ACC002 Describing the GAP: Public Sector vs Private Sector Accounting and Reporting

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Abstract

"The state of government reporting is 'the elephant in the room.'"
— World Bank Group CFO Vincenzo LaVia

The global debt crisis has illustrated the dire consequences of insufficient transparency and accountability of governments and poor public finance management and reporting. Governments are not risk-free and the failure of fiscal management in the public sector has an economic impact that far exceeds the impact of losses incurred by corporate failures. This affects both the interests of the public as well as investors. With finances tight, growth stalling and unemployment high, the legacy of the financial crisis continues to play out across borders. Key decision-makers, politicians, and public finance management leaders are all taking key steps toward meaningful reform, including the adoption and implementation of accrual accounting and International Public Sector Accounting Standards (IPSASs).

Transformation within the public sector has never been more relevant as public institutions are being increasingly scrutinised in terms of their effectiveness in discharging government services and managing public funds. In South Africa, the public sector aims to bring financial transformation through increased legislation and regulation, and with accounting and reporting standards for the public sector entities that are closely aligned with IPSAS. However, while South Africa is rated first by the World Economic Forum for its strength in auditing and reporting standards, the accountability and reporting in the public sector lags far behind – how is it that this GAP exists?

The aim of this paper is to describe the reform in government accounting and the development of IPSAS to improve accountability in government reporting internationally. The IPSAS standards are then compared to the IFRSs that are developed and adopted broadly by private sector entities. Followed by the development and broad adoption of IPSAS, this paper describes the development of the local GRAP standards in South Africa. Key challenges, relating to public sector accounting in general, as well as the unique challenges in South Africa are then addressed, including the adoption of different types of accounting (cash basis accounting, modified cash basis accounting and accrual accounting) in South Africa.

Describing the GAP: Public Sector vs Private Sector Accounting and Reporting

The various economic and financial crises in recent years have highlighted the need for governments to not only improve the management of public sector assets and resources, but to also demonstrate this improvement by generating more transparent and comparable financial reports. Key decision-makers, politicians, and public finance management leaders are all taking key steps toward meaningful reform, including the adoption and implementation of accrual accounting and International Public Sector Accounting Standards (IPSASs).

Administrative reform within the public sector has never been more relevant as public institutions are being increasingly scrutinised in terms of their effectiveness in discharging government services and managing public funds. In South Africa, the public sector aims to bring financial transformation through increased legislation and regulation, and with accounting and reporting standards for the public sector entities that are closely aligned with IPSAS. However, while South Africa is rated first by the World Economic Forum for its strength in auditing and reporting standards, the accountability and reporting in the public sector lags far behind – how is it that this GAP exists?

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Introduction

Business and public sector entities today face several challenges such as emerging globalisation, new economic activities, and rapid advancements in information technology. In the wake of the global financial crisis, citizens, parliaments, the media and other interest groups are increasingly demanding timely, reliable and detailed information from public entities and institutions. To satisfy this demand for increased transparency and accountability, governments and other public sector organisations need to provide better and more comprehensive information about their financial position and performance. Many governments are exploring the adoption of accrual-based accounting frameworks in order to improve their decision-making ability, resulting in a push for the inclusion of accounting principles and practices in a set of globalised public sector accounting standards.

Global corporate collapses have also called for harmonisation between the accounting frameworks for private sector entities. This is demonstrated by the enlarged adoption of IAS/IFRS (International Accounting Standards/ International Financial Reporting

Standards) and the convergence project of the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) (Nobes, 2011; Berger, 2012; Christiaens, Vanhee, Manes-Rossi, Aversano and Van Cauwenberge, 2014). The aim of the converging process of accounting standards is to enhance the international comparability of financial information in order to satisfy the information needs of different kinds of stakeholders in international markets. There has been a similar demand for the development and harmonization of public sector accounting.

Public sector entities often have a different purpose to that of private sector entities. In the public sector, the aim is for the entities to **provide the services** as set out in the entity's mandate, while the aim of private sector entities is to earn a profit for the owners of the entity. As a result, the accounting standards in the public sector need to cater for different circumstances to that of private sector entities, for example, the entity may be required to supply goods at a price which is below the market related price for the goods, the entity may hold assets which do not generate cash flows but which are necessary in order to fulfil its mandate, and the entity may earn revenue in a transactions for which it does not give anything to the counter-party in return (Berger, 2012; Deloitte, 2012).

Public sector accounting is in a phase of transition in many countries, where considerable differences still exist between the accounting systems and the published financial statements. There is a movement away from bureaucracy, towards accountability and transparency in public sector reporting. The key objectives of financial management and reporting in the public sector include achieving reliable, consistent and comparable accounting and financial reporting (Nobes, 2011; Berger, 2012; IPSAS Board, 2014). Debates in recent years have identified the International Public Sector Accounting Standards (IPSAS) as a suitable means of harmonising and aligning public sector accounting.

The development and adoption of the IPSAS on a global scale can be described as a revolution in government accounting. These standards aim for a greater focus on government financial accountability and transparency. IPSAS is a catalyst for providing high-quality transparent financial statements and, more importantly, enabling sound public finance management and improving operational performance (PwC, 2014). International organisations, such as the World Bank, that provide financial assistance to developing countries, are urging these countries to adopt IPSAS. Other countries, regardless of their political and economic systems, are encouraged to harmonize their national standards with IPSAS. Thus, IPSAS have become *de facto* international benchmarks for evaluating government accounting practices worldwide. For these reasons, IPSAS deserves the attention of accounting policy-makers, practitioners and scholars alike (Berger, 2012; Christiaens, et al., 2014).

