THE MALTESE PERSPECTIVES ON THE CONCEPTUAL FRAMEWORK FOR THE PUBLIC SECTOR PROPOSED BY THE IPSASB

BY

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A dissertation in the Faculty of Economics, Management and Accountancy submitted in partial fulfilment of the requirements for the award of the Bachelor of Accountancy (Honours) degree at the University of Malta

APRIL 2012

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Title: The Maltese Perspectives on the Conceptual Framework for the Public Sector proposed by the IPSASB.

Purpose: This study highlights the key differences between the conceptual framework for the public sector being proposed by the IPSASB and the IASB conceptual framework for the private sector. It then analyses the arguments in favour and against the public sector conceptual framework, including the perceptions of Maltese government officials, the National Audit Office, the Internal Audit and Investigations Department and academics. Currently, Malta’s governmental accounting is cash-based, however, the ultimate aim is to move to a full accrual accounting system at central government level. Thus, the General Government needs to adopt a set of accounting standards which are normally based on a conceptual framework.

Design: Information about governmental accounting and any relevant conceptual framework is scant in Malta, therefore, the nature of this study is exploratory. As a consequence, a qualitative approach was considered more appropriate than a quantitative approach. The research tool used was the semi-structured interview.

Findings: The conceptual framework being proposed by the IPSASB differs in some aspects from the IASB framework. This can be attributed to the fact that the public sector is different from the private sector, mainly due to the reporting objectives and the users of financial reports. Problems regarding the identification of the reporting entity and the going concern concept become evident in the public sector. Overall, the opinions in Malta support the concepts depicted in the IPSASB conceptual framework. Unfortunately, a drawback of this conceptual framework is that it still lacks the legal and professional basis before it can be applied to the Maltese public sector.

Conclusions: The current sovereign debt crisis revealed many weaknesses in public sector accounting and this framework can provide the basis for a way forward.

Value: This study aimed to highlight the need for more guidance in governmental financial reporting. Many professionals reported difficulties in applying certain concepts to the public sector, suggesting the need for more education in public sector accounting.

Key words: Conceptual Framework, governmental accounting, IPSASB, Public Sector.

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DECLARATION

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I hereby declare that I am the legitimate author of this Dissertation and that it is my original work.

No portion of this work has been submitted in support of an application for another degree or qualification of this or any university or institution of learning.

_________________________________________  ________________________________
Signature of Student                          Name of Student (in Caps)

26th April 2012

Date
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To my parents,
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<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>CP</td>
<td>Consultation Paper</td>
</tr>
<tr>
<td>DAS</td>
<td>Departmental Accounting System</td>
</tr>
<tr>
<td>ED</td>
<td>Exposure Draft</td>
</tr>
<tr>
<td>ESA</td>
<td>European System of Accounts</td>
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<tr>
<td>EU</td>
<td>European Union</td>
</tr>
<tr>
<td>FASB</td>
<td>Financial Accounting Standards Board</td>
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<tr>
<td>GASB</td>
<td>Governmental Accounting Standards Board</td>
</tr>
<tr>
<td>GBE</td>
<td>Government Business Entity</td>
</tr>
<tr>
<td>GPFR</td>
<td>General Purpose Financial Report</td>
</tr>
<tr>
<td>GPFS</td>
<td>General Purpose Financial Statement</td>
</tr>
<tr>
<td>HoTARAC</td>
<td>Heads of Treasuries Accounting and Reporting Advisory Committee</td>
</tr>
<tr>
<td>IAID</td>
<td>Internal Audit and Investigations Department</td>
</tr>
<tr>
<td>IAS</td>
<td>International Accounting Standard</td>
</tr>
<tr>
<td>IASB</td>
<td>International Accounting Standards Board</td>
</tr>
<tr>
<td>IFAC</td>
<td>International Federation of Accountants</td>
</tr>
<tr>
<td>IFRS</td>
<td>International Financial Reporting Standard</td>
</tr>
<tr>
<td>IPSAS</td>
<td>International Public Sector Accounting Standard</td>
</tr>
<tr>
<td>IPSASB</td>
<td>International Public Sector Accounting Standards Board</td>
</tr>
<tr>
<td>KPI</td>
<td>Key Performance Indicator</td>
</tr>
<tr>
<td>MFEI</td>
<td>Ministry of Finance, the Economy and Investment</td>
</tr>
<tr>
<td>MGAS</td>
<td>Malta Government Accounting Standard</td>
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</table>
MP  Member of Parliament
NAO  National Audit Office
PAC  Public Accounts Committee
PSC  Public Sector Committee
SNA  System of National Accounts
UK   United Kingdom
USA  United States of America
VFM  Value For Money
CHAPTER 1

INTRODUCTION

“To understand a story you must first refer to the beginning”
Chapter 1

1.1 BACKGROUND INFORMATION

General Governments also include local governments within their structures. In fact it is rather misleading to refer to the government as a single entity. This complex structure attached to the general government has led to different accounting practices between one section and another (Jones and Pendlebury, 2010).

Figure 1: The Structure of the Public Sector

The emergence in recent years of the International Public Sector Accounting Standards Board (IPSASB) within the International Federation of Accountants (IFAC) has clearly resulted from the need for clear guidance when dealing with governmental accounting, especially in the situation where governmental financial accounts which are traditionally prepared on a cash basis have to be converted to an accrual basis (Pitzer and Dupuis, 2006).
board was formerly known as the Public Sector Committee (PSC) which was set up with the objective to focus on the accounting and financial reporting of national and local governments (Deloitte, IAS plus [Online], 2011). With this objective in mind, the IPSASB issued a number of International Public Sector Accounting Standards (IPSASs), which were mainly based on the International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB). However, as stated by Gingell (2003) in his dissertation,

‘It is simply not possible to ingrain IAS in totality into public sector accounting rules and expect them to work.’

(Gingell, 2003: 9)

In December 2010, the IPSASB issued an Exposure Draft (ED) entitled, “A Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities.” The main insights of this conceptual framework are the following:

- Role, Authority and Scope;
- Objectives and Users;
- Qualitative Characteristics; and
- Reporting Entity.

The need for such standards within the public sector has caused a wide debate. The same applies for this Conceptual Framework.
1.2 RESEARCH OBJECTIVES

The main objective of this study is to analyse the Conceptual Framework being proposed by the IPSASB. The focus will be on highlighting the differences between the conceptual framework issued by the IPSASB and the one issued by the IASB. The other objective is to analyse the arguments in favour and against this Conceptual Framework for public sector entities, including some local perceptions on the matter.

1.3 THE NEED FOR SUCH A STUDY

Currently, in Malta the Financial Administration and Audit Act\(^1\) requires the accountant general to prepare and forward to the auditor general the financial report for the central government of Malta, prepared on a cash basis\(^2\).

