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Accounting standards

International Public Sector Accounting Standards

Note by the Secretariat

Presents a summary of the impact of the adoption of International Public Sector Accounting Standards on the Organization and proposes an initial plan of action.

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Introduction

1. The objective of this paper is to inform the Board of the impact of the adoption of International Public Sector Accounting Standards (IPSAS) on UNIDO, in particular on the financial statements and budgeting, and to seek the Board's agreement in principle to adopt IPSAS by 1 January 2010.

2. Preliminary information on the IPSAS was presented to the PBC in document IDB.32/7-PBC.22/7, paragraphs 18 to 22. The Task Force on United Nations Accounting Standards, established under the sponsorship of the Chief Executives Board for Coordination (CEB) and the High-level Committee on Management (HLCM), recommended that the United Nations system adopt IPSAS by 2010, replacing the current United Nations System Accounting Standards (UNSAS).

3. At a special session held on 30 November 2005, HLCM accepted that recommendation, after its endorsement by the United Nations system Finance and Budget Network (ref. CEB/2005/HLCM/R.25). As part of the United Nations system-wide management reform, the CEB, at its session in April 2006, endorsed the recommendation of HLCM for adoption of IPSAS throughout the United Nations system by 2010.

4. Consequently, at its sixtieth session in July 2006, the General Assembly approved the adoption of IPSAS by the United Nations General Assembly (resolution A/RES/60/283 (IV) 1).

5. The Standards represent international best practice for public sector and not-for-profit organizations accounting. IPSAS are credible, high quality, independently produced accounting standards, underpinned by a strong due process and supported by Governments, professional accounting bodies and international organizations. The Panel of External Auditors of the United Nations, the specialized agencies and the International Atomic Energy Agency (IAEA) consider the adoption of IPSAS as a significant step forward to improving the quality, consistency and comparability of financial reporting within the United Nations system. Further, the adoption of IPSAS is seen as an essential component of good governance, accountability and transparency. As a main feature, adoption would constitute a move to full accrual accounting, thereby recognizing income and expenditure in the period it is earned and incurred respectively, and not necessarily in the period in which cash is received or paid.

6. IPSAS are issued by the International Public Sector Accounting Standards Board (IPSASB). The IPSASB is itself a standing committee of the International Federation of Accountants (IFAC), which represents over 160 member bodies in 120 countries. Further details of IFAC, IPSASB and the Standards are available on the Internet site www.ifac.org.

7. The widely-acknowledged benefits of IPSAS adoption include:

(a) Improved stewardship and transparency with respect to all assets and liabilities;

(b) More comprehensive and consistent information about costs and income, which could better support the governance of the Organization;

(c) Improved consistency and comparability of financial statements over time and over different organizations.

8. To facilitate a better understanding of the expected changes a list of major differences between UNSAS and IPSAS is included in annex I. Annex II describes the financial terms used in the present document.

9. Within United Nations system organizations, IPSAS adoption would impact on several important areas, including the accounting and reporting of transactions and changes to financial management systems. It would also have a consequential impact on budgeting, funding and management, requiring a redefinition of the financial regulations and rules. UNIDO would also have to deal with these important issues upon the agreement in principle to adopt IPSAS at the present session of the Board, prior to formal approval by the General Conference. Moreover, during 2007 UNIDO would seek approval from its governing bodies regarding changes to the financial regulations, besides other issues that may arise in the course of analyses. Resource requirements for the project would also be presented.

I. Impact on accounting, financial reporting and associated financial management systems

10. The impact of IPSAS adoption on UNIDO accounting would include:

(a) Full recognition of liabilities for employee benefit obligations such as After Service Health Insurance (ASHI) and other accruing compensatory benefits, e.g. annual leave and repatriation grants;

(b) Recognition and depreciation of capital assets such as buildings, vehicles, furniture and equipment;

(c) Recognition of expenses on the basis of the delivery principle, which is more restrictive than the current obligation principle. Under the delivery principle, expenditure is recognized on the basis of goods and services received. As a result, during the initial period of IPSAS adoption, there would be a decrease in reported expenditure, in particular the reported expenditure under technical cooperation activities;

(d) Changed basis for recognition of revenue from certain voluntary contributions and exchange transactions. As a consequence of (c) above, the support cost income attributable to the operational budget would be reduced in the initial period of IPSAS application;

(e) Valuation of inventories;

(f) Change in structure and content of financial reports at all levels (Organization and donor reporting);

(g) Annual, rather than biennial, audit of the financial statements.

11. Compliance with IPSAS accounting and reporting requirements would necessitate an in-depth analysis of the changes required to existing financial systems. In particular, recording of detailed information on capital assets and depreciation, inventories, employee benefits and expenditure recognition would need to be incorporated in the system. In this regard the possible options of modification, upgrading of the existing system or sourcing a viable alternative would be considered.

