

Accrual Accounting and Management of Public Investment Program

*TRANSPARENCY AND BEYOND: HARNESSING THE POWER
OF ACCRUAL IN MANAGING PUBLIC FINANCES*



WORLD BANK GROUP

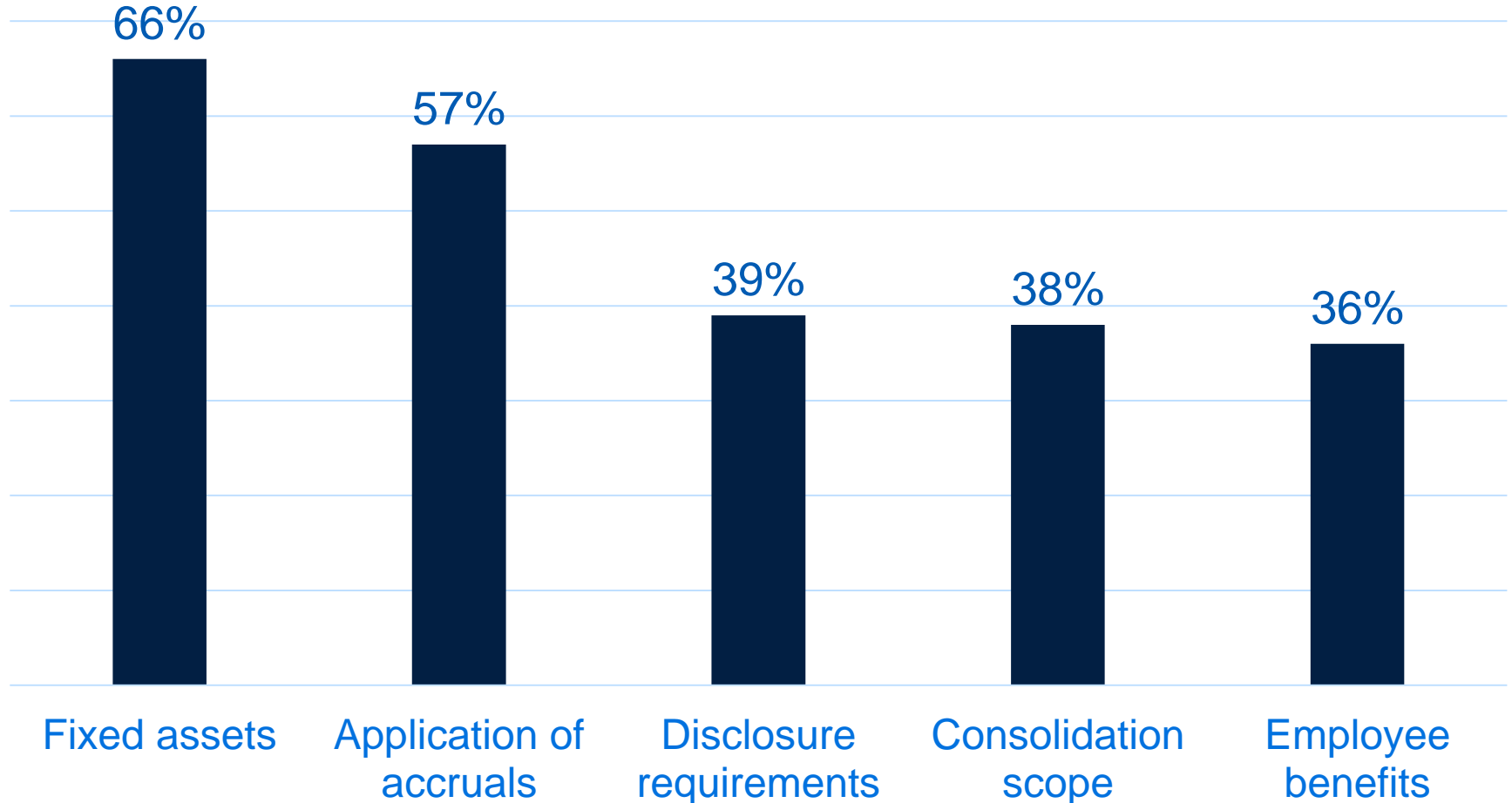
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FIXED ASSETS ACCOUNTING AND MANAGEMENT: REVISITING THE STATUS QUO

