INTERNATIONAL AUDIT

The NAO provides external audit services to international organizations, working entirely independently of its role as the Supreme Audit Institution of the United Kingdom. The NAO has a dedicated team of professionally qualified staff with wide experience of the audit of international organizations.

The Comptroller and Auditor General is the head of the National Audit Office (NAO), the United Kingdom’s Supreme Audit Institution. The Comptroller and Auditor General and the NAO are totally independent of the United Kingdom Government and the Executive, and are primarily concerned to ensure the proper and efficient spending of public funds and accountability to the United Kingdom’s Parliament. We audit the accounts of all central public sector bodies as well as a number of international organizations.

The NAO employs some 850 people, mainly in its London headquarters, but also in regional and international locations. Three quarters of the professional staff are graduates and qualified accountants or accountants under training, many with specialist expertise in addition to audit skills. We also engage consultants and experts on short-term contracts when further specialist knowledge and skills are required.

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This National Audit Office guide, IPSAS – Preparing for Audit, has been produced especially to assist our international client organisations in understanding what their external auditors will require to support an unqualified audit opinion against the requirements of International Public Sector Accounting Standards.

This latest guidance for the preparers of accounts is a practical complement to the NAO’s IPSAS Compliance Guide, already issued, which provided a comprehensive, step-by-step checklist to ensure accounts which conform to the requirements of the Standards.

IPSAS – Preparing for Audit explains what organisations need to do and to prepare in order to produce accounts which are capable of withstanding audit scrutiny. The guidance sets out the circumstances required and the evidence needed by external auditors from management; and gives illustrations of the audit issues and problems that can arise and which need to be avoided.

We hope this new guide will be of interest and practical help to organisations, senior management and finance staff in contending with the systems and procedures needed to support the new demands of IPSAS-compliant financial reporting.

Martin Sinclair
Assistant Auditor General
PART ONE

Introduction

1 This National Audit Office guide is primarily addressed to accountants of entities producing Financial Statements under International Public Sector Accounting Standards (IPSAS). The purpose of the guide is to provide practical assistance on issues that entities may face in preparation for the implementation of IPSAS and shows how entities can prepare for the external audit of their IPSAS compliant accounts.

2 Whilst guidance is provided on the application of IPSAS\(^1\), it is not intended to replace the need for a detailed knowledge of the IPSAS, which is fundamental to the proper implementation of the Standards.

3 The key messages from this guide are:
   - The successful implementation of IPSAS will depend heavily on the level of planning and preparation undertaken by entities and any sponsoring organisations;
   - A thorough understanding of the entity risks, systems of internal control, and financial transactions is necessary to allow effective application of the IPSAS. This includes the formulation of appropriate accounting policies at the outset that reflect the organisation's circumstances; and
   - The disciplines brought to an organisation by the implementation of the standards are important to successful financial management.

4 This guide complements the National Audit Office IPSAS Compliance Guide which provides details on the disclosure requirements that entities will need to meet in producing IPSAS compliant financial statements.

Scope

5 The International Public Sector Accounting Standards Board have established IPSAS for use by governments to tailor financial reporting standards to the public sector context. They provide a framework for all public sector entities other than Government Business Enterprises.

6 IPSAS are largely aligned to International Accounting Standards, and differ only where there is a public sector specific issue which warrants a departure. Where no IPSAS is available, entities are encouraged to draw upon the requirements of the relevant International Financial Reporting Standard (IFRS) or International Accounting Standard (IAS) issued by the International Accounting Standards Board. Annex 4 shows the relationship between standards setting bodies.

7 A statement of compliance with IPSAS should only be made where all requirements of each applicable IPSAS are met. However, there are a number of provisions available during the transitional years of adoption, although such departures should be clearly disclosed in the Accounting Policies of the entity. Some governments may adopt different policies in certain circumstances, and these should be taken into account when considering accounting policies and compliance with the IPSAS. A comprehensive Cash Basis IPSAS has also been issued but this would, if appropriate, represent a transitional arrangement only, which is not recommended and is not covered in this guidance.

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\(^1\) This guidance draws on IPSAS's in force at October 2007.
Throughout the guide, references will be made to alternative sources of information. In particular, where no IPSAS has been issued, references to appropriate IFRS Standards will be made.

Benefits of IPSAS

Adopting IPSAS can help internal financial management as well as providing more informative disclosure of financial affairs. For example, implementing an accruals-based financial system with appropriate cultural changes can provide:

- Greater visibility and stewardship of all assets and liabilities, and may assist in:
  - Asset replacement strategies;
  - Credit control;
  - Developing effective supply chains and identifying key suppliers;
  - Identifying obsolete assets;
  - Managing working capital requirements;
  - Planning repayments of liabilities;

- Greater detail and consistency over all expenditure and income to better support the governance of entities – IPSAS will require entities to recognise expenditure and income in the period to which it relates. This may assist in:
  - Monitoring actual costs against budgeted costs independent of cash flows;
  - Assessing the full cost of providing services;
  - Assessing the true margin from income.

- Improved consistency and comparability of financial information between organisations, and over time.
The implementation of IPSAS will represent a significant undertaking for most entities. Entities will need to develop a project plan that covers at least the following areas:

- Implementation of new systems:
  - Infrastructure to support accounts preparation;
  - Compatibility with existing key systems;
  - Development of new information systems and internal control mechanisms;
  - Staff training.

- Finance staff training in IPSAS;

- Training of non-finance staff in accounting policies (accruals-based concepts) to ensure cultural change to recognise and record relevant financial data;

- Re-design of key processes and information flows, including financial procedures;

- Management verification of balances and accounts classifications, including appropriate challenge of output data prepared by finance;

- Liaison with internal and external auditors. Engagement of auditors is crucial to successful change.

Accounts Production

Entities will be required to prepare annual Financial Statements which give a fair presentation of the financial position, financial performance and cashflows of that organisation. Entities and their finance team will therefore need their own assurances that finances and financial systems are in good order, and should ensure that the financial statements are supported and validated by comprehensive reviews before being presented for audit.

In particular, it is important to consider the information requirements of the various entity stakeholders when considering the extent and presentation of information within the accounts.

It is the responsibility of entities to establish accounting policies that meet the requirements of applicable IPSAS and other complementary standards. However, in the transitional years of adoption, it is advisable for entities to consult with any sponsoring bodies and the external auditor to ensure that full and consistent compliance with IPSAS is made.

Audit

The responsibilities for auditors will vary dependent on the terms of engagement. However, for most audit engagements, auditors will be required to carry out sufficient work to provide opinions on whether the Financial Statements are ‘presented fairly’, and are prepared in accordance with the financial reporting framework and any relevant statutory requirements.

The level and detail of the work required to meet the auditors responsibilities will vary dependent on the scope and terms of each engagement. However, during transitional periods of adopting IPSAS, increased focus may be required to ensure that the entity has acceptable financial systems in place and that the entity’s accountants are familiar with the requirements of IPSAS.
In planning their approach to auditing an entity’s Financial Statements under IPSAS, the external auditors will initially be concerned to ensure that:

- the entity has acceptable financial and other information systems in place, along with arrangements to provide annual assurance on the reliability of such systems;
- the entity’s finance team have sufficient knowledge and understanding of IPSAS and their applicability to the entity’s Financial Statements; and
- the entity has arrangements in place to produce reliable Financial Statements, along with adequate supporting working papers, to an acceptable timetable.

Generally, the auditors will adopt a risk-based focus when auditing the financial statements, identifying where risks of financial mis-statement could arise and how the entity has managed that risk. To do this, auditors will need to gain a thorough understanding of the organisation’s activities, its governance structure and the entity’s attitude to risk assessment and management. This will include a review of systems of internal control and information flows within the entity.

Having identified the key risks, auditors will test controls, transactions and balances, and review other client documentation as appropriate, in order to gain sufficient, appropriate evidence on which to form an opinion on the accounts.
Accounting Systems

1. The transition to IPSAS may require an entity to undertake significant changes to their core financial systems. The extent of these changes will depend on the current financial systems adopted by entities. Significant changes in systems may lead to an increased risk in the reliability of information produced from the systems.

2. This risk is amplified where the transition is being made from reporting under a cash basis to an accruals basis, under IPSAS. It should be noted that entities may produce accounts on a cash basis using the Cash Basis IPSAS, which includes mandatory and encouraged disclosure sections. The Cash Basis IPSAS is designed as a transitional arrangement on the move to full compliance with Accruals based IPSAS, and not as a long term alternative.

3. In assessing the impact of such changes, entities and auditors will need to ensure that they gain a detailed understanding of the new systems and any impact on the control environment and control procedures.

4. To support the assessment of internal control, it is important that the entity maintains a good standard of technical documentation. System documentation should include:
   - An overview describing the purpose, operation and job scheduling of each functional module (General Ledger, Fixed Assets, Accounts payable etc.) comprising the system; and
   - A high level graphical description of all processes in terms of inputs and outputs and the programs which process them, including manual procedures and controls.

5. The transition to a new accounting system will require entities to develop a detailed migration plan. Such a plan should ensure that the migration of information is successful, and will provide evidence to support the opening balances in the new accounting systems.

6. A common mistake can be attempting to adapt existing systems and processes to an accruals–based framework without adoption of suitable internal governance arrangements, including education of budget holders and other staff to ensure appropriate recognition and challenge of underpinning financial data. The need for a cultural shift can be the biggest barrier to successful implementation, and requires a sustained strategy for embedding systems and processes within the organisation.

7. In designing and implementing new systems and controls, engagement with internal and external audit to challenge assumptions and to undertake testing can ease the process and allow incorporation of audit issues at the earliest opportunity.