II. Impact on budgeting and funding

12. Adoption of IPSAS would change the basis for financial reporting from modified accruals to full accruals. To facilitate the reconciliation between budgeted and actual results, it would be necessary to align the budget preparation to full accrual. The enhancement of existing capacity allowing reporting and comparison of

budget against actual results would also allow for improvement in results-based budgeting. While ultimately over time—except for implementation costs—IPSAS adoption would result in no additional cost to the Member States, it would change the timing of those costs and consequently have a bearing on funding requirements, as explained below. These changes to the budgeting methodology fall into two categories.

(a) First, purely accounting timing differences, which themselves represent no change to current funding requirements, e.g. the recognition of capital assets and their subsequent depreciation over their useful lives, and the adoption of the delivery principle for the recognition of expenditure;

(b) Secondly, there are changes that would lead to a requirement for budgetary resources to be made available earlier than the current practice. This derives primarily from the need to fully accrue and provide for the liabilities of the organization. An example is the full recognition of employee benefit obligations, which would affect budgeted payroll costs twofold: (i) recognition and funding of past liabilities, e.g. ASHI of already retired personnel, and (ii) accruals for on-going obligations, e.g. ASHI accruals for serving staff. Currently, funding for both these liabilities is provided on a pay-as-you-go basis. However, the ultimate level of resource requirement from Member States would depend on the funding arrangement to be approved by the governing bodies to meet these presently unfunded liabilities.

13. The existing financial regulations governing carry-over of budgetary appropriations for unliquidated obligations for a period of twelve months beyond the end of a biennium would require review in the context of accrual budgeting. Such a review would also need to consider the possibility of separate capital budget necessitated by the requirement to capitalize the assets and revenue budget. Corresponding changes required to the financial regulations would follow the established approval process.

III. Impact on management

14. IPSAS adoption is a significant initiative requiring changes to the financial regulations and rules, management practices and business processes. Initially, an in-depth review of the financial regulations and at a later stage of the financial rules would have to be undertaken, in order to determine amendments needed to comply with IPSAS.

15. In accordance with financial regulation 12.2, all amendments to the financial regulations require approval by the General Conference. An important first step is the consideration by the Programme and Budget Committee and the Board to facilitate a recommendation to the Conference. Consequently, in order to be able to prepare the programme and budgets for biennium 2010-2011 during the biennium 2008-2009, some essential amendments to the financial regulations would already need to be approved by the General Conference in 2007.

16. The adoption of IPSAS would also necessitate staff training on the application of IPSAS, the financial management system and business processes. In this regard, a training needs analyses, development of training plans and estimation of associated costs would be undertaken. The centralized IPSAS technical team at the United Nations level would assist organizations in the process, particularly in developing training specifications, identifying and procuring IPSAS training material.

IV. Centralized support

17. System-wide support, coordination, guidance and leadership within the United Nations system is provided through the IPSAS technical team under the guidance of a Project Steering Committee and the Task Force on Accounting Standards, to ensure consistent interpretation and application of IPSAS across the system. As a member of these bodies, UNIDO would have to contribute its share of the common costs to the extent of $44,000 for the period 2006 to 2009, based on current estimates.

18. UNIDO is a member of the Accounting Policy and Guidance Group, a sub-group of the Task Force on Accounting Standards, which would review the policy and guidance related to IPSAS implementation. This provides UNIDO with an opportunity for a better understanding of policy development and for contributing to the recommendations, taking into account UNIDO's specific needs.

V. Action plan

19. To achieve the full benefits of IPSAS adoption, the implementation process must recognize the magnitude of the change and include sufficient time and resources to work through its potentially far-reaching implications. In light of the strict timelines set for the adoption of IPSAS and to set in motion the approval process, UNIDO would require the full cooperation and support of its governing bodies. A provisional action plan to the end of 2007 is shown below.

20. During 2006 and 2007, the tasks to be completed in order of priority would be:

(a) Conduct an initial impact analysis of IPSAS;

(b) Consider alternate budgeting practices;

(c) Ascertain the implications for the financial regulations and rules;

(d) Ascertain the impact on the financial system;

(e) Identify resources required and prepare a project budget covering costs related to: project team, personnel and training, coordination and systems to be included for consideration in the Director-General's proposal for the programme and budgets, 2008-2009;

(f) Prepare necessary amendments to the financial regulations for approval;

(g) Prepare a detailed implementation plan for 2008-2009;

(h) Disseminate information to key stakeholders of the Organization.

