



Much Ado About Very Little: Differences Between IFRS and IPSAS

Summary

There are approximately 180 differences between International Public Sector Accounting Standards (IPSAS) and the present International Financial Reporting Standards (IFRS). Of these fewer than a dozen appear to have real implications, and of these the two with most significant and immediate impact are:

1. *a new requirement to report revenue, expenses, assets and liabilities by segment* – this raises issues around the interface with the requirement to prepare group level Funding Impact Statements under the Local Government Act, the manner in which local authorities define their groups of activity for reporting purposes, and potentially some one-off costs classifying assets to segments
2. *a lack of a standard to guide the preparation of prospective financial information* – with no legislative or statutory presumption that the financial information in long-term plans will be prepared on the basis of the “best available information”, robustness of these plans may suffer in the short-term.

Other potential issues include:

- a wider definition of Government Business Enterprise
- a narrower definition of control
- optional recognition of heritage assets
- a requirement to recognize and measure revenue from non-exchange transactions
- differences in the measurement of some items of inventory
- no requirement that valuers be independent or registered
- less guidance on the application of depreciated replacement cost
- changes to disclosures about related parties.

Another difference cited is that IPSAs contains no standard for reporting service performance. We do not see this as an issue at all as:

- local authorities are already subject to statutory requirements to report service performance
- there are standards in preparation at the present time.

Introduction

In the middle of 2011, the External Reporting Board (XRB) signalled its intention to abandon sector-neutral standards and move towards separate standards for the private sector and for public benefit entities (PBEs). Further communication from XRB suggests that it will be drawing heavily on International Public Sector Accounting Standards (IPSAS) as the basis for the PBE standards, though it has taken pains to emphasize it will not adopt IPSAS wholesale.

This paper summarises the key differences between IPSAS and the current set of IFRS-based standards local government adheres to. Much, but not all, of the material herein has been sourced from reports prepared by XRB and the New Zealand Institute of Chartered Accountants – we refer those wanting more information to these reports (see the reference section).

We understand that there are approximately 180 differences between IFRS and IPSAS. These are summarized in the table below¹

Difference Type	Number of Differences
Scope of standard	26
Recognition (often with measurement implications)	52
Measurement only	23
Presentation	26
Disclosure	49
Other	6
Total	182

This paper discusses the major differences between IFRS and IPSAS – those wanting more information about the full range of changes are referred to ASRB (2010), in particular to Appendix Three.

Significant Issues

¹ Source, Gulliver P (2011), Accounting Standards Update May 2011, a presentation given to SOLGM's 2011 Financial Management Seminar.

Segment Reporting

This is perhaps the biggest practical difference between IFRS and IPSAS – and the one that the sector needs to come to grips with most quickly. *IPSAS 18 Segment Reporting* requires the reporting of revenues, expenses, assets and liabilities for each segment. A segment is (perhaps somewhat loosely) defined as an activity or group of activities for which it is appropriate to separately report financial information. IPSAS 18 notes that a segment could potentially be either service based (e.g. Water or Recreational Facilities etc) or geographically based (e.g. Waikikumukau ward).

Local authorities initial response may well be to match their definitions of segments to their groups of activities as they have defined for long-term and annual planning and reporting purposes (including the five mandatory groups).

We caution against leaping straight to this conclusion. Although local authorities are used to reporting revenue and expense information at sub-council level, we are not aware of many local authorities that report asset and liability information at this level. Some local authorities have reported difficulties separating revenue and expense information to report against the five mandatory groups (particularly those providing both stormwater disposal and flood protection), separating asset information may add further complexity.

We suspect that many local authorities will need to think further about how they group activities from both an LGA accountability perspective and a GAAP compliance perspective. Some further aggregation of groups and disaggregation of other groups is a certainty.

Those local authorities that operate ward/community based accounting systems will need to give further thought to whether these could or should constitute segments for the purposes of IPSAS18, and how these will interface with reporting on activities (including the statutory requirements).

The 2012/22 LTPs are notable for being the first LTPs to require preparation of so-called funding impact statements – prescribed information about flows of funding into and out of each group of activities. Non-cash items are expressly excluded from the FIS and the FIS is subject to its own presentational rules² and is therefore exempt from those aspects of GAAP.

Some local authorities elected to supplement this information with additional cost of service statements for each of their groups of activity. These also do not have to be GAAP compliant.

² Contained in the Local Government (Financial Reporting) Regulations 2011 – regulations made under the authority of section 259 of the Local Government Act.

One of the other practical implications of IPSAS is that local authorities *will have to* produce two sets of financial information at group of activity/segment level – the non-GAAP compliant FIS, and GAAP compliant disclosures of segment revenues, expenses, assets and liabilities. This has the potential to create confusion for readers of local authority financials and/or create a need for local authorities to make additional disclosures reconciling the two sets of statements etc.

No Standards Relating to Prospective Financial Statements and Summary Financial Statements

There are no IPSAS equivalents of *FRS 42 Prospective Financial Statements* or *FRS 43 Summary Financial Statements*. A wholesale adoption of IRFS would result in omission of these two standards.

