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PUBLIC SECTOR ACCOUNTING

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CHAPTER 8
IPSAS CONCEPTUAL FRAMEWORK AND
VIEWS ON SELECTED NATIONAL FRAMEWORKS

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SUMMARY

This chapter is about conceptual frameworks in public sector accounting, particularly addressing the IPSAS conceptual framework. While taking this as a reference, the chapter also offers brief views on selected national frameworks from a group of European countries—namely the UK, Finland, Austria, Germany and Portugal—, as illustrative examples of how conceptual frameworks can approximate or diverge from that of IPSASB.

The explanations enable an understanding of the role of a conceptual framework underlying public sector accounting standards, as well as the main issues normally included in it.

KEYWORDS

financial information, users, qualitative characteristics, elements of financial statements, measurement criteria

1. Introduction

The beginnings of accounting conceptual frameworks (CFs) may be found in the 1930s in the USA, originating in the accounting profession. A clear attempt to reach an accounting theory was the American Accounting Association 1966 “*A Statement of Basic Accounting Theory*” (ASOBAT)¹. However, it was not before 1973, with the creation of the Financial Accounting Standards Board (FASB), that accounting conceptual frameworks began to be discussed and developed across countries, starting from the Anglo-Saxon world.

FASB’s CF, started in 1973, was the major and most complete one, comprising several statements on a wide range of financial accounting and reporting matters (e.g., objectives of financial reporting, qualitative characteristics of accounting information, elements of financial statements, recognition and measurement in financial statements, and presentation of financial statements). This work has inspired others, such as those from the Accounting Standards Committee in UK, and more recently, that from the International Accounting Standards Board (IASB).

As to public sector accounting (PSA), the origins of its CFs come from the USA as well, being derived from those of business accounting, at least in the last forty years. Separating between federal accounting and governmental accounting for state and local level, the latter followed, since the 1930s, principles and standards issued by a national council (currently the Governmental Accounting Standards Board – GASB). However, at the beginning of the 1980s, FASB, which was concerned explicitly with business organizations, started to concern itself with nonbusiness organizations too, issuing a statement on the objectives of financial reporting by nonbusiness organizations, conflicting with GASB’s responsibilities². Nowadays, GASB focuses on state and local government accounting, including non-for-profit public sector units. Since its establishment in 1984, GASB has initiated its own CF, starting from the FASB’s framework; currently, some important

¹ Jones (1992).

² Jones (1992).

pronouncements are GASB Concept Statements no. 1 (1987), no. 4 (2007) and no. 6 (2014). At the federal level, there is the Federal Accounting Standards Advisory Board (FASAB) *Handbook of Federal Accounting Standards and Other Pronouncements* (2012), including the Statements of Federal Financial Accounting Concepts no.1 to no.7.

While, in principle, there should be only one commonly accepted (financial) accounting theory, historically derived from practice, it is acknowledged that, even within business accounting, developing a single generally accepted accounting CF is not easy. Additionally, considering that accounting is to be a purposive activity, aimed at producing and reporting information that must be useful for somebody to do something,³ the development of accounting CFs has been based on approaches considering the users of financial accounting reports and their needs,⁴ which, in turn, are determined by the context where they act. Environment is deemed to determine the objectives of accounting information and consequently other dimensions of the accounting CF.⁵

This explains why, although based on business accounting, specific CFs (as standards) have been especially derived and developed for PSA. Even those who argue for 'one single world of accounting' recognize that there might be context specifics determining PSA particularities, hence requiring its CF to reflect differences (e.g., different concepts and different interpretations of principles), at least at a detailed level, from the one for financial accounting overall.

Accordingly, though deriving from the IASB's CF, the IPSASB (2014) published a specific CF for PSA, considering the following public sector specific characteristics⁶:

- The primary objective of delivering public services – rather than to make profits and generate a return on equity for investors; requires

³ Jones and Pendlebury (2010).

⁴ Jones (1992).

⁵ Vela Bargues (1992).

⁶ See IPSASB (2014, preface).

- information beyond financial position, financial performance and cash flows, to properly evaluate the performance of public sector entities;
- Non-exchange transactions (e.g., taxes and grants) – the involuntary and compulsory nature of major contributions makes accountability an overriding purpose of GPFs;
 - A budget to be accomplished – considering the budget as an instrument of public policy and a law, GPFs must report on the budget (public policies) accomplishment;
 - Nature of the programs and longevity of the public sector – financial statements have to be complemented with information allowing the assessment of sustainability in the long run, and the going concern principle cannot be assessed only by the net financial position;
 - Nature and purpose of public sector assets and liabilities – there are infrastructure and other public domain assets (e.g., heritage, military assets) difficult to measure and with no market; entities assume certain liabilities in order to provide a public service (e.g., the provision of social benefits);
 - The regulatory role of public sector entities – in order to safeguard public interest or bring the market to function; judgment is required to evaluate whether the regulatory role creates assets or liabilities;
 - Relationship to statistical reporting – public sector accounts, namely concerning the General Government Sector, are input for the National Accounts and Government Financial Statistics – convergence is needed but differences remain.

In the European context, some diversity can be found regarding public sector accounting CFs. While the UK is IFRS-based (e.g., *The Government Financial Reporting Manual – FreM*, revised on an annual basis), in Continental countries there are some IPSASB's adopters (e.g., Spain, Portugal, France and Austria), whereas others are based on deeply-rooted national traditions, even though some concepts of the IPSASB's might be adopted (e.g., Germany and Finland).

This chapter continues discussing the definition and role of a CF and the authority of the IPSASB's CF over the standards or recommended

practice guidelines. It follows by presenting and explaining the main topics addressed in the IPSASB's CF. In a first part, the objectives, users and qualitative characteristics of the GPFR information are introduced; and in a second part, the definitions, recognition and measurement criteria for the elements within the financial statements are discussed. Finally, it presents a comparative-international analysis of the principal topics/concepts included in the frameworks of a group of European countries (Austria, Finland, Germany, Portugal and the UK) taking the IPSASB's CF as a benchmark.