The widespread move towards the adoption of IPSAS internationally, resulted in the development of Generally Recognised Accounting Practices (GRAP) by the Accounting Standards Board (ASB) for public sector (also referred to as government) accounting and reporting in South Africa. GRAP are accounting standards issued by the ASB in terms of section 89 of the Public Finance Management Act (PFMA), Act No. 1 of 1999. These standards are developed in alignment with IPSAS, with the aim to improve comparability at different governmental levels globally, as well as amongst the different spheres of government in South Africa. The Constitution of South Africa requires that national legislation must prescribe measures to ensure transparency by introducing GRAP to the three spheres of government. The PFMA addresses this requirement, by requiring public sector entities to comply with GRAP. The ASB issues GRAP standards based on all currently published IPSAS that are relevant to the National Treasury in South Africa. GRAP would be applicable to all levels of government (national, provincial and local), all public entities, parliament and provincial legislatures. However, national and provincial departments in South Africa are currently still using a modified cash basis for the presentation of financial statements, as set out in the 'Modified Cash Standard', published by National Treasury (2013).

This paper aims to describe the reform in public sector accounting and the development of IPSAS to improve accountability in government reporting internationally. The IPSAS standards are then compared to the IFRSs that are developed and adopted broadly by private sector entities. Followed by the development and broad adoption of IPSAS, this paper describes the development of the local GRAP standards in South Africa. The paper aims to identify the similarities and differences between these different reporting standards, and identifies certain challenges relating to financial reporting in the public sector and IPSAS's applications.

The development of public sector accounting standards

The International Federation of Accountants (IFAC) is the global organisation for the accountancy profession. The IFAC serves the public interest and contributes to the strengthening of the international economy by developing the global accountancy profession, establishing high quality standards, and promoting international convergence of standards. With the aim to focus on public sector entities, the IFAC established the Public Sector Committee (PSC) in 1986 as a standing technical committee. The PSC focused on the accounting, auditing and financial reporting needs of national, regional and local governments, related governmental agencies and constituencies. The PSC was renamed in 2004 the International Public Sector Accounting Standards Board (IPSAS Board), with the purpose to set standards for the general purpose financial statements in the public sector. Since 2011, the IPSAS Board has mainly focused on the development and issue of high quality accounting standards (Berger, 2012; IPSAS Board, 2013). The main objective of issuing IPSAS is to promote the significant benefits of achieving consistent and comparable financial information across jurisdictions, while the adoption of IPSAS by governments should improve both the quality and comparability of financial information reported by public sector entities around the world (Berger, 2012).

The IFAC and IASB agreed, in 2011, to strengthen their cooperation in developing public and private sector accounting standards, thereby committing to enhance initiatives of common and mutual interest. This includes collaboration such as regular liaison meetings, sharing of work programmes and input to specific projects, specifically to the Conceptual Framework project (Berger, 2012; IPSAS Board, 2014). The continued development and standardisation of public sector accounting is in the public interest, and the IPSAS Board achieves this by publishing International Public Sector Accounting Standards (IPSASs), promoting their acceptance and compliance on an international scale, and publishing other documents that contain guidance on issues and experience with financial reporting in the public sector (IPSAS Board, 2014).

IPSASs address issues on financial measurement and financial reporting for public sector entities, based on the accrual basis of accounting, as well as for financial statements prepared on the cash basis of accounting. Specifically, they define the form and content of the so-called “general purpose financial statements” and related financial disclosures in a government’s annual report. These financial statements consist of a statement of financial position and a statement of financial performance produced by an accrual financial accounting system, as well as a statement of cash flows produced by a cash accounting system. Budgets and the budgeting process is significant for government accounting, however, the IPSASs do not deal with the financial measures used in budgeting. IPSAS do not address the contents of reports produced to demonstrate compliance with laws and regulations, performance management and budget execution. These reports are regarded as “special purpose reports” outside of the scope of IPSAS, which are then often seen as a less-important spin-off of the financial information (Colyvas, 2014).

The emphasis on assuring financial integrity and a shift to accruals has led to the adoption of IPSAS in major countries and regions, including Australia, Canada, the UK and the United States, as well as countries such as the so-called BRICS countries, namely Brazil, Russia, India, China and South Africa (Berger, 2012; IPSAS Board, 2014). Developing countries require public sector institutional capacity for setting and implementing public policy, including the necessity for accounting reform (Chan, 2006). The social value of government accounting reform lies in its contribution to the development of goals, including poverty reduction.

The main features of IPSAS

The IPSAS program has evolved in two stages. From 1996 to 2002, the IFAC Public Sector Committee essentially imported international business accounting and financial reporting standards into the public sector by making relatively minor modifications. Since 2003, the IPSAS Board has consciously focused on issues that are unique to the public sector. These issues include taxation and other non-exchange transactions, the implications of the budget for financial reporting, and social policy commitments (IPSAS Board, 2014). The rising importance of financial accounting in the public sector, as epitomized by the emergence of the IPSAS on the world scene, reflects the belief in the power of objective financial recordkeeping, which has been credited with inducing business-like behaviour (Chan, 2006; Berger, 2014). The current focus of the IPSAS Board is on ‘public sector specific' issues, in areas where there is an urgent need for guidance regarding the financial accounting and reporting of the issue (IPSAS Board, 2014).