Accounting Policies

8. Accounting policies provide a set of principles for presenting a specific entity’s activities in the financial statements, including appropriate recognition and valuation criteria for transactions and balances to ensure compliance with IPSAS. IPSAS 1 Presentation of Financial Statements contains guidance on the selection of accounting policies, and requires the disclosure of significant accounting policies in the notes to the financial statements. IPSAS 1 states that

   “Management should select and apply an entity’s accounting policies so that the financial statements comply with all the requirements of each applicable IPSAS. Where there is no specific requirement, management should develop policies to ensure that the financial statements provide information that is:
Relevant to decision making needs of users; and
Reliable in that they:
- Represent faithfully the financial performance and financial position of the entity;
- Reflect the economic substance of events and transactions and not merely the legal form;
- Are neutral, that is, free from bias;
- Are prudent; and
- Are complete in all material respects."

9 Where an IPSAS allows for one or more alternative accounting policies, an entity should choose and apply consistently one of those policies. Once an initial policy has been selected, a change in accounting policy should only be made in accordance with IPSAS 3 – Net Surplus or Deficit for the Period, Fundamental Errors and Changes in Accounting Policies.

10 Audit includes an assessment of the applicability of accounting policies in the context of providing a fair presentation of the financial position and performance. Auditors will also consider whether the adopted policies have been applied and so failure in the application of an accounting policy may result in a qualification of the accounts. Management should therefore ensure all accounting policies are embedded within internal procedures.

11 For first time adoption of IPSAS, it may be appropriate for the disclosed accounting policies to include a description of the valuation method(s) used to obtain opening balances for certain assets and liabilities.

Policy Development

15 In developing accounting policies, entities will need to consider the extent of the entity’s authority to develop its own accounting policies, particularly where the entity may also be consolidated into larger group accounts. In such an instance, the entity may be required to adopt accounting policies which are consistent with those adopted by the larger group (or make provisions to ensure that requisite financial information is collected to comply additionally with differing group accounting policies).

16 Where an organisation has constituted an audit committee, this should review the appropriateness of the policies and recommend adoption or change to the governing board. The board, or other governing body, should formally adopt the accounting policies.

Reporting Boundaries

17 IPSAS 6 Consolidated Financial Statements and Accounting for Controlled Entities provides guidance on the issues that need to be addressed in identifying entities that should prepare financial statements, and in identifying controlled entities that should be included in the consolidated financial statements.

Transitional Provisions

12 The IPSAS contain a number of transitional provisions to smooth the transition to reporting under IPSAS. Whilst these transitional provisions may be freely adopted by entities, in line with the relevant IPSAS, it is generally encouraged that full compliance with the IPSAS requirements be made at the earliest possible date.

13 The earliest possible adoption will ultimately lead to earlier realisation of the benefits of reporting under IPSAS, and should assist in the understandability and comparability of financial statements for stakeholders.

14 Where transitional provisions are taken advantage of, entities should clearly disclose this fact and provide details of the transitional accounting policies that are not in accordance with those prescribed in the relevant IPSAS.
There are a number of steps that an entity can take to ensure that an external audit runs smoothly and minimise the risk of a disclaimer or qualified audit opinion. They include:

- Understanding the auditor’s objectives;
- Maintaining audit trails;
- Having supporting information and schedules ready; and
- Being aware of common audit issues and taking steps to avoid their occurrence.

Addressing these issues will also improve an entity’s governance, including the robustness of financial information for management and the effectiveness of internal control systems.

### Audit Objectives

In examining whether the assets and liabilities as stated in the financial statements meet the requirements of the audit opinion, external auditors will determine whether they comply with the general audit objectives outlined below. As part of this, external auditors will consider whether the combination of systems, controls, validations and management reviews address these objectives.

### General audit objectives for:

#### Account balances at the period end

- Existence – assets, liabilities, equity interests exist.
- Rights and Obligations – entity holds or controls the rights to the asset, and liabilities are the obligation of the entity.
- Completeness – all assets, liabilities and equity interests that should have been recorded, have been recorded.

- Valuation and Allocation – assets, liabilities and equity interests are included in the financial statements at appropriate amounts, and any resulting valuation or allocation adjustments are appropriately recorded.

#### Presentation and Disclosure

- Occurrence and Rights and Obligations – disclosed events, transactions, and other matters which have occurred and pertain to the entity.
- Completeness – all disclosures that should have been included in the financial statements have been included.
- Classification and Understandability – financial information is appropriately presented and described, and disclosures are clearly expressed.
- Accuracy and Valuation – financial and other information is presented fairly and at appropriate amounts.

### Classes of transactions and events for the period

- Occurrence – transactions and events that have been recorded have occurred and pertain to the entity.
- Completeness – all transactions and events that should have been recorded have been recorded.
- Accuracy – amounts and other data relating to recorded transactions and events have been recorded appropriately.
- Cut-Off – transactions and events have been recorded in the correct accounting period.
- Classification – transactions and events have been recorded in the proper accounts.
Audit Trail

4 An audit trail consists of a positive set of links for each transaction or balance from source to account, and back.

The Audit Trail

‘The ability to track from the financial statements back through the prime accounting records to the underlying transactions and events (and back again) so that management and the auditor may substantiate the individual account figures’.

A proper audit trail:

- ensures that all, and only, proper transactions and balances are included in the accounts;
- comprises a positive set of links for each transaction or balance from source to account, and back;
- must cope with bulk postings such as payroll e.g. through control totals;
- must deal with paperless transactions e.g. through retention of trail data within the system.

5 Maintaining an adequate audit trail is essential for compiling a robust set of accounts. It can provide important management information for managing the business and supports the transactions and balances reported. For example, maintaining an adequate trail for a creditor balance, including contract details, purchase order data, the dates of goods received and the supporting invoice, can help if dispute arises over payment or the quality of items received.

Supporting Schedules

6 Maintaining supporting schedules to explain how judgements and estimates have been reached provides evidence for the assumptions used to compile the accounts. This eases the audit burden, and allows consistent application year on year. Such files should be made available to the auditors as part of the audit process.

7 The types of supporting schedules required will vary depending on a number of factors, including the account area, complexity of the entity, level of risk in the account area etc.

8 In general, supporting schedules should provide the auditor with a high level understanding of:

- What type of transactions make up the account area figure (e.g. income streams, source of provisions etc.);
- Where the account area figures have been taken from (e.g. sales ledger references, manual journal entries etc.);
- Any reconciling items between the account area figure and the General Ledger; and
- Any areas of significant judgement and/or estimates.

9 Throughout this guide, examples of the type and nature of supporting schedules that are required for account figures are included.

Common Audit Issues

10 Using our knowledge developed through auditing a wide range of public sector bodies, this guide will highlight areas where we have encountered issues in the past.
The Balance Sheet (Statement of Financial Position)

1 The Balance Sheet is designed to provide a financial picture of the assets and liabilities of the entity at a point in time, giving an indication of the financial management of the organisation. It can aid investment and other financial decisions by providing a definitive record of committed and available resources.

Opening Balances

2 Any new balances created under the application of IPSAS will need to meet the following audit requirements.

Opening Balances need to:

- Be recognised and valued according to the chosen accounting policies;
- Be accurately entered into the accounting system;
- Be consistent with any figures brought forward from the prior year accounts (e.g. suspense accounts);
- Have clearly identifiable, documented sources;
- Have evidence of management review for ownership, accuracy and completeness; and
- Have evidence of physical verification, where appropriate.

Assets

Property, Plant and Equipment

Recognition

3 These assets are the physical building blocks on which an entity delivers its functions. The accounting principle is to match the cost of these assets over the period they are actively supporting the organisation’s activities in order to provide an indication of the true cost of those activities within the reporting period. This matching occurs through depreciation and valuation.

4 IPSAS 17 defines property, plant and equipment as “tangible assets that a) are held by an entity for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and b) are expected to be used during more than one reporting period”. Obviously, before an item can be recognised, for financial reporting purposes, it must meet the definitions of an asset and property, plant and equipment.

5 Annex 1 details the steps that entities will need to follow when recognising assets.

Useful Lives

6 The useful life of an asset will vary depending on the type of asset and its intended use. There are a number of sources available to assist in determining appropriate useful lives including:

- Useful lives of similar assets used by other entities;
- Discussions with those that supply and maintain the assets; and
- Records of previous asset purchase and disposal dates.

7 Useful lives need to be reviewed periodically to ensure that they remain extant. Indicators such as a large number of fully written down assets still in use, would suggest that useful lives need revising.

Impairment

8 The impairment of assets is addressed in IAS 36 Impairment of Assets. Under IAS 36, impairments are defined as a loss in the future economic benefits or service potential of an asset, over and above the systematic recognition of the loss of the asset’s future economic benefits or service potential through depreciation.
9 Entities should assess at the reporting date whether there is any indication that an asset is impaired. As a minimum, public sector entities should consider the following indicators:

External Factors

- Significant decreases in market values of assets; and
- Significant adverse changes in the market in which the entity operates e.g. new restrictive legislation.

Internal Factors

- Evidence of physical damage to assets;
- Changes of the entity that may reduce the benefit of assets e.g. restructuring plans or discontinuing operations; and
- Any other evidence that suggests the economic performance of an asset is reduced.

10 Under IAS 36, impairment losses should be recognised whenever the recoverable amount of an asset is less than its carrying amount.

11 Asset registers are complete lists of assets owned by an entity. It records the opening and closing values of property, plant and equipment and is used to support the figures in the financial statements. The asset register is a critical component of an asset management information system. The size and complexity of an asset register will depend on the number and type of assets held by an entity and the volume of movements on the asset register (additions, disposals or transfers).

12 In its simplest form, the asset register may be a simple spreadsheet or database of assets. In more complex scenarios, the asset register is more likely to be a computerized system that interfaces directly with the general ledger. It is important to note that the details in the asset register are intended to support the balances of assets reported in the financial statements, therefore the asset register should be regularly reconciled to the balances in the general ledger.

13 As a minimum, an effective asset register should contain the following information:

- Name of asset;
- Physical description;
- Serial Number, unique identifier, or other asset identity tag;
- Date of purchase (date asset was brought into life);
- Physical location;
- Responsible persons (charged with stewardship of the asset);
- Expected useful life;
- Date of last impairment review (and assessment of useful life);
- Historic cost;
- Depreciation method;
- Book Value; and
- Date of disposal.