2. The role of the CF *versus* the public sector accounting standards

The literature has presented several definitions for a CF in accounting, emphasizing different elements, either focusing on its contents, or on its purposes.⁷ However, commonalities point to a definition of a CF that, in the first place, embraces accounting objectives that will guide the establishment of fundamental principles and key concepts, which, in turn, will be followed by more procedure-oriented standards.

The IPSAS CF presents a definition as a basic theoretical structure addressing the main elements of the financial statements, which

establishes the concepts that underpin general purpose financial reporting [...] by public sector entities that adopt the accrual basis of accounting.⁸

These concepts are assets, liabilities, revenue, expenses, net financial position, ownership contributions and ownership distributions, for which the CF also outlines recognition and measurement criteria to be considered overall in the standards. The CF also defines the objectives and main users of GPFRs, and the qualitative characteristics of financial information.

The IPSAS CF applies to GPFRs of governments at all levels, as well as to other public sector entities.

⁷ Vela BARGUES (1992).

⁸ IPSASB (2014, CF 1.1).

Historically, because accounting theory has developed from practice,⁹ CFs follow the standards, and not the opposite. Therefore, reasons for the existence of accounting CFs include the need to have harmonized concepts – a common explicit theoretical reference (set of concepts and principles based on postulates or premises) capable of giving coherence to accounting practices, and on which rules (standards) and recommendations must rest – and to give legitimacy to the standards themselves and to the work of standard-setters.¹⁰

Therefore, the CF is not a standard, as it does not offer (binding) guidance for recognizing, measuring, presenting and disclosing specific transactions or topics. These authoritative requirements are for the IPSAS, and in cases of conflict between these and the CF, the standards requirements prevail.¹¹

Overall, the main purposes and importance of a CF in PSA may be summarized as:

- To support *preparers* of the financial statements, in the application of (accrual-based) PSA standards (e.g., IPSAS and future EPSAS) and in the accounting treatment of topics that become relevant as a matter of the standards;
- To help in forming opinion about the adequacy of the financial statements to the standards (*auditors'* perspective);
- To support *users* in the interpretation of the information within the financial statements prepared by public sector entities; and
- To offer PSA *standard-setters* the proper concepts needed to prepare PSA standards.

CFs are accounting theory, and hence, conventionally concerned with financial accounting. They do not address management accounting, because they are concerned with accounting for external providers of finance¹²;

⁹ Jones and Pendlebury (2000).

¹⁰ Jones (1992); Jones and Pendlebury (2000).

¹¹ IPSASB (2014, CF 1.2-1.3).

¹² Jones and Pendlebury (2000).

they do not embrace budgeting either, perhaps because budget theory has much to do with political science and also with economics, particularly public finance, which do not seem so attractive for accounting theorists (academics/researchers) and even less for professionals.

Nevertheless, in some jurisdictions, like in Portugal, there was a need to create a CF also for budgetary (cash-based) accounting and reporting, defining specific principles and terms – some terms with a similar designation in financial accounting have different meanings in budgetary accounting – e.g., revenue/expenditure, current/non-current, financial assets/liabilities¹³.

The IPSAS CF does not refer particularly to budgetary reporting. However, as explained in other chapters, the scope of GPFs admittedly embraces information and statements to report also on how budgets have been accomplished.

3. The IPSAS CF – part I

The IPSAS CF is nowadays the only one existent at an international level, with wider geographic scope and resorting to the CFs from FASAB, GASB and specially that of IASB, as sources of inspiration. Therefore, the remainder of this chapter concentrates on the IPSAS CF as the main international benchmark.

Like the IPSAS, the CF is not obligatory, as the IPSASB does not have enforcement power; to be in force, IPSAS must be formally and/or legally adopted by each country or jurisdiction. Moreover, as explained, standard requirements supersede CF principles.

¹³ See Decree-Law 192/2015 – NCP 26, PORTUGAL, DECRETO-LEI n°192/2015, of 11 September, Sistema de Normalização Contabilística para as Administrações Públicas (SNC-AP).

3.1. Objectives and main users of financial reporting within the public sector

Most of the CFs for national governments developed during the 1980s used a user/user needs approach, implying that the objectives of GPFs, hence their usefulness, have been determined by the users' needs, considering integral and differential approaches.¹⁴ Some criticisms have been made, in regard to the fact that the users and needs considered are, in reality, potential; they do not result from empirical studies, but rather from assertions and normative approaches.¹⁵ The lack of 'verifiability' is

(...) symptomatic of a continuing problem with the user/user needs approach of financial reporting theory: we are still not clear that a substantial number of users exist.¹⁶

Due to the difficulties in identifying who the real users of public sector GPFs are, ultimately, one could say that, in a democratic regime, everyone in the population could be assumed to be a user or potential user of the accounts of public sector organizations. This, however, would create serious problems in identifying their information needs and defining statements in order to satisfy them. Still, in democratic contexts, there is a governmental duty to be publicly accountable, so accountability is an implicit objective of public sector GPFs, regardless of who the users are and what their needs might be.¹⁷

Given that GPFs in the public sector seem to be particularly oriented to external users, decision-making needs have been added and explicitly considered in CFs, also derived from business accounting.

Nevertheless, users' needs (GPFs purposes) for accountability and decision-making seem to be rather controversial within the public sector

¹⁴ Jones and Pendlebury (2000).

¹⁵ Jones (1992); Rutherford (1992).

¹⁶ Jones and Pendlebury (2000, p. 138).

¹⁷ Jones and Pendlebury (2000).

context. For example, Jones (1992, p.260) explains that the 'accountability' notion should somehow have implicit the 'decision-making':

(...) accountability must imply some purpose for some external user and that, however casual the decision might be, the purpose must lead to a decision: if the accountee is entirely passive, accountability surely must be an empty notion.