XRB does not consider this a significant issue. The author considers that non-inclusion of a standard on prospective financial statements could potentially be very significant in the local government context.

FRS 42 establishes that prospective financial information be prepared on the basis of the “best available information” at the time the prospective information is prepared. It is one of the fundamentals that underpin the audit approach to long-term plans. Without a standard in place to provide guidance there is a risk that some of the rigour and robustness maybe lost from LTPs, or at least that more are issued with non-standard audit opinions drawing people’s attention to questionable assumptions. At very least, there is a likelihood that taking short-cuts and/or presenting the most favourable or politically palatable assumptions at an early point in the LTP will have consequences come audit time.

While there appear to be no current plans to add a standard on prospective financial statements to the IPSAS suite, events in Europe have highlighted the need for a standard (if only to enable more robust budget preparation in central government). It cannot be long before such a standard is put in place.

The author considers that a domestic modification of IPSAS to address prospective financial information is a must. Local government (and central government for that matter) are used to working with FRS 42 so the easiest answer would be to simply “roll over” this standard (having first ensured it is consistent with the rest of IPSAS).

Moderate/Minor Level Issues

Government Business Enterprises

IPSAS defines a government business entity (GBE) a little more widely than NZ equivalents to IFRS, the practical effect of this is that some subsidiaries that are currently treated as PBEs may need to prepare financial statements under “for profit” standards.

Under IPSAS, a GBE is defined as an entity which:

- (a) has the power to contract in its own name
- (b) has been given the financial and operational authority to carry on a business
- (c) sells goods and services, in the normal course of its business, to other entities at a profit *or full cost recovery* (emphasis supplied)
- (d) is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arms length) and
- (e) is controlled by a public sector entity.

The main area of difference is that entities which trade on the basis of full cost recovery are regarded as a GBE under IPSAS, whereas IFRS may not treat them as such. Determining whether a particular entity may come within this wider definition will probably require close examination of:

- the entity’s constitution and statement of intent (or their equivalent) and
- consideration of the service that the GBE provides to your local authority and on what basis.

Control

We understand the definition of control for consolidation purposes may be narrower in IPSAS than in NZ IFRS, and consequently some councils may find they have fewer entities to consolidate. These may also be removed from the scope of the Public Audit Act 2001.

The basic definitions of control in NZ IAS 27 and IPSAS 6 Consolidated Financial Statements and Accounting for Controlled Entities appear to be substantially similar³. More detailed guidance is contained in each standard, IPSAS6 set out a series of power and benefit conditions – the power conditions appear closely aligned with the definition of CCO in the Local Government Act, the benefit conditions include the power to dissolve the entity and obtain a significant portion of the residual economic benefit or the power to extract distributions of assets. The guidance is also supplemented by a set of power and benefit indicators which include:

- the ability to veto budgets of the other entity
- the ability to veto or modify decisions made by the governing body of the other entity
- the ability to approve hiring and dismissal of key personnel

³ The former says control is “the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.” The latter defines control as “the power to govern the financial and operating policies of another entity so as to benefit from its activities.”

- the mandate of the other entity is established by legislation or the entity holds a “golden share” in the other entity
- the entity holds direct or indirect title to the assets of the other entity
- the entity is able to direct the other entity to cooperate with it to achieve its objectives
- the entity is exposed to the residual liabilities of the other entity
- the entity has the right to a significant level of the assets of the other entity in the event of a liquidation or distribution other than a liquidation.

This definition and the associated tests appear to capture most of the entities that would or should be consolidated. Any differences will be very much “line calls” – so for most local authorities this is unlikely to have much impact. In the event that a local authority finds an entity excluded by IPSAS however, the difference to any group level statements could potentially be significant.

Accounting for Heritage Assets

Under IFRS all bodies should be recognizing and measuring heritage assets (*NZIAS16 Property, Plant and Equipment*). It is our understanding that while many local authorities have placed these assets on asset registers (at the urging of auditors), the ongoing recognition and measurement of heritage assets is honoured more in the breach than the observance. The rationale for this lack of recognition and measurement is presumably that these assets are immaterial when placed alongside infrastructure⁴.

IPSAS17 Property, Plant and Equipment makes the recognition and measurement of heritage assets strictly optional. We understand this standard does not even define what a heritage asset is. While XRB documentation emphasizes this as a key point of difference between IFRS and IPSAS, for most local authorities there will be little or no practical difference.

Revenue from Non-Exchange Transactions

Unlike IFRS, IPSAS has an accounting standard that explicitly covers revenue from non-exchange transactions – *IPSAS23 Revenue from Non-Exchange Transactions (Taxes and Transfers)*. IPSAS23 defines non-exchange transactions thus:

“in a non-exchange transaction an entity 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”

⁴ This changes for some museums where heritage is a more material issue – a casual glance at the last few audit B29s reveals a number of non-standard reports on various Museums that cite non-observance of IAS16 as an issue.