A major reform which is currently being undertaken by the Government of Malta is the introduction of a system of accrual-based accounting. The end goal of this reform is that all government ‘reporting units’ will have to present a set of accrual-based financial statements which will be consolidated. The final reporting entity may ultimately be the Central or General Government\(^3\).

---

\(^1\) Chapter 174 of the Laws of Malta.

\(^2\) An abstract from the financial report of 2010 is included in Appendix VIII (Pg. A. 19) for reference purposes.

\(^3\) IPSASs apply to all Public Sector entities with the exception of GBEs that is Public Corporations. Therefore any reference to the Public Sector will exclude Public Corporations.
Malta’s governmental accounting is cash-based at central government level\(^4\) and a modified accrual basis is being used to produce trial financial statements by these “reporting units”. However, accounting reforms are being directed towards the implementation of full accrual accounting by the central government, therefore the General Government would need to adopt a set of accounting standards. These accounting standards are normally based on a conceptual framework as in the case of business accounting and IFRSs. The Government needs to be aware of such a framework, refers to it, and ultimately decides what aspects are acceptable or not.

Lapsley (1988) points out that one of the four main issues in the accounting literature with regards to financial accounting and accountability is the search for a conceptual framework.

The question which arises is whether government accounting differs from business accounting in the private sector. Since the IPSASs, which are applicable to public sector entities are based on the IFRSs, one would question whether the public sector should have its own conceptual framework. Another issue is that Governments are sovereign and therefore the question arises whether their sovereignty would be challenged by such a conceptual framework.

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\(^4\) Central government refers to the ministries and the departments and entities in their portfolio (excluding public corporations).
1.4 SCOPE AND LIMITATIONS

This dissertation only tackles the first phase out of the four phases of the conceptual framework project undertaken by the IPSASB. The IPSASB had to also take into consideration the statistical bases of reporting of the System of National Accounts (2008) (SNA 08)\(^5\) together with the European System of Accounts (ESA 95) and the Government Finance Statistics Manual (GFSM 2001). A project has been undertaken to harmonise the concepts of the SNA 08, ESA 95 and GFSM 2001 with the accounting standards for the public sector (Dupuis et al, 2006). These concepts, however, will not be detailed in this study as they fall out of scope of this dissertation. Reference to the IASB framework will be the one issued in September 2010. In the case of the reporting entity, reference is made to the IASB framework issued in 1989 as there is no reference in the one issued in 2010.

\(^5\) Vide Appendix IV (Pg. A.7) for more detail.
1.5 DISSERTATION OVERVIEW

Figure 2: Dissertation Overview

1. **Introduction**: This chapter focuses on the research objectives, the role of the IPSASB and the need for such a study in the Maltese public sector.

2. **Literature Review**: This chapter gives a general overview of how the IPSASB Conceptual framework is being discussed in other countries and the differences between this framework and the one issued by the IASB.

3. **Research Methodology**: This chapter describes the research methodology used for the collection of primary data.

4. **Findings and Discussion**: This chapter gives an explanation of the findings together with a detailed discussion.

5. **Conclusions and Recommendations**: This chapter gives an overall summary of the study, with some conclusions and recommendations.
“The Art of Understanding”
Chapter 2

Literature Review

Figure 3: Chapter Outline

s2.1 Introduction

s2.2 Public Sector Accounting

s2.3 Public Sector Conceptual Framework

s2.4 The need for a public sector conceptual framework

s2.4.1 Differences between the public and private sector

s2.5 Role, Authority and Scope

s2.6 Objectives and Users

s2.6.1 Relevance of these objectives

s2.6.2 Problems with objectives and users

s2.7 Qualitative Characteristics

s2.7.1 Problems with characteristics

s2.8 The reporting entity

s2.8.1 Problems with the reporting entity

s2.9 Global Comparative Study

s2.10 Conclusion
Chapter 2

2.1 INTRODUCTION

This chapter outlines the main trends in public sector accounting, focusing in particular on the issues behind the recently proposed public sector conceptual framework.

2.2 PUBLIC SECTOR ACCOUNTING

‘Member State governments and government sub-sectors maintain public accounting systems which include elements such as bookkeeping, internal control, financial reporting, and auditing. Those systems should be distinguished from statistical data which relate to the outcomes of government finances based on statistical methodologies, and from forecasts or budgeting actions which relate to future government finances.’


A major distinguishing characteristic of national governments is sovereignty over their territory and their right to impose taxes, unlike private businesses which have to earn their revenues and compete with similar businesses (Jones and Pendlebury, 2010).

The need for guidance in this sector has led to the development of accounting standards suitable for the public sector. However, each government is sovereign and will interpret these standards according to its accounting practices. The most important information for government is that information required for the creation of the budget which is prepared annually in order to
summarise all revenues and expenditures of the government. Accounting, therefore, plays an important role here; however, in some countries the budget is not consistent with the accounting information (Jones and Pendlebury, 2010).

A major reform being considered by many governments is the preparation of accrual-based financial statements and budgeting. There are some problematic issues in accrual accounting that need to be addressed, such as the accounting treatment of heritage assets, infrastructure assets or non-exchange transactions (Jones and Pendlebury, 2010).

2.3 PUBLIC SECTOR CONCEPTUAL FRAMEWORK

The financial and sovereign debt crisis has led to the need for a better financial reporting by governments worldwide (IPSASB, 2011b). The next step for general governments is the preparation of a set of financial statements for the government as a whole. This set of financial statements needs to be regulated by accounting standards, which in turn need to be based on a conceptual framework, which is:

‘A high-level set of principles that guide a standards setter when deliberating future standards and evaluating existing standards and practices.’

(GASB, 2006: 33)
In May 2005, the IASB and the US Financial Accounting Standards Board (FASB) joined forces to create a common conceptual framework that had the purpose of creating an improved set of International Accounting Standards (IASs) for the private sector (Bence and Fry, 2007). A problem which each country faces is that when a country adopts IASs, it automatically gives up the right to make its own accounting standards (House, 2004).

Another problem which the IASB had to face was that international standards for the private sector were being created without an effective conceptual framework and that many decisions relating to conceptual issues were decided in the development of new standards (Bence and Fry, 2004).

One may expect that these same problems are also encountered in the public sector. The IPSASB has engaged in this project of developing a conceptual framework for general purpose financial reporting by public sector entities, since it holds the view that the public sector should have its own guidelines in financial reporting (IPSASB, 2006). However, it is even harder for a government to give up its sovereignty and hand it over to a private sector organisation.

2.4 THE NEED FOR A PUBLIC SECTOR CONCEPTUAL FRAMEWORK

Does the Public Sector really need its own Conceptual Framework? Cannot the Public Sector apply IFRSs like GBEs and therefore rely on the IASB’s
“Conceptual Framework”? However, as Ranson and Stewart (1994) argue, financial reporting for the public sector should be based on the distinctive features of this sector, which are completely different from that of the private sector. Lüder (2008) strengthens this point by stating that what is needed is a conceptual framework for the public sector to further develop the standards for this sector.