- Accounting and management of PP&E strengthens PFM and Public Investment Management (PIM) systems
- Growing demand for government services associated with population growth and with rising standards of living means that governments' control more assets which need to be efficiently and effectively measured.
- Accounting for fixed assets includes traditional govt assets, infrastructure assets, heritage items, military assets and other agreements/partnerships.
- Demand for accountability for governments' use of assets has increased and will continue to increase. Better financial reporting enables public, elected decision makers and management to evaluate existing situation and take better decisions.
- Good accounting and management of assets can:
 - Improve the provision of public services;
 - Reduce corruption through better control of fixed assets;
 - Contribute to economic growth through the improved assets planning and enhanced management of infrastructure assets.

FIXED ASSETS ACCOUNTING AND MANAGEMENT: REVISITING THE STATUS QUO

Accounting impacts of accrual-based financial statements



Source: PwC Global Survey on accounting and reporting by central governments

IPSAS 17 *PROPERTY, PLANT AND EQUIPMENT*

- Definition, Recognition, Measurement at Recognition, Measurement after Recognition, and Disclosure
- No clear guidance on natural resources
- First time adopters: 5 years to recognize PP&E
- IPSAS 33 suggests reducing transition period to three (3) years
- Work needed to account for PP&E on accrual basis will depend on:
 - Individual country's current practices to recognize, measure and record PP&E
 - Clarity of legal framework establishing control and ownership of government assets
 - Degree of documentation of accounting policies and procedures
 - Current information systems in use and level of integration between registers and ledgers

APPROACH TO TRANSITIONING

- Define end goal from start
- ENDPOINT: arrive at an accurate opening balance for each PP&E category and design methodology defining recognition, measurement and disclosure criteria going forward
- Improve gov't service delivery
 - Identify obsolete assets
 - Prepare asset replacement strategies
 - Evaluate full cost of service
- We'll discuss common challenges and approaches to the non-linear process of IPSAS 17 implementation

APPROACH TO TRANSITIONING

- Key building blocks for the implementation of accrual accounting for PP&E in the public sector:
 - Legal and regulatory framework
 - Applicable accounting standards, processes and asset management principles
 - Information Systems
- IPSASB Study 14 guides the process of establishing authoritative backing for formulation and approval of accounting policies

TRANSITIONING: LEGAL AND REGULATORY FRAMEWORK

- Political system and legal framework have significant influence on adoption and implementation of government accounting standards in general, and IPSAS 17 in particular, by establishing the key players and defining the environment in which implementation takes place.
- Political System - federal or unitary, centralized or decentralized, influences accrual accounting for PP&E in many ways, e.g. by determining the authoritative basis to adopt standards and prepare accompanying policies and procedures and establishing which entities will maintain custody of the assets and recognize items of PP&E in their financial statements.
- Example: in federal political systems, central and sub-national governments typically have independent laws including financial reporting requirements. In unitary systems there is one central authority that dominates at the central and local government level, with varying levels of devolution of powers.

TRANSITIONING: LEGAL AND REGULATORY FRAMEWORK

Regardless of the political system in place, an analysis of the legal framework will be a critical starting point to comply with the general asset recognition principles that are the bedrock of IPSAS 17.

Three key areas that are dependent on the characteristics of the legal framework are:

- (i) determination of control and rights to future economic benefits or service potential of PP&E;
- (ii) establishment of legislative basis for the accounting policies and procedures to account for PP&E; and
- (iii) amendment of the Chart of Accounts (COA) to facilitate correct categorization and classification of assets and the input of accrual based information related to recognition and measurement of PP&E.