Moreover, even if

There is no difficulty in identifying parties who are unequivocally external to a public sector organisation who might in principle be users of financial reports (e.g., *taxpayers, voters, service recipients, investors*). (...) There is, however, a difficulty in identifying the decisions which a rational actor falling within one of these classes might seek to take by employing the general purpose statements of any government unit. [italics provided]¹⁸

Rutherford (1992) argues that there are no rational reasons to consider that citizens, even as voters and taxpayers, are indeed users of information for decision making, although it might be admissible that certain experts, such as the *media* and policy analysts, are users of public sector financial information on their behalf. However, in the context of control and accountability, the author admits a variety of intermediate users who might be considered internal from one perspective and external from another. Politicians in central government are an example: they are internal users as decision-makers within the government on the one hand, but they are external users while exerting their oversight role on lower-level governments or agencies. Parliamentarians are another example: in principle, they are capable of demanding any information they want; nonetheless, in practice, they exert a limited power of control, making them act as external users, using the financial reports of government and public sector entities at large for the purposes of assessing accountability and general compliance with the legislation (e.g., budgetary restrictions).

¹⁸ Rutherford (1992, p. 267).

Getting around these controversies, the IPSASB has followed a normative and prescriptive approach while addressing the objectives and users of GPFs. Accordingly,

The objectives of financial reporting by public sector entities are to provide information about the entity that is useful to users of GPFs for accountability purposes and for decision-making purposes.¹⁹

Several (potential) users are considered, distinguishing between primary users and others, as in Table 8.1.

Primary users	Other users
<ul style="list-style-type: none"> • Service recipients and their representatives • Taxpayers and their representatives • Resource providers (investors/markets, donor agencies,...) 	<ul style="list-style-type: none"> • Government statisticians • Analysts and financial advisors • <i>Media</i> • Regulators and oversight bodies • Audit institutions and control bodies (e.g., General Audit Office; Court of Audit,...) • Parliamentary or government committees • Public interest and lobby groups and others (e.g. rating agencies; entity management,...)

Table 8.1: Users of GPFs
Source: IPSASB (2014, CF 2)

The main users of GPFs in the public sector

do not possess the authority to require a public sector entity to disclose the information they need for accountability and decision-making purposes.²⁰

¹⁹ IPSASB (2014, CF 2.1).
²⁰ IPSASB (2014, CF 2.4).

Politicians are the representatives of service recipients, taxpayers and citizens at large. They are assumed to make extensive and ongoing use of GPFs when acting in that capacity.²¹

In view of the above discussion, questions may arise about whether all those considered by the IPSASB are, in reality, users of GPFs in the public sector, or whether they are only ‘addressees’ or stakeholders. Given that the discussion about financial information users and their needs is a recurring topic in the accounting field, recently there has been another attempt to shed some light on the matter, particularly addressing the use by politicians.²²

Despite the lack of empirical evidence, the IPSASB assumes the following as the main information needs of users of GPFs in the public sector:²³

1. Performance (accomplishment of operational and financial objectives; resource management; compliance with regulation and laws);
2. Liquidity and solvency of the entity;
3. The sustainability of the entity’s service delivery and other operations over the long term;
4. Whether resources are used economically, efficiently, effectively and as intended;
5. Whether the volume and cost of services provided during the reporting period are appropriate;
6. Whether levels of taxes or other resources raised are enough to maintain the volume and quality of services;
7. How current operations are being funded (taxes, borrowing, other sources...); and
8. Future funding needs and sources.

While 1 to 3 are common to both service recipients and resource providers, 4 to 6 are more specific to the former and 7 and 8 to the latter.

²¹ IPSASB (2014, CF 2.4).

²² See, for example, Jorge et al. (2016) and other authors in that issue.

²³ IPSASB (2014, CF 2).

3.2. Main accounting principles

There are main accounting principles constituting important postulates or assumptions in PSA, the interpretation of which might be different from that in business accounting. Even if generally developed in other chapters, these principles – **accrual**, **going concern** and **substance over form** – are addressed here, within the IPSAS perspective.

Like in business accounting, in PSA under IPSAS the **accrual regime** prevails in financial accounting – transactions are recognized when they occur (and not when cash or equivalent is received or paid); transactions and events are recorded and recognized in the financial statements of the periods to which they relate. Elements to be recognized are assets/liabilities, expenses/revenue and net assets/equity.²⁴ Still, the application of the matching concept required under this principle is problematic in public sector organizations, questioning the meaning of the deficit/surplus in the financial performance statement and raising a need to consider non-financial performance reporting as a complement.

Unlike IFRS-based business accounting, under IPSAS, a cash regime might also be used in financial accounting. Within most European countries, this prevails in budgetary accounting, recognizing transactions only when cash or equivalent is received or paid; statements provide information on sources of cash raised during the period, the purposes for which cash was used, and the balance at the reporting date. Elements to be recognized are cash expenditure – payments, and cash revenue – receipts.²⁵

Still, overall, budgetary accounting is not a synonym of cash accounting; in fact, budgetary accounting might also be accrual-based (e.g., in UK and Austrian central government, and in German local government), and in accrual-based reporting there is cash-based information too, such as in the cash-flow statement.

²⁴ IPSASB (2018, IPSAS 1.7).

²⁵ IPSASB (2018, Cash Basis IPSAS 1.2.2).

Another important principle is the **going concern**, by which

Financial statements must be prepared on a going concern basis, unless there is an intention to liquidate the entity or to cease operating, or if there is no realistic alternative but to do so.²⁶

While this appears to be similar to business accounting, a different interpretation is required in the public sector context: instead of considering financial viability issues (essentially reflected in the net financial position), a long-term perspective of financial sustainability must be considered, pointing to continuity in public service provision.