The IPSASB has already developed one cash-based and thirty-one accrual-based IPSASs (IPSASB, 2011b). This project was developed to create a public sector conceptual framework to be used as a basis for IPSASs and also to tackle the problem of the reporting entity, which is not so easily identifiable for accounting for public sector entities (IPSASB, 2006).

2.4.1 DIFFERENCES BETWEEN THE PUBLIC AND PRIVATE SECTOR

Laughlin (2008) argues that ideally, there should be one conceptual framework for both sectors, however, this is quite difficult due to the differing nature and characteristics. Differences revolve around many issues such as objectives, profit motive, users with different information needs, sources of revenue and ability to operate in the long term (GASB, 2006).

Another aspect is budget reporting, which is a control tool for government operations. Unlike private businesses, this is not an internal management tool but is available to the general public and thus needs to be guided thoroughly (GASB, 2006).
According to the Governmental Accounting Standards Board (GASB) report (2006), differences in user needs between the two sectors can be seen in the financial reporting model, the definition of the reporting entity, service-oriented infrastructure assets, grants and debt refunding.

These differences between the public and private sector environments are summarized in Table 1.

Table 1: Key Differences between the Public and the Private Sector

<table>
<thead>
<tr>
<th>Public Sector: Key Differences</th>
<th>Private Sector: Key Differences</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Objective:</strong> Delivery of Goods and Services</td>
<td><strong>Objective:</strong> Generation of Profits</td>
</tr>
<tr>
<td>Non-Exchange Transactions</td>
<td>Voluntary exchange transactions</td>
</tr>
<tr>
<td>Users have broader information needs</td>
<td>Users have lesser information needs</td>
</tr>
<tr>
<td>Budget is publicly available</td>
<td>Budget is an internal management tool</td>
</tr>
<tr>
<td>Non-competitive Environment</td>
<td>Competitive Environment</td>
</tr>
<tr>
<td>Responsibility for national and local heritage</td>
<td>No responsibility for national and local heritage</td>
</tr>
<tr>
<td>Existence for a very long time</td>
<td>Existence for a shorter time</td>
</tr>
<tr>
<td>Ownership of Natural resources</td>
<td>No ownership of Natural resources</td>
</tr>
<tr>
<td>Regulatory responsibilities</td>
<td>No regulatory responsibilities</td>
</tr>
</tbody>
</table>


Furthermore, the constant pressure for governments to prepare a set of financial statements for the whole public sector emphasise the importance of concepts on which ultimately these statements will have to rely on.
Chapter 2

2.5 ROLE, AUTHORITY AND SCOPE

As explained in the ED issued by the IPSASB in December 2010, this conceptual framework is intended for public sector entities, excluding Government business entities (GBEs) such as public corporations. This ED is intended for those entities using accrual-based accounting. The proposed conceptual framework does not have authoritative powers. Consistent with the IASB framework, it also does not override any IPSASs (IPSASB, 2010: par. 1.2). The concepts found in this conceptual framework are there to guide governmental financial reporting. In the case of the IASB framework, concepts are used for the preparation and presentation of financial statements for external users.

The problem with IPSASs is that many of them are based on the IASs/IFRSs designed for the private sector, adjusted to cater for public sector requirements. Lüder (2008) argues that it is difficult to find substantive differences between the two conceptual frameworks. Current IPSASs reflect concepts and definitions of the IASB framework, again, with some adjustments to reflect the public sector environment. Moreover, as stated by Jones and Pendlebury (2010), these public sector accounting standards have no formal status both in the United Kingdom (UK) and the United States of America (USA). This is also true for the IPSASB framework which does not have any authoritative powers.
The framework issued by the IPSASB, makes use of the words “General Purpose Financial Reports (GPFRs)” which are broader and include more information than “General Purpose Financial Statements (GPFSs)”\(^6\). As stated in the ED, GPFRs include financial statements and their notes and also financial and non-financial information (IPSASB, 2010: par. 1.6). Figure 4 provides an illustration of these meanings.

**Figure 4: The Difference between GPFRs and GPFSs**

![Diagram showing the difference between GPFRs and GPFSs](image)


The requirement for non-financial information will enable a government to better assess its performance in delivering services to its citizens and the achievement of social objectives (IPSASB, 2006). Management accounting

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\(^6\) It is interesting to note that even the IASB framework (2010) makes use of the words GPFRs; in fact it establishes an objective of financial reporting and not just of financial statements. This indicates that the scope is broader.
emphasises the importance of non-financial information for service
businesses, and this is also true for governments being service providers. In
the private sector, the measure used for performance reporting is profit
based, which may be inappropriate for the public sector (GASB, 2006).

The German literature does not refer to the difference between GPFSs and
GPFRs. The only reference is that GPFSs should include a commentary
(Heiling, 2011). The framework states that reports will include non-financial
information, which even though is important, will have audit implications
(KPMG IFRG, 2011). Another concern is that accrual accounting was not

2.6 OBJECTIVES AND USERS

The urgent need for a proper governmental financial reporting was felt at the
end of the nineteenth century and at the beginning of the twentieth century,
when the government no longer served for military purposes only but also
became a service provider (GASB, 2006). The need to provide a better service
led to the emergence of government accountability:

‘A government’s responsibility to justify to its citizenry
the raising of public revenues and to account for the use
of those public resources.’

(GASB, 2006: 5)
Consistent with the IASB framework, the one issued by the IPSASB gives us an indication that the scope of financial reporting should conform to the objectives of reporting. In addition, the IPSASB framework states that it also has to respond to the particular characteristics of public sector entities (IPSASB, 2010, par. 1.5).

In addition to the objective pointed out in the IASB framework (2010), that is to provide information useful for decision making, the IPSASB also included the objective to provide information for accountability purposes.

The IPSASB identified service recipients, resources providers and their representatives to be primary users of GPFRs. In fact, the government, being a service provider has to ultimately satisfy its customers who are the citizens and their representatives. The IPSASB identified the legislature as users of GPFRs in their capacity of being representatives of citizens. In the case of the IASB framework (2010), primary users include potential and existing investors, lenders and other creditors. It is a fact that financial statements cannot satisfy the information needs of every user, however it is also true, as highlighted by the IASB framework (1989), that,

‘... there are needs which are common to all users.’

(IASB Framework, 1989: par. 10)
The IPSASB also added the point that service recipients will use GPFRs in order to assess that resources are being used efficiently; the level of taxes is enough to maintain the same level of quality of services and that ultimately objectives are being reached. (IPSASB, 2010: par. 2.8, 2.10). In order to satisfy those needs, users have to be provided with information on the entity’s financial performance, cash flows and financial position in the reporting period. Here the IPSASB is being consistent with the concepts in the IASB framework (2010).

