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(002 1212286 9570)

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2 March 1999

The Director - General,  
International Federation of Accountants,  
535 Fifth Avenue, 26<sup>th</sup> Floor,  
New York, New York 10017,  
U.S.A.

Dear Sir,

**IFAC Public Sector Committee Exposure Draft**  
**on International Public Sector Accounting Standards**

--- Please find enclosed a copy of the Society's submission on the first five Exposure Drafts of International Public Sector Accounting Standards issued by the IFAC PSC for comments in October 1998. In formulating our views on the EDs, we have also obtained and taken into account comments made by the Treasury and the Audit Commission of the Government of the Hong Kong Special Administrative Region. Our submission is consistent with the views expressed by the two government bodies.

If you have questions on any points made in our submission, please contact Ms. Winnie Cheung, the Society's Director of Professional Practices in the first instance.

Yours faithfully,

LOUIS L.W. WONG  
REGISTRAR  
HONG KONG SOCIETY OF ACCOUNTANTS

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Encls.

[PSC\IFAC-Ltr]

**Submission by the Hong Kong Society of Accountants**

**IFAC Public Sector Committee Exposure Draft  
on International Public Sector Accounting Standards**

**ED 1 - 5**

Overall Opinion

1. We are in full support of the steps taken by IFAC to set accounting standards for the public sector in pursuance of the aim to improve the quality of public sector financial reporting worldwide.

Supplemented Detail Comments

2. The Exposure Drafts prescribe standards to be applied to four identified bases of accounting, namely, cash, modified cash, modified accrual and accrual. They do not prescribe the conditions or circumstances under which a particular basis should be adopted. Although guidance is given in the IFAC PSC's Guideline for Governmental Financial Reporting that the choice of the basis shall be determined by the objective of the reporting entity, it is very much a free choice for the entity concerned.
3. We are fully aware of the reason and the need for IFAC to adopt this approach. However, within each of the two streams of reporting, i.e., reporting of cash flows of an entity on one hand, and reporting of the financial position, financial performance and cash flows of an entity on the other, two different bases of accounting are allowed at the entity's choice: cash and modified cash in the former case and modified accrual and accrual in the latter case. The two permitted bases within each of the cash or accrual stream of reporting will produce accounts that will present a very different view from one another.
4. We disagree with the oversimplified approach taken in para.22 and 23 of ED1, that financial statements should present fairly the financial position, financial performance and cash flows of an entity when **either the accrual basis or modified accrual basis** underlies the preparation of the financial statements and similarly, financial statements should present fairly the entity's cash flows when **either the cash basis or modified cash basis** underlies the preparation of the financial statements.
5. In order to enhance the understandability and comparability of the accounts, it is imperative that the Standard should prescribe a requirement for the accounts to show a clear specification and explanation of the objective and the basis under which the accounts had been prepared and to relate these to the views given in the accounts. It will be helpful if standard wording could be prescribed for such disclosures in the accounts and also for the audit opinion (particularly with regard to any view that the auditor is expected to form on the choice of basis).

6. It is unnecessary to reproduce the definition of terms set out in ED 1 in every statement. For example, the definition of cash basis, modified cash basis, modified accrual basis, accrual basis, government business enterprises, net assets, net financial assets etc., which should be common terms applicable to all statements forming the set of standards and should not need to be repeated in each statement.

## **ED 1 - PRESENTATION OF FINANCIAL STATEMENTS**

### Specific Requests for Comments

7. (a) - Proposal to define the bases of accounting

#### *Accrual basis and modified accrual basis*

- (i) The definition in para.7 together with the explanatory paragraphs 15 to 17 are not sufficiently succinct or comprehensive to draw out a clear distinction between the accrual basis and modified accrual basis. For example, the major distinction in the treatment of physical assets is not highlighted. This can only be deduced from reading together the definition of "expenditures", "expenses" and "surplus/deficit from ordinary activities".

We believe a comprehensive yet succinct definition should be prescribed for each accounting basis. This should be a stand alone description which is capable of being adopted for disclosure of the accounting basis used in the accounts (see proposal in point 5. above).

- (ii) The wording of the definition of the two basis should be better aligned with each other in terms of the common features (e.g. compare the wording "and not as cash or its equivalent is received or paid") in the definition of "accrual basis", and "rather than when cash is paid or received" in the definition of "modified accrual basis".
- (iii) The words "cash equivalent" should appear in the definition of all four basis.

#### *Cash basis and modified cash basis*

- (iv) See (iii) above.
- (v) In the definition of "modified cash basis", it is not clear whether the period of "around a month after year end" is specified by and form part of the Standard or rather, is an example of the period that may be specified by the entity. If the former, the wording should be tightened. If the latter, a disclosure requirement of the "specified period" should be prescribed.