The initial goals of IPSAS were to promote greater government accountability, improved quality and reliability in accounting and financial reporting, better financial and economic performance, better financial management and discipline, and international harmonisation of reporting requirements (IFAC, 1996). Even though IPSAS was not meant only for developing countries, is may be reasonable to infer that developing countries were intended to be its primary beneficiaries. In recent years, the IPSAS Board has addressed developing countries by issuing a set of comprehensive 'cash basis IPSAS'. The cash basis, by definition, exclude the recognition of grants receivable and loans payable, and other non-cash assets and liabilities. Public sector entities that keep their accounts in accordance with IPSASs can choose to use either accrual accounting or cash accounting (Berger, 2012). The emphasis and preferred basis of accounting, as supported by the IPSASs, remains the accrual basis of accounting, although the cash-basis accounting is still very common, especially in Asia and Africa.

Rossi, Aversano and Cristiaens (2012) argue that IPSASs are more comprehensible if one is aware of their underlying assumptions. The first assumption is that there are so many common transactions in the private and public sectors that it is possible, and indeed preferable, to have one set of generally accepted accounting principles for both sectors. That is why most IPSASs are set by making modest changes to the standards promulgated by the IASB. Additionally, specific standards are developed for transactions and events that are unique to the public sector. The second assumption is that since business firms annually prepare consolidated financial statements under the accrual basis, governments should do the same. Consolidated financial statements cover a primary organisation and its subsidiaries in which the primary organisation has a majority ownership interest. This is only possible if all of the underlying entities apply the same set of accounting standards. The third assumption is that accounting standards are more objective and of a higher quality if an expert group that is independent of the organisations obliged to follow the standards sets them. For the public sector, independence can be achieved or at least enhanced by giving the task to a separate body, an advisory board, or increase the number of public (non-government) members. Finally, accounting standards should be produced through a due process. Due process means that research and deliberation should precede decisions. Furthermore, adequate opportunities are provided for interested parties to provide inputs before standards are finalised (Rossi, et al, 2012).

Among the more than thirty IPSASs, the most important standards are the first and second ones, which require governments to issue government-wide financial statements under the accrual basis at the end of a fiscal year. IPSAS1 provides the bases of presentation for general purpose financial statements in order to ensure comparability on the one hand with entity's financial statements of previous periods, and, on the other, with the financial statements of other public sector entities. It provides the structure and minimum requirements of the content of such financial statements, the recognition and measurement of specific transactions and other events, and the corresponding disclosure requirements. IPSAS2 requires the presentation of information about the historical changes in cash and cash equivalents of an entity by means of a statement of cash flows that classifies cash flows during the period between operating, investing and financing activities. Cash flow information allows users to understand how a public sector entity raised the cash it required funding its business and administrative operations and how that cash was used. Other IPSASs provide guidance on accounting for specific accounts, for example property, plant and equipment, inventories, intangible assets, investment property, and accounting for financial instruments; and required disclosures, for example related parties and segment information.

IPSAS versus IFRS – a comparison

There is a close relationship between IPSAS and the International Financial Reporting Standards (IFRS) as IPSAS standards are largely based on the principles of IFRS. The rationale for drawing from IFRS is to ensure greater comparability between private and public sector reporting when accounting for similar types of transactions (IPSAS Board, 2014; Deloitte, 2012). However, IFRSs are developed primarily for profit-oriented entities, whereas IPSASs are written for public sector entities that provide services to enhance and maintain the well-being of the citizens of a state. These differences between the two reporting frameworks stem primarily from the following three sources (Ernest & Young, 2013):

- Changes made by the IPSAS Board when developing an equivalent IPSAS based on an IFRS, to reflect differences between the public and private sectors
- Differences in the range of topics covered by the two sets of standards because of differences in the prevalence of particular types of transactions, such as non-exchange transactions
- Differences in the timing of when new or amended requirements are introduced into each set of standards Process of setting IPSAS standards

The following summary includes some of the **key differences** between IPSAS and IFRS (Ernest & Young, 2013, 2014; Deloitte, 2012), based on standards issued up until the end of 2014. This information is available in the public domain, and has been verified against several sources and publications. A more comprehensive table listing and comparing the various standards is included in Appendix A.

Service potential as part of the definitions and recognition criteria

Many of the assets and liabilities of entities within the public sector are acquired or incurred as a result of the entity's service delivery mandate, for example, heritage assets and parks maintained for public access. IPSAS introduces the concept of service potential into the definition of assets, liabilities, revenue and expenses. Service potential is also a supplementary recognition criterion to account for items that do not result in the inflow or outflow of economic benefits, where an item either contributes to or detract from the entity's ability to deliver its services.

Exchange versus non-exchange transactions

Non-exchange transactions are those transactions where an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange. Within the public sector, non- exchange transactions are prevalent. IPSAS provides principles to guide the measurement and recognition of non- exchange transactions, whereas IFRS is generally silent on the matter.

Recognition of revenue from government grants

IPSAS focuses on whether there is entitlement to the revenue from government grants (even though there may be restrictions on how the funds are spent), or an obligation to meet certain conditions, which is recorded as liability. The distinction between restrictions and conditions is crucial in determining whether to recognise revenue from a non-exchange transaction. As a result, government grants are generally fully released to income earlier under IPSAS than under IFRS.

Income tax

IPSAS presumes that entities that operate within the public sector are generally exempt from income taxes and therefore does not cater for the accounting of income taxes. In the unlikely event that an entity reports using IPSAS but is liable for tax, reference should be made to IFRS (IAS 12, *Income Taxes*) for guidance.

Financial instruments classification and measurement

With the introduction and ongoing development of IFRS 9, *Financial Instruments*, the classification and measurement of financial instruments under IFRS is changing from IAS 39. Prior to IFRS 9, the recognition and measurement of financial instruments were similar under IFRS and IPSAS. The impact of IFRS 9 on the public sector accounting and reporting is currently under review by the IPSAS Board.