As in businesses, material uncertainty might raise doubts about an entity's ability to continue. Yet, in the public sector, not only tests of liquidity and solvency are important, but other (non-financial) issues (e.g., power to levy taxes, multi-year funding agreements, merging, restructuring, etc.) are, too, so the going concern relates to the ability of maintaining public service provision as expected.

Finally, there is the **substance-over-legal-form** principle, by which

Information that faithfully represents an economic or other phenomenon depicts the substance of the underlying transaction, other event, activity or circumstance – which is not necessarily always the same as its legal form.²⁷

The legal form is associated to ownership that may lead, e.g., to the legal property of assets.

While this has been a generally accepted accounting principle in business accounting, in the public sector it is not, as such. The legality principle is linked to traditional PSA; therefore, it has prevailed in some jurisdictions, like in Portugal, although substance over legal form was considered applicable in particular cases (e.g., financial leases and public domain assets). As a general principle underlying IPSAS, it has significant implications in jurisdictions where the legality principle used to override

²⁶ IPSASB (2018, IPSAS 1.38).

²⁷ IPSASB (2014, CF 3.10).

(e.g., Portugal). An IPSAS-based accounting system implies economic control criteria to prevail over ownership and legal-based control criteria, hence, as it was significant changes in asset recognition in countries where the legality principle used to prevail.

3.3. Qualitative characteristics (and main constraints) of the financial information

In order to be useful, information included in GPFs of public sector entities must contain certain attributes. The IPSAS CF explains that these qualitative characteristics are: **relevance, faithful representation, understandability, timeliness, comparability, and verifiability**,²⁸ with no particular hierarchy of importance. The IPSAS CF vastly develops these issues,²⁹ which may be summarized as follows.

Financial and non-financial information is said to have relevance when it ‘makes a difference’ in achieving the objectives of financial reporting. In order to be relevant, information must have confirmatory value, predictive value, or both, the confirmatory and predictive roles of information being interrelated (e.g., historical information helps to make judgments about the future). Materiality establishes the quantitative threshold for relevance.

Information must be a faithful representation of the economic and other phenomena that it purports to represent. The presentation of the phenomena must be neutral (neither biased, nor intentionally selected), complete (without material omissions) and as free from error as is possible.³⁰ Free from error does not mean complete accuracy in all respects; instead, it means there are no errors or omissions individually or collectively material in the description of the phenomenon.

Faithful representation also implies depicting the substance of the underlying transaction, using prudence while making judgments needed

²⁸ IPSASB (2014, CF 3.2).

²⁹ IPSASB (2014, CF 3).

³⁰ IPSASB (2014, CF 3.14).

under conditions of uncertainty (e.g., in making estimates, such that assets or revenue are not overstated, and liabilities or expenses are not understated); these judgments might not be so neutral.

To be useful, information must also be understood by the users, implying a certain balance between complexity and simplicity, and using plain language; understandability may be enhanced by comparability. Users are assumed to have reasonable knowledge about the entity and be able to read its financial information.

Information must be made available before it loses its capacity to be useful; if it is delayed, relevance might be jeopardized, so timeliness is a critical quality of financial information. Still, some items may continue to be useful for long periods after the reporting date.

Information must also be comparable (in time and in space), allowing users to identify similarities and differences between two sets of phenomena. Comparability differs from consistency and uniformity (same accounting principles/policies), although consistency is required to assure comparability.

Finally, information must be verifiable, to help ensuring that it faithfully represents the economic and other phenomena that it purports to represent. Also referred to as 'supportability',³¹ verifiability means that information must be supported by evidence, allowing independent observers to reach a consensus that it appropriately reflects the entity's reality. Verification may be done directly (e.g., counting cash), or indirectly (e.g., calculating the carrying amount of inventory).

There are issues constraining the attainment of the above qualitative characteristics, and, as also acknowledged by the IPSAS CF, the balance between them is not easy, as they sometimes conflict. Figure 8.1 illustrates this.

³¹ IPSASB (2014, CF 3.26).

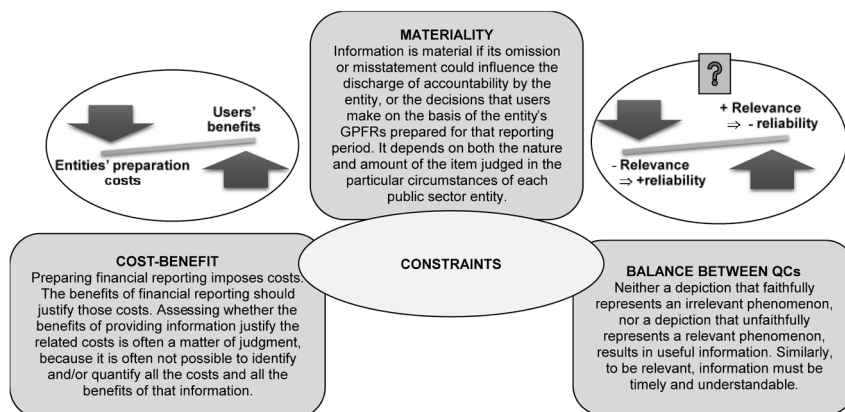


Figure 8.1: Qualitative characteristics (QCs) – balance and constraints
 Source: IPSASB (2014, CF 3.32-3.42)

4. The IPSAS CF – part II

This section explains the principal elements of the financial statements, and their recognition and measurement criteria, as in the IPSAS CF.³²

4.1. Elements of the financial statements

Financial statements are demonstrations representing the financial and economic reality of a public sector entity. Main financial statements are: statement of financial position, statement of financial performance, cash flow statement, statement of changes in net assets, and notes (*IPSAS 1 – Presentation of financial statements* and *IPSAS 2 – Cash Flow Statements*). Overall, they reflect the financial effects of transactions and other events, by grouping them into broad classes which share common economic characteristics – these are called elements of financial statements.