Moreover, the IASB framework (2010) makes reference to a hierarchy of users in its basis for conclusions. This hierarchy would mean that some users, identified as primary users, will be considered more important than others. The IPSASB does not make reference to such a hierarchy.

2.6.1 THE RELEVANCE OF THESE OBJECTIVES

The inclusion of accountability as an objective is fundamental. Simpkins (n.d.) and Lennard (n.d.) advocate that stewardship or accountability were not given enough importance by the IASB framework. In fact Simpkins (n.d.) concludes that accountability should be considered as an objective on its own.

Moreover, Christensen and Demski (2003) have indicated two schools of accounting theory. The first is the “value school” which refers to the objective to facilitate economic decision making whilst the second one is the “information school” which refers to the objective to have updated information at hand for accountability purposes. Sundem (2007), states that a
revenue/expense approach is the most suitable for the objectives of accounting highlighted by the “information school” and an asset/liability approach conforms to the objectives of the “value school”.

2.6.2 PROBLEMS WITH THE OBJECTIVES AND USERS

The fact that IPSASB has identified two objectives of financial reporting rather than one is causing a lot of turmoil in Europe. Furthermore the two objectives identified in the proposed framework have not been approved by all. For instance in German literature, we find ‘objectives’ referred to as ‘purposes’ (Heiling, 2011). The GASB and the FASB have also identified two other objectives, including compliance with the applicable laws and the comparison of actual figures with budgeted ones (Granof and Khumawala, 2010).

Some respondents to this framework (IFAC, IPSASB n.d. b) argue that there are differences between the two objectives: accountability⁷ and decision usefulness. The former is considered to be more generic than the latter one. Figure 5 illustrates such differences.

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⁷ Stewart (1984) divides accountability into four, leading to a ‘ladder of accountability’, which include accountability for probity and legality, process accountability, performance accountability, programme and policy accountability.
Laughlin (2008) points out that the IPSASB makes use of the word ‘accountability’ rather than ‘stewardship’. This implies that accountability is used in order to include the concept of stewardship in the framework. However, the Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) argues that there is a distinction between the two concepts.

Jones and Pendlebury (2010) argue that it is hard to determine the external decision-usefulness of governmental reports, since one would not be aware of who makes use of these reports. Another problem is that it does not matter whether a government is using cash accounting or accrual accounting, because reports would not be scrutinised by investors or financial analysts, as in the case of the private sector. Investors are less inclined to use government
financial statements as they lack the incentives they would otherwise have in the private sector (Jones and Pendlebury, 2010).

With regards to users, the proposed framework makes reference to service recipients, resource providers and their representatives, however, many more users can be identified. For instance, the Australasian council of Auditors-General (2011) refers to the intermediary role of the media in providing relevant information to citizens. Granof and Khumawala (2010) have also identified donors, investors and employees. The problem is that this framework does not consider these other users to be primary users and so includes them all in the term ‘other parties’.

With regards to users’ information needs, the Auditor-general of South Africa (2011) has identified the need to disclose the situation in which the entity is operating and any risks involved within the entity’s strategic objectives. Furthermore, as already explained, GPFRs cover not only a wider area of information but also satisfy the information needs of many users, not just specific users. In some cases a limited form of GPFRs can be the solution to the problem (HoTARAC, 2011).

2.7 QUALITATIVE CHARACTERISTICS

Qualitative characteristics are those characteristics which make information available in GPFRs more practicable to users and at the same time achieve the objectives of financial reporting (IPSASB, 2010: par. 3.1).
The IASB framework (2010) makes a distinction between fundamental and enhancing qualitative characteristics, where the former are considered to be more important. The issue of which characteristics to include has been discussed at length and this is also true for the IPSASB. For instance, the IASB supports the view that the most important characteristics are relevance and faithful representation. In fact, fundamental qualitative characteristics include relevance, materiality and faithful representation.

In the public sector framework, the characteristics identified include: relevance, faithful representation, understandability, timeliness, comparability and verifiability.

The IASB framework (2010) treats materiality as an entity-specific aspect of relevance. On the other hand in the case of the IPSASB framework (2010), materiality is depicted to be more a constraint on information. IPSAS 1 identifies materiality as to be ‘the relevance of information’. The IPSASB is of the view that materiality can have an effect on the other qualitative characteristics and thus can be considered as a constraint on information.

Another issue pointed out by some respondents to Phase I Consultation Paper (CP) was that legislation may require the inclusion of certain items irrespective of whether they are material or not (IPSASB 2010: par. BC 3.33). The IASB framework (2010) points out the cost constraint on useful financial reporting. The IPSASB has also identified the achievement of a balance between the qualitative characteristics as a constraint on information.
Another issue is that the IPSASB framework (2010) does not make reference to the going concern assumption as in the case of the IASB framework (2010).

2.7.1 PROBLEMS WITH THE QUALITATIVE CHARACTERISTICS

From an examination of the comments submitted by the various accounting bodies, one may conclude that these bodies support the view that characteristics should be divided into fundamental and enhancing as in the case of the IASB framework (2010). Many respondents\(^8\) (IFAC, IPSASB n.d. b) do not support the replacement of reliability with faithful representation as the former is better understood in the public sector. Also one must take into account that cost-benefits trade-offs may differ for different entities. Another concern is that materiality should be considered to be more an entity-specific component of relevance rather than a constraint on information.

The proposed framework does not make reference to the going concern assumption and the reason why is not given. This assumption is considered to be more relevant to individual entities rather than for the government as a whole (IPSAS 14: par. 16). For those entities that are budget-funded, going concern issues arise when the government’s intentions are to stop funding that entity (IPSAS 14: par. 19). However, recent government failures have led to the conclusion that the going concern assumption should not be taken for granted in the context of governments.

\(^8\) All the submitted comment letters can be found at http://www.ifac.org/publications-resources/conceptual-framework-general-purpose-financial-reporting-public-sector-enti-0.
2.8 THE REPORTING ENTITY\textsuperscript{9}

The IASB framework of 1989, identified a reporting entity as follows,

\textit{‘... an entity for which there are users who rely on the financial statements as their major source of financial information about the entity.’}

[IASB, 1989: par. 8]

The IPSASB framework describes a reporting entity as follows:

\textit{‘A public sector reporting entity is a government or other public sector organisation programme or identifiable activity that prepares general purpose financial reports. A public sector group reporting entity comprises two or more separate entities that present GPFRs as if they are a single entity.’}

[IPSASB, 2010: par. 4.1]

Furthermore, in accordance with the definition in the IASB framework of 1989, the public sector framework highlights the fact that:

\textsuperscript{9} IPSAS 1 defines the term ‘economic entity’ as a ‘group of entities comprising the controlling entity and any controlled entities’. Even though the term ‘Reporting Entity’ is not defined in IPSASs it is commonly used to include both a single entity and a group of entities preparing a set of financial statements as if they are one single entity.
‘... a key characteristic of a reporting entity is the existence of service recipients or resource providers who are dependent on GPFRs for information about the activities of particular governmental organizations...’

