

# RSM! Salustro Reydel

Public sector  
accounting, an  
obstacle to fair  
evaluation of the  
performance of  
public services

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# Principal characteristics of public sector accounting

## *Receipts-based accounting*

- Public sector accounting is traditionally based on a budgetary concept
  - ✓ Receipts and expenditures are entered as a function of changes in cash position
  - ✓ Recognition of revenues and expenses is not linked to the provision of services or the transfer of goods
  - ✓ Hence, it is impossible to measure the performance of a public-sector entity correctly, i.e., to know the real cost of a service rendered or a good transferred
    - For example, the absence of a notion of inventory in public sector accounting makes it impossible to determine and control the cost of production of goods
- Public-sector accounting is traditionally characterized by the absence of the concept of the balance sheet
  - ✓ There is no distinction between expenses (which pertain to the activity of a public-sector entity) and fixed assets (which pertain to the asset base of a public-sector entity)
  - ✓ There is no notion of commitments given and received: various receivables, labor-related commitments (pensions, etc.) or financial commitments (guarantees, collateral, provisions for contingent liabilities, etc.)
  - ✓ Therefore, public-sector accounting does not give a true image of the asset base of the central or local government, and makes it impossible to project the future correctly
    - For example, the lack of provisions for impairment of customer receivables makes it impossible to take the risk of non-payment into account
    - Also, the absence of a concept of depreciation makes it impossible to relate the level of wear on an asset and the need to replace it.

# Principal characteristics of public-sector accounting

## *Treatment of financial data*

- Deficient reporting
  - ✓ no clearly defined financial aggregates
  - ✓ no publication of a full financial statement differentiating the income statement, the asset base and the cash flow of a public-sector entity
  - ✓ And therefore, the performance of the public-sector entity cannot be measured on the basis of the operating income it generates, but only with reference to the amount allocated to it in the budget
    - traditionally, the larger this is, the more the government agency is considered to have accomplished significant actions
- A diversity of accounting standards
  - ✓ there is no single set of accounting standards common to all governments and public-sector entities in the world
  - ✓ and hence it is impossible to compare the performance and the cost of services provided by government agencies
- Audits and penalties
  - ✓ regional accounting chambers monitor the use made of public funds by examining the application of budgetary rules and the execution of the budget (overruns, pertinence of certain decisions, etc.)

## Principal characteristics of public-sector accounting *derived from French experience*

- Significant experience was gained by RSM Salustro Reydel when it was assigned responsibility for supporting the privatisation of a telecommunication company. Considering the new privatisation programme underway in France, the following issues will have to be dealt with: EDF, Aéroports de Paris, motorways,...
  
- In this context, our principal assignments were to
  - ✓ assure the shift from public-sector accounting standards to business accounting standards
  - ✓ provide support for changes in its IT system
  - ✓ set up rules for in-house audit similar to those of private companies
  - ✓ and ensure the quality of published information
  
- More concretely, this involved
  - ✓ setting up a detailed file of fixed assets
  - ✓ setting up a system for entry of all operations affecting the company's asset base, in particular the treatment of all new commitments (mainly pensions)
  - ✓ determining the basis for the valuation of elements of the balance sheet, in order to estimate the going-concern value of the entire asset base, in particular real-estate holdings
  - ✓ determining the cost of different functions
  - ✓ determining tax expense
  - ✓ establishing projected income and expenses and determining the difference between projected and realized figures

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## Private sector participation to improve performance evaluation

### *Regulation and audit authorities*

- The participation of the private sector in the management of infrastructure or public services, in the form of concessions or public-service contracts, permits the introduction of a “best practice” approach that makes it possible to improve efficiency and make a fair evaluation of the performance of public services
- The participation of the private sector in the management of public infrastructure requires transparent laws and regulations
  - ✓ administrative procedures (awarding contracts, performance evaluation, subsidies, penalties, procedures for contract renewal, etc.)
  - ✓ legal and fiscal regulations
  - ✓ financial and accounting regulations
- The participation of the private sector implies the creation of credible audit authorities
  - ✓ follow-up on reciprocal commitments and contractual provisions between public and private sector
  - ✓ control of the quality, sales price and cost of services provided
  - ✓ respect for fiscal rules
  - ✓ respect for accounting regulations and monitoring financial information

## Private sector participation to improve performance evaluation

### *Accounting standards and the transparency of financial information*

- In this context, private sector accounting (accounting for commitments) allows for greater flexibility, better mastery of the costs of services and greater efficiency of the services provided
- The concessionaire company should provide the granting authority with all information that could bear on the quality or price of services it provides in the medium and long term, in order to permit a comparison with public sector services of the same nature
  - ✓ the classification of costs and expenses, related to financing and operating the service
  - ✓ capital expenditures (CAPEX) made, future expenditures for which provisions have been booked (replacement of infrastructure or bringing it up to standards, etc.)
  - ✓ respect for the accounting standards peculiar to the service concerned and to the applicable form of contract (inscription of capital expenditures made by the concessionaire, modalities of depreciation, CAPEX subsidies, provisions for major repairs, provisions for renewals, etc.)
  - ✓ respect for quality standards imposed in regulations and/or in the contract with the public authority (technical aspects, safety, hygiene, pollution and impact on the environment, etc.)
  - ✓ All this information is contained in a management report containing the financial statements (income statement, balance sheet, cash flow table) and an analysis of the quality of the service provided

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# IPSAS standards, bringing together public and private sector accounting standards

## *History and definition*

- The modernization of the accounting regimes of public-sector institutions began some ten years ago in many countries. It aimed at
  - ✓ providing them with a more effective and more harmonized accounting system
  - ✓ Responding to the new financial responsibilities deriving from enhanced decentralization and new requirements in accounting and financial reporting
- In this context, a process of reflection was begun that led to the creation of IPSAS (International Public Sector Accounting Standards) beginning in 1996
- These standards recommend adoption of accounting for commitments based on private-sector accounting, especially IAS standards, and the establishment of financial statements applied to all aspects of a government
- They were adopted
  - ✓ by the OECD in 2000, for the elaboration of financial statements
  - ✓ by NATO and the European Union in 2002 (coming into effect in 2005)

# IPSAS standards, bringing together public and private sector accounting standards

## *What are the advantages?*

- IPSAS standards are a common accounting framework for all public-sector entities of a government or an organization
  - ✓ they provide a “business” view of public-sector accounting, while proposing solutions that are adapted to the special characteristics of public sector organizations
  - ✓ They promote a close tie with the budgetary process and at the same time strengthen the idea of audit and comparability
- Setting up financial statements in conformity with IPSAS standards makes it possible to:
  - ✓ make the true cost of public administration more transparent
  - ✓ have a greater number of indicators for the preparation of the budget
  - ✓ make lawmakers aware of future expenses that do not appear in a purely budgetary approach
- In the absence of public service concessions or contracts, the adoption of these standards by government authorities, with an independent expert to audit their application, can also contribute to improved efficiency and a better evaluation of the performance of public-sector services

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## Conclusion

- Public administrations are traditionally characterized by resistance to change in the way they operate, for lack of innovation, a difficulty in adapting to demand, high operating costs and inappropriate capital expenditures
- The introduction of regulations and accounting standards applicable to the private sector, whether in the form of concessions or other contracts or through the evolution of public-sector accounting standards (IPSAS standards), makes it possible to improve flexibility, dynamism and efficiency in management, as well as the financial or socio-economic profitability of public services or infrastructure
- “Accounting is not an end in itself, but a means of providing information to enhance the continuity of budgetary policies and measure the performance and transparency of government finances.” (Florence Parly, French Minister of the Budget, 2000).