Demonstrating the entity's financial position includes: assets (plus other resources), liabilities (plus other obligations), ownership contributions

³² IPSASB (2014, CF 5 to 7).

and ownership distributions. Other resources and other obligations refer to deferred outflows and inflows, respectively. The 'net financial position' presented in this statement, also called Balance Sheet, is

(...) the difference between assets and liabilities after adding other resources and deducting other obligations recognized in the statement of financial position. Net financial position can be a positive or negative residual amount.³³

Revenue and expenses are the elements to demonstrate the entity's financial performance, in a statement where the bottom line is the (accrual-based) deficit or surplus.

Recognizing items in these elements means incorporating them in the amounts displayed on the face of the appropriate financial statements, in accordance with the criteria established in the CF.³⁴ Overall, recognition criteria require that the item satisfies the definition of the element, and that it can be measured with reliability.

Therefore, understanding the definitions of each type of element of the financial statements in the public sector setting is critical, as these identify recognition criteria.

An **asset** is defined as a resource presently controlled by the entity as a result of a past event, with service potential or the ability to generate economic benefits.³⁵

Consequently, as in the private sector, also considering the substance over legal form, ownership is not a requirement for an asset to be recognized in a public sector entity. Controlling the resource, instead, is critical, meaning the entity has the ability: to use the resource (or direct other parties on its use) so as to derive the benefit of the service potential or economic benefits embodied in it; or to determine the nature and the way other entities make use of the economic benefits generated by the resource.³⁶

³³ IPSAS (2014, CF 5.28).

³⁴ IPSASB (2014, CF 6).

³⁵ IPSASB (2014, CF 5.6-5.7).

³⁶ IPSASB (2014, CF 5.11-5.12).

A past transaction is also a requirement leading to the present control of an asset; it may result from internal development, an exchange (e.g., purchase) or non-exchange transaction (e.g., donation or the exercise of sovereign tax powers).³⁷

The service potential is the distinctive factor in the definition compared to business accounting, given that many assets in the public sector do not generate economic benefits. It refers to the asset's capacity to provide services that contribute to achieving the entity's objectives, without necessarily generating net cash inflows or equivalents for the entity (e.g., recreational, heritage, community, and defense assets),

(...) which are held by governments and other public sector entities, and which are used to provide services to third parties. Such services may be for collective or individual consumption.³⁸

Still, some assets also generate future economic benefits, i.e., cash or equivalent inflows (or a reduction in cash or equivalent outflows), derived from an asset's use in the production and sale of services (e.g., water provision), or from the direct exchange of an asset for cash or other resources.³⁹

A **liability** is a present obligation of the entity for an outflow of resources, which results from a past event.⁴⁰ It has to be a binding obligation (either legally or non-legally), regarding which an entity has little or no realistic alternative to avoid an outflow of resources; therefore, it implies an outflow of resources from the entity for it to be settled, and it is always towards a third party. It may be originated by an exchange or a non-exchange transaction. The past event leading to the present obligation might be more or less straightforward to identify, depending on whether an arrangement has a legal form and is binding, or not.⁴¹ For example, an

³⁷ IPSASB (2014, CF 5.13).

³⁸ IPSASB (2014, CF 5.9).

³⁹ IPSASB (2014, CF 5.10).

⁴⁰ IPSASB (2014, CF 5.14).

⁴¹ IPSASB (2014, CF 5.15-5.26).

invoice coming from a contract with a supplier undoubtedly generates a present obligation; however, a legal suit in court may require the entity to assess whether there will be a liability – the outflow might not be certain yet and/or might not be reliably measured.

Therefore, a legal obligation, enforceable in law (even if it may arise from a variety of legal constructs), gives rise to a liability. But, a non-legal (though binding) obligation, because the party to whom the obligation exists cannot take legal (or equivalent) action to enforce settlement, only gives rise to a liability under certain conditions. These are:⁴²

- The entity has indicated to other parties that it will accept certain responsibilities;
- The entity has created a valid expectation of those other parties that it will discharge those responsibilities;
- The entity has little or no realistic alternative to avoid settling the obligation arising from those responsibilities.

Accordingly, in a government setting, political promises do not give rise to these types of obligations.

Ownership contributions and distributions, for (from) the net financial position, are inflows (outflows) of resources to an (from the) entity, contributed by (distributed to) external parties in their capacity as owners, which establish or increase (return or reduce) an interest in the Net Financial Position of the entity.⁴³

Although these notions are more related to business accounting, they may also apply in public sector organizations, e.g., in business-type government entities with shareholders, applying PSA standards. The figure of ‘the owner’ and ownership interests may arise when one entity contributes resources to provide another entity with the capacity to start operational activities. This is the case in public hospitals in Portugal, which

⁴² IPSASB (2014, CF 5.23).

⁴³ IPSASB (2014, CF 5.33-5.37).

are companies under the business law, owned by the government and subject to the public sector accounting system.

In the public sector, contributions to, and distributions from, entities are sometimes linked to the restructuring of government [or of public sector organizations] and will take the form of transfers of assets and liabilities rather than cash transactions.⁴⁴

Ownership distributions may derive from: a return on investment; a full or partial return of investment; or a return of any residual resources, in the event of the entity being wound up or restructured.⁴⁵

Revenue and **expenses** are, respectively, increases or decreases in the net financial position of the entity, other than increases or decreases arising from ownership contributions or distributions.⁴⁶

The entity's surplus or deficit for the period is the difference between revenue and expenses reported in the statement of financial performance (also called Income Statement). Revenues and expenses are distinct from cash flows, and their matching to ascertain the surplus or deficit is rather debatable in the public sector, as will be discussed in Chapter 9.

Revenues and expenses arise from exchange and non-exchange transactions, or from other events, such as: changes in prices and unrealized increases and decreases in the value of assets and liabilities; the consumption of assets through depreciation; and erosion of service potential and ability to generate economic benefits through impairments.⁴⁷

Recognizing an item in the financial statements, apart from fulfilling the definition, requires attach a monetary value to it. This process entails

⁴⁴ IPSASB (2014, CF 5.36).