(IPSASB, 2010: par. 4.2)

The proposed framework also includes the fact that a reporting entity does not need to have a separate legal identity, as would be the case of government departments. In addition, with respect to the group reporting entity,

‘A government frequently has the authority and capacity to direct activities of one or more entities so as to benefit from the activities of those entities.’

(IPSASB, 2010: par. 4.7)

The framework is referring to all those entities which have their activities directed by governments with all the implications.

2.8.1 PROBLEMS WITH THE REPORTING ENTITY

The proposed framework does not define on what basis an entity forms part of a group, and when a group is required to prepare consolidated financial statements\(^\text{10}\). Private enterprises use the basis of ‘control’, but this may be impracticable for governments since their environment lacks ‘equity

\(^{10}\) The IPSASB is of the view that this is a matter to be dealt with at standards level (IPSASB, 2010: BC 4.18). IPSAS 6 deals with this matter.
ownership\textsuperscript{11}. The reporting entity should be more based on accountability principles, which, even though broader, are still more appropriate (GASB, 2006). Christiaens (1999) has indicated another approach which is that of the legal entity. This approach would make use of the legal framework to include entities in the consolidation of financial statements. Another possible approach identified in a study done by the PSC (IFAC, 2000) is that of the authorised allocation of funds. Under this approach, the reporting entity will include those entities which are dependent on the allocation of government funds.

2.9 GLOBAL COMPARATIVE PUBLIC SECTOR ACCOUNTING STUDY

A global comparative Public Sector Accounting study was conducted by Ernst & Young in July 2011. A total of 28 countries participated in this study. The main objective was to analyse the situation of public sector accounting worldwide. Results have shown that the majority of the countries make use of an accrual accounting system.

\textsuperscript{11} Both the PSC (IFAC, 2000) and Christiaens (1999) identified the concept of control as a potential basis. Under this approach, the boundary of the reporting entity will be determined through ‘ownership mechanisms’. However, the problem with this approach is that in the public sector, governments have ‘wider potential ranges of control’ than private companies. Therefore, one may require judgement on the case presented. Vide Appendix III (Pg. A.4) for more detail.
The results of this study have shown that:

‘... there is generally no formal process to identify user needs.’

(Ernst & Young, 2011: 7)

Furthermore, the users of governmental financial statements were identified as shown in Figure 7.
Countries intending to implement a new accounting system stated that the global crisis has not influenced their intentions. The reasons behind their decision to implement a new accounting system include improved financial reporting and accountability, an improvement in transparency of public finance, and finally, to achieve international comparability. These countries have also highlighted that the most important reason to apply IPSASs is the comparability of financial information (Ernst & Young, 2011).

This study concluded that IPSASs are recognised worldwide together with the main principles, however, these principles are still not consistently understood. Furthermore, countries using the cash basis or a modified cash
based accounting system, do not see the necessity of a balance sheet or an income statement in the public sector (Ernst & Young, 2011).

2.10 CONCLUSION

As a concluding note, the HoTARAC (2011) has indicated that the proposed framework should be authoritative in countries which make use of IPSASs and not just provide guidance. Another concern is that this framework has been developed for accrual-based financial statements. Montesinos and Vela Bargues (1996) argue that users of financial reports would find cash accounting simpler to understand.

The first objective of this study to highlight the differences between the IASB and IPSASB framework was covered in this chapter. This study evolves by carrying out empirical research to explore the Maltese perspective on the proposed Conceptual Framework for the Public Sector and compare it with the international literature.
CHAPTER 3

RESEARCH METHODOLOGY

“Who fails to plan is planning to fail”
3.1 INTRODUCTION

This chapter outlines the main research method and approach used for carrying out this study.

Figure 8: Chapter Outline

3.2 THE RESEARCH METHOD

There are two main methods how research can be carried out, namely, the quantitative approach and the qualitative approach. Tewksbury (2009) identifies the quantitative approach as a ‘scientific’ approach where the things and their relationships are described in numbers. On the other hand, Tewksbury (2009) highlighted that qualitative approaches are more
appropriate in social science because they provide an in-depth understanding of what is going on.

The Public Sector Conceptual Framework is a model developed by the IPSASB. Even though such a framework has been intensely discussed by academics, it is a newly introduced subject, in fact, it is still an ED. Therefore, for the purposes of this study, the qualitative approach was seen to be the most appropriate method to collect primary data. The main reason behind this decision was that since the conceptual framework is still a new concept, as a researcher I have to analyse the evidence that will enable me to understand the meaning of what is going on. Furthermore, I am investigating an area about which there is little (if any) information about the actual situation.
3.3 THE RESEARCH PROCESS

Figure 9: Overview of the Research Process

- Feasibility of the Study
- Formulation of Research Objectives
- Identifying the main issues through the collection of secondary data
- Formulation of the Research Questions
- Contacting the Research Participants
- Collecting primary data through semi-structured interviews
- Analysing and interpreting the data collected
- Concluding Remarks and Recommendations
3.3.1 FEASIBILITY OF THE STUDY AND RESEARCH OBJECTIVES

Planning is very important when conducting research. The first step to be undertaken by the researcher is to assess the feasibility of the study by conducting some preliminary research. Informal meetings were held with a local preparer of governmental financial reports and an academic. Having determined the feasibility of the study, the next step is the formulation of appropriate research objectives.

3.3.2 LITERATURE REVIEW

As identified by Seuring et al (2005), good research can only be carried out if one has the necessary knowledge on the topic being researched. The literature review was fundamental for this purpose; not only did it contribute in building up the general background necessary for the study, but it also gave a general overview of how the topic is being tackled beyond our shores. Various documents including recent articles, books, research papers, past dissertations, electronic sources, legal sources and some material kindly provided by the National Audit Office (NAO) were reviewed to collect the secondary data.

I personally found the literature review very important, as it provided me with the ideas and issues being discussed about the topic. It also contributed towards the formulation of relevant research questions for gauging the local opinion.
3.3.3 THE RESEARCH QUESTIONS

After an in-depth analysis of the issues behind the literature review, a set of open ended questions\textsuperscript{12} were identified as the basis for the analysis. These questions were divided into five sections, as depicted in Figure 10.

Figure 10: Section Overview of the Research Questions

- Objectives of financial reporting
- Users
- Qualitative characteristics
- Contents
- Issues

After formulating the research questions, these were again examined by my supervisor. In fact an interview was conducted with her, given her knowledge and interest in the public sector. The questions were amended in such a way as to render them more understandable to the interviewees. An introductory paragraph was also included with these questions, to help the interviewees understand the context and the topic being researched.

