

Public-Sector Accounting and the International Standardization Process of Presenting Financial Statements

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ABSTRACT

A new movement to internationally standardize public-sector financial reporting started in 2000. This standardization process is led by the International Federation of Accountants (IFAC). IFAC has published standards for all public-sector entities, whether national central governments or local governments. In this article, both the standardization process and the chosen conceptual framework for the standards are critically assessed. The analysis is done in the country context of Finland, where the national government accounting board assessed the standards' usability.

Key Words: Accounting, standards, financial reporting, Finland.

1. Introduction

A strong movement to harmonize private-sector financial reporting has concerned listed companies. The comparability of financial statements presupposes that listed companies account for identical transactions and events in the same way. In Europe, the EU has stipulated that financial statements of listed EU companies must follow the IAS/IFRS standards¹ of the IASB (International Accounting Standard Board). In addition, there is a joint effort between European (IASB in Europe) and American (Financial Accounting Standard Board, FASB, in USA) standard setters to merge their conceptual frameworks (CF).

The IASB and its predecessor, the IASC, have been dominated in their standard-setting by the Anglo-American accounting tradition, and the standards have reflected the needs of the growing internationalization of capital markets and the information needs of capital providers (Camfferman and Zeff 2007). According to Botzem and Quack (2009, 994), there is little doubt that the Anglo-American coalition, led by accountants from global auditing firms, has been successful and has managed to

¹ International Accounting Standards/International Financial Reporting Standards.

ensure its influence through the IASC's² transformation into the IASB. The organizational configuration shows a strong dominance of the principle of expertise, mostly at the cost of representativeness.

The standardization process has also started in the public sector. It is not led by the IASB but by the International Federation of Accountants (IFAC) and its special committee. The IFAC is a non-governmental organization (NGO) registered in Geneva, Switzerland. It has in recent years become an integral player in global financial governance, as evidenced, for instance, by the European Commission's acceptance of International Standards on Auditing (ISAs) as authoritative statements on auditing practice (Loft, Humprey and Turley 2006, 429).

The IFAC has released not only standards on auditing but also international public-sector accounting standards for all public-sector entities, whether they are national central governments or local governments since 2000. The IFAC declares that its aim is to serve the public interest and to contribute to the efficiency of the global economy. The objective of the International Public Sector Accounting Standards Board (IPSASB) of the IFAC is to serve the public interest by developing high-quality accounting standards for use by public-sector entities around the world in the preparation of general-purpose financial statements (GPFS) (IFAC 2008, 4).

The aim of this article is to analyze, in a country-specific context, public-sector accounting and the present striving to standardize the presentation of financial statements in the public sector. A general goal to develop GPFS in the public sector can hardly raise any protests. However, the standardization process as well as the standards and their conceptual framework can be formed in different ways. In this article, both the standardization process and the conceptual framework chosen for the standards will be critically assessed. The analysis is carried out in the country context of Finland, where the national government accounting board has been conducting an assessment of the need to renew the Finnish model of government financial statements. However, the conclusions should have some universal applicability when considering the accounting and financial statement presentation model in any public-sector entity.

The focus is on accounting and general-purpose financial statements and not on the standardization of budget presentation, even if the IPSASB has published a standard on this. This problematic question of international budget standardization and regulation is only briefly addressed.

The novelty of this article comes from the case analysis focused on the FGAB's work regarding international standards. Why did a national authoritative accounting board take a negative stand and not recommend the adoption of IPSAS standards?

The empirical research material consists of the documents produced by the Finnish Government Accounting Board (FGAB) and of qualitative participatory observation by the author lasting a period of nine years, three years as a deputy member (2000-2003) and six years as a full member (2003-2009) of the FGAB. The author's participatory observation consisted of document analysis, direct participation and observation in FGAB meetings. During the period 2005-2009, the FGAB evaluated almost all standards released by the IPSASB and also gave a thorough

² IASC International Accounting Standards Committee, founded in June 1973 in London and replaced by the International Accounting Standards Board on 1 April 2001.

comment of the preliminary conceptual framework (CF) the IPSASB published in 2008. The special advantage of participatory observation comes from the insider's view of what is happening (Patton 1991, 75).

The structure of the paper is as follows. The introduction describes the background, aim, method and structure of the article. Section 2 describes the international standardization process, section 3 the main conceptual frameworks directing standard-setting and section 4 the unique Finnish governmental accounting system. Section 5 describes the FGAB and the output of its work. Finally, section 6 presents the conclusions.