⁴⁵ IPSASB (2014, CF 5.37).

⁴⁶ IPSASB (2014, CF 5.29-5.32).

⁴⁷ IPSASB (2014, CF 5.31).

selecting an appropriate measurement basis, ensuring that the measurement is sufficiently relevant and faithfully representative.⁴⁸

4.2. Measurement criteria

Measuring implies determining the monetary amounts to be used in the valuation of the elements to be recognized in the financial statements, by selecting specific measurement bases.

Regarding the objectives of measurement, the IPSASB instructs that an entity must select measurement bases that most fairly reflect its **cost of services, operational capacity and financial capacity**, and are useful in holding the entity to account and for decision-making purposes.⁴⁹ These measurement bases must also provide information that meets the qualitative characteristics.

The CF does not propose a single measurement basis (or combination of bases) for all transactions, events and conditions; instead, it provides guidance on the selection of a measurement basis for assets and liabilities, based either on the **historical cost** or **current value**, and may be **entry (recognizing) values** or **exit (derecognizing) values**. From this range of criteria, each IPSAS then specifies which basis is to be specifically used.

Entry values and Exit values

- For **assets**, *entry values* essentially reflect the cost of purchase/acquisition (e.g., historical cost and replacement cost); *exit values* reflect the economic benefits from sale, or the amount that will be derived from use of the asset (e.g., net selling price and value in use).
- For **liabilities**, *entry values* relate to the transaction under which an obligation is received or the amount that an entity would accept to assume a liability; *exit values* reflect the amount required to fulfil

⁴⁸ IPSASB (2014, CF 6.7-6.8).

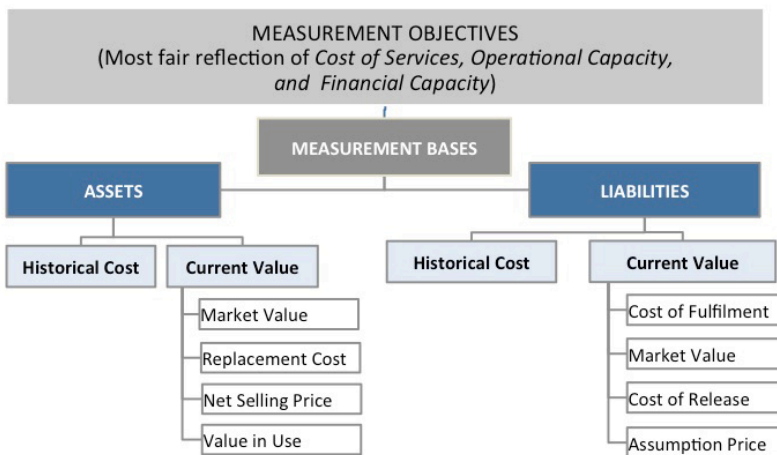
⁴⁹ IPSASB (2014, CF 7.2-7.4).

an obligation or the amount required to release the entity from an obligation.

Observable and Unobservable Measures

- Certain measures may be classified according to whether they are observable in an ‘open, active and orderly market’ (e.g., market value/fair value), or instead need to be calculated (e.g., value in use).
- Observable measures are likely to be more understandable and verifiable than unobservable measures; they may also be more faithfully representative of the phenomena they are measuring.

As displayed in Figure 8.2, there is a large variety of measurement bases suggested. And even if within each standard the options may be reduced, it is a fact that there is too much flexibility and diversity, which jeopardizes the comparability claimed for the IPSAS.



*Figure 8.2: Measurement criteria
Source: IPSASB (2014, CF 7)*

Figure 8.2 shows different criteria regarding the current value of assets and liabilities, though some are mirrored concepts.

Replacement cost in assets is equivalent to the assumption price in liabilities; both are entry criteria, and they may be the most suitable for reflecting either the financial or the operational capacity of the entity, being

the amount the entity would pay for the asset and would be willing to accept for the liability.

Likewise, net selling price for assets pairs with cost of release for liabilities; both are exit criteria, and they reflect respectively the amount the entity can obtain from selling the asset (less costs of sale) and the amount the entity would be willing to pay to immediately 'get rid of' the obligation. Contrary to the market value (in business accounting called 'fair value'), which may be an exit or entry criteria, these criteria do not require an open, active and orderly market or the estimation of a price in such a market. Because of this requirement, market value is eventually the least likely applied criterion, as for many assets in the public sector there is no market, and even less so for liabilities.

Value in use as an exit value for assets, is often complex to obtain, as it implies calculating the net present value of cash flows generated by the assets or, for non-cash generating assets, calculating the remaining service potential (frequently using replacement cost as a surrogate). Its complexity makes it inappropriate to reflect the entity's costs of services and reduces its usefulness in assessing its operational and financial capacity.

Historical cost, an entry criterion both for assets and liabilities, is probably the most suitable for reflecting the entity's cost of services.

5. Comparative analysis of different CFs

This section presents a summarized comparative-international analysis involving the different CFs of several European countries – Austria, Finland, Germany, Portugal and the UK – taking the one from the IPSASB as reference. These are illustrative examples on how national CFs may approximate or diverge from that of the IPSASB.

The issues to be compared are financial statements (FS) objectives and main users (Table 8.2), main accounting principles (Table 8.3), FS elements and recognition criteria (Table 8.4), and measurement criteria used in financial accounting (Table 8.5). These tables were prepared based on Brusca et al. (2015) with some additions from the countries' CFs.