Impairment of non-cash-generating assets

In light of the assets recognised based purely on their service potential (as opposed to economic benefits), IPSAS also caters specifically for impairment considerations for non-cash-generating assets. IFRS assumes that all assets will be cash-generating; whereas IPSAS assumes that the majority of a public sector entity's assets are likely to be non-cash generating. IPSAS 21, *Impairment of Non-cash-generating Assets* provides specific guidance on how to determine the value-in-use of such assets.

Reporting of budgets versus actual

With the increased focus on stewardship, service delivery and budget management in the public sector, IPSAS requires a comparison of the actual financial performance of an entity with the approved budget of that entity, where the budget is publicly available. There is no equivalent requirement in IFRS.

Elimination of private sector specific concepts
IFRS provides principles for certain economic phenomena that are irrelevant to the operations of a public sector entity, such as accounting for share-based payments and earnings per share disclosures. IPSAS excludes such guidance and refers reporting entities back to IFRS if and when applicable.

Consolidations and interests in associates and joint ventures
With the introduction of IFRS 10, *Consolidated Financial Statements*, IFRS 11, *Joint Arrangements* and IFRS 12, *Disclosures of Interests in Other Entities*, there are significant differences between IFRS and IPSAS. However, the IPSASB has issued a similar 'package of five' new IPSASs for the public sector, with final adoption in 2017. IPSAS 34, *Separate Financial Statements*, IPSAS 35, *Consolidated Financial Statements*, IPSAS 36, *Investments in Associates and Joint Ventures*, IPSAS 37, *Joint Arrangements*, and IPSAS 38, Disclosure of Interests in Other Entities. Because the underlying IFRSs have changed, the IPSASB has developed IPSASs 34 to 38 so that convergence with the related IFRSs is maintained to the extent appropriate. These IPSASs also incorporate important guidance to make them appropriate for application in the public sector. "These five IPSASs establish requirements for how public sector entities, including governments, should account for their interests in other entities," said IPSASB Chair Andreas Bergmann (2014). "Accrual-based accounting practices provide a comprehensive picture of the financial performance and position of public sector entities. Appropriate accounting for interests in other entities is an important aspect of this comprehensive picture."

Growing divergence in the conceptual framework of the IPSAS Board and IASB
The IPSAS Board is in the process of developing its own conceptual framework, proposing concepts that may be more suitable in the public sector context. We may see further differences in the outlook and focus of the IPSAS Board and IASB in the future. The development of the public sector conceptual framework is discussed in more detail below.

Consideration of other recently published IFRSs, namely IFRS 13, *Fair Value Measurement*, and IFRS 14, *Regulatory Deferral Accounts*, have not yet been completed by the IPSAS Board for its appropriateness for the public sector. The IASB has recently published IFRS 15, *Revenue from Contracts with Customers*. The impact of this new standard on the existing public sector IPSAS 9, *Revenue from Exchange Transactions*, and IPSAS 23, *Revenue from Non-exchange Transactions (Taxes and Transfers)* has not yet been determined (ASB, 2014).

It is noticeable that the differences listed above are mainly limited to the specific information needs of users of public sector financial information, and timing differences between IFRS and IPSAS. The major differences are to be expected, since the IFRS is developed for profit-oriented entities while the IPSAS is geared towards public sector entities that provide public services.

Challenges in public sector accounting

In their study of accounting and reporting systems in Europe, Rossi, et al (2012) argues that even though the IPSAS Board has, as one of its main purpose the harmonisation process, that its efforts are rather towards unification of accounting procedures and tools. The IPSASs and IPSAS Board Conceptual Framework project are based on accrual accounting, while many countries still applies the cash basis of accounting, or in other cases a modified cash basis. In many countries, the cash based accounting system remains an important condition to enable democratic decisions regarding the resources to be collected and to be spent by government (Rossi, et al., 2012).

The IPSAS is considered the definitive set of accrual-based international accounting standards for the public sector. However, a key issue for public sector financial reporting is that many governments still adhere to the cash basis of accounting, and therefore provide minimal disclosures relative to what the public, banks, investors, and credit providers generally expect of the private sector (Bergman, 2014). There is a growing demand for the same level of financial transparency and accountability from the public sector as is already expected from the private sector, given the multitude of banks and private sector investors that hold government debt. Accrual-based accounting ensures greater transparency and accountability in public sector finances as well as better monitoring of government debt and liabilities. Implementing these standards would in effect compel a government to open its books to outsiders. As mentioned earlier, IPSAS seeks to balance some governments' possible reluctance to tell and the public's right to know. In addition to the historical use of the cash basis for accounting and reporting, there are several other challenges in public sector accounting. These include adequate accounting systems that support the IPSAS reporting requirements, comprehensive internal controls, accountability and authorisation, and the shortage of appropriately skilled individuals, which are all external to the scope of the IPSAS.

System Capability and Skills Shortages

Annual financial reporting to the public is not the only function of a government's accounting system. Throughout the year, the accounting system is responsible for producing reports in response to requests by department managers, political executives, and parliamentary committees or members. Reports to management and other authorities, including reports against budgets and predetermined performance indicators and objectives, require sophisticated accounting systems and internal controls. Public sector entities and government departments need to ensure the implementation of the right software and other reporting systems to meet their accounting and reporting requirements. Too often, the wrong systems are in place, or the systems are insufficient to meet the information requirements or vice-versa, the right systems are in place but not implemented effectively (Rossi, et al., 2012). Government accounting systems' hardware is useless without software applications, and software is mindless without an adequate and integrated system of internal controls.