TRANSITIONING: ACCOUNTING POLICIES AND PROCEDURES

- Necessary precursor to drafting accounting policies in accrual accounting for PP&E is a gap analysis of the current accounting requirements in comparison to IPSAS 17.
- Influence of the contextual financial reporting culture, including the preponderance for rules versus principles and vice versa, can not be underestimated.
- Four (4) common areas that are particularly challenging during transitioning are: (a) ***Classification of assets (including componentization)***; (b) ***Lack of historical cost data and initial measurement***; (c) ***Subsequent measurement***; (d) ***Asset register***.

ACCOUNTING POLICIES AND PROCEDURES – ASSET CLASSIFICATION

- Revise and harmonize accounting policies at two levels:
 - Categorize asset in accordance with appropriate accounting standard
 - Divide and group PP&E into asset classes based on pre-determined characteristics
- Measurement of PP&E items, especially subsequent measurement, varies depending on the chosen asset class (IPSAS 17.52 provides examples of separate classes)
- Sub-classes (components) within a larger class can have different measurement methodology and depreciation period.

ACCOUNTING POLICIES AND PROCEDURES – ASSET CLASSIFICATION

Sample components of infrastructure assets



Electricity Transmission	State Highways	Rail	Water
<ul style="list-style-type: none">• electricity distribution network• electricity generation assets	<ul style="list-style-type: none">• surface pavement• other pavement• bridges	<ul style="list-style-type: none">• earthworks• ballast• sleepers• rail• tunnels and bridges• culvert• signals• communication system• station buildings	<ul style="list-style-type: none">• pipes• reservoirs• pumping stations• service connections

ACCOUNTING POLICIES AND PROCEDURES: *LACK OF HISTORICAL COST DATA AND INITIAL MEASUREMENT*

Infrastructure Assets

- Engineer's blueprint
- Interviews with construction team:
 - Operators
 - Managers
 - Owners
- Interview residents
- Visual observations
- Extrapolations of buried assets (comparison)
- Contracts
- Budget
- Appropriations

Real Property

- Land registry
- Tax records
 - Sales of land or buildings
 - Periodic tax assessments
- Interviews with construction team:
 - Operators
 - Managers
 - Owners
 - Contracts

ACCOUNTING POLICIES AND PROCEDURES: *LACK OF HISTORICAL COST DATA AND INITIAL MEASUREMENT*



Austria

Land

- Land registry data and price per m² (using tax agency data of land sales)
- Reduced comparative values of limited use areas

Roads, railways, ports, etc

- Neighboring countries average values

Heritage Assets

- Expert appraisal

Roads

- Valued in accordance with depreciated replacement cost (DRC)

Specialist Military Equipment

- Statistical methods to estimate historical cost

Heritage Assets

- Tax value
- Expert appraisal



France



USA

General PP&E

- Cost of similar assets at time of acquisition
- Current cost of similar assets discounted for inflation since time of acquisition

ACCOUNTING POLICIES AND PROCEDURES – SUBSEQUENT MEASUREMENT

- IPSAS 17 offers two choices for subsequent measurement of PP&E- the cost or revaluation models. Entities may chose either model for different classes of PP&E, however only one of the measurement approaches can be used across an entire class of PP&E.
- These measurement approaches require accounting for consumption of the asset over its useful life (depreciation), and impairment losses when they occur.
- Service life (useful life) and residual value has to be reliably estimated in order to determine the depreciable base.