14 To improve asset management in the entity, the asset register can be used to record other (non-financial) information relevant to the asset, such as insurance details or maintenance schedules.

15 Most organisations set a capitalisation threshold for inclusion within the asset register. This reflects that recording low value items does not affect a user's interpretation of the asset balances and that maintaining a register for such items is disproportionate effort. Nonetheless, a register may include low value items for alternative purposes, such as security. Care should be taken regarding valuation of such assets, particularly if they are transient in nature.

16 Once an asset register has been compiled, to provide accurate information for inclusion in the financial statements, and to ensure effective asset management, it is important that the asset register is subject to continuous and effective validation. In most situations, the asset register will alter in size over time, as assets are removed or new assets added. To ensure that the financial statements report the substance of all such movements, asset transactions should be entered into the asset register as soon as possible after the date of the movement, combined with the regular reconciliation of the asset register to the general ledger.
Valuation of Assets

17 Valuations may be required at the time of recognition of an asset, where the cost cannot be reliably identified, and upon any subsequent valuations after recognition. IPSAS 17 requires an asset to be recognised initially at cost on the date that it was acquired, unless that cost was nil or nominal. In such instances, the cost should be equivalent to its ‘fair value’ – that is “the amount for which the asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction”. Methods for assessing fair value include: open market value; market-based value or depreciated replacement cost.

18 Assets may be valued internally, by entity staff, or, externally by professional valuers. From an audit perspective it is likely that professional valuations will provide the most accurate and reliable valuations, however, this may not be true where the assets are complex and/or highly customized. Where professional valuers are used, this does not absolve management from its responsibilities to review the valuations for reasonableness, or to consider the need for obtaining subsequent valuations for consistency and reliability.

19 Annex 2 provides some guidance on the tasking of professional valuers. Many of the principles set out in the Annex also apply when entity staff are used to value assets.

Transitional Provisions

20 Early recognition of property, plant and equipment on the adoption of IPSAS is preferable to ensure improved, effective and useful financial reporting and management. However, entities are not required to recognise property, plant and equipment for reporting periods beginning on a date within five years following the date of first adoption of IPSAS 17.

21 An entity that adopts accrual accounting for the first time in accordance with IPSAS may initially recognise property, plant and equipment at cost or fair value. Items that were acquired in non-exchange transactions should be recognised at fair value.

Audit Issues – Property, Plant and Equipment

22 Supporting schedules required by auditors may include:

- Copy of the asset register;
- Reconciliation of opening and closing balances;
- Reconciliation of the asset verification exercise to the asset register;
- List of impairments and details of results form impairment review;
- List of asset disposals made in the period;
- Details of any valuation reports received in the period;
- Schedule of expenditure incurred on the improvement or upgrade of assets; and
- Details of asset verification exercise.

23 Examples of issues identified during the course of audits include:

- Physical verification of assets not being carried out
  - Entities should ensure that there exists a clear programme for verifying assets;
  - The execution of the programme should be documented and retained as audit evidence;
  - Where discrepancies have been found from the exercise e.g. asset surplus/deficits, details of the resultant investigation should be retained to support any asset write-off or write-on;

- Depreciation rates and useful lives not reviewed regularly – leading to a large number of assets fully depreciated but still in use;
  - An annual review of the number of fully depreciated assets provides assurance that the validity of useful lives is being regularly conducted;

- Lack of documentation to support movements in the asset register – additions, disposals, transfers etc.;

- Wherever there is a movement on the carrying value of assets, other than through depreciation, entities should retain sufficient evidence to support the movement e.g. for disposals – a disposal voucher; for additions – purchase invoice/or invoices for expenditure on upgrades. Guidance should be provided to staff to ensure changes to state, such as disposal or obsolescence, are recorded at the appropriate time.
Figures presented for audit not subject to any prior management review;

- Asset register not regularly reconciled to the general ledger;
- Policies, procedures and training not being in place to ensure that asset registers are kept up to date and are accurate;
  - In particular, there are often no clear procedures in place to ensure that all expenditure over capitalisation thresholds is considered as to whether it should be capitalised.

Intangible Assets

24 There is currently no IPSAS on intangible assets. In the absence of an IPSAS, IAS 38 may be used as the authoritative standard for the treatment of Intangible Assets. IAS 38 defines intangible assets as “identifiable non-monetary assets without physical substance held for use in the production or supply of goods or services, for rental to others, or for administrative purposes”.

25 Therefore, under IAS 38, intangible assets should only be recognised where the assets meet both the general definition of an asset and the additional requirements of the definition. In keeping with other non-current assets, intangible assets must have a useful life greater than one year. A portion of its value must therefore be amortised over time as an expense.

26 Examples of Intangible assets include:
- Goodwill;
- Patents;
- Copyrights;
- Trademarks;
- Computer Software; and
- Capitalised research and development costs.

27 A summary of key requirements of IAS 38 are:
- Permits the recognition of an identifiable intangible asset only when it is probable that the future economic benefits that are attributable to the asset will flow to the entity, and the cost of the asset can be measured reliably;
- There are limits to the extent that expenditure on internally generated assets may be recognised. In particular, expenditure on the research phase is to be expensed in the period that the expense is incurred. Expenditure on the development phase is recognised as an asset when, and only when, the entity meets certain criteria indicating that there is some certainty that the potential benefits from the asset will be realised;
- Intangible assets should initially be measured at cost and subsequently carried at cost or revalued as appropriate;
- The cost of the asset (less any residual value) should be expensed over the useful life of the asset – this is known as amortisation. Where assets are identified as having an infinite life, amortisation is not required. In such instances, the asset must be reviewed for impairment on an annual basis. Assets with a finite life should be reviewed for impairment where there is an indication of impairment (IAS 36); and
- Non-separable assets, ie those that cannot be disposed in isolation, should not be recognised as an asset.

Goodwill

28 Although IAS 38 does not allow the recognition of internally generated goodwill, it requires purchased goodwill to be recognised.

29 Tasks associated with accounting for goodwill, under IAS 38, for the first time include:
- Identifying situations where previous acquisitions may have given rise to a payment for goodwill;
- Determining reliable fair values for assets and liabilities acquired at the time of acquisition. If fair values cannot be reliably identified, goodwill cannot be retrospectively identified;
- Calculating initial level of goodwill and the amount that will have been amortised to date; and
- Recognising goodwill in the separate controlling entity ledger.

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2 Identifiable assets may be referred to as being separable from other assets or the general business, as arise from a legal or contractual right, e.g. a licence.
3 Goodwill would be purchased upon the combination of businesses. Therefore, consolidated financial statements may include goodwill.
Audit Issues – Intangible Assets

30 Supporting Schedules required by auditors may include:

- List of intangible assets and associated financials (e.g. historic cost, depreciation etc.);
- Reconciliation of closing balance to opening balance;
- List of movements in the period (additions, disposals, transfers etc.);
- Details of any impairment in the period; and
- Details of exercises to assess the need for impairments.

31 Examples of issues identified during the course of audits include:

- Assessment for impairment not being carried out;
  - Entities need to demonstrate how they have assessed the need for impairment by considering the indicators of impairment.

- Intangible assets linked to property, plant or equipment not being transferred or written off alongside the property, plant or equipment;
  - Where intangible assets are clearly linked to property, plant or equipment (e.g. development costs etc.), entities should carry out a regular review to ensure that the associated property, plant or equipment is still owned by the entity and has not been impaired.

- Recognition of development expenditure incurred during the research phase;
  - Entities should clearly identify the point at which the recognition criteria for intangible assets have been met (IAS38 Intangibles). At this point, entities should establish a mechanism for ensuring that expenditure incurred during the research phase is not capitalised as though incurred during the development phase (e.g. a change of project codes against which expenditure is booked or retrospective review of all development expenditure capitalised in year).

32 The main risk for recognition of such assets is appropriate valuation. External, professional valuers can provide evidence, although this is not always practical or economic, particularly where the asset has no equivalent on the market. Ultimately, internal management judgement may be the only option. Auditors would wish to review the terms of reference for external valuers to establish their reliability and objectivity. Internal valuation would have to be justified in light of future anticipated economic benefit, and all management assumptions would have to be supported by auditable evidence. Where such assets are identified, early engagement of external audit should be sought to consider the most appropriate accounting treatment.

Inventories

33 IPSAS 12 defines inventories as assets:

- In the form of materials or supplies to be consumed in the production process;
- In the form of materials or supplies to be consumed or distributed in the rendering of services;
- Held for sale or distribution in the ordinary course of operations; or in the process of production for sale or distribution.

34 In the public sector, where inventories are often held for use in service delivery, some examples of inventories include:

- Consumable Stores, whether for production purposes or for other usage within the entity’s functions (including ammunition or items for resale);
- Spares for plant and equipment (other than those identified as components under IPSAS 17, which are subject to capitalisation);
- Work in progress; and
- Land and property held specifically for sale.

Systems

35 Crucial to the effectiveness of inventory control is the implementation of an inventory management system that meets the following objectives:

- Inventories are available to meet the needs of ongoing activities;
- Reduces the level of funds tied up in inventory and storage costs; and
- Facilitates good internal control to reduce loss through damage, deterioration or theft of inventory.
Inventory systems usually fall into one of two types – perpetual or periodic. In perpetual systems, inventory records are updated upon each movement in inventories (receipt of goods, consumption of goods or sale of goods). In periodic systems, information on the level of goods held is obtained through data received from periodic stocktakes. Where the level of inventories is significant and/or there are significant movements in inventories, it may be desirable for the inventory system to be computerised and interfaced to the purchasing, accounts payable and receivable systems. This will assist in ensuring that all inventory movements are reflected in the general ledger. As a check, the inventory system should be regularly reconciled to the general ledger.

Note that periodic systems are usually only relevant for slow-moving or small numbers of items.