\textsuperscript{12} Vide Appendix VII (Pg. A. 13).
3.3.4 THE RESEARCH PARTICIPANTS

Table 2: The Research Participants

<table>
<thead>
<tr>
<th>Interviewee 1</th>
<th>NAO</th>
<th>Assistant Auditor General</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interviewee 2</td>
<td>NAO</td>
<td>Audit Manager at the NAO</td>
</tr>
<tr>
<td>Interviewee 3</td>
<td>Treasury</td>
<td>The Accountant General</td>
</tr>
<tr>
<td>Interviewee 4</td>
<td>MFEI</td>
<td>Director General Strategy and Operations Support</td>
</tr>
<tr>
<td>Interviewee 5</td>
<td>Ex-MFEI</td>
<td>Ex-Director General Strategy and Operations Support</td>
</tr>
<tr>
<td>Interviewee 6</td>
<td>PAC</td>
<td>Member of the Public Accounts Committee</td>
</tr>
<tr>
<td>Interviewee 7</td>
<td>Gov. Dept.</td>
<td>Director General Corporate Services</td>
</tr>
<tr>
<td>Interviewee 8</td>
<td>PAC</td>
<td>Member of the Public Accounts Committee</td>
</tr>
<tr>
<td>Interviewee 9</td>
<td>MP/Ex-PAC</td>
<td>Economist and Member of Parliament</td>
</tr>
<tr>
<td>Interviewee 10</td>
<td>Academic</td>
<td>Assistant Lecturer at the University of Malta</td>
</tr>
<tr>
<td>Interviewee 11</td>
<td>Academic</td>
<td>Senior Lecturer at the University of Malta</td>
</tr>
<tr>
<td>Interviewee 12</td>
<td>Academic</td>
<td>Assistant Lecturer at the University of Malta</td>
</tr>
<tr>
<td>Interviewee 13</td>
<td>IAID</td>
<td>Director General at IAID</td>
</tr>
</tbody>
</table>

Given the concepts dealt with in the research questions, my interviewees had to be chosen according to their experience or relations with the public...
sector\textsuperscript{13}. Academics were chosen according to their expertise in financial reporting. Director Generals and the Accountant General were chosen in their capacity as preparers of financial reports. Interviewees also included internal and external auditors of governmental financial reports. Members of the Public Accounts Committee (PAC) and a Member of Parliament (MP) were chosen in their capacity as users of governmental financial reports. These persons were contacted mainly by email with few exceptions who were contacted by phone\textsuperscript{14}.

3.3.5 DATA COLLECTION AND ANALYSIS

The research tool used was the semi-structured interview; this was used during face-to-face meetings with research participants. This tool was chosen so as to present the issues in a relaxed environment which proved to be beneficial, since in this way, I was able to delve into other related issues (Boyce and Neale, 2006).

However, a major drawback of this technique is that it is time consuming (Boyce and Neale, 2006). These face-to-face interviews were carried out in a time span of two months (September and October 2011). One must consider the fact that an interview requires more time than answering a questionnaire and the majority of the participants are important officials in the public sector

\textsuperscript{13} In total twenty-one persons were initially contacted. Out of these, thirteen interviews were eventually held, totalling a response rate of 62%.

\textsuperscript{14} Vide Appendix VI (Pg. A. 11).
with many duties to carry out. The interviewees were available for an interview only after being contacted several times\textsuperscript{15}.

The duration of the interviews ranged from one hour to two hours. In the majority of the interviews I was granted the permission to record the conversation. When permission was not granted, I managed to take note of the key points. Finally, transcripts were made from the conversation recorded and the key points noted down. This analysis was essential to point out any similarities in the data collected.

\textbf{3.4 LIMITATIONS OF THE STUDY}

A constant problem encountered is that the conceptual framework is still an ED and therefore, still subject to changes. Despite the fact that a substantial number of the concepts tackled in this framework have a minimal possibility of being modified, there was an element of uncertainty present during the research as to whether key aspects would change. Some of the interviewees also highlighted this problem. The website of the IPSASB was constantly monitored for any changes. However, one must keep in mind that this research was carried out in the period between April 2011 and April 2012.

\textsuperscript{15} In the case of the other persons contacted but did not participate in the study, the reason given was mainly time constraint, with few exceptions where no answer was given. However, on one occasion I did contact the accountant of a local council, and the reason for not participating in this study was that the issues behind this research were mainly issues concerning the central government. Given that local councils prepare reports according to IFRSs as adopted by the EU, the accountant highlighted the fact that she was unable to answer my questions. The financial controller of the Central Bank of Malta did not want to participate because even though he was aware of IPSASs, the Bank is bound by special regulations from the European Central Bank.
Therefore, all the opinions included in this dissertation reflect the facts and circumstances covering this period.

Another limitation was the fact that in Malta, local government authorities and government entities already use accrual accounting and refer to IFRSs as adopted by the European Union (EU). Therefore the findings and discussion will be limited to central government which is in the process of moving to an accrual basis and has unofficially stated that it will be referring to IPSASs.

3.5 CONCLUSION

The next chapter will focus on the main findings of the study conducted, together with an analysis and comparison of the findings with the issues highlighted in the literature review.
“Interpreting data into useful information”
Figure 11: Chapter Outline
4.1 INTRODUCTION

This chapter summarises the main results of the research conducted together with a detailed discussion. The aim of this chapter is to highlight the arguments in favour and against the framework including the local perception, which is the second objective of this study.

4.2 THE LOCAL CONTEXT

The two forms of reporting in the Maltese public sector are statistical and financial reporting. Statistical reporting is used for the excess deficit procedure reported to Eurostat, which requires accrual data prepared according to ESA 95. The majority of this data is derived from the government accounting system. Although officially central government prepares cash-based financial reports using the Departmental Accounting System (DAS), the Treasury still collates accrual data from departments using a system of templates, which is mainly used for statistical reporting. The governmental financial reports will ultimately move to a full accrual accounting basis. The standards used to prepare these templates of accrual data were the Malta Government Accounting Standards (MGAS). In February 2011, the Malta
Government Accounting Standards Committee\textsuperscript{16}, which reviewed the MGASs, decided to adopt the IPSASs.

\textbf{4.3 THE OBJECTIVES OF FINANCIAL REPORTING}\textsuperscript{17}

According to the IPSASB, the objectives of financial reporting are to provide information for accountability and decision-making purposes. These objectives are also supported by the interviewees. However, the Treasury further remarked that one must be accountable for every system used, agreeing with the respondents\textsuperscript{18} in stating that this objective is generic and does not address any specific user\textsuperscript{19}. Furthermore, IAID did stress that accountability is even more important in the public sector since one is dealing with public funds, strengthening the point of Simpkins (n.d.)\textsuperscript{20}. The academics highlighted that even though the initial objective of financial reporting was accountability, over the years its usefulness for decision-making has taken priority. Furthermore,

\textsuperscript{16} The Malta Government Accounting Standards Committee is composed of the Permanent Secretary of MFEI as the chairman, the Policy Directorate of MFEI, the Treasury, IAID, the Budget Office, the National Statistics Office (NSO), the Malta Information Technology Agency (MITA) and the Auditor General as an observer.