Countries	FS objectives	FS main users
IPSASB	<ul style="list-style-type: none"> Provide financial information about an entity (or an activity) for accountability and decision-making purposes 	<ul style="list-style-type: none"> Citizens (services recipients and taxpayers), their representatives (politicians in Parliament) and other resource providers (e.g., investors) Oversight authorities and statistics authorities
Portugal		
UK	<ul style="list-style-type: none"> Provide financial information about the reporting entity or reportable activity, to permit users to assess the stewardship and accountability of management for the resources entrusted to the entity 	<ul style="list-style-type: none"> Parliament, as representative of the public as well as the voter of resources; other users include the entity's management board, the entity's audit committee, and the taxpayer Investors, lenders and other creditors
Austria (CGov)	<ul style="list-style-type: none"> Provide financial information about an entity (or an activity) for accountability and decision-making purposes 	<ul style="list-style-type: none"> Citizens and Parliament Other resource providers (e.g., investors) Supreme auditing and statistics authorities
Austria (R&LGov)	<ul style="list-style-type: none"> Provide information about the entity budget accomplishment for accountability purposes 	<ul style="list-style-type: none"> Citizens and Central Government Supreme auditing and statistics authorities
Finland	<ul style="list-style-type: none"> Accountability purpose overrides the provision of information for decision-making Accountability for service performance and budget compliance 	<ul style="list-style-type: none"> Citizens and Parliament Supreme auditing and statistics authorities
Germany (IF accrual-based accounting)	<ul style="list-style-type: none"> Accountability purpose Financial information aiming at comparability and intergenerational equity 	<ul style="list-style-type: none"> Parliaments Citizens Supreme auditing and statistics authorities

Table 8.2: FS objectives and main users

Table 8.2 evidences fewer differences in users than in objectives, both between countries and compared to IPSASB. Regarding the objectives, in Finland and Germany, accountability is clearly the main purpose, while in UK providing information for decision-making is not explicitly an objective.

In the case of Austria, one must distinguish between central (CGov) and regional and local governments (R&LGov); while central government has going ahead with a considerable reform introducing accruals (IPSAS-based) even in the budget, at the regional and local level there is yet a lot of heterogeneity, with most entities still using essentially budgetary cash-based accounting and reporting. These different accounting systems have determined the FS objectives and users.

In the case of Germany, the reform has followed a bottom-up process, starting in local governments (municipalities), many already using accrual accounting, but not IPSAS. At federal and state (*Länder*) levels, in 2009 a reform also started and in 2016 new legislation was passed⁵⁰, given the option to use either cameralistic (budgetary cash accounting and single entry) or accrual-accounting (but not IPSAS).

Currently, only two states (Hesse and North-Rhine Westfalia) use accruals and double entry, plus two city states – Hamburg and Bremen. The government at federal (central) level still uses essentially modernized (extended) cameralistic accounting, meaning cameralistics including product-oriented extensions such as expenditure-revenue data for single reports and budgets (performance budgeting), KPIs built on a comprehensive cost and activity accounting system, and capital account. Therefore, the line in the table applies only IF entities use accrual-based accounting, which might not happen in several states, the federation (ongoing) and smaller municipalities, who still use cameralistic accounting.

⁵⁰ GERMANY, Governmental Accrual Accounting Standards (GAAS) [Standards staatlicher Doppik; SsD]; pursuant to section 7a and section 49a of the Budgetary Principles Act (HGrG); Resolution of 29 November 2016 of the committee pursuant to section 49a HGrG (to be updated on a yearly basis).

Countries	Main accounting principles
IPSASB	<ul style="list-style-type: none"> • Accrual regime, substance over legal form, going concern • No explicit references to bookkeeping, but double entry might be assumed • No references to budgetary accounting, only to reporting budgetary (cash or accrual-based) information within the accounts (IPSAS 1 and IPSAS 24)
Portugal	<ul style="list-style-type: none"> • Accrual regime, substance over legal form, going concern in financial accounting • Cash and commitments regime in budgetary accounting and reporting • Double entry bookkeeping in both budgetary and financial accounting
UK	<ul style="list-style-type: none"> • Accrual regime, substance over legal form, going concern and true and fair view (IASB's CF) • Parliamentary accountability, and regularity • Cash basis with accrual-based additions in annual budgets; accrual-based three-year budgets • No references to bookkeeping, but double entry might be assumed
Austria	<ul style="list-style-type: none"> • Central government – accrual-based accounting (IPSAS-based) and budgeting (double entry); substance over legal form, going concern • Regional and local government – cash- and commitment-based single entry budgetary accounting
Finland	<ul style="list-style-type: none"> • Accrual regime (double entry), matching and revenue realization in financial accounting • Budgetary accounting is accrual-based for exchange transactions and cash-based for non-exchange revenues; non-exchange expenditures are commitment-based • Budgetary bookkeeping is single entry, but double entry is used to cross-check with the financial accounts • Prudence
Germany (IF accrual-based accounting)	<ul style="list-style-type: none"> • Accrual-based regime (double entry), continuity/going concern, substance over legal form, realization of gains and losses, prudence (conservatism), aiming at true and fair view in financial accounting • Central and state level: no reference to budgeting; mostly cash and commitments regimes (single entry) are in place • Local level: accrual and cash-based budgeting

Table 8.3: Main accounting principles

IPSAS endorse accrual accounting, despite the existence of a cash-based IPSAS – *Financial reporting under the Cash Basis of Accounting*.

In Table 8.3, Portugal, in spite of being an IPSAS adopter, is the only country where budgetary accounting and reporting is cash and commitment-based, with double entry. Regional and local governments in Austria appear

to be similar, but in fact they have traditional single entry cash-based budgetary accounting. In the other countries (as in the IPSASB framework), an accrual basis is admitted, even in the budget: accrual-based budgets and budgetary accounting exist in the central government in UK, Austria and Finland, and may be an option in Germany. In this country, in the local government, although some small municipalities in specific federal states still use only cameralistic (cash and single entry budgetary) accounting, the majority of those using accrual accounting also prepare an accrual-based budget, in addition to the cash-based one.

A striking feature is that conservatism (prudence) seems to be a clearly prevailing principle in the CFs of Germany or Finland, reflected in the following tables.