Whatever system is adopted, proper recording and reconciliation of movements and changes in state are vital to keep track of inventory items.

Stocktaking

To provide assurance that the balances held in the inventory system are accurate, it is important that the entity establishes a programme of regular stocktakes. The majority (by value) of inventory items should be covered by an annual stocktake at the period end. However, where entities hold significant balances of inventory, it may be more appropriate to develop a cyclical stock programme, whereby inventory items are counted on a regular basis (with the majority counted each year), but not necessarily all at the period end.

In either instance, it is important that all discrepancies, identified during stocktaking, are recorded and actioned accordingly. For low value discrepancies, management may decide that limited action, if any, is required. However, recording the discrepancies will help identify trends and allow future action, as appropriate, to limit losses. Management should also consider the risk of fraud in such cases.

Measurement

Inventories should be measured at the lower of cost and net realisable value, unless they are to be distributed at no charge or for a nominal charge. In such instances, inventories should be measured at the lower of fair value (at date of acquisition) and current replacement cost. IPSAS 12 provides detailed guidance on this issue, and external audit should be consulted regarding valuation policies and methodologies.

To ensure that the cost of inventories is correctly measured, it is important that inventory is regularly reviewed for obsolescence and damage. This is usually addressed by incorporating this review into the stocktaking programme. However, under this option, it is important that stocktaking staff are adequately trained and skilled to identify evidence of obsolescence or damage.

Biological assets

There is currently no IPSAS covering the treatment of biological assets. Agricultural products are specifically excluded from the scope of IPSAS 12. IAS 41 prescribes the treatment and disclosures relating to agricultural activity, i.e. prior to harvest or preparation for sale. After harvest, produce should be treated as within the scope of IPSAS 12.

Construction Contracts

Where an entity holds assets as inventories for sale or distribution (as defined in IPSAS 12), work in progress of these assets should be accounted for in accordance with IPSAS 12. However, in some cases an entity may enter into a contract to construct an asset for another entity. In these instances, where work in progress relates to a construction contract (as defined in IPSAS 11), the work in progress should be accounted for in accordance with IPSAS 11.

Audit Issues – Inventories

Supporting schedules required by auditors may include:

- Calculations of balance sheet inventory values;
- Details of stocktaking programme and performance;
- Details of amendments to inventory records and any write-off action;
- Calculation of any provision for obsolescence of inventories;
- Comparison of inventory values by type and location, with explanations for significant variances.
Examples of issues identified during the course of audits include:

- Inventory recorded at cost, with no assessment of net realisable value or current replacement cost;
  
  While the cost of inventory is usually lower than replacement cost/net realisable value, entities need to develop a process for ensuring that this remains the case, especially where stock is not held for resale. Actions could include a review of list prices (from supplier lists) against cost to identify significant differences; comparison of year end sales price against cost; obsolescence reviews.

- No audit trail for adjustments made as a result of discrepancies identified during stocktaking;
  
  As for the verification of property, plant and machinery, where stocktaking discrepancies are identified, the subsequent investigation carried out should be documented and retained to support any adjustment to inventories in the General Ledger.

- Inclusion in the balance sheet of inventory held on behalf of third parties;
  
  In carrying out stocktaking procedures, entities should pay attention to ensure that inventory items held on behalf of third parties are not incorrectly added to the General Ledger. Likewise, it is important to account for inventory items held at outstations or in transit.

- Omission of inventory held by third parties;
  
  Entities should ensure that inventory items held by third parties are included in the stocktaking programme. If the entity wishes to rely on third parties to confirm the balance of inventory items held on their behalf, the entity should satisfy itself that the confirmation is reliable and accurate, and covers a review of obsolescence.

Receivables

Receivables represent the amounts that are owed to the entity. These may include:

- Amounts due in respect of services or goods delivered;
- Interest not yet received;
- Amounts due in respect of loans and advances, including those made to employees or sponsored bodies; and
- Taxation receivable or other levies.

Whilst prepayments are not themselves receivable, as they represent payments in excess of the expenditure recognised in the period and therefore an asset held by others, they are often reported within receivables because they are assets of the reporting entity.

Opening Balances

To determine a complete list of opening balances for receivables, an entity will need to examine in detail all goods, services or other deliveries that have been made but for which final settlement has not been made. Other steps in the process include:

- Agreement of the amount due with the respective parties. Indeed, an annual debtors circularisation can be an important tool in debt management;
- Ensuring that amounts identified as receivable are gross and not shown net of amounts owed by the entity to the other party (such amounts should be recognised as liabilities unless a formal set-off arrangement is in place);
- Assessing the likelihood of the amounts being recovered (this may include checking the legal entitlement to the amounts, the liquidity of the other party, the time elapsed since the delivery of the service or goods, agreed discounts etc.); and
- Review of any amounts paid in advance for services that are to be received by the entity (prepayments).

Write-offs

An entity needs to develop policies for the systematic review of receivables, to ensure that receivable balances actually reflect the amounts that are likely to be recovered. This may involve a central review based on the age of receivable balances and then a more detailed review of the recoverability of individual balances.

Where the assessed recoverable amount is lower than the balance recorded as receivable, it may be appropriate for the entity to consider writing off the balance as an expense in the period. The entity will need to set clear procedures and guidance as to what balances may be written off. Given that large write-offs are often politically sensitive, it is appropriate to set thresholds above which authority is required to action a write-off.

It is important to recognise that the write-off of a receivable balance does not intervene with the legal right to recover the full amount that is receivable.
Where receivable balances are identified as having some degree of uncertainty over the recovery, the entity may raise a provision recognising that there is some doubt over the ability to recover the full debt. Such provision, known as provisions for bad and doubtful debts, may be raised against specific balances or generally as a proportion of the overall receivable balance.

Systems

Most accruals accounting systems will automatically generate receivable balances from the books. However, in most instances, the entity will still be required to periodically assess balances for accrued income and prepayments. This process requires a more detailed understanding of the operations of the entity. Details of accrued income will be obtained through a period end assessment of completion of all outstanding deliveries. Similarly, prepayments will rely on an end of period assessment of those payments made where there is likely to be a payment in advance. Typical examples of where prepayments arise are:

- Rents payable;
- Grant payments;
- Utilities;
- Maintenance contracts; and
- Staff advances.

Audit Issues – Receivables

Completeness can often be a risk, especially where accruals-based systems have not matured or staff are not fully trained to identify and record receivables when amounts fall due.

Supporting schedules required by auditors may include:

- Copies of source documentation for receivables;
- List of aged receivables;
- Calculation to support bad and doubtful debt provision; and
- Details of all receivable balances written-off in the period.

Examples of issues identified during the course of audits include:

- No evidence to support the calculation of bad and doubtful debts.

Where general provisions for bad and doubtful debts are raised, entities should ensure that the basis on which the provision was calculated is available as audit evidence, is supported by appropriate documentation and has been subject to management review.

Cash

Most public sector entities will already have good records of most of their cash payments, receipts and balances. Cash should therefore be a relatively simple asset to account for. However, there are a number of issues that need to be considered when planning the adoption of IPSAS:

- IPSAS 2 requires the cash flow statement to include both cash and cash equivalents – some cash equivalents may not be readily identifiable to entities; and
- Cash balances should be recognised where they are controlled by the entity. There may be some instances where funds are held by the entity but not controlled by the entity – and therefore possibly shouldn’t be recognised in the financial statements; or there may be some cash balances that are controlled by the entity but are held and administered by other parties.

The definition of cash used in IPSAS includes “cash on hand and demand deposits”. Cash on hand includes:

- Bank account balances;
- Cash awaiting banking;
- Petty cash; and
- Cash in transit.

Cash held in bank account balances may refer to specific accounts in a named bank account, or it could represent ‘notional bank accounts’ where a group of entities operates a central bank account (but separately identify individual cash balances).

Cash Equivalents are “short term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value”. Cash equivalents may therefore include:

- Short term deposits;
- Deposits at call; and
- Other highly liquid investments that are readily convertible to cash on hand at the entity’s option.
Control of Cash

62 Cash balances should only be recognised by the entity in the financial statements where the cash balances are controlled by the entity. The concept of control can be difficult to define. In the context of cash receipts, the following scenarios illustrate instances of control and non-control:

- Receipts that are controlled – revenue or receivables received by an entity and the revenue is available to be used by the entity.
- Receipts not controlled – entity collects taxes on behalf of the government for payment to a central fund or other government entity. The entity is not entitled to spend the receipts and is clearly acting in an administrative capacity.

63 Where receipts described in scenario 2 are held in bank accounts, intermingled with entity funds, it is important that the entity puts in place controls and procedures to ensure that the funds remain separately identifiable.

64 Cash that is held in trust for another party and is not controlled by the entity should not be recognised as an asset of the entity. Amounts should, however, be disclosed with appropriate descriptions.

Audit Issues – Cash

65 Supporting schedules required by auditors may include:

- Bank balances at the period end will usually be confirmed independently by the issue of a bank confirmation report from respective banks to the auditors (entities should ensure that banks are provided with a letter giving ‘Authority to Disclose Information’ to auditors);
- Entities should complete regular bank reconciliations, to incorporate cash in transit balances into the cash at bank balance and as control to ensure that cash flows match those described in the cash books. Discrepancies should be investigated immediately; and
- Details of all bank accounts, deposits and other highly liquid investments.

66 Examples of issues identified during the course of audits include:

- Regular bank reconciliations not being performed
- The performance of bank reconciliations is an important component of an entity’s financial management process and internal control. Regular reconciliation can identify discrepancies early, which makes it easier to correct. It can also help identify fraudulent or otherwise erroneous activity.
- Incorrect translation of foreign account balances
- Where accounts are held in currencies other than the reporting currency, it is important that entities translate the balance with the exchange rate prevailing on the reporting date.