The classic examples of non-exchange transactions in the public sector generally apply to various types of taxation – including rates. However this line of thought needs to be applied carefully. For example, water by meter, where the charge varies according to the actual level of water supplied or consumed is, we understand, viewed by accountants as an exchange transaction and not a tax⁵.

Some other common transactions require further consideration – for example is a development contribution or a financial contribution an exchange or a non-exchange transaction. Likewise is a transfer from central government an exchange or a non-exchange transaction. Ideally the sector would do further thinking on these and other issues and agree on an interpretation with the accounting profession and, more particularly, the audit sector.

Inventories

There are minor differences between *NZIAS2 Inventories* and *IPSAS12 Inventories*. NZIAS 2 defines inventories as assets held for sale in the normal course of business or held for use in the process of production of assets for sale or to be consumed in the production process. IPSAS12 adds a fourth limb to the definition – asset held for use in the rendering of services.

The differences apply where

- (i) inventories have been acquired via a non-exchange transaction – IAS2 would see these measured at the lower of cost or net realizable value, IPSAS12 requires fair value measurement as at date of acquisition
- (ii) inventories distributed for no or nominal consideration – IAS2 requires measurement of replacement cost at date of acquisition, IPSAS12 requires measurement at the lower of cost (? – the author was not clear what this meant) or current replacement cost.

The practical effect of these differences is that local authorities will need to maintain information on cost at acquisition and current replacement cost - that is some transaction cost will be involved. There may also be one-off impacts on inventory values – which could be material if a local authority has a large stock of assets.

Valuation Issues

IPSAS 17 Property, Plant and Equipment provides less guidance on the application of depreciated replacement cost (DRC) in revaluing these types of asset. We understand that NZ IAS contains around a dozen New Zealand specific paragraphs on the application of DRC. We

⁵ This is one of the reasons why the Financial Reporting Regulations 2011 place water by meter with revenue from fees and charges, all are viewed as exchange transactions.

consider that local authorities in this country are well practiced in applying DRC (and other methods), and many supplement this experience by retaining valuation advice. As long as local authorities are sensible in their choice of valuation advice (see the next paragraph) the practical implications of this change are unlikely to be significant.

NZIAS 16 requires that local authorities requires that valuations of property, plant and equipment, and investment property be undertaken by an independent valuer or by an employee with an independent review. Qualifications of that valuer must be disclosed. IPSAS17 and IPSAS16 Investment Property do not contain either of these requirements – though both note that valuations would normally be undertaken

Asset valuations, especially infrastructure, are an extremely important piece of financial information in local authorities. Among other things they drive the setting of depreciation and therefore go to the heart of local authorities setting of rates and charges, and beyond that, the approach to prudence and financial sustainability. Sudden changes in valuations of investment property can also sometimes act as an indicator that investments are underperforming. We would strongly advise local authorities to retain qualified valuers as they would now.

Reporting Service Performance

IPSAS currently has no standard for reporting service performance – though in late 2011 IPSASB took the first steps towards a standard by issuing a consultation paper.

Local authorities are required to report on:

- the levels of service associated with major aspects of their activities and the performance measures associated with those levels of service
- intended changes in any levels of service
- mandatory performance measures (these cover the five mandatory groups of activity).

In addition to attesting that the reported performance results do not contain material errors, auditors also comment on whether the measure and related disclosure actually provide a fair reflection of actual performance.

Taken together the author considers that the legislative requirements and the audit test hold local authorities to a higher standard than is apparent in the IPSASB consultation paper. Therefore, it is unlikely that IPSAS guidance on reporting service performance would ever have any significant practical effect on local authorities.

Related Party Disclosures

There are differences in the related party disclosures required under IFRS and IPSAS.

The definition of “close family member” is wider under IPSAS. *NZ IAS 24 Related Party Disclosures* defines a close family member as being any of a person’s children, spouse/domestic partner and their children, the person’s dependents and those of their spouse/domestic partner. *IPSAS 20 Related Party Disclosures* also specifically includes:

- any relative living in a common household (for example if an elected member has an aunt or uncle living with them)
- a grandparent or parent
- a brother or sister
- a parent-in-law or a sibling-in-law.

Local authorities should take additional care to identify all of the parties involved in, or related to those entities that they conduct business with, make grants to etc. Elected member’s assistance will be needed to identify those people who fall within the scope of this wider definition – which may mean some disclosure of personal or sensitive information (such as who may be a domestic partner, which other relatives are living with them etc). The wider definition will mean that more transactions fall within scope of this disclosure – adding slightly to the length of financial statements.

On the other hand disclosures about transactions between GBEs are narrower under IPSAS than IFRS. IPSAS does not require disclosures of transactions that are on normal business terms – other than those with key management personnel.

References

Accounting Standards Review Board (2010), *Suitability of IPSAS Review – Report of the Working Group*.

External Reporting Board (2011), *PBE Standards Consultation Paper*