21. Following the agreement in principle by the Board for the adoption of IPSAS by UNIDO, the analyses of the most appropriate budgeting method, changes required for the financial regulations, resources required and the project cost estimates as part of the programme and budgets for the biennium 2008-2009 and implementation plan would be presented for consideration by the Committee, the Board and finally for approval by the General Conference in 2007 to commence implementation in 2008.

VI. Action required of the Board

22. The Board may wish to consider the adoption of the following draft decision:

"The Industrial Development Board:

"(a) Takes note of the information provided in document IDB.32/12;

"(b) Agrees, in principle, to the adoption of International Public Sector Accounting Standards by UNIDO, as part of a United Nations system-wide adoption of IPSAS by 2010;

"(c) Requests the Director-General to proceed with the assessment, planning and estimation of project costs for inclusion in the programme and budgets for the biennium 2008-2009;

"(d) Further requests that the Member States be kept informed of the developments in the adoption of IPSAS."

Annex I

Major differences between United Nations System Accounting Standards (UNSAS) and International Public Sector Accounting Standards (IPSAS)

	UNSAS	*IPSAS*	*Impact*
1.	Reporting requirements take a "modified accruals" approach that is very close to cash accounting.	Requirements are on a "full accrual" basis.	The effect of this is that IPSAS reports a larger group of items (assets and liabilities) on the balance sheet than does UNSAS. The pattern of expenses associated with these assets and liabilities is different. Under IPSAS, expenses associated with investments in assets are reported later than would be the case under UNSAS, while expenses associated with liabilities are reported earlier than would be the case under UNSAS.
2.	Costs of fixed assets are reported as expenditure, in the Statement of Income and Expenditure, when the assets are purchased.	Costs of fixed assets are capitalized and are included on the balance sheet when the assets are first acquired. The original cost of the assets is spread over their useful lives as the assets are used (depreciation expense).	There will be a decrease in reported expenditure and an increase in assets reported. Under IPSAS upon initial recognition of existing fixed assets, a corresponding capital reserve needs to be established. Application of this principle to assets acquired for technical cooperation projects is still under evaluation by the IPSAS support team.
3.	Accrued employee benefits in respect of repatriation grants, ASHI and annual leave are reported in the note to the accounts.	Full recognition of liabilities for employee benefits and reported as an expense.	This would result in an increase in reported expenditure and negative overall equity due to creation of the accrued liabilities, amounting to €70 million at 31 December 2005. This would need a funding mechanism to be put in place to meet the unfunded liabilities.
4.	Reported expenditure represents, disbursements and unliquidated obligations.	Recognition of expenditure on the basis of goods and services received (the delivery principle).	As not all unliquidated obligations of the financial period would be recognized as expenditure, there would be a reduction in reported expenditure, particularly for technical cooperation activities, during the initial years of IPSAS adoption. Accordingly, support cost income for operational budget would be reduced during the initial years.

	UNSAS	*IPSAS*	*Impact*
5.	Costs of expendable property (stocks and supplies) are charged to expenditure on purchase.	Only costs of expendable property consumed will be recorded in expenditure. The value of inventories at the end of the financial period will be considered an asset.	There would be a reduction in reported expenditure during the initial years of IPSAS adoption. There would be a requirement to conduct physical verification of inventories at financial period end and also to determine the basis for valuation.
6.	Recognition of voluntary contributions on cash basis.	Voluntary contributions recorded on the accrual basis under certain conditions.	Reporting of revenue from COMFAR, sales publications, BMS income and programmes funded by voluntary contributions, including trust funds, would require analysis.
7.	Financial period consists of two calendar years with an audit opinion issued on the financial statements every biennium.	Financial period will be 12 months – requiring annual audits.	Result in an increase in audit fees.
8.	Preparation of programme and budgets on a cash basis.	Preparation of programme and budgets on accrual basis.	Changes in the format and content of budget presentation. Reconciliation between budgeting and financial reporting, which may lead to additional work by the External Auditor.

Annex II

Definitions of terms used in this document

1. **Accrual basis**—A basis of accounting under which transactions and other events are recognized when they occur (and not only when cash or its equivalent is received or paid).

2. **Assets**—Resources controlled by an entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity.

3. **Cost—**The amount of cash or cash equivalent paid or the fair value of the consideration given to acquire an asset at the time of its acquisition.

4. **Depreciation—**The systematic allocation of the cost of an asset or other amount substituted for cost in the financial statements, over its useful life.

5. **Delivery principle—**The principle in which the expenses are recognized in the financial statements on the basis of goods and services received.

6. **Exchange transactions—**Transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange.

7. **Expenses—**Decrease[s] 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 decrease in net asset/equity.

8. **Fair value—**The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

9. **Liabilities—**Present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential.

10. **Net assets/equity—**The residual interest in the assets of the entity after deducting all its liabilities.

11. **Useful life**—The period of time over which an asset is expected to be used by the entity.