Liabilities

General Audit Issues – Liabilities

67 In order to prepare a plan for the recognition of liabilities, an entity needs to assess the amount and availability of information already available on those liabilities. General steps include:

- Compilation of a list of liabilities held by the entity;
- Determination of categories of liabilities that will be used in the chart of accounts and the financial statements;
- Preparation of accounting policies for each category;
- Assessment of the accuracy and completeness of existing information on each category;
- Computation of accurate opening balances; and
- Design and implementation of systems to maintain the financial information to meet IPSAS.

Accounts Payable and Accrued Expenses

68 Accounts payable (or creditors) represent amounts owed by the entity to other parties in respect of transactions such as the purchase of goods or services, the liability for welfare payments and grants due to other government entities.

69 Accrued expenses occur on similar transactions to accounts payables, but where no invoice has been received for payment by the accounting reference date. All liabilities for goods and services received in the period of account should be recognised, whether or not a physical invoice has been received.
To determine the opening balance for accounts payable and accrued expenditure, an entity needs to:

- Compile a list of all known amounts payable – by reference to outstanding invoices, contracts let, and goods and services received up to the balance sheet date. Reviewing post-period end invoices received can help identify liabilities present at the balance sheet date. Such a review should be documented and presented to the auditors as evidence to support the statement of financial position;

- Check that the amounts recorded for individual transactions are correct (as for receivables, entities may consider circularising suppliers to confirm the accuracy of amounts);

- Check that the list of amounts payable is complete through discussion with regular suppliers, sponsored bodies etc.; and

- Review all expenditure streams to ascertain the likelihood of accrued amounts at the period end (this procedure would be combined with the process for identifying possible prepayments).

Debt

Debt is a form of liability that represents money borrowed from individuals, banks or other institutions. Borrowings take many different forms, and have a variety of different characteristics, some of which are described below:

- Interest bearing – security bears interest;

- Marketable – security may be traded in financial markets, rather than being held until maturity;

- Bills – Short-term obligations, may be up to one year or up to 90 days;

- Notes – Medium-term obligations, term of usually between one and ten years;

- Bonds/Debentures – Long-term obligations, usually over 10 years. Gives the holder the unconditional right to a fixed or contractually determined variable money income – either in the form of coupon payments or stated fixed sums on specified dates; and

- Loans and Advances – loans from other parties including banks, other government departments etc.

Audit Issues – Accounts payable

Many organisations struggle to identify a complete set of liabilities when they first implement an accruals-based accounting framework as they have not embedded within the culture of the entity a system that accurately records the progress of procurement from purchase order through goods received note to invoice. A common failure of controls occurs when expenditure can be incurred without a purchase order; even where the IT systems have been upgraded, errors can occur when purchase orders are routinely raised only on receipt of an invoice because procurement can be initiated locally without reference to the ledger system. Education of staff throughout the organisation is required to ensure a smooth transition.

Supporting schedules required by auditors may include:

- Copies of source documentation to support accounts payable and accrued expenses.

- Details of contracts let, leases acquired, other goods and services received.

- Details of any debt instruments held by the entity.

Examples of issues identified during the course of audits include:

- Accrued expenses not supported by source documentation.

- Entities need to ensure that accrued expenditure is fully supported – i.e. the basis of any calculation must be clear and reasonable.

- No classification between current and non-current payables.

- Entities need to ensure that all payables are analysed to identify any liabilities which are non-current.
Provisions and Contingent Liabilities

75 Where items do not meet the definition of an account payable, they may meet the definition of a contingent liability or provision. IPSAS 19 describes when contingent liabilities and/or provisions should be recognised. They are different from accounts payables because the outflow of economic benefit is conditional on some uncertain future event.

76 There is a close relationship between contingent liabilities and provisions. In a general sense, all provisions are contingent liabilities because they are uncertain in timing or amount. However, in IPSAS 19, the term contingent is used to describe liabilities or assets that are not recognised because their existence will be confirmed only by the occurrence of one or more uncertain future events not wholly within the control of the entity. The difference between contingent liabilities and provisions is set out below:

- Provisions are recognised as liabilities because they are present obligations and it is probable that an outflow of resources will be required to settle the obligation; and

- Contingent liabilities are not recognised as liabilities because they are either:
  - Possible obligations, as it has yet to be confirmed whether a present obligation exists; or
  - Present obligations that either are not probable to result in an outflow of resources or where the amount of the outflow cannot be estimated reliably.

77 Annex 3 contains a decision tree for assistance in deciding when potential liabilities should be recognised as a provision, disclosed as a contingent liability or not disclosed at all.

78 Once a provision has been recognised, it should be regularly reviewed (at least at each reporting date) and adjusted to reflect the current best estimate of economic outflow. If it is no longer probable that an outflow of resources will be required to settle the obligation, the provision should be reversed. Changes in estimate may arise from a change in the assumptions for the estimate, change in conditions relating to the obligation or where expenditure has been incurred to reduce the future liability.

79 Where provisions are recognised for obligations in the future, entities may be required to discount the value of the provision to recognise the present value of the liability, where this has a significant effect. At each reporting date, as the carrying value of the provision increases to recognise the effect of unwinding the discount, this expense should be recognised as an interest expense.

80 Below are some examples of the application of the Recognition and Measurement rules set out in IPSAS 19:

- Future operating deficits – do not meet the definition of liabilities or the recognition criteria for provisions because there is no present obligation – they should therefore not be recorded as provisions but recognised in the period they relate to.

- Onerous contracts – onerous contracts arise where the costs of meeting the obligations under the contract exceed the benefits expected to be received under it – the present obligation, less any possible recoveries, should be recognised as a provision. This reflects that the event resulting in the loss has already occurred and is irreversible.

- Restructuring – restructuring may include termination of an activity, closure of an office, changes in management structure or other fundamental reorganisations – the costs of the restructuring should be recognised when there is a sufficient degree of certainty over the plans to mean that the costs will inevitably be incurred, for example where there is a detailed formal plan for the restructuring and there is an expectation that the plan will be implemented, either by its commencement or by its announcement to those affected.

- Liabilities for decommissioning or other future remedial work, for which the obligation is unavoidable and independent of future activities. An example is remediating environmental damage where there is a current legal or constructive obligation to mitigate the effects – The future anticipated costs to remedy or mitigate against the effects should be recognised as a provision. The trigger for recognition is the legal obligation to correct the environmental impact, which has already occurred and means the liabilities will crystallise in the future.
In each of the examples, IPSAS 19 provides further details about the amount of expenditure that may be provided for and also the disclosures that must be made relating to the provisions in the financial statements.

Note that contingent assets should not be recognised in the balance sheet, although disclosure within a note to the accounts may be appropriate.

Transitional Provisions

The effect of adopting IPSAS 19 on its effective date should be reported as an adjustment to the opening balance of accumulated surpluses/(deficits) for the period in which the standard is first adopted. Entities are encouraged, but not required, to adjust the opening balance of accumulated surpluses/(deficits) for the earliest period presented and to restate comparative information. If comparative information is not restated, this fact should be disclosed.

Audit Issues – Provisions and Contingent Liabilities

Supporting schedules required by auditors may include:

- Details of all provisions and contingent liabilities including sources of estimates, evidence of past event, calculation of any discounting and source of the discount rate;
- Board and committee papers, plus legal correspondence to help identify potential commitments;
- Details of any changes in existing provisions

Examples of issues identified during the course of audits include:

- Lack of evidence to support estimate of provision
  - The calculation of provisions is often complex, particularly given that there is some uncertainty over the timing or amount of probable economic outflows. It is therefore important that entities provide all information relevant to the calculation of provision amounts.
  - Where provisions are unlikely to be settled in the short term, it is important that entities consider the impact of discounting cash flows. Where discounting is used, United Nations entities should seek advice from the UN Task Force on Accounting Standards on a suitable discount factor to use.
- Provisions disclosed as contingent liabilities, based on no reliable estimate being available.
- IPSAS 19 is clear that provisions should seldom be classified as contingent liabilities due to a lack of a reliable estimate. It may be necessary for entities to seek external advice when seeking a reliable estimate, such as from actuaries or pension fund administrators, although entities should consider the benefit of providing a reliable estimate over the cost of providing such an estimate.
- Lack of completeness of provisions
  - Entities need to ensure that mechanisms are in place throughout the organisation to identify potential provisions. This means that adequate training should be provided to staff from an operational level through to the strategic level of the organisation.

Net Assets/Equity

Net assets/equity is the term used to refer to the residual measure in the statement of financial position (assets less liabilities). It is usually represented by the following constituent parts:

- General Fund – this represents the total of assets less liabilities of the entity to the extent not covered by other reserves. In private companies, this represents the Profit and Loss reserve and is effectively accumulated operating surpluses and deficits.
- Revaluation Reserve – this represents the unrealised element of the cumulative balance of revaluations to assets (other than those that are donated).
- Donated Assets Reserve – this represents the net book value of assets donated to the entity.
- Public Dividend Capital – equivalent to share capital owned by government, representing the public investment.
- Other reserves – any other reserve balances not covered above. Usually these would only exist where they add clarity to the users of the financial statements.
Audit Issues – Net Assets/Equity

Supporting schedules required by auditors may include:

- Reconciliation of opening and closing balances for all reserve balances.
- Reconciliation of reserve movements to other account areas eg Revaluation Reserve to property, plant and equipment.

Examples of issues identified during the course of audits include:

- Unsupported movements in the revaluation reserve.
  - Entities should ensure that movements in the revaluation reserve are supported by movements in the carrying values of assets. Many Fixed Asset Registers will contain an associated Revaluation Reserve. In this instance, the Revaluation Reserve balances can be reconciled with that in the General Ledger.
1 The income statement is designed to provide a financial picture of the revenue and expenditure of an entity in a given period.

**General Audit Issues – Revenue and Expenditure**

2 In order to prepare a plan for the recognition of revenue and expenditure, an entity needs to assess the information already available on those transaction streams. General steps include:

- Compiling a list of all types of revenues and expenses relevant to the entity;
- Determining the categories of revenue and expenditure to be used in the chart of accounts and the financial statements;
- Preparing accounting policies for each category of revenue and expenditure;
- Assessing the accuracy and completeness of existing information on each category;
- Establishment of systems to support the recognition of revenue and expenditure on an accruals basis; and
- Documenting and evaluating the internal control mechanisms handling transactions.