The collection, recording, analysis and extracts of financial data are all products of the capacity, security and efficiency of the accounting system, whether it is situated within a private or public entity. Decision useful financial information on the accrual basis can be produced only by an accounting system with sophisticated features. These features include: (1) the accounting equation, as its conceptual foundation; (2) a detailed chart of accounts for the elements of the accounting equation, as well as revenues and expenses as changes in net assets; (3) a double-entry recording system; and (4) the ability to translate standards (such as IPSAS) into specific policies and procedures applicable to the organisation concerned. These features have to be incorporated in the accounting system, along with human resources and financial resources made possible by political support and managerial leadership. By assuming these prerequisites, the IPSAS is silent on the necessity of building system capability. The emphasis in IPSAS is rather on the outputs of a government's accounting system, and pays little attention to its "through-puts" (operating procedures) and inputs. Reporting in accordance with IPSAS has little value if the financial information reported is not supported by operational systems that include features and controls ensuring the completeness, accuracy, validity, classification and authorisation of the underlying transactions. This means that officials responsible for designing and funding a government's accounting system have to take a holistic and operational perspective.

There is a significant shortage of appropriately skilled professionals in the public finance management area (specifically in South Africa), which is affecting financial reporting and good governance (Gloeck, 2012; Warren, 2014; Ramabulana, 2015). This is an ongoing challenge which needs to be addressed with urgency. The public sector needs to be innovative in attracting and retaining the best talent, ensure resources are equipped to execute their mandates and should enforce a stronger ethical compass in order to better serve the public. An emphasis on accountability and political will, as well as collaboration between the government and private sectors, will address some of the current challenges.

Conceptual Framework

The Conceptual Framework (CF) project has been the priority of the IPSAS Board for the past eight years, resulting in its approval and publication in October 2014. The CF establishes the concepts that are to be applied in developing IPSAS and Recommended Practice Guidelines (RPGs) that are applicable to the preparation and presentation of general purpose financial statements for public sector entities (IPSAS Board, 2014). It reflects key characteristics of the public sector in its approach to elements of financial statements, the measurement of assets and liabilities, and the presentation of financial reports.

The main view of the developers of the CF is that it should address certain key characterises of the public sector and include both **accountability** and **decision-making** as objectives of financial reporting. The notion of accountability is broad, and includes the provision of information about the public sector entity's management of the resources entrusted to it, which is useful to assess the sustainability of the entity's activities and the continuity of the provision of services in the long term. Financial reporting should further provide information that is useful to lenders, creditors, donors and others to inform their decisions about whether they should provide resources on a voluntary basis. Taxpayers generally provide resources on an involuntary basis, but they need information to inform their voting decisions (Stanford, 2014). This emphasis on accountability of governments and public sector entities give rise to an increased importance of the reporting of information such as service performance and long-term fiscal sustainability reports.

Critics feel that government accounting principles are not likely to be derived from the kind of conceptual framework being formulated at the IPSAS Board (Chan, 2006; Rossi, 2012). They argue that conceptual frameworks have not been helpful in making *specific* accounting policy choices, and if the experience of other accounting standards boards' is any guide, constructing conceptual frameworks is a never-ending exercise and requires a delicate balance between generality and specificity. Andreas Bergmann, the Chair of the IPSAS Board (2014) comments that, "without robust, transparent, and accountable arrangements for financial reporting and financial management, it is not possible to reliably assess whether decision- making by governments has been in the public interest" (Bergmann, 2014, p2). Bergmann (2014) states that for governments to adequately discharge their accountability and provide the standard of information required by investors, the reporting of high-quality financial information is paramount.

Impact of global financial crisis

The stress in the economy and the debt crisis in several countries around the world have demonstrated the challenges of maintaining financial stability for many countries. Many governments are exploring the adoption of accrual-based accounting frameworks in order to improve their decision-making ability to prevent and respond to these issues. The global financial crises in 2008 – 2009 broad the interdependency between the public sector (governments) and private enterprises to the foreground, and required unprecedented government interventions. Such interventions typically included the recapitalisation and investments by governments in public sector entities (for example Freddie Mac and Fannie Mae in the US, Hype Real Estate in Germany and Northern Rock in the UK). In some cases, direct asset purchases were made, for example public sector entities purchasing illiquid or toxic bonds from banks. In many countries, state guarantees were provided for bank deposits, interbank loans and even corporate loans. These interventions raised the question of how to reflect these actions appropriately in the financial reporting of public sector entities, emphasising the need for a clear and fair presentation of the economic consequences of these interventions (Ernest & Young, 2011; Berger, 2012).

The global financial crisis has raised a number of issues that required thorough consideration in the analysis and development of accounting standards. When some governments purchased interests in financial institutions and other corporate entities, the public sector entities became shareholders of these entities. From the perspective of the public sector entity, consideration had to be given to how these interests should be accounted for and whether they need to be consolidated. A further question was how to measure these assets, and the risk that impairment losses might need to be recognised in the public sector entities in subsequent accounting periods. In some of these examples IPSAS provides sufficient guidance to achieve accountability in reporting, however, in other cases where current IPSASs contain no specific guidance, for example non-contractual financial guarantees, this gives rise to financial risks not shown in the general purpose financial reports. Warren (2014) argues that to properly report on public finances, all the obligations of governments, and their movements, need to be reported. This emphasises the need of transitioning from cash- to accrual-based financial reporting. The move to accrual reporting is an important step in improving public sector financial management (Warren, 2014).

Developing countries face the daunting challenge of raising the standard of living of their peoples. The UN Millennium Development Goals and Poverty Reduction Strategies can be realised only if governments and government officials have the necessary capacity to manage scarce resources and institutional capacity building programs (Chan, 2006). The success of government accounting reform depends on political and management support, in addition to the availability of budgetary and human resources, and information technology.

