their past performance in reaching financial objectives. The reporting basis must also be suitable for supporting decision making about the future allocation of resources. The reporting segments for IPSAS are different from their counterparts in IAS 14 in that public sector organizations must employ service or geographical segments. To identify the segments required, each entity must analyze its organizational structure and reporting processes.



With segments identified, organizations must disclose the following: segment revenue and segment expense for each segment, the total carrying amount of segments and liabilities for each segment, and the total cost incurred during the period to acquire assets in that segment. Organizations can use the financial reporting functionality of SAP ERP to perform multisegment reporting activities and create statements of financial performance and financial position.

The multisegment reporting in SAP software does not extend to budget reporting. In budgetary accounting, only one segment (the primary segment) is available. Reconciliation between financial accounting and budget data is therefore possible only for the leading primary segment. However, based on the reported experience of SAP customers, budgets are adopted on a single-segment level in a majority of cases. SAP software therefore does support widely used practices. In terms of IPSAS compliance, multilevel segmentation is not mandatory, although the standards do encourage multilevel segmentation.

IPSAS 24: "PRESENTATION OF BUDGET INFORMATION IN FINANCIAL STATEMENTS"

IPSAS 24 calls for organizations to include in their financial statements a comparison of budget amounts and the actual amounts spent. This standard applies to public sector organizations that are required to – or elect to – make their budgets available to the public. The act of making budgets public also makes organizations publicly accountable for their budgets. Compliance with the requirements of this standard is a way to

ensure that organizations are meeting these public accountability obligations because it provides a means for documenting adherence to their budgets through transparent financial reporting. When budgets and financial statements are prepared on the same basis, compliance with this requirement will also demonstrate organizations' financial performance in achieving their budgeted results.

The study found that organizations can use the funds management functionality in SAP ERP to conduct budget comparisons and produce budget status information, and to compare funds committed in budgets to funds actually spent. With SAP solutions, organizations can perform budget definition and organization functions, including approval, carry-forward, and final budget setup activities. Organizations can use reporting functionality in SAP ERP, in the SAP NetWeaver® Business Warehouse component and SAP BusinessObjects™ software, and in SAP for Public Sector solutions to create statements that include the data for complying with IPSAS 24.

SAP will continue to monitor the development of IPSAS and the impact on public sector financial reporting.



SAP Software Support for IPSAS Compliance

Hundreds of SAP customers in the private sector use the accounting functionality of SAP solutions to enable them to provide financial reporting based on IAS standards. The study found that the differences between the standards in IAS and IPSAS do not have a significant impact on the ability of public sector organizations to use SAP software to facilitate their financial reporting activities. To comply with IPSAS, the principal undertaking for public sector entities is to make changes to their accounting practices. And with changes to accounting business practices, software implementations must also be modified to provide underlying process support for new and altered business activities. With the proper parameterization – and depending upon the business processes of the public sector entity – software from SAP can be widely used by public organizations to perform financial reporting activities that are in compliance with IPSAS. To ensure compliance, software implementations must be performed and customized according to IPSAS auditing specifications.

Public sector organizations, including a number of major supranational entities, already do use SAP software to enable their efforts at IPSAS compliance. For example, the European Commission introduced full accrual accounting in January 2005 using SAP for Public Sector solutions to support their financial records. The Organization for Economic Co-operation and Development (OECD) has implemented accounting procedures that leverage SAP solutions to prepare financial statements compliant with IPSAS.

SAP engaged in the joint study with Ernst & Young to analyze each IPSAS standard with the purpose of identifying any potential bearing of the regulations on SAP software. SAP will continue to monitor the development of IPSAS and the impact on public sector financial reporting.

LEARN MORE

To learn more about SAP solutions for your organization, call your SAP representative today or visit us on the Web at www.sap.com/publicsector.

FOOTNOTES

- 1. All statements concerning the content of individual IPSAS standards are based on extracts from the standards as contained in the 2008 Handbook of International Public Sector Accounting Pronouncements of the International Public Sector Accounting Standards Board, published by the International Federation of Accountants (IFAC) in April 2008. The information in this document only reflects SAP's understanding of such IPSAS standards and does not constitute legal advice, and SAP AG and all of its affiliated companies ("SAP Group") make no warranty or representation of any kind and disclaim any liability in regards to this document or the information contained in it. The reader is solely responsible for any conclusions as to regulatory interpretation or compliance and should consult their own legal advice. Information may change without notice. SAP does not accept liability with regards to the information provided in this presentation.
- **2.** Graphic provided by Ernst & Young AG Wirtschaftsprüfungsgesellschaft Steuerberatungsgesellschaft, Germany; used with permission. .
- **3.** Table provided by Ernst & Young AG Wirtschaftsprüfungsgesellschaft Steuerberatungsgesellschaft, Germany; used with permission.

- **4.** The study was based on the then existing 26 standards outlined in the Handbook of International Public Sector Accounting Pronouncements 2007.
- **5.** The work performed by Ernst & Young AG does not constitute an audit or a certification under professional standards. This study is addressed exclusively to SAP for internal purposes. Third parties cannot deduct any contractual claims from the contract between Ernst & Young AG and SAP and can especially not benefit from the legal concept of a third party beneficiary contract. Ernst & Young AG assumes no responsibility, liability, or other obligations toward third parties unless Ernst & Young has concluded a written agreement to the contrary with the respective third party.

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