**Revenue**

3 Revenue is defined as “the gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net assets/equity, other than increases relating to contributions from owners”.

4 Some examples of revenue in public sector entities include:
   - Non-Exchange Revenues:
     - Taxes;
     - Duties; and
     - Fees and fines.
   - Exchange Revenues:
     - Sale of goods or services;
     - Grants or other contributions towards projects, other than where this constitutes direct funding of activities from sponsor organisations;
     - Dividends;
     - Interest; and
     - Gains arising from sale of assets.
   - Other gains.

5 General funding of activities from sponsor bodies should be accounted through reserves as financing.

**Accruing for revenue**

6 Controls and processes that should be implemented to support the accruing for revenue include:
   - Identification of authorities for setting charges and fees;
   - Identification of authority to charge other entities;
   - Regular review of charges and fees;
   - Establishment of guidelines for providing credit;
   - Regular reconciliations between subsidiary and control ledgers;
   - Active management of amounts owed to the entity;
   - Regular review of bad debt;
   - Accurate and complete records of debtors;
Consistent application of accounting policies and regular review of the application of accounting policies; and

Dissemination of internal guidance to non-finance staff on when to recognise debt, including trigger points for long term contracts.

**Audit Issues – Revenue**

7 Supporting schedules required by auditors may include:

- Details of accrued revenue.
- Details of any exceptional revenue items.
- Description of accounting policies for the recognition of revenue (for each revenue stream).

8 Examples of issues identified during the course of audits include:

- Lack of documentation to support accrued revenue items.
- Entities need to ensure that they provide evidence to support the amount and timing of revenue that is to be accrued, particularly where these cannot be supported by post year end sales vouchers/receipts. Such evidence could include project completion or progress certificates signed by experts, such as surveyors, or other evidence of fulfilling orders.

**Expenditure**

9 Expenditure is defined as “decreases in economic benefits or service potential during the reporting period in the form of outflows or consumption of assets or incurrence of liabilities that result in decreases in net assets/equity, other than those relating to distributions to owners”.

10 Some examples of expenditure in government entities includes:

- Personnel related costs;
- Cost of goods sold/services provided;
- Administration costs;
- Physical asset use (depreciation and impairment);
- Rental and leasing costs;
- Maintenance;
- Interest charges;
- Transfers to other governments, organisations or individuals; and
- Other losses (changes in market value, foreign exchange losses) or consumption of resource.

**Classification**

11 Entities will need to develop a system for classifying revenue streams, in the chart of accounts and the financial statements. There are some expenditure classifications that are specifically required by the IPSAS:

- Separate identification of expenses by the nature of the expense or by function. Operating costs applicable to revenues recognised as expenses are to be classified by nature;
- Depreciation and amortisation;
- Salaries and employee benefits;
- Finance costs;
- Borrowing costs – to ensure that they meet the conditions for capitalisation to qualifying assets;
- The carrying amount of inventories sold, exchanged or distributed during the period, or operating costs (raw materials, consumables, labour costs, other operating costs and the net change in inventories) applicable to revenue; and
- Write-downs or losses associated with inventories, and any reversals of write-downs during the period.

12 For other transactions, presentation in the accounts should be made with reference to stakeholder information needs, such as on a programme or project basis.

**Recognition**

13 The general recognition criteria of measurability and probability underlie the recognition of all revenues. However, the application of these general principles to specific types of transactions means that an entity needs to develop systems to identify the appropriate recognition point for such transactions. For example:

- Rendering of services – reliable measurement of stage of completion, costs associated with that stage of completion and the costs required to complete the transaction;
- Sale of goods – reliable measurement of costs incurred or to be incurred in relation to the transaction; and
- Inventories sold – a system for recognising the cost of inventories consumed in relation to transactions.

14 The timing of recognition depends on legal or constructive obligations arising, and is usually on receipt of the goods or the commencement of services.
To meet the requirements of IPSAS 18 – Segment Reporting, entities should ensure that the recognition of revenue can be allocated to the segment to which it relates (see Specific Topics – Segment Reporting page 35).

**Purchasing and Payment Systems**

Prior to the implementation of IPSAS, it may be appropriate for an entity to review existing purchase and payment systems and procedures. Key requirements are that:

- There are sound controls over the authorisation of expenditure. Organisations should evaluate their corporate risks, both in terms of risks to achievement of objectives and the risks of financial error or loss, and ensure appropriate controls are in place to mitigate against the crystallisation of those risks. Internal and external audit should be consulted.
- Public money is spent for the purpose intended and in accordance with budgetary and legislative authority;
- Payments are made on time. This requires good cashflow management and forecasting;
- Systems are able to provide accurate and timely information.

Entities should consider the efficiency and effectiveness of centralising some aspects of the purchasing and payment system and process. Some advantages of such centralisation are that:

- Greater control can be exercised over the use of suppliers – introduction of preferred suppliers (bulk discounts, standardisation of service/goods etc.);
- It is easier to implement policies regarding controls over certain types of spending; and
- Coding systems can be used to automatically allocate the cost of purchases to budgets. Where individuals with budget responsibilities have on-line access to their financial information they can then track actual spending to budgets during the reporting period.

However, de-centralised functions can help meet local needs more rapidly. In such cases, clear central guidance should be disseminated and the implementation of effective controls periodically verified.

**Accruing for expenses**

Below is a list of controls that should be operated to support the accruing for expenditure:

- Regular reconciliations between subsidiary and control ledgers;
- Periodic review of costs (against charges where relevant);
- Active management of creditors to ensure payments are made in accordance with the policy on payment;
- Consistent application of accounting policies and regular review of the application of accounting policies;
- Establishment of policies and procedures for purchasing;
- The establishment of policies for contracting out services;
- Regular review of suppliers to ensure they are meeting the needs of the entity and are acting in accordance with supply agreements; and
- The establishment of procedures to verify the receipt of goods and services against purchase orders, and for the authorisation and payment of invoices.

**Audit Issues – Expenditure**

Supporting schedules required by auditors may include:

- Details of accrued expenditure.
- Details of any exceptional expenditure items.
- Description of accounting policies for the recognition of expenditure (for each expenditure stream).
- Systems descriptions, including IT and manual controls;
- Results of key controls, such as reconciliations and exception reports;
- IT access, including downloads of ledger data, where practicable, to allow the application of computer aided audit techniques;
- Contract and purchase order information, goods received notes and post period-end transactions.

Examples of issues identified during the course of audits include:

- Lack of documentation to support accrued expenditure items;
  - Entities need to ensure that they provide evidence to support the amount of expenditure that is to be accrued, particularly where these cannot be supported by post year end invoices.
Cash Flow Statement

1. The cash flow statement should report cash flows during the period classified by:
   - Operating activities;
   - Investing activities; and
   - Financing activities.

Operating activities

2. Cash flows from operating activities are primarily those that are generated from the cash-generating activities of the entity e.g. receipts from supply of goods/services, payments to employees etc. IPSAS 2 provides examples of other cash flows that would generally be regarded as representing cash flows from operating activities.

3. Cash flows from operating activities should be reported using either:
   - The direct method – whereby major classes of gross cash receipts and payments are disclosed; or
   - The indirect method – whereby net surplus or deficit is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of revenue or expense associated with investing or financing cash flows.

Foreign Currency

4. Cash flows arising from transactions in a foreign currency should only be recorded in an entity’s reporting currency by applying to the foreign currency amount the exchange rate at the date of the cash flow.

Audit Issues – Cash Flow Statement

5. An imbalance in the cashflow statement can often indicate a failure within the double entry applied to transactions throughout the year. Imbalances are particularly prevalent where entities have not brought in an accruals-based ledger system, relying on manual adjustments to the IT data. It is important, therefore, to undertake regular cash reconciliations, taking account of accrual adjustments.

6. Supporting schedules required by auditors may include:
   - Schedules supporting the allocation of cash flows between Operating, Investing and Financing activities.
   - Reconciliation schedules to support cash flows in the cash flow statement that differ in amounts from those disclosed in the main financial statements.
   - Schedules to support any disclosures for acquisitions or disposals of controlled entities.

7. Examples of issues identified during the course of audits include:
   - Inconsistencies between non-cash movements disclosed in the cash flow statement (indirect method) and those in the other financial statements e.g. depreciation.
   - When using the indirect method, it is important that the non-cash movements in the cash flow statement are the same as those in the notes to the accounts. A simple review of draft account figures should identify such discrepancies. Differences usually indicate that either the notes to the accounts or the cash flow statement are incorrect.
Employee Related Liabilities

1 There is currently no IPSAS that covers the treatment of employee related liabilities. However, the International Public Sector Accounting Standards Board have issued an Exposure Draft (ED 31) which addresses the accounting for employee related liabilities. The Exposure Draft is based on IAS 19 Employee Benefits, with the following key differences:

- When discounting liabilities, ED 31 requires entities to apply a risk-free rate based on the yields of government bonds with a currency and term consistent with the obligation. IAS 19 requires entities to apply a rate based on the yields of high quality corporate bonds with a currency and term consistent with the obligation; and

- On adoption, ED 31 and IAS 19 require entities to determine an initial liability for defined benefit plans. Where the liability is more or less than that accounted for under the entities previous accounting policies, ED 31 requires entities to recognise the difference immediately in opening accumulated surplus/deficits. IAS 19 allows entities to recognise any difference over a period of five years from the date of adoption.

2 Employee related liabilities are derived from the accruing or provision of employee related expenses, such as:

- Salaries;
- Annual leave;
- Other leave entitlements;
- Pensions;
- Redundancy payments; and
- Other employee benefits e.g. free healthcare.

