



Ian Sanderson and Frans van Schaik explore how IPSAS 6 and IAS 27 approach the issues of power and control in public sector accounts

You may or may not know much about them, but the truth is that the International Public Sector Accounting Standards (IPSAS) are quickly gaining popularity. In May, the Swiss federal government issued its first IPSAS financial statements, and many governments and intergovernmental organisations will follow soon. IPSAS are the public sector accounting standards of choice for much of the world, and even countries that have not specifically adopted IPSAS – such as Canada, Australia and New Zealand – have similar standards to IPSAS. A number of international bodies, such as the European Commission, NATO and the United Nations, have also chosen to prepare their financial statements according to IPSAS.

Many readers in the UK, however, may not be familiar with IPSAS because the UK public sector has chosen to adopt International Financial Reporting Standards instead. But the UK does supplement IFRS

with IPSAS-similar treatment of public sector-specific accounting issues that are not dealt with by IFRS, such as tax revenue.

Legacy of Enron

In general, the scope of consolidation – ie, the issue of what should be included when an organisation prepares consolidated financial statements – is critical because choosing to include or exclude certain organisations can have an enormous impact on the picture the statements provide about an organisation's finance. If you think of the Enron scandal, you will understand how important it is to determine which organisations should be included in consolidated financial statements. Enron excluded many debt-ridden entities from its consolidated financial statements.

The scope of consolidation is as much of an issue in the public sector and international public sector as in any other sphere – knowing how a department or

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international organisation has spent its resources is important to establish the true cost of public services. If you want proof that IPSAS and IFRS are making public sector bodies more accountable, just think of the private finance initiative projects that may have to come onto the UK government's balance sheet, or even Northern Rock.

Control = Power + Benefit

IPSAS 6 and IAS 27 (on which IPSAS 6 is based) deal with consolidated and separate financial statements.

Both standards use the concept of control for determining the scope of consolidation, and are of interest because the criteria for defining control are different from those currently applied by the UK government.

Both IPSAS 6 and IAS 27 define control as the 'power to govern the financial and operating policies of another entity so as to benefit from its activities'. This is significant because to be in control is no longer about the actual exercise of power but the potential to exercise power. When the UK government adopts IFRS next year, full compliance with IAS 27 would open up a lot more potential organisations to consolidation.

There are some differences between IPSAS 6 and IAS 27, since one focuses on the public sector and the other on the private sector. Unlike IAS 27, IPSAS 6 provides guidance to help determine whether control exists for financial reporting purposes by using a number of conditions and indicators. Also, some differences relate to terminology so that 'income' becomes 'revenue' under IPSAS 6, and 'parent' and 'subsidiary' become 'controlling entity' and 'controlled entity'.

Breaking boundaries

The potential impact of IAS 27 or IPSAS 6 when compared with current practice in the UK public sector is best illustrated by way of an example.

Think of a national museum that is governed by a board of trustees who are all chosen by the government department responsible for funding the museum. The trustees are given freedom by the department on how they decide to run the museum. The museum prepares a set of financial statements that are published. The museum's financial statements are not consolidated into the department's financial statements, because although the government department has some budgetary control over the museum, it has chosen not to interfere with the operating policies of the museum; these are decided by the trustees.

Under IAS 27, it is not the actual exercise of in-year budgetary control over the museum that establishes control; it is the potential to exercise the power to govern the financial and operating policies of the

museum should it choose to.

The ability of the department to appoint the majority of the museum's trustees means that it has the potential to exercise power, because it could choose to replace the current trustees with trustees who will carry out the department's wishes. Under IAS 27, this museum is a controlled entity of the government department and should be consolidated in the department's accounts.

At the moment, the consolidation boundary in the UK governmental sector is typically based on a department having in-year budgetary control over an entity. However, in order to be fully IFRS-compliant, departments would need to determine the scope of consolidation following the definition of control in IAS 27, which is different from current practice in the UK public sector.

Political manoeuvres

In intergovernmental organisations, control is a significant issue. These are organisations that are governed by a large number of countries where the concept of control has political significance.

This can be illustrated with an example. Two national governments agree to build a school in a developing country; one nation agrees to pay the majority of the costs of construction and is given three out of five seats on the management board. Under both IPSAS and IFRS, the result is that the nation with the most seats on the board has control of the project. It has the power to influence the operating and financial decisions and to benefit from them. Interestingly, in the absence of any equity shareholding agreement, the controlling nation should consolidate the *whole* of the construction project; there is no minority interest.

Another illustrative example would be an international donor who funds a small project in a developing country. The donor uses a small, local agency in the country to run the project for it. The agency has its own management board but is highly dependent on the donor for funding. In this case, there is no consolidation, because however pressed for money the agency may be, it retains the power to turn down the funding from the donor.

Principles versus rules

Both IPSAS 6 and IAS 27 are principles-based standards, which, as with all such standards, leave room for interpretation.

There is, however, a widely held view that principles-based standards are superior to rules-based standards since these can often be circumvented. We are noticing a high level of debate in this area, which is indicative of the complexity of control, and its importance in determining the scope of consolidation.



Ian Sanderson



Professor Frans van Schaik

Ian Sanderson works in the field of international development for Deloitte in Geneva. Professor Frans van Schaik is a member of the IPSAS Board of the International Federation of Accountants and works for Deloitte in The Hague