ACCOUNTING POLICIES AND PROCEDURES – SUBSEQUENT MEASUREMENT (SELECTED NEW ZEALAND POLICIES FOR THE PP&E, FS 2014)

Asset Class	Subsequent Valuation	Estimated Useful Life
Land and Buildings	Land – revaluation model	No depreciation
	Railroad land – revaluation model with estimate based on adjacent use, as an approximation to fair value (FV)	No depreciation
	Buildings – revaluation model. Componentization to at least three levels: structure; building services; and fit-out.	25-60 years
Specialist Military Equipment	Depreciated replacement cost basis less depreciation and impairment losses since the assets were last revalued.	5 – 55 years
State Highways	Depreciated replacement cost basis less depreciation and impairment losses since the assets were last revalued.	Pavement (surfacing): 7 years Pavement (other): 50 years Bridges: 70 to 105 years

ACCOUNTING POLICIES AND PROCEDURES – ASSET REGISTER

- Example: the United Kingdom's National Asset Register 2007, which is a comprehensive list of Central Government assets with a valuation of approximately £337, 104 million and covering 370 different government bodies.
- The challenges countries face in building an asset register that will aid compliance with IPSAS 17 occur at the level of the enabling environment and the asset register itself.
- Laws or regulations that clearly identify and systematize the management and custody of assets, and the updating of the asset registers, at the entity level and the consolidated level are essential.
- It is worthwhile to consider the use of asset register software that is linked to the General Ledger.

ACCOUNTING POLICIES AND PROCEDURES - *BUILDING ASSET REGISTERS: SELECTED CHALLENGES AND APPROACHES*

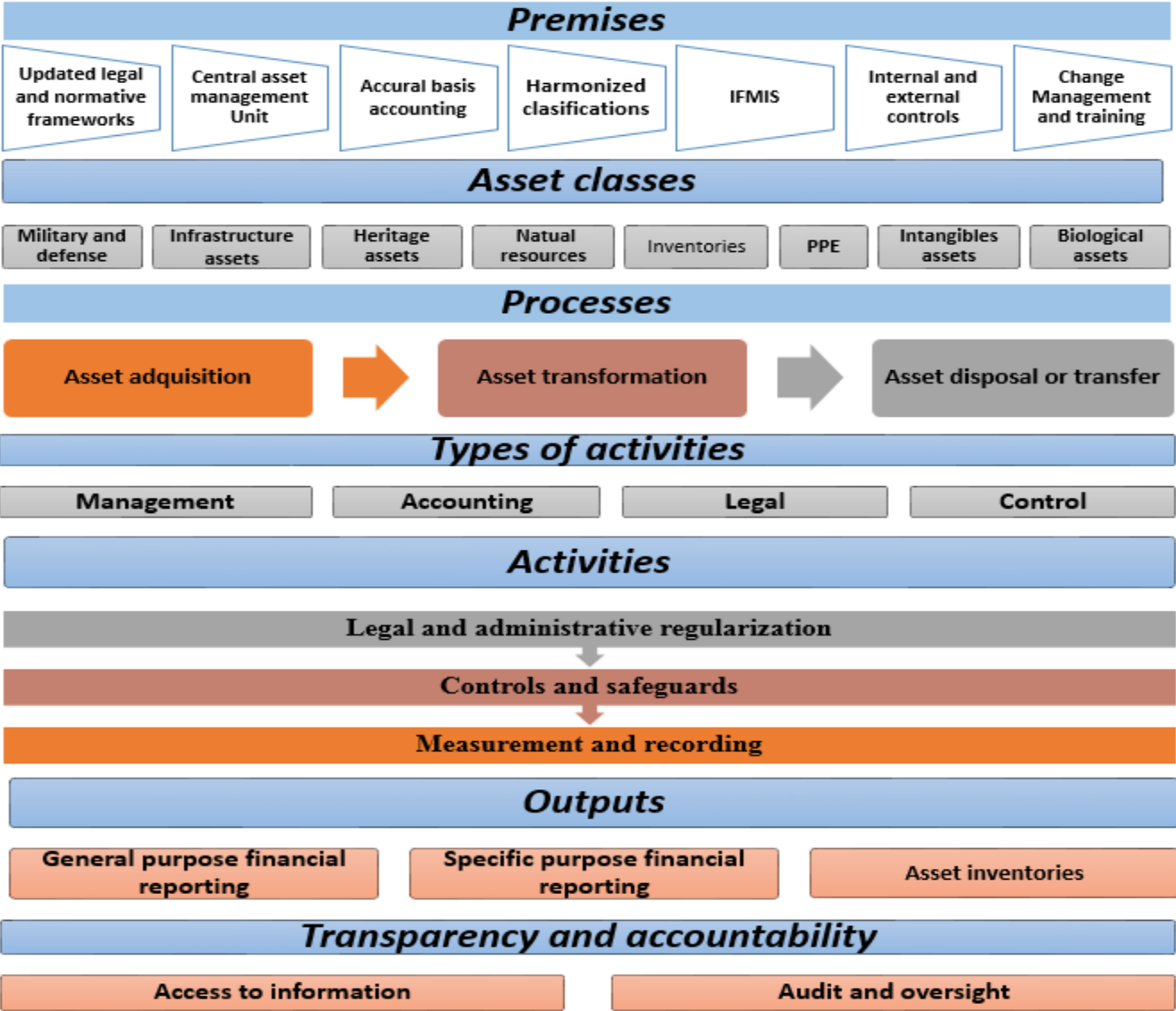
Challenge	Possible Approaches
Unrecorded Assets	<ul style="list-style-type: none"> ▪ Design project to identify all unrecorded PP&E ▪ Strengthen the internal control environment
Fully depreciated on the books	<ul style="list-style-type: none"> ▪ Revalue assets if still in use and update register ▪ Re-categorize and dispose of obsolete assets
Assets that need to be in the register but not counted as PP&E	<ul style="list-style-type: none"> ▪ Design system to record and classify the following assets separately: <ul style="list-style-type: none"> ▪ Heritage assets reported per option in IPSAS 17 ▪ Assets held in trust ▪ Assets held for sale (IPSAS 12) ▪ Investment property (IPSAS 16) ▪ Assets held under operating lease
Under- or over-counting (most at risk when transfers occur)	<ul style="list-style-type: none"> ▪ Maintain “Summary of Movements” by each custodial entity. ▪ Periodic reconciliation of “Summary of Movements