3 For the majority of these expenses, the liability at the period end will be a straightforward calculation:

- Salaries – accrual for salaries due but not yet paid (based on payment amounts and payment dates), accrual of any performance related pay where the conditions for the payment have been met in year. Where these are significant but the conditions for payment have not been met at the period end, entities may consider the appropriateness of disclosure as contingent liability;

- Annual Leave – accrual of annual (and other) leave entitlements not taken (based on amounts of leave outstanding and any policies for the amount of annual leave that may be carried forward to the next period);

- Redundancy payments – accrual (or provision) for agreed amounts payable upon redundancy (based on amounts agreed, agreed take up rates and the date of agreed departure); and

- Other – will depend on the amount, nature and timing of the benefit.

4 The liabilities for pension entitlements, however, require more complex calculations. In order to meet the requirement of reliable measurement, such calculations are usually formed by an appointed actuary. However, there are still a number of steps entities must take to ensure that the liabilities (as calculated by the actuary) are complete and accurate:

- Identify all pension plans/payments relating to employees of the entity;
- Maintain details for the contributors and recipients of each plan;
- Identify those obligations that relate to the entity and those that may be reported at a different level e.g. whole of government;
Determine whether schemes are defined benefit or defined contribution plans (IAS 19 provides more detail);
Determine how schemes are funded and whether regular actuarial valuations are required to support the amounts of any unfunded liabilities;
Review changes in relevant legislation or authorities that may alter the extent and timing of future payments and therefore the amount of pension liability; and
Selection of an appropriate discount rate for calculating the present value of the liability.

Non-Exchange Revenue

5 ‘IPSAS 23 Revenue from Non-Exchange Transactions (Taxes and Transfers)’ was released in December 2006 to provide guidance on the treatment of revenue transactions where an entity receives resources for little or no consideration. For example, taxpayers pay taxes because the tax law mandates the payment of those taxes. Whilst the taxing government will provide a variety of public services to taxpayers, it does not do so in consideration for the payment of taxes or the receipt of a grant.

6 In identifying whether a transaction should be classified as exchange or non-exchange, the substance of the transaction will need to be examined. For example, the sale of goods would ordinarily be classed as an exchange transaction. If however, the transaction is conducted at a subsidised price (i.e. the price is not approximately equal to the fair value of the goods), the transaction would fall into the definition of a non-exchange transaction and accounted for in accordance with IPSAS 23. Entities may however receive trade, or other discounts, for a variety of reasons – in such instances, these transactions would not be classified as a non-exchange transaction. In determining the substance of a transaction, professional judgement should be exercised.

7 The main features of the IPSAS are:
Inflows of resources from non-exchange transactions are analysed to determine whether they should be recognised as an asset (and also whether a liability is also required to be recognised);
Recognition of assets at their fair value on the date of acquisition;
Liabilities recognised as a result of non-exchange transactions to be recognised in accordance with the principles of IPSAS 19;
Revenue equal to the increase in net assets associated to the inflow of resources to be recognised;
Specific guidance on the treatment of taxes and transfers;
Permits, but does not require, recognition of services in kind; and
Requires disclosures to be made in respect of revenue from non-exchange transactions.

Analysis of Inflows of Resources

8 The flowchart below provides a useful illustration of the process that entities should undertake in determining whether revenue has arisen.

Measurement

9 An asset acquired through a non-exchange transaction should initially be measured at its fair value at the date of acquisition.

10 The recognition and measurement of revenue in respect of non-exchange transactions is based on the fair value of the asset recognised to the extent that a liability is also recognised in respect of the same inflow (i.e. revenue is equal to the increase in net assets attributable to the transaction).

11 Where a liability has been recognised in respect of an inflow of resources from a non-exchange transaction (e.g. for advance receipts), at the same time it is released to revenue when the trigger event occurs.

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4 Defined benefit plans are schemes under which the pension entitlement is based on the employees’ remuneration and length of service. These are sometimes referred to as ‘Final Salary schemes’.
5 Defined contribution plans are schemes under which the employer and employee make specified contributions to the plan during a set period. The pension entitlements are then based on the value of the contributions at the beginning of the retirement period. These are sometimes referred to as ‘Money Purchase schemes’.
6 IPSAS 23 becomes effective for annual financial statements covering periods beginning on or after 30th June 2008, although early application is encouraged.
Analysis of Inflows of Resources

Reference: IPSAS 23 Revenue from non-exchange transactions, Dec 2006, IFAC

Does the inflow give rise to an item that meets the definition of an asset? (IPSAS 1)
- No
- Yes

Does the inflow satisfy the criteria for recognition as an asset? (IPSAS 23 Para 31)
- No
- Yes

Does the inflow result from a contribution from owners? (IPSAS 23 Para 37–38)
- No
- Yes

Is the transaction a non-exchange transaction? (IPSAS 23 Para 39–41)
- No
- Yes

Has the entity satisfied all of the present obligations related to the inflow? (IPSAS 23 Para 50–56)
- No
- Yes

Recognise:
- An asset and revenue to the extent that a liability is not also recognised; and
- A liability to the extent that the present obligations have been satisfied. (IPSAS 23 Para 44–45)

Reference: IPSAS 23 Revenue from non-exchange transactions, Dec 2006, IFAC
Taxes

12 Entities should recognise an asset in respect of taxes when the taxable event occurs and the asset recognition criteria are met.

13 The taxable event will vary depending on the taxation law and the variety of taxes levied, but in general, it is likely that the taxable event for:

- Income tax is the earning of assessable income during the taxation period;
- Value added tax is the undertaking of taxable activity during the taxation period;
- Goods and services tax is the purchase or sale of taxable goods and services during the taxation period;
- Customs duty is the movement of dutiable goods or services across the customs boundary;
- Death duty is the death of a person owning taxable property; and
- Property tax is the passing of the date on which the tax is levied or the period for which the tax is levied, if the tax is levied on a periodic basis, or at the transaction date if so related.

14 Assets arising from taxation should be measured at their fair value at the date of acquisition. This equates to the best estimate of the inflow of resources to the entity. The estimation for these assets should consider the probability that the resources will flow to the entity and also the fair value of the resultant assets.

15 Where there is a separation between the timing of the taxable event and the collection of taxes, entities may reliably measure assets arising from taxation transactions through the use of statistical modelling, based on the previous history of collecting such taxes. Such models should take account of the following:

- Timing of cash receipts;
- Declarations made by taxpayers;
- Relationship of taxation receivables to the performance of aspects of the economy;
- Filing point of tax returns;
- Valuing non-monetary assets for tax assessment purposes;
- Tax law allowing for extended periods for assessing taxes for certain taxpayers;
- Financial and political costs of tax enforcement outweighing the benefits received;
- Tax laws allowing for the deferment of some tax payments; and
- Other circumstances particular to individual taxes and jurisdictions.

16 Auditors will review assumptions and seek justification for the modelling used. Where third party experts are used, the auditors may wish to speak with them to test the sensitivities and validity of assumptions.

Transfers

17 Entities should recognise an asset in respect of transfers when the transferred resources meet the definition of an asset and satisfy the criteria for recognition as an asset (i.e. probable that the resources will flow to the entity and can be measured reliably).

18 Transfers include grants, debt forgiveness, fines, gifts, donations and goods and services in kind. All of these have the common attribute that the transfer of resources is not exchanged for approximately equal value (and are not taxes).

19 Assets arising from transfers should be measured at their fair value at the date of acquisition. This equates to the best estimate of the inflow of resources to the entity. The estimation for these assets should consider the probability that the resources will flow to the entity and also the fair value of the resultant assets.

20 The recognition and measurement of different types of transfers are shown below:

- Grants – grants should be recognised when all conditions attached to the receipt of the grant have been met. The value of the revenue recognised will represent the increase in net assets as a result of the grant. This should consider the need for the recognition of a liability as a result of the grant, for example where grants are issued in advance of when then they are to be utilised, or where it is not yet probable that attached conditions will be met.
- Debt Forgiveness – revenue should be recognised in respect of debt forgiveness when the relevant debt no longer meets the definition, or satisfies the recognition criteria, of a liability. The revenue would usually be measured at the carrying amount of the liability.
Fines – fines should be recognised when the receivable meets the definition of an asset and meets the recognition criteria. It is measured at the best estimate of the inflow of resources (usually cash) to the entity. It should be noted that where an entity collects fines in the capacity of an agent (i.e. it does not have control over the resources that are collected), the fine should not be recognised as revenue of the entity.

Gifts and Donations – gifts and donations are recognised as assets and revenue when it is probable that the future economic benefit will flow to the entity. As the making of the gift or donation is usually simultaneous with the transfer of legal deed, on transfer the revenue would be recognised.

Entities should ensure that where possible, the amounts of transfers recognised agree to those amounts disclosed in the published financial statements of the transferor.

Services In-Kind

Entities may, but are not required to, recognise services in-kind as revenue and as an asset. Examples of services in-kind include:

- Technical assistance or other resources from governments or other international organisations; and

- Volunteer assistance.

These services meet the definition of an asset because the entity controls the resource (which gives rise to future economic benefit or service potential). However, these assets are immediately consumed, and therefore the value of the asset is immediately reduced to nil and offset by an equal expense.

Where the service in-kind contributes to the construction of an asset, the amount recognised in respect of the services in-kind, are included in the cost of the asset. In either instance, the service in-kind is measured at the fair value of the service received.

In establishing the fair value of the service in-kind, entities should consider the market value of attaining the service from suitably qualified professionals, and additionally how the service delivery would differ if performed by a professional.

Entities may conclude that once these factors have been considered, the value of services in-kind are not material, and therefore do not require disclosure. However, entities should consider whether services received in-kind are material by their nature. For instance, they would be considered material if the entity was dependent on the class of services in-kind to meet its objectives.

Transitional Provisions

Entities are not required to change their accounting policies in respect of the recognition and measurement of taxation revenue for reporting periods beginning on a date within five years following the date of first adoption of IPSAS 23.

Entities are not required to change their accounting policies in respect of the recognition and measurement of revenue from non-exchange transactions, other than taxation revenue, for reporting periods beginning on a date within three years following the date of first adoption of IPSAS 23.