Usefulness of IPSAS for developing countries

The application of IPSAS is relatively new for many developing countries. The historical orientation of financial accounting information further limits its *usefulness* for control and planning, which require real-time and future oriented information. Summarised financial statements are often not sufficiently disaggregated to match the scope of responsibility of managers. IPSAS-based financial statements are not designed to demonstrate the accountability of subordinates to their superiors, and of the executive to the legislature. Under the initial leadership and influence of mostly English speaking countries, the IFAC Public Sector Committee chose to emphasise year-end consolidated financial statements. This kind of reporting addresses only external financial accountability at best. As such, IPSAS can make only a limited contribution to institutional capacity building in developing countries (Chan, 2006).

Several government departments in developing economies are currently using the modified cash basis, with the aim to move towards accrual accounting as the long-term objective. The accrual basis of accounting provides users with more reliable and relevant information regarding governments' assets, liabilities and any obligations. It also provides users with information regarding managements' performances with resources to achieve its service mandate (Berger, 2015). A strong argument is made for government accounting and reporting in developing economies to not only include the accrual-basis of accounting for financial reporting purposes, but to also integrate it into the budgeting process. To the public at large and to most government officials, the budget is still the primary financial document of government. Warren (2014) argues that the budget is key for government financial decisions, and it is the budget to which governments are held accountable by their legislatures. Therefore, financial information based on the accrual basis should be integrated into the budget process (Warren, 2014). Accrual budgeting explicitly forecasts and shows how resources are raised and used, and how obligations are incurred and settled. Cash budgeting, on the other hand, only focuses on the forecasting and allocation of one economic resource, that is, cash. Fundamentally, accrual budgeting differs from cash accounting by being transparent about two separate decisions. First, there is a decision on the cost of an item, and secondly, there is a decision on how and when that cost will be settled. Cash budgeting conflates these two separate decisions, and therefore fails at times to fairly forecast their economic impact (Warren, 2014).

IPSAS assumes the existence of a robust system of internal control in a government's financial management and accounting systems. As recent corporate financial scandals in many developed countries have demonstrated, the reliability of accounting-based financial statements can be undermined by the manipulation of underlying transactions. This situation can also happen in public sector financial reporting. Considering the vulnerability of the government in developing countries to financial misconduct, the reliability of numbers in their financial statements cannot be taken for granted, even if IPSAS are used. For this reason alone, the accounting profession has an important role to play in the global fight against government corruption. A study by Olken and Pande (2011) has shown that developing countries are far more susceptible to corruption amongst government officials. The impact on service delivery is clear, in that government is forced to render services with greater resource constraints, thereby hindering either the quality and/or quantity of services rendered.

Public Administration recognises three models of administration that governments have followed over time. These models are not strictly and neatly applied, as overlapping would naturally exist when applied in a real world scenario. These models are *Traditional Public Administration*, *New Public Management*, and *Governance/Networking Theory*. The New Public Management and Governance are more recently developed administrative models that require the treatment of the State as a corporation, or for government to engage in intensive collaboration with the private sector in order to discharge its mandate. Some would argue that Traditional Public Administration is an out-dated model and would not be suitable as a framework by which to manage a country in the 21st century.

However, the general characteristics of Traditional Public Administration are far more appropriate in a developing country than the latter two models. These include, among others: hierarchical structures, highly regulated legal frameworks, and merit based appointments, rather than political (Hughes, 2003). Official corruption threatens a government's legitimacy and authority, and reduces the amount of public money available to fund public services. Incompetent financial management is costly in terms of the inefficiency and disruptions it induces in the government itself and the economic system. Mismanagement of cash results in financial losses. Imprudent financial investments can lead to greater risk exposure and reduced returns. Delayed or under-collection of taxes reduces the amount of available financial resources and increase liquidity and solvency risks. Failure to pay bills when they are due can potentially create liquidity or solvency problems for employees, contractors and other creditors. Defaulting on interest payments and principal repayments to bond holders harms creditworthiness and may raise the cost of borrowing. For all these reasons, government accountants, auditors and financial managers are on the front-line of the fight against corruption. In her address at the National Conference on Corruption and Governance Challenges, in Nigeria on 21 January 2010, the Public Protector of the Republic of South Africa, Advocate Thuli N. Madonsela, has drawn attention to the need to promote good governance, with specific reference to the values of accountability, integrity and responsiveness as pillars.

Currently, IPSAS seems to take for granted that transactions are duly authorised and properly executed. The role of accounting standards is to decide whether to recognise the consequences of these transactions and, if so, how to measure and report these effects. Accounting standard setters are certainly aware of the possibility that transactions may be "structured" to take advantage of what accounting standards allow. However, it is primarily the auditor's role to deal with this phenomenon. Similarly, unauthorised transactions and improperly executed transactions are matters of concern to auditors and management. This attitude overlooks the auditor's reliance on the capability of the accounting system to generate audit trails (Christiaens, 2014). Management is responsible for the authorisation and proper recording of transactions, and audits conducted in terms of the International Standards on Auditing (ISAs) would highlight these deficiencies and non-compliance.

Besides the broader economic and social considerations, the detrimental effects of financial misconduct on government financial reports should motivate the IPSAS Board to pay explicit attention to financial integrity. Specifically, the board might undertake or encourage research on the implications of financial integrity, or lack thereof, for IPSAS. In principle, weak internal controls may lead to unreliable numbers in financial statements. Generally, accounting standards take on a greater social role as accountability requirements in countries that require higher standards of ethical behaviour. Government accounting standards in effect become government accountability standards.