2. The standardization process in the government sector

Generally one can discern four different stakeholders in the standardization process with varying powers to shape the outcomes (conceptual frameworks and separate standards). These four groups are financial statement users, preparers (management), independent public accountants and national regulators of accounting standards (Kwok and Sharp 2005, 76)

The quest for authority is an imperative for non-governmental standard setters like the IFAC and IPSASB. Reliance on approval and acceptance by private actors such as preparers, users or third parties (for example, banks or rating agencies) is not enough. International standards need to be permitted and endorsed by public actors like the US Securities and Exchange Commission and the European Commission. State recognition is a crucial requirement for international standard development (Botzem and Quack 2009, 994).

Before the turn of the century, governments did not have international accounting standards geared to the uniform presentation of financial statements and budgetary outcomes. Governments regulated their accounting systems and financial and budgetary reporting from their own starting points. This has led to diverse public-sector reporting systems. Nonetheless, a common trait in preparing accounts has been cash-based or modified cash-based book-keeping. The so-called cameral accounting model developed for the public sector emphasizes the money and payment control and budgetary control instead of emphasizing – like commercial accrual accounting models – the presentation of financial performance (profit or loss) and financial position (Monsen 2002 and 2007).

At the beginning of the 21st century, the situation changed. The IFAC began to release international public-sector accounting standards for public-sector entities, whether they be central governments or local governments. National governments and other public-sector entities are now urged towards conformity in presenting their general-purpose financial statements and budget outturn statements. Before this, the presentation modes and ways were a matter to be decided entirely by the governments themselves.

By the end of 2009, the IPSASB had released 26 accrual-based standards for governments. The IPSASB also issued a standard for cash-based financial statements but opted for a policy according to which cash-based accounting should be only a temporary solution for governments on their way to full accrual-based business like accounting and presentation of financial statements.

The standardization process so far can be criticized with several arguments. First, it is done by the IFAC and its special board (IPSASB), which are private-sector bodies and closely connected to the private-sector accounting profession and private funding. The private standard setter IFAC on its own initiative took the lead in international standardization. Other instances that could have been active are, for instance, the United Nations, the OECD or some other corresponding international institutes with a wide membership and financing base. It is positive that some national public-sector standard setters and public-accounting experts are represented in the IPSASB. The board conducts its standard preparation openly by giving stakeholders and any interested parties the option to make comments on discussion papers and drafts of standards.

The other severe problem in the standardization process is that the IFAC began to release the standards without first doing a thorough assessment and development of a conceptual framework for public-sector accounting and financial reporting. Only after releasing almost a whole package of standards did it begin to develop a general framework containing the principles standards should be based on. Initially it neglected basic conceptual work and just took the private sector IAS/IFRS standards for listed companies as a model for public-sector standards. The choice of standards for listed companies as a reference can be strongly criticized (Ellwood and Newberry 2007, Mack and Ryan 2006). The criticism by the FGAB regarding the CF is presented later in section 5.

Third, if a government chooses the IPSAS standards and is going to announce that the financial statement has been done according to the IPSAS standards, it must obey all standards issued, not just those that it considers useful. What makes this practically difficult and resource-demanding is that the IPSASB must continuously adjust standards. The IPSASB has so far concluded that any changes the IASB makes to IAS and IFRS standards for listed companies will require that the IPSASB must consider in due course the necessary changes in the corresponding IPSAS standards. This is a perpetual motion machine.

Fourth, the IPSASB has taken an approach in which the budget outturn statement is subordinate to the GPFS. From the point of view of government accountability and the information needs of parliaments, the highest budget decision-makers, the budget follow-up reports are the most essential reports that the government produces. Another question is how far budget models should be harmonized via IFAC standard-setting because budgets and budget decision-making are the realm of sovereign parliament decision-making and policy.

3. Accounting frameworks for the public sector

The methods of preparing accounts can be roughly divided into cash-based methods and accrual-based methods. Traditionally the public sector has emphasized the need to control public tax money and budget implementation, and these needs have been served with the help of cash-based or modified cash-based book-keeping (Monsen 2002 and 2007). According to the IPSASB (standard 1, definitions), accrual basis means accounting under which transactions and other events are recognized when they occur (and not only when cash or its equivalent is received or paid) and there-

fore, the transactions and events are recorded for the periods to which they relate. The elements recognized under accrual accounting are assets, liabilities, net assets/equity, revenue and expenses.

Accounting as a science is not an empirical science where one can empirically verify one accounting theory to be better than another as a description of an empirical state (Sterling 1981, 83-86). We cannot therefore empirically verify that one way of presenting financial accounts is theoretically better than another. This conclusion is relevant when considering a suitable conceptual framework, accounting methods and presentation models for public-sector financial reports.