Changes in accounting policies in respect of recognition and measurement of revenue from non-exchange transactions, made before the expiration of the permitted transitional periods identified above, shall only be made to better conform to the accounting policies of IPSAS 23. Accounting policies may be changed on a class by class basis.

Where an entity takes advantage of the transitional provisions, this must be disclosed in the accounting policies. Further, entities should disclose their plans for implementing accounting policies that are consistent with IPSAS 23. As classes of non-exchange revenue are recognised in accordance with IPSAS 23, but were previously recognised under another basis, this fact should be disclosed in the accounting policies.
Segment Reporting

31 In IPSAS 18, a segment is defined as a distinguishable activity or group of activities of an entity for which it is appropriate to separately report financial information for the purpose of evaluating the entity’s past performance in achieving its objectives and for making decisions about the future allocation of resources.

32 In most cases, the major classifications of activities identified in budget documentation will reflect the segments for which information is reported to the governing body and the most senior manager of the entity.

33 Determining the activities which should be grouped together as separate segments and reported in the financial statements involves judgement. However, in reaching this judgement entities should consider factors including the expectations of stakeholders; relevance, reliability and comparability of the financial statements and whether the segments reflect the basis on which decisions are made by senior management and the governing body.

34 Segments reported to senior management are often referred to as service segments or geographical segments.

- Service segments – refers to a distinguishable component of an entity that is engaged in providing related outputs or achieving particular operating objectives consistent with the overall mission of each entity; and
- Geographical segments – refers to a distinguishable component of an entity that is engaged in providing outputs or achieving particular operating objectives within a particular geographical area.

35 Factors that would be considered in determining whether outputs are related and should be grouped as segments for financial reporting purposes include:

- The primary operating objectives of the entity and the goods, services and activities that relate to the achievement of each of those objectives and whether resources are allocated and budgeted on the basis of groups of goods and services;
- The nature of the goods or services provided or activities undertaken;
- The nature of the production process and/or service delivery and distribution process or mechanism;
- The type of customer or consumer for the goods or services;
- Whether this reflects the way in which the entity is managed and financial information is reported to senior management and the governing body; and
- If applicable, the nature of the regulatory environment.

36 Factors that would be considered in determining whether financial information should be reported on a geographical basis include:

- Similarity of economic, social and political conditions in different regions;
- Relationships between the primary objectives of the entity and the different regions;
- Whether service delivery characteristics and operating conditions differ in different regions;
- Whether this reflects the way in which the entity is managed and financial information is reported to senior management and the governing board; and
- Special needs, skills or risks associated with operations in a particular area.

37 In some cases, an entity may report to the senior management and governing body on the basis of more than one segment structure. In this case, the segments may be reported separately as a matrix. In addition, a primary and secondary segment reporting structure may be adopted with only limited disclosures made about secondary segments.

Audit issues for other topics

38 Auditors should be engaged at an early stage of policy formulation and system implementation where issues covered by the standards listed within this section may affect the classification of transactions or balances within the financial statements.

Related Parties

39 Related party relationships exist throughout the public sector. IPSAS 20 requires the disclosure of the existence of related party relationships where control exists; and the disclosure of information about transactions between the entity and its related parties in certain circumstances.
Parties are defined as related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions or if the related party entity and another entity are subject to common control. Related parties include:

- Entities that directly, or indirectly through one or more intermediaries, control, or are controlled by the reporting entity;
- Associates;
- Individuals owning, directly or indirectly, an interest in the reporting entity that gives them significant influence over the entity, and close members of the family of any such individual;
- Key management personnel, and close members of the family of key management personnel; and
- Entities in which a substantial ownership interest is held, directly or indirectly, by any person described above, or over which such a person is able to exercise significant influence.

Related party transactions are transfers of resources or obligations between related parties, regardless of whether a price is charged. However, they exclude transactions with any other entity that is a related party:

- Solely because of its economic dependence on the reporting entity or the government of which it forms part, such as funding grants; and
- That are within the normal operating procedures of the reporting entity, such as staff salaries or transactions between entities within the same financial reporting group.

To comply with the requirements of IPSAS 20, entities are required to:

- Identify all of its related parties;
- Identify and maintain records of the relevant related party transactions. These records should outline:
  - The nature of the related party relationships;
  - Types of transactions that have occurred; and other elements of the transactions necessary to clarify the significance of the transactions to its operations such as the terms and conditions of these transactions;

- Identify and disclose all of the remuneration and benefits (both direct and indirect) of key management personnel and their close family members derived from the reporting entity;
- Identify loans provided to key management personnel and their close family members, the availability of which is not widely available to persons who are outside the key management group or which are not widely known by the public. Management should establish policies and criteria on when and how such loans can be approved. Entities providing these types of loans should have systems that are able to generate:
  - The amount advanced and the terms and conditions thereof;
  - The amount repaid during the period and the closing balance of all loans and receivables; and
  - Where the recipient is not a member of the governing body nor part of the senior management, the relationship of the individual as such.

Definitions for the following key terms can be found in Paragraph 4 of IPSAS 20:

- Close members of the family of an individual;
- Key management personnel;
- Related party;
- Remuneration of key management personnel; and
- Significant influence.

Topics not covered in this guide

There are a number of topics that have not been covered in this guide, but are within the scope of the IPSAS. These topics include:

General standards

- IPSAS 13 Leases – sets out guidance on how to identify assets held under a lease and how such leases should be reported in the financial statements. The guiding principle is to recognise where risks and rewards lie and ensure that appropriate presentation of commitments are within the accounts. Details of leases should be provided for audit, including terms and payment schedules.
IPSAS 14 Events after the Reporting Date – sets out guidance on how entities should report on events that occur after the reporting date, but before the financial statements are authorised for issue. Auditors will review relevant documentation and seek verbal and written representations from management on the impact of events occurring in this period of the information presented within the accounts.

Specialist standards

Entities should liaise with their auditors on how to apply these standards to their circumstances:

- IPSAS 6 Consolidated Financial Statements and Accounting for Controlled Entities – sets out guidance on identifying controlled entities, identifying which entities should be consolidated and describing how consolidated financial statements should be produced.

- IPSAS 7 Accounting for Investments in Associates – sets out guidance on identifying associates and how investments in associates should be treated in both the entity’s and the group’s financial statements.

- IPSAS 8 Financial Reporting of interests in Joint Ventures – sets out guidance on identifying joint venture interests and how investments in joint ventures should be treated in both the entity’s and group’s financial statements.

- IPSAS 10 Financial Reporting in Hyperinflationary Economies – sets out guidance on how financial statements should be produced for entities reporting in the currency of a hyperinflationary economy.

- IPSAS 22 Disclosure General Government Sector – sets out guidance on the disclosures that are required in consolidated financial statements produced by Governments.
Step 1
Develop policies:
- Identify authoritative standards;
- Develop capitalisation thresholds;
- Identify measurement policies for each class of asset;
- Develop policy on the capitalisation of upgrade expenditure;
- Develop depreciation methods; and
- Develop impairment policy.

Step 2
Identify the information that will be required to meet the policies etc. identified in Step 1.
Plan timetables and responsibilities for collecting information (and validating such information).

Step 3
Develop the asset register.

Step 4
Determine the opening balances for assets:
- Obtain historic cost information; and
- Obtain valuations where required.

Ongoing
Ongoing issues:
- Maintain the asset register, updating for all asset movements throughout the year, and reconcile to ledger;
- Calculate depreciation;
- Carry out regular revaluations (where applicable); and
- Carry out regular existence and obsolescence reviews.

Reference: Transition to the accrual basis of accounting: Guidance for governments and government entities, Dec 2003, IFAC
Suggestions for developing instructions for valuers include:

1. The classes of assets should be clearly defined.

2. The basis of valuation should conform to the accounting policies adopted by the entity.

3. The requirement should be to value all defined assets on a site, NOT to value assets in a given list. A draft list may be provided, but it should be part of the requirement that the valuers establish that it is complete.

4. The valuers should be required to provide, for each asset, both a value and an estimated useful life.

5. Implementation of a capitalisation threshold implies that a proportion of the asset value will not be included in the Balance Sheet. Entities have to make a judgement about whether the proportion of assets excluded by application of the threshold is acceptable. For this judgement to be made a relatively low threshold must be used in the valuation. Subsequent analysis may reveal that a higher threshold is acceptable for compilation of the asset register and for inclusion in the financial statements.

6. For the first valuation, it is important not to prejudge the threshold to be used for the asset register and then value assets covered by that threshold. The threshold for inclusion in the valuation report should be applied to gross replacement cost and not the net book value.

7. Where there is a large population of small value assets (e.g. a network of computer terminals) there may be scope for treating a group of items as a single asset.

8. Valuations should state explicitly whether they are inclusive of Value Added Tax (Goods and Services Tax). Non-recoverable VAT should be included in valuations arrived at on the basis of replacement cost, but not in (any) valuations arrived at on the basis of disposal value.
ANNEX THREE

Decision Tree – Recognition of Provisions

Potential liability identified

Definite current obligation as a result of a past event?

Yes

Probable outflow of resource?

Yes

Equivalent estimate?

Yes

Recognise liability as a provision

No

Potential obligation?

Yes

Is likelihood very remote?

Yes

No

No (exceptional)

No requirement to report

The International Federation of Accountants (IFAC) is the global organisation of the accounting profession. One of its key missions is to establish and promote adherence to high quality professional standards, such as IPSAS.

The International Public Sector Accounting Standards Board (IPSASB) focuses on the accounting and financial reporting needs of the public sector – including national and regional governments, government related agencies and the constituencies that they serve. They are principally responsible for issuing and promoting benchmark guidance to the public sector community.

The United Nations Task Force on Accounting Standards has been tasked by the General Assembly to provide interpretation and guidance on IPSAS for the UN organisations as part of its co-ordination of the transition to IPSAS in the UN system.