\textsuperscript{17} For simplification purposes, the opinion expressed by the interviewees will be grouped according to the middle column in Table 2 (Pg. 37). The interview code number will be used for a direct quote.

\textsuperscript{18} The respondents is the term that will be used to refer to the comments received by the IPSASB on the ED.

\textsuperscript{19} Vide figure 5 (Pg. 21).

\textsuperscript{20} Vide section 2.6.1 (Pg. 19).
“These objectives enhance the way figures/data is collected IF a set of core standards is adhered to”

(Interviewee 12)

4.3.1 THE IMPORTANCE OF TRANSPARENCY

The Treasury, the PAC, the Ministry of Finance, the Economy and Investment (MFEI) and the NAO\textsuperscript{21} stress the importance of transparency when reporting. The public sector deals with public funds and is, therefore, accountable to the general public. However, accountability can only be achieved if one is transparent when reporting. They all concluded that once the statements are transparent they automatically become credible in the eyes of the users. This also becomes important for budget reporting, as the MFEI indicated. Given the current economic situation, budgets should address economic problems, especially when these are scrutinised by the EU. However, in order to address these economic problems, a true and fair view of the situation is required, which can only be achieved with transparent reporting and accrual accounting.

Another important objective of financial reporting for the PAC is controllability. Presently, there is no mechanism to show that an entity has exceeded its allocated budget. The PAC stressed the importance of controlling

\textsuperscript{21} The comment submitted to IPSASB on this ED was prepared by a senior auditor at the NAO, supervised by the Assistant Auditor General. Some of the views reflected in this chapter may differ from the comment submitted on this ED.
exactly what is coming in and going out and for each department to develop a business plan which is especially effective in terms of Value for Money (VFM). This was again emphasised by the IAID, the MFEI, and an academic, who stated that VFM can only be achieved if there is performance reporting. They also stressed the importance of Key Performance Indicators (KPIs) to focus on the outputs and resources effectiveness.

In the absence of accrual accounting, the end of the year expenditure increases and is not necessarily justified. Thus, the current system is counter-productive and not utilising funds to their maximum. Furthermore, IAID stated that in reporting to parliament and citizens, then there are certain questions of compliance. This point was also mentioned by the GASB and the FASB.\(^{22}\)

However, two academics and the government department were of the opinion that accountability and decision usefulness are the two objectives that public sector accounting should focus on.

\subsection{4.3.2 Accountability versus Stewardship}

Laughlin (2008) points out that the framework makes use of the word ‘accountability’ rather than ‘stewardship’. Nine interviewees, as HoTARAC, saw a distinction between the two concepts. Both the MFEI and the PAC are of

\footnotesize{\(^{22}\) Vide section 2.6.2 (Pg. 20).}

\footnotesize{\(^{23}\) Vide section 2.6.2 (Pg. 21).}
the view that when you are accountable you are also responsible for the consequences; whereas stewardship is when

“You have given me this object and I took care of it, reflecting more custodial stewardship”

(Interviewee 5)

An academic made a distinction between custodial and performance stewardship, with the latter signifying the use of accounts to increase performance. Unfortunately, in Malta, there is more concern with custodial stewardship. The PAC and the government department link stewardship with ownership and policy terms. Moreover, the NAO and an academic were of the view that accountability applies to everyone, unlike stewardship which is restricted to civil servants that have to follow the rules.

The IAID stated that accounts are a means to assess your stewardship, therefore it is important that they are accountable as much as possible. If, for example, €1 million is spent in order to triple output, then that expenditure is justified. However, in Malta, as highlighted by IAID and MFEI, there is not enough analysis of the financial statements. In fact, most discussions revolve around the budget. This lack of analysis of the financial statements may also be attributed to lack of resources. For instance the PAC is made up of members of parliament who ultimately are part-timers and do not have enough time to analyse well the situation.
The remaining interviewees are of the opinion that the difference between accountability and stewardship is minimal.

4.4 THE IDENTIFICATION OF USERS OF GOVERNMENTAL FINANCIAL REPORTS

Jones and Pendlebury (2010) argue that it is difficult to determine the users for the public sector. However, Ernst & Young (2011) did identify the government, parliament, auditor general, media, citizen, international financial institutions, rating agencies and others. The interviewees were also able to identify many more users besides these, as shown in Table 3.

Ernst & Young (2011) identified a group of others as users of governmental financial reports, however, these others were not specified.
Table 3: Users of Governmental financial reports and their information needs

<table>
<thead>
<tr>
<th>Users</th>
<th>Information Needs</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Media</td>
<td>To scrutinise Government finance</td>
</tr>
<tr>
<td>Financial Institutions, Suppliers</td>
<td>Enough cash to meet immediate liabilities</td>
</tr>
<tr>
<td>Civil Servants</td>
<td>Job Security</td>
</tr>
<tr>
<td>NAO, European Court of Auditors</td>
<td>Specific purposes</td>
</tr>
<tr>
<td>Students</td>
<td>Academic purposes</td>
</tr>
</tbody>
</table>

Both the government department and the academics highlight the importance of distinguishing between internal and external users which would make the framework more useful. The MFEI and the IAID also make a distinction between national and international users.

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\(^{25}\) Granof and Khumawala (2010) have also identified investors and employees as users (Pg. 22).
4.4.1 USERS’ INFORMATION NEEDS

Different users have different information needs. The opinions of the participants as to various users’ needs are analysed in Table 3. Concurring with the IASB framework (1989), Table 3 shows that there are needs which are common to all users. One of the academics refrained from answering this question because of certain implications. On the other hand, one of the PAC members concluded that reports are not used so much and thus it is difficult to determine the exact information needs.

All the interviewees identify Parliament as the key user that scrutinizes the reports to assess the government’s degree of accountability in terms of best usage. This concurs with the IPSASB that identified representatives as primary users. Even though the interviewees identified the above users for governmental financial reports, still the IAID, PAC, Ex-MFEI, NAO and an academic are of the view that users will look more to the national statistics rather than directly to the financial reports. National statistics assess the strength of a country against economic shocks. However, data used for national statistics are mostly derived from government accounts.

The PAC further remarked that experts are needed to analyse the situation and see what other information is required to satisfy those needs. This is why,

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26 The IPSASB did mention that service recipients will use GPFRs to assess that resources are being used efficiently, the level of taxes is enough to maintain the same level of quality of services and that objectives are being reached (Pg. 19). This is also supported by the interviewees as indicated in Table 3 (Pg. 49).