Yet the researcher can form normative and practical conclusions on the best model for a specific accounting environment. One may emphasize the accountability of the use of tax money and follow-up of budget compliance. Or one may emphasize financial performance that is reported in GPFS and less budget compliance. These different approaches lead to different models of financial reporting.

It has traditionally been important in the public sector to serve the information needs of governments' principals. The government is accountable to parliament and voter-taxpayers, not so much investors or lenders, which are the most important stakeholders in the private sector regarding general-purpose financial statements. The tax-financed government does not pursue profit but rather a balanced economy and efficient and effective management of operations for the well-being of citizens.

These cornerstones may be forgotten or pushed aside in eager reforming. Traditional public-sector management has been increasingly replaced ever since the late 1980s with the so-called new public management (NPM). This NPM has included several dimensions, for instance the breakup of hierarchic public organizations into separately managed responsible units, a shift toward greater competition and market-based steering and a move towards the use of private-sector management practices within the public sector. Connected to the movement towards private-sector management practices has been mounting pressure to adapt businesslike accounting in the public sector (Hood 1995, Lapsley 2008). This has been clearly evidenced in the public-sector standards released by the IFAC and its board. The IFAC has recommended that public-sector entities should distance themselves from traditional cash-based accounting and move to accrual business-like accounting regulated by IPSAS standards.

The development of cameral accounting and cash-based accounting for the public sector no longer attracts much interest. During the NPM movement, interest has been directed at commercial accrual bookkeeping. Substituting cameral and cash-based accounting with commercial accrual accounting has been criticized for ignoring the special characteristics of governments (Falkman 1997, Mack and Ryan 2006, Christiaens and Rommel 2008). However, no unanimity amongst the accounting researchers has been achieved regarding the extent to which accounting frameworks and models should be different for private-sector for-profit organizations and public-sector not-for-profit organizations (Broadbent and Guthrie 2008, 150).

Critical writing often includes critical conclusions on the transferability of private-sector conceptual-accounting frameworks and standards directly to the public sector. General purpose financial reports may be based on two different conceptual frameworks: on a so-called decision-usefulness framework or on an accountability

framework. The decision-usefulness framework serves the needs of investors' decision-making while the accountability model of reporting emphasizes the accountability of agents to their principals (Ijiri 1983). Several researchers have seriously questioned the adoption of a private-sector reporting model based on decision usefulness as inconsistent with the accountability-reporting model relevant in the public sector. Theoretical criticism (Falkman 1997, Broadbent 1999, Monsen 2002, Pallot 2003, Christiaens 2004, Barton 2005, Christiaens and Peteghem 2007, Luoma, Oulasvirta and Näsi 2007) has been supplemented with some empirical research showing that the current private-sector general-purpose financial-reporting framework is not relevant for user needs in the public sector (Näsi 1999, Kohvakka 2000, Mack and Ryan 2006, 604).

4. The Finnish central government accounting system³

The Finnish central government book-keeping since 1998 can be described as a dual system that combines two different book-keeping methods. Budgetary (administrative) book-keeping and commercial double-entry book-keeping. In the accounting reform of 1998, budgetary book-keeping was supplemented by commercial double-entry book-keeping, which made it possible to present performance accounts in the form of an income statement (profit and loss statement) and a comprehensive balance sheet. Budgetary book-keeping belongs to administrative, cameral book-keeping. With the help of the budgetary book-keeping method, a statement of budget accounts is prepared and compared to the budget appropriations and revenue estimates.

The State Treasury merges the ledgers of all 90 or so accounting entities in a consolidated central-government financial statement. This contains the accounts of all government-budget entities, but not government funds, government enterprises, state-owned companies and universities (since 2010), all of which prepare their own separate financial statements.

The present book-closure model of central-government book keeping in Finland consists of three basic calculations:

- 1) A statement of revenues earned and expenses incurred (financial performance accounts). Budget entities do not pursue profit and this is one reason why the reformers were reluctant to name the statement a profit-and-loss statement, but rather a revenues-earned/expenses-incurred statement. Moreover, the pattern of this statement differs from the Finnish enterprise profit-and-loss statement.
- 2) A balance sheet that is now comprehensive, including all assets and all liabilities.
- 3) An annual statement of budget accomplishment (budget outturn).

³ Based on Monsen and Oulasvirta 2008.