8. (d) - Proposal to apply the going concern assumption

It is stated in para. 36 that 'Financial statements should be prepared on a going concern basis .....'. There is an anomaly in that it is not clear what a going concern basis is in relation to a set of financial statements.

The wording used in the IAS is "The financial statements are normally prepared on the assumption that an enterprise is a going concern and will continue in operation for the foreseeable future ....".

It is not clear why there is a need to deviate from the IAS wording. We prefer adoption of the entire wording of para. 23 of the IAS framework.

Other Comments

9. According to the definition of "Government Business Enterprise" (GBE) in para. 7, one of the separately identified essential characteristics of this type of entity is that it should have a separate legal identity. Our Government operates Trading Funds which are effectively GBE's in the way that they are accounted for separately from the rest of government, but they do not, in fact, have a separate legal status.

We propose deletion of the word "legal" in para. (a) of the definition in para. 7 on page 15.

10. Para. 21 - we consider that disclosure of compliance with legislative, regulatory or other externally imposed regulations as they relate to the accounts should be made in the financial statements rather than "for a note to the financial statements to refer to any documents which include that information" as suggested by para. 21.

11. Inconsistencies of terms and other typographical points.

(a) Para. 7

- (i) **Expenditures.** The term "accounting period" (used twice) is inconsistent with the wording "reporting period" in the definition of Revenue;
- (ii) **Expenses.** The term "accounting period" is inconsistent with the wording "reporting period" in the definition of Revenue;
- (iii) **Extraordinary items.** A full-stop is missing at the end of the paragraph;
- (iv) **Financial assets.** The wording "These assets are restricted to those that are in the form" is inconsistent with the wording "These assets are in the form" in the definition of Financial Assets in ED3 and ED5;

- (v) **Revenue.** The term "inflows in financial assets" in sub-paragraph (a) is inconsistent with the wording "inflows of financial assets" in the definitions of Revenue in ED2 to ED5. The term "accounting period" in sub-paragraph (b) is inconsistent with the wording "reporting period" in sub-paragraph (a) in the definition of Revenue in ED2 to ED5; and
  - (vi) **Surplus/deficit from ordinary activities.** The wording "after expenses have been deducted from revenue" in sub-paragraph (a) and the wording "after expenditures have been deducted from revenue" in sub-paragraph (b) should be revised as extraordinary items of expenses, expenditures and revenues are to be excluded.
- (b) Para. 84, pg. 39
- The term "long-term interest bearing" is inconsistent with the term "long-term interest-bearing" used in paragraph 87(j) on page 40.
- (c) Para. 95, pg. 43
- The term "described by" in sub-paragraph (a) should be changed to "described in". The wording "accumulated surpluses and deficits" in sub-paragraph (e) should be changed to "accumulated surpluses or deficits".

## **ED 2 - CASH FLOW STATEMENTS**

### Other Comments

12. The drafts take the format of embedding the standard (in italic) with explanatory notes (in standard fonts). This has the obvious advantage of providing elaboration on relevant parts at the right context. Part of the elaboration, however, is prescriptive in nature, and should form part of the standard. Examples of these include para. 60, 44, 46 and last sentence of para. 7.
13. Para. 12 on Government Business Enterprises and Para. 13 to 15 on Cash and Cash Equivalent are elaborations on the definition paragraphs. To be consistent, they should immediately follow the respective paragraphs in the definition. The content of these few paragraphs are essentially repetition of the definition and do not actually provide elaboration. Perhaps examples should be given in these paragraphs instead of putting almost the same wordings as in the definitions but in a different format.
14. Para. 21 (j): the sentence "... held for dealing or trading purposes" should be changed to "... held for dealing or trading of securities" given that the elaboration in para. 22 refers only to "securities". If the intention is to cover other financial instruments, para. 22 should be amended to reflect the intention.

15. Para. 42 provides elaboration on para.41, which applies to all basis of accounting. For cash and modified cash basis, the cash flow statement would be the primary statement, in which case the need to provide further explanation by way of note on extraordinary items should also apply. The last sentence in the para. seem to suggest that further explanatory note is only needed for the other two bases and only apply to the statement of financial performance.
16. Para. 49 requires tax to be classified according to operating, investing and financing activities and total tax to be disclosed. There is no guidance on the format for reporting the latter.
17. Non-cash Transactions -  
  
In para. 57 - It is recommended that in disclosing non-cash transactions "elsewhere in the financial statements", a reference note is placed on the Cash Flow Statement to indicate where such transactions can be found.  
  