Public Sector Accounting in South Africa

The World Economic Forum (WEC) rates South Africa first for the strength of its auditing and reporting standards, and third for efficiency of corporate boards (WEC Global Competitiveness Report, 2014/2015). Yet, on the burden of government regulation South Africa is ranked 120th out of 144 countries. Given the tendency of developing states to be more prone to corruption, it seems that the model most appropriate for South Africa as a developing economy would be one which compliments most the internal and external audit process. Formal documentation usage and controls, management supervision, and suitably trained and skilled management are all components of a good control environment. A hierarchical organisational structure also allows for greater facilitation of audit procedures compared to a disaggregated organisational structure where operations are carried out in an inter-organisational manner. The Traditional Public Administration model is presently considered the most appropriate model for South Africa to use. This does not, however, preclude the government from applying principles from the more advanced models, such as outsourcing of certain functions to the private sector. The ranking on legislative burden identified above therefore may reflect an onerous administrative environment, but in reality, these requirements are unavoidable in order to minimise maladministration.

Most government departments in South Africa prepare financial statements in accordance GRAP. These financial statements, as well as performance reports, financial management and internal control, are some of the onerous reporting requirements set out in different legislature promulgated since 1995, as well as numerous sets of regulations and guidelines. In fact, as argued by Gloeck (2012), never before in the history of South Africa has the public sector undergone such a comprehensive, sustained and far-reaching programme of reforms.

South Africa has, since the promulgation of the PFMA, witnessed a torrent of financial management reforms in the public sector (Gloeck, 2012). As mentioned earlier, the ASB is required to determine GRAP for government departments, public entities, trading entities, constitutional institutions, municipalities and boards, commissions, companies, corporations, funds or other entities under the ownership control of a municipality, and parliament and the provincial legislatures, which are set out in Directive 5 (ASB, 2014). The ASB revises the GRAP Reporting Framework on a regular basis, and publishes 'Directive 5' to reflect new standards of GRAP, interpretations or other publications that have become effective or have been issued by the Board, standards and pronouncements issued by other standard-setters for a particular reporting period (ASB, 2014). This includes new standards and updates issued by the IPSAS Board and the IASB (where they are relevant to the South African public sector). The GRAP Reporting Framework for a particular reporting period comprise of a combination of the standards of GRAP and IFRSs. In practice, a number of departments and public entities have not implemented GRAP and are still using the modified cash basis of accounting.

Reporting on the modified cash basis of accounting recognises transactions and events only when cash is either received or paid. A transaction incurred on debt, for example normal purchases and sales where the creditors and debtors will pay or be paid later, is not recorded in the financial records when the transaction occurs. Recording is done only when the actual cash is received or paid on the credit sales and/or purchases (Berger, 2012). Under the modified cash basis, supplementary accrual information is provided in the notes to the financial statements to assist the users in identifying other assets and liabilities that would have been recognised had an accrual basis of accounting been applied (Modified Cash Standard, National Treasury, 2013). Currently, provincial legislatures are allowed to apply the modified cash basis, however, for financial periods commencing on or after 1 April 2015, all trading entities, parliament and the provincial legislatures are required to prepare their financial statements in accordance with the Standards of GRAP (ASB, ED128, 2014).

The financial management and reporting of South Africa’s government departments and local municipal departments are showing marginal improvements, as evidenced by the slight increase in the number of ‘clean’ audits in the 2013/14 financial year. Of the 469 audits conducted by the Auditor General’s office (AGSA) in the 2013/14 financial year, 119 (25%) attained clean audits – this is a year-on-year improvement of 3% from the 22% in the previous financial year. According to Ramabulana (2015) the three biggest losers of poor financial management in the public sector in South Africa are business, the economy and vulnerable communities. He argues that “poor financial management impacts negatively on service delivery to already marginalised previously disadvantaged communities already entrenched in the grip of poverty” (Ramabulana, 2014, p2). The biggest problem that needs to be addressed in the public sector in South Africa is the lack of skills, which is especially evident in the rural areas and smaller provinces (AGSA, 2014). The South African Institute of Government Auditors (SAIGA), states in their position paper about the financial skills shortage in South Africa’s public sector (2012), that the financial skills shortage is the combined responsibility of the universities, the auditing firms, the public sector at large, and the AGSA (Gloeck, 2012).

Conclusion

The goal of IPSAS is to improve the quality of the financial information of public sector entities, to strengthen the transparency of public accounts and to make decision makers more accountable. This modernisation seems necessary particularly in the context of the sovereign debt crisis which requires particular attention to accountability and control of public accounts. Accrual accounting is a key element of modern public management, as it increases transparency of government accounting and provides more complete information. This improves, among other things, government decision making and makes them more responsible. However, IPSAS do not address all the accounting and reporting challenges in the public sector, for example, the preparation of budgets and its comparability to the reported financial results, setting and meeting predetermined objectives and key performance indicators, and issues relating to fraud and corruption.

This paper describes the development of IPSAS and the urgent need, globally as well as in South Africa, for compliance with independently set accounting standards that are attested by an independent auditor. This will not only validate the reliability of the reported financial information, but also assist in reducing the debates of smoke and mirrors in accounting, towards debates on financial and economic impact. This is where fiscal policy debates should be (Warren, 2014). Professional accounting skills are needed to introduce the accrual basis in all areas of public sector accounting and financial management, including accrual budgeting, in order to support transparency, accountability and financial decision-making in the public sector.

Several challenges are identified in public sector accounting, pointing towards areas for further studies. An investigation of the efficiency of internal systems and capacity building in South Africa may point to possible gaps in the availability of reliable financial information to support management decision-making, planning, and financial reporting in accordance with IPSAS. Stated differently, do regulations and legislature (including enforcing the application of IPSAS) actually lead to transparency and quality financial information that is useful for decision making and planning in the public sector? Lastly, how, if at all, will the new developments in Integrated Reporting result in a fresh, holistic approach to public sector accountability and decision-making?