According to the cameral accounting theory developed for public-sector entities (Monsen 2002, 2007), accountability of budget-money use is essential. This is still clearly reflected in the Finnish government-accounting model, where the annual statement of budget accomplishment (budget outturn) can be considered the most important calculation completed with the annexes and annual report explaining achievements in budget implementation. Although the new commercial book-keeping statements (the Statement of revenues earned and expenses incurred and the balance sheet) give new information, the real use of these statements in decision-making has been criticized as insignificant (Kohvakka 2000).

The Finnish government's commercial book-keeping differs from Finnish commercial enterprise accrual book-keeping. First, it is regulated differently. The government's commercial book-keeping as well as the government's budgetary book-keeping are both stipulated in the budget law and statute (act 423/1988, statute 1243/1243) whereas the commercial enterprise book-keeping is stipulated in the general book-keeping law (1336/1997) and statute (1339/1997). Secondly, the recognizing principles in accounting differ. The government transactions are mainly non-exchange transactions. The Finnish government has developed budget-allocating principles for non-exchange transactions and corresponding recognizing principles for book-keeping both in budgetary book-keeping and commercial book-keeping. There are even some differences in the accounting of exchange transactions, for instance, such as accounting for value-added tax, heritage assets and equity in the balance sheet (Pöllä and Etelälahti 2002, 149-157).

The Finnish government's commercial book-keeping differs even more from IAS/IFRS- and IPSAS-based accrual accounting, which emphasizes the balance sheet and has adopted an asset/liability model instead of the revenue/expense approach adopted in Finland. Both government commercial book-keeping and private-sector enterprise commercial bookkeeping before the influence of the asset/liability model have strongly emphasized the realization principle and the matching principle.⁴ The Finnish practice emphasizes the income statement as a flow statement that correlates revenues realized and earned with the expenses incurred. It is typical that the income statement must be done first and after that, the balance sheet is a carryover calculation from one accounting flow period to the next (the balance sheet as an opening to the next accounting period). The balance sheet contains expenditures bringing benefits in the future periods and because of this, they will be located with coming income statements of future periods. The FGAB has made a statement that this model serves public-sector information needs better than the asset/liability model and the presentation mode adopted by the IFAC and the IPSASB.

5. The FGAB's evaluation of the IPSAS framework

The FGAB members (7-9) are appointed to serve for three years at a time by the Ministry of Finance. According to the Budgetary Statute (11 December 1992/1243,

⁴ The realization principle means that profits should be recognized only when they have been realized or when this realization is assured. The matching principle requires that expired costs are matched against revenues realized during the accounting period.

§71a) the FGAB may issue statements and recommendations regarding how to apply the rules of government-accounting and the presentation of financial statements. It may also take initiative and make recommendations on how to develop government-accounting and -reporting and issue statements on important development plans for government accounting.

The author participated during the period 2005-2009 in almost all FGAB meetings where IPSAS standards were considered. The FGAB had 4-5 members representing Finnish government ministries and offices (preparers), one member represented the Finnish Supreme Audit Institution (auditors), 1-2 members the State Treasury and one (the author) academia. The chairman of the FGAB was a distinguished Finnish professional auditor with experience in both private- and public-sector auditing. The working schedule was that usually 1-2 IPSAS standards were considered in each meeting, held about 10 times per year. Each IPSAS standard was compared to the existing Finnish government accounting rules, and during the meeting, a conclusion was reached on the possible needs to change and accommodate government accounting rules to match IPSAS standards.

The FGAB also made comments on the consultation paper prepared by the IPSASB framework project. The IPSASB requested comments on this consultation paper (published in September 2008) regarding the conceptual framework for general-purpose financial reporting by public-sector entities. Comments were requested before the end of March 2009. The Finnish Government Accounting Board presented its critical comments on 31 March 2009. The FGAB in 2006 had already published a memorandum on the IPSAS standards and their application in government accounting. No dissenting opinions were attached to these two documents of the FGAB.

The FGAB analyzed the IPSAS standards and the conceptual framework presented by the IPSASB as a consultation paper in the year 2008. Although the IPSASB mentions in the consultation paper that there are differences in public-sector activities and aims compared to those of the private-sector business entities, it does not proceed far enough with the analysis. The conceptual framework has been developed too slavishly on the basis of the IASB (International Accounting Standards Board) framework, which was developed for private-sector listed companies. This conceptual framework of IASB is currently being developed in a joint project with the FASB (Financial Accounting Standards Board). According to the IASB framework, the principal objective in the preparation of financial statements and financial reporting is to determine the value of a listed company's equity for the decision-making purposes of investors.