In para. 58, non-cash transaction should cover transactions like exchange of major assets in a non-cash manner.
18. In para. 62, it is not clear how cash under restricted use should be disclosed, whether by note or on the face of the account, and if the latter, the format to do so.
19. Inconsistencies of terms and other typographical points
  - (a) Para.11
    - (i) Same comments as points 7, 9, 11 above.
    - (ii) **Extraordinary items.** The word "occur" in (a) and (b) should be changed to "recur" and a comma should be added after "in the context of a cash flow statement" in (b), to be consistent with the wording in the definitions of Extraordinary items in ED1 and ED3.
    - (iii) **Government Business Enterprise.** The wording "A Government Business Enterprise is" should be changed to "Government Business Enterprise means", to be consistent with the wording in the definitions of Government Business Enterprise in ED1 and ED3 to ED5.
    - (iv) **Specified period.** This term appeared only in the definition of modified cash basis and nowhere else in the ED. The term modified cash basis also appears, but a definition for specified period has not been specified in ED1 and ED3 to ED5.
  - (b) The heading "INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARD XX" should be changed to "INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARD IPSAS XX" for consistency.

- (c) The wording "for the purposes of this definition" should be added at the end of paragraph 12 after the word "control". This is in line with the wording in ED1 and ED3 to ED5.
- (d) The wording "cash in cash equivalents" in paragraph 15 should be changed to "cash and cash equivalents".
- (e) The term "cash flows" should be changed to "cash flows from operating activities".

### **ED 3 - NET SURPLUS OR DEFICIT FOR THE PERIOD, FUNDAMENTAL ERRORS & CHANGES IN ACCOUNTING POLICIES**

#### Specific Request for Comments

- 20. With regard to examples of extraordinary items, they would depend on the particular circumstances of a public sector organisation and would also vary from country to country. Therefore, it would be better to leave such classification to the judgement of the public sector entities.

#### Other Comments

- 21. Changes in Accounting Policy (Para. 61) - Para. 61 seems to suggest that under an accrual or modified accrual basis of accounting, no retrospective adjustments can be made, but other paragraphs in that section and the example on page 49 of the ED would suggest that retrospective adjustments may be allowed.
- 22. Government Business Enterprise (Para. 10, pg. 16) - One of the criteria in the term is "... not reliant on government funding to be going concern". More explanatory guidance on the meaning of funding will be helpful (including land, manpower, capital injection etc.).
- 23. Para. 41, pg.25 - "Omission of major revenue or expenses" may be a better example from Government's angle than omission of a major asset/liability, for "fundamental" error with a significant effect to the financial statement.
- 24. Inconsistencies of terms and other typographical points
  - (a) Para. 10  
Same comments as points 7, 9, 11 above.
  - (b) In para. 10 of pg. 15, the definition of exchange rate may be deleted as it is not used in other paragraphs of ED3.
  - (c) The term "accumulated surplus or deficit" in paragraphs 43 and 44, and pages 45, 46, 49 and 50 should be changed to "accumulated surpluses or deficits", as used in paragraphs 61, 70 and 72.

## ED 4 - THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

### Specific Request for Comments

25. We concur that the standard should follow IAS and allow both a benchmark treatment and an alternative treatment for the recognition of exchange differences associated with the purchase of assets in certain circumstances.

### Other Comments

26. Inconsistencies of terms and other typographical points
- (a) Para. 11
    - (i) Same comments as points 7, 9, 11 above.
    - (ii) **Revenue.** The terms "modified accrual basis of accounting" in sub-paragraph (a) and "accrual basis of accounting" in sub-paragraph (b) are not consistent with the wording "modified accrual basis" and "accrual basis" respectively in the definitions of revenue in ED1 to ED3 and ED5.
  - (b) In para. 19 of pg. 17, the wording "the accrual basis or modified accrual basis of accounting" should be changed to "the accrual basis or modified accrual basis". This is in line with the wording used throughout the Exposure Draft.
  - (c) In para. 63 of pg. 30, the term "Accounting for Income Taxes" should be changed to "Income Taxes" which is the proper name of IAS 12.
  - (d) The wording "the preparation of financial statements" in paragraphs 65 and 68 should be changed to "the preparation of the financial statements". This is in line with the wording used throughout the Exposure Draft.

## ED 5 - BORROWING COSTS

### Other Comments

27. In para. 9 - Borrowing costs in relation to the cash basis or modified cash basis should also include the discounts or premiums relating to borrowings as well as the ancillary costs incurred in connection with the arrangement of borrowings.
28. Inconsistencies of terms and other typographical points
- (a) Para. 7
    - (i) Same comments as points 7, 9, 11 above.
    - (ii) **Financial assets.** The wording "a past event" is inconsistent with the wording "past events" in the definitions of financial assets in ED1 and ED3.



- (b) Para. 16 requires that, when the cash basis or modified cash basis underlies the preparation of the financial statements, the financial statements should disclose total borrowing costs recognized as payments during the period. There should be a corresponding requirement that, when the accrual basis or modified accrual basis underlies the preparation of the financial statements, the total borrowing costs incurred during the period should be disclosed.