PROPERTY, PLANT AND EQUIPMENT: ACCRUAL ACCOUNTING AND ASSET MANAGEMENT IN LATIN AMERICA - STUDY OBJECTIVES

- Examine links between asset management / financial reporting and:
 - Efficient public investment management;
 - Stronger transparency and accountability.
- Document current status and challenges related to control and management of fixed assets in Chile, Mexico, Panama, Paraguay, and Uruguay
- Propose comprehensive methodology for asset management, including administrative and financial implications



Asset Control and Management System (SACA)



Main results

- Asset management and financial reporting are not deemed as a priority despite their impact on sustainability of fiscal policies and public finances.
- Financial statements of the Governments do not always include and disclosure reliable financial information, which affects Governments' capacity to: (i) objectively assess their financial position and performance; (ii) efficiently and responsibly spend public funds.
- Incomplete information on infrastructure assets and provisions related to their maintenance and replacement, which contributes to the regional challenge to boost productivity and competitiveness.

Selected recommendations

1. Continue and complete IPSAS implementation !!
2. Revise and update legal and normative frameworks on: (i) accounting and financial reporting; (ii) asset control and management; (iii) accountability and oversight; (iv) transparency and access to information.
3. Establish central asset management units to manage all classes of assets from normative and SACA management perspective.
4. Implement and/or update IFMIS, including the SACA module, which would allow to: (i) introduce harmonized budget, accounting, and asset classifications and maintain comprehensive, real-time, accrual-based records of all transactions.
5. Conduct on a periodic basis: (i) stock taking and physical verification of assets; (ii) reconciliation of administrative and accounting records; (iii) review of assets maintenance and replacement plans.