Countries	FS elements	Recognition criteria
IPSASB	<ul style="list-style-type: none"> Assets, liabilities, ownership contributions, ownership distributions (net financial position) Revenues, expenses (deficit/surplus) 	Under the accrual regime: <ul style="list-style-type: none"> Fulfilling the definition – economic control Be measured with reliability Recognition of events after the reporting date (if referred to the reporting date)
Portugal		
UK		
Austria (CGov)		
Austria (R&LGov)	<ul style="list-style-type: none"> Receivables/payables; Receipts/payments 	<ul style="list-style-type: none"> Realization principle (commitment or cash-flows)
Finland	<ul style="list-style-type: none"> Assets and liabilities, but focus on revenues and expenses (<i>income statement-led approach</i>) 	<ul style="list-style-type: none"> Realization principle for exchange transactions Cash and short-term liability for non-exchange transactions Measurement reliability ensured under the cost convention
Germany (IF accrual-based accounting)	<ul style="list-style-type: none"> Assets, liabilities, deferred revenues/expenses, ownership contributions, ownership distributions (net financial position) Revenues, expenses (deficit/surplus) 	<ul style="list-style-type: none"> Fulfilling the definition – economic control Be measured with reliability (historical cost principle) Recognition of events after the reporting date (if incurred before reporting date) Realization principle

Table 8.4: FS elements and recognition criteria

Table 8.4 shows that IPSAS-follower countries emphasize the elements within the main financial statements, the exception being Austria for regional and local government (R&LGov), which, as mentioned, has essentially cash-based budgetary accounting.

Finland has an explicit focus on revenue and expenses, the annual reporting following what is called an *income statement-led approach*. The prevalence of the historical cost convention and the realization principle again evidences more conservatism in Finland and in Germany.

The German CF explicitly makes reference to deferred revenues (received in current year and perceived in the following) and expenses (paid in current year and incurred in the following), which also exist in the Balance Sheet of the IPSASB, Portugal, the UK and Austria, but they are not explicitly defined in their CFs.

Countries	Measurement criteria (financial accounting)
IPSASB	Historical cost convention, but fair value is allowed for certain assets and liabilities, as well as amortized cost; non-current assets may be revaluated, depreciated and subject to impairment review
Portugal	Historical cost convention, but fair value is allowed for certain assets and liabilities, as well as amortized cost; non-current asset revaluation is NOT allowed, but they are depreciated and subject to impairment review
UK	Historical cost convention, but fair value is allowed for certain assets and liabilities, as well as amortized cost; non-current assets may be revaluated, depreciated and subject to impairment review (IFRS-based)
Austria	Historical cost convention, but fair value is allowed for certain assets and liabilities, as well as amortized cost; non-current asset revaluation is NOT allowed, but they are depreciated and subject to impairment review
Finland	Historical cost convention and conservatism (prudence) Securities and other financial assets may be measured at estimated market value if lower than cost; liabilities use face value, but if indexed, might be adjusted higher; non-current assets revaluation may be allowed for some assets (e.g., land), which are NOT depreciated BUT subject to impairment review
Germany (IF accrual-based accounting)	Historical cost convention; market value occasionally admitted under conservatism (prudence) – if lower than costs for assets, or if higher than settlement amount for certain liabilities (e.g., provisions), or subject to a reversal of impairment (maximally to amortized cost if impairment would not have incurred); non-current assets revaluation is NOT allowed, but they are depreciated and subject to impairment review

Table 8.5: Measurement criteria used in financial accounting

As expected, Table 8.5 displays (again) more prudent measurement criteria in Finland and in Germany, with no references to fair value and market value admitted for use in exceptional cases only. However, while Finland allows for revaluation of non-current (non-financial) assets in some cases, such is not allowed in Portugal, Austria and Germany. In the case Portugal, a legal instruction from the central government is required, so that revaluation can be authorised.

6. Conclusion

While closely following the IPSAS CF, and referring to this as much as possible, this chapter addressed CFs overall, namely their contents in the public sector setting; objectives and users, and qualitative characteristics of financial information; elements of financial statements, and their recognition and measurement criteria.

It discussed the importance of a CF as an accounting theory, when standards derive from practice – there is a need to have a common theoretical basis to give consistency to practices. Standard-setters might have also used CFs to legitimize their own activities.

The chapter likewise explained that CFs for PSA have derived from those in business accounting, but they have been adapted due to context specifics that may entail different users and users' needs of public sector organizations' financial information.

Accountability is an almost natural purpose of GPFRs of public sector entities in democratic regimes, but the IPSASB establishes that decision making is also an important purpose. Some more critical literature has raised questions not only about who the real users of public sector entities' financial statements are, but also about their needs, underlining the fact that most of the CFs have adopted prescriptive and normative, rather than empirical, approaches.

Qualitative characteristics of financial information are also a part of a CF. Those attributes are crucial to determine the usefulness of that information; however, balancing between them is not an easy task, as they often conflict.

As to the elements of financial statements, although similarities can be found to those in business accounting, again public sector context specifics require particularities in the definitions, impacting on their recognition, and specially on their measurement criteria.

Finally, despite the international reference of the IPSAS CF, not all countries necessarily follow this, as they do not follow IPSAS. Countries with very deep-rooted accounting national traditions, such as Germany and Finland, tend to diverge from the IPSASB's perspective – even if some of their principles and concepts may approach this, a more conservative posture is clear.

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Discussion topics

- What is the role of a CF compared to that of PSA standards?
- What are the main objectives and who are the main users of financial (and budgetary) information reported by public sector entities, according to the different CFs presented in this chapter (comparative-international perspective)?
- What are the main recognition criteria for assets, liabilities, expenses and revenues, according to the different CFs presented in this chapter (comparative-international perspective)?
- Distinguish the main criteria which can be used to measure assets, liabilities, expenses and revenues within the financial statements, according to the different CFs presented in this chapter (comparative-international perspective).