Because the principal objectives of government financial statements and budget-accomplishment statements differ from corresponding private-sector objectives, the FGAB stated that the approach chosen by the IPSASB is not well-suited as the cornerstone for developing a conceptual framework for financial reporting by public sector entities. IPSAS standards are based on IAS standards that emphasize that the most important task of accounting is to prepare a balance sheet for the public-sector entity. This is a suitable approach for private-sector actors who invest money in different assets and who want to know the market value of their investments. But it is not a good accounting basis for a government with the core function of providing

services and with no shareholders who want to know the market value of government. The IASB framework as a model for IPSAS standards is not a realistic conceptual framework for public-sector entities (Finnish Government Accounting Board, 30 November 2006).

A more realistic approach according to the FGAB would be to develop a conceptual framework for financial reporting by public-sector entities from the starting point that the amounts of cash or cash equivalents arising from service production and other activities are registered in their accounting records. The financial statements are then constructed primarily on the basis of such accounting data (Finnish Government Accounting Board, 31 March 2009).

The government is accountable to its citizens and to parliament, which represents the citizens. The government is responsible for providing tax-financed public services and other activities effectively and in a financially sustainable manner. These aims require far more many-sided information than just book-keeping and accounting information in published GPFS. For instance, the government must give performance and qualitative information on services provided and macroeconomic information on government-budget policy results regarding growth, stability, inflation, unemployment and so on.

Further, the FGAB criticized in its comment of 31 March 2009 that the information needs of the primary users of GPFRs are different for public-sector entities operating on different levels (e.g. national, state, provincial, local government and agency level) so much so that the IPSASB framework should acknowledge the need for different reporting information needs.

Altogether 55 comments on the IPSASB's consultation paper regarding the CF were given in time, and these appear on the IFAC's website (<http://www.ifac.org>). The comments were analyzed in the FGAB, and the result of this analysis was that little over half of the comments were profoundly critical of the conceptual framework presented in the consultation paper.

6. Conclusions: Interpretation of the international harmonization project of public-sector accounting and the Finnish case

Although the general goal of reliable and comparable public-sector general-purpose financial statements as such is a relevant goal, there have been many flaws in the IPSASB's standard-setting work. The IPSASB has taken some of the critics seriously in its recent work. Still, it would be very difficult for the IPSASB to assent to a new road that leads to a different conceptual framework than it has relied on so far. If the IPSASB wants to do so, it will have to rewrite all its standards and admit the false bases in the standard-setting process.

The IASB spearheading the international harmonization of standards for listed companies has been interpreted to be an expression of the Anglo-American private interests (professional experts that have gained much of their expertise in the firms they worked for) which managed to establish a self-regulatory regime at the global level (Botzem and Quack 2009, 997). In the IFAC, too, the big international auditing firms' experts have had a strong influence and have been represented in IFAC's structures in their own right rather than via the representative structures of national

professional accounting bodies (Loft, Humprey and Turley 2006, 438, 442). It is noteworthy that IFAC's member organizations in Finland are two private-sector accountant associations and not public sector bodies.

A country may primarily adopt from the outside recommended CF because of persuasion and not because of free rational argue. It seems that international standards have been adopted in developing countries partly because of World Bank and IMF pressure connected to money lenders' interests (Loft, Humprey and Turley 2006, 431). According to Camfferman and Zeff (2007, 441), the early diffusion of IAS in developing countries is to be attributed to the World Bank's development agenda and less to the convincing content of the standards. These conclusions are also valid regarding IPSAS standards and their adoption in developing countries (Luoma, Oulasvirta and Näsi 2007).

In the background of the FGAB's work in Finland was, certainly, a pressure to be alert and mindful of international harmonization trends and plans. But no persuasion of international capital providers for the Finnish government was noticed in the FGAB meetings. The international institutions lending money to the Finnish government are able to have special-purpose financial reporting explicitly targeted to them by the State Treasury of Finland. My personal impression was that we based our work in the board only on our free reasoning without any threat or pressure coming from outside.

The board chairman may have a major influence on the board's decision-making. Regarding the FGAB, the chairman was a distinguished and highly appreciated professional in the Finnish accounting society. His reasoning during the meetings was strong and always well-grounded. It is important to note that he was not working for any firms belonging to the so-called Big Four group of international auditing firms.

Maybe the unique tradition of Finnish governmental accounting that has developed on its own premises and serves the government accounting and reporting needs well was an institutional barrier. When the Finnish government adopted commercial double-entry book-keeping in 1998, the choice of CF was our own accrual accounting framework based on a revenue/expense model instead of the asset/liability model that the IPSASB promotes in its CF.

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