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APPENDIX

The following table lists the Standards of IPSAS and, if applicable, the equivalent IFRS standard which are in issue:

Standards and Interpretations of IPSAS for which there is an IFRS equivalent

Standards of IPSAS	IFRS Standards
Framework for the Preparation and Presentation of Financial Statements	Framework for the Preparation and Presentation of Financial Statements
IPSAS 1 Presentation of Financial Statements	IAS 1 Presentation of Financial Statements
IPSAS 2 Cash Flow Statements	IAS 7 Statement of Cash Flows
IPSAS 3 Accounting Policies, Changes in Accounting Estimates and Errors	IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors
IPSAS 4 The Effects of Changes in Foreign Exchange Rates	IAS 21 The Effects of Changes in Foreign Exchange Rates
IPSAS 5 Borrowing Costs	IAS 23 Borrowing Costs
IPSAS 9 Revenue from Exchange Transactions	IAS 18 Revenue
IPSAS 10 Financial Reporting in Hyperinflationary Economies	IAS 29 Financial Reporting in Hyperinflationary Economies
IPSAS 11 Construction Contracts	IAS 11 Construction Contracts
IPSAS 12 Inventories	IAS 2 Inventories
IPSAS 13 Leases	IAS 17 Leases
IPSAS 14 Events After the Reporting Date	IAS 10 Events After the Reporting Period
IPSAS 16 Investment Property	IAS 40 Intangible Assets
IPSAS 17 Property, Plant and Equipment	IAS 16 Property, Plant and Equipment
IPSAS 18 Segment Reporting	IFRS 8 Operating Segments
IPSAS 19 Provisions, Contingent Liabilities and Contingent Assets	IAS 37 Provisions, Contingent Liabilities and Contingent Assets
IPSAS 20 Related Party Disclosures	IAS 24 Related Party Disclosures
IPSAS 25 Employee Benefits	IAS 19 Employee Benefits
IPSAS 26 Impairment of Cash-Generating Assets	IAS 36 Impairment of Assets
IPSAS 27 Agriculture	IAS 41 Agriculture
IPSAS 28 Financial Instruments: Presentation IPSAS 29, Financial Instruments: Recognition and Measurement IPSAS 30, Financial Instruments: Disclosures	IFRS 7 Financial Instruments: Disclosures IFRS 9 Financial Instruments IAS 32 Financial Instruments: Presentation IAS 39 Financial Instruments: Recognition and Measurement
IPSAS 31 Intangible Assets	IAS 38 Intangible Assets
Package of five IPSAS (effective 2017) <u>IPSAS 34, Separate Financial Statements;</u> <u>IPSAS 35, Consolidated Financial</u>	'Package of five' (effective 2017) IFRS 10, Consolidated Financial Statements,

Statements; IPSAS 36, Investments in Associates and Joint Ventures; IPSAS 37, Joint Arrangements; and IPSAS 38, Disclosure of Interests in Other Entities. These five standards will replace current requirements in: • IPSAS 6, Consolidated and Separate Financial Statements; • IPSAS 7, Investments in Associates; and • IPSAS 8, Interests in Joint Ventures.	IFRS 11, Joint Arrangements and IFRS 12, Disclosures of Interests in Other Entities IAS27 Separate Financial Statements IAS28 Interests in Associates and Joint Ventures
IPSAS 33, First-time Adoption of Accrual Basis IPSASs	IFRS 1 First-time Adoption of International Financial Reporting Standards

(IPSASB, 2014; E&Y, 2014; Deloitte, 2014)

Standards of IPSAS for which there is no IFRS Equivalent

There is no equivalent IFRS for these Standards and so significant principle differences exist between IPSAS and IFRS.

- 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
- IPSAS 24 Presentation of Budget Information in Financial Statements
- IPSAS 32 Service Concession Arrangements: Grantor

(IPSASB, 2014; E&Y, 2014; Deloitte, 2014)

IFRS Standards for which there is no IPSAS Equivalent

No Standard of IPSAS has been issued for these topics. Some of these Standards form part of the IPSAS, for example IAS12

- IFRS 2 Share Based Payment
- IFRS 4 Insurance Contracts
- IFRS 6 Exploration for and Evaluation of Mineral Resources
- IAS 12 Income Taxes
- IAS 26 Accounting and Reporting by Retirement Benefit Plans
- IAS 33 Earnings per Share
- IAS 34 Interim Financial Reporting

(IPSASB, 2014; E&Y, 2014; Deloitte, 2014)

Recommended Practice Guidelines
The IPSASB has introduced Recommended Practice Guidelines (RPGs) in 2013. RPGs are pronouncements that provide guidance on good practice in preparing general purpose financial reports that are not financial statements. The following RPGs have been issued since 2013:

- RPG 1 Reporting on the Long-term Sustainability of an Entity's Finances
- RPG 2 Financial Statement Discussion and Analysis

(IPSASB, 2014)

Standards of Generally Recognised Accounting Practice (GRAP), published by the Accounting Standards Board (ASB) for which there are currently no IPSAS equivalent, but for which there is an IFRS equivalent

- GRAP 100 Discontinued Operations
- GRAP 103 Heritage Assets
- GRAP 104 Financial Instruments (refer to new IPSAS 'package of five')
- GARP 105 Transfer of Functions Between Entities Under Common Control
- GRAP 106 Transfer of Functions Between Entities Not Under Common Control
- GRAP 107 Mergers

(ASB, 2014)