27 Vide section 2.6 (Pg. 18).
according to the academics, the EU and international organisations are putting more pressure on governments to prepare more comprehensible reports.

We are also dealing with international users,

"... presently the EU budget for 2013 is being discussed. This budget determines how much a country will take funds from the EU. Therefore the EU will analyse your economic situation"

(Interviewee 4)

The MFEI explained that, in the case of the EU, the country’s performance determines whether it is a contributor or a receiver. Furthermore, IAID argued that it is the responsibility of every member state to know how each member state is performing, in order to take collective decisions on the accounts used.

The NAO and the IAID highlighted the fact that the key question is how to account for all these needs. GPFRs will cover a wide area of information and satisfy the information needs of many users, however, the most important thing is that users get the true picture.

In the basis for conclusions, the IASB framework (2010) refers to a hierarchy of users. As identified above, the key user is parliament who is the decision-taker. The MFEI and the IAID stated that if these decisions are wrong, then
any repercussions will be suffered by the citizens, such as the austerity measures imposed on Greece. However, the NAO commented that if a hierarchy should exist, it would be as shown in Figure 12.

**Figure 12: Hierarchy of Users according to the NAO**

![Hierarchy of Users according to the NAO](image)

The MFEI also stressed the importance of the EU, since it takes certain decisions concerning Malta. However, the remaining interviewees agreed that the information needs of all users are ultimately important, and, therefore, it would be difficult to place them in a hierarchy.

“I compare the government to a jigsaw puzzle where every piece is important to the whole picture”

(Interviewee 6)
4.4.2 THE RELEVANCE OF GOVERNMENTAL FINANCIAL REPORTS FOR INVESTMENT DECISIONS

According to the MP, investors should be interested in the general economic and financial situation of a country, of which government finances form an essential part. The most interested in the government’s financial statements would be those investors in government stocks or bonds\(^\text{28}\) (whether or not there is a risk of default). Other investors would look to the government financial statements so as to assess the ongoing economic and financial trends in the country as a whole. Therefore, the investors should have access to reliable government financial statements so as to make informed decisions.

In Malta, many people prefer to invest in governmental stocks, even if they are offered at a lower rate of return than that offered by a private company. A contributing factor for this confidence is that most of the public debt is traded locally. According to the NAO, investors do not take into consideration the fact that the government still produces cash-based reports. This observation concurs with Jones and Pendlebury (2010)\(^\text{29}\). In fact, investors in government stocks only look to that part concerning stocks. Still, the scenario can change if the country reports an increase in debt for a substantive amount of time. According to the interviewees, foreign investors and financial institutions are

\(^{28}\) The NAO, the PAC and the academics also distinguished between investors for governmental stocks, foreign investors and other investors such as financial institutions.

\(^{29}\) Vide section 2.6.2 (Pg. 21).
more concerned with the national accounts, focusing more on KPIs, such as rate of interest, tax issues and sovereign debt.

However, the Treasury and the MFEI stress the importance of annual financial reports and how they are presented. When investors apply for a tender, they need to ensure that the government is operating well. Furthermore, Moody’s credit rating depends on these accounts and the country suffers the consequences when these ratings decrease.

According to NAO and the PAC, local investors will not give importance to whether the statements are governed by a framework or not. However, the application of a framework would affect large investors and international lenders, who, after the Greek demise, will scrutinise more the financial situation of a country. The fact that financial statements of different countries are prepared using the same rules will facilitate comparison. Even the academics and IAID stressed that if Malta prepares statements according to an appropriate structure, this will enhance their credibility and accountability, thus attracting more foreign investment.

4.5 QUALITATIVE CHARACTERISTICS OF GPFRs

4.5.1 RELIABILITY VERSUS FAITHFUL REPRESENTATION

According to PAC, this concept has to depict the actual situation. The Treasury argued that in the case of Greece, EU lost confidence on the reliability of the data presented and now places more emphasis on the quality of the statistics
submitted. Furthermore, the academics view reliability as incorporating both faithful representation and verifiability. One of the academics argued that reliability is linked with the measurement model. Since accountability is very important in the public sector, there should not be any attempt to implement a fair value measurement model.

“The margin of error of reliability is lower than faithful representation”

(Interviewee 2)

According to NAO, faithful representation means “actually stating the facts”. For example, if a tax of 3.5% is collected instead of the required 4%, this would mean that there was no compliance with the law, even though the figures are faithfully represented. However, according to IAID, “faithful representation” is a term wide enough to include reliability. In fact, it signifies that reports are free from material misstatements.

The real issue is what is being done to ensure these principles are adhered to, so as to show a true and fair picture? Precision costs money, and in the public sector you are dealing with public funds. Moreover, MFEI highlighted that having professional accountants in this sector will ensure they abide to their professional ethics and the correct treatment of these principles.

Moreover, faithful representation is treated as a fundamental characteristic by the IASB framework (2010) (Pg. 23).
4.5.2 TIMELINESS AS A FUNDAMENTAL CHARACTERISTIC

Unlike the IASB framework (2010), the IPSASB does not make a distinction between the fundamental and enhancing characteristics. The fundamentals are required for disclosures whilst the enhancing are there for decision-making.

Eight interviewees did not see the need for such a classification\(^{31}\). The MFEI, the Treasury, IAID and the academics considered all the characteristics to be important. The government department concluded that it is too early to make such a classification. According to NAO, a distinction can only be done so as to identify priorities.

However, the MFEI, IAID, NAO and the PAC highlighted the importance of timeliness which should be treated as fundamental. If data is not presented on time, reports would be useless. According to MFEI, financial statements should at least be issued each quarter for internal consumption facilitating decision-making and supervision.

“... I would rather prefer having a lot of timely information which is not fully correct, so as to make an informed decision”

(Interviewee 13)

\(^{31}\) Here the interviewees disagreed with the respondents to the public sector framework as pointed out in section 2.7.1 (Pg. 24).
4.5.3 MATERIALITY AS AN ENTITY-SPECIFIC COMPONENT OF RELEVANCE.

Two academics agreed that materiality is a principle which must be taken into consideration at all times when preparing accounts and if certain information is not material then it is not included, acting as a constraint. However, the public sector must adhere to legislation and certain items have to be disclosed irrespective of whether they are material or not\(^{32}\).

However, the other interviewees disagreed with the IPSASB treating materiality as a constraint on information. According to PAC, materiality will show the competence of the person in including the required information. Trivial things may lead to the wrong decisions, ultimately affecting the tax payers. The NAO argues that without materiality, accounts have to be 101% precise which is impossible. Furthermore materiality provides you with the necessary benchmark\(^{33}\).

“What is material to Malta is immaterial to Germany”

(Interviewee 12)

\(^{32}\) This observation was also made by the respondents to Phase I CP of the public sector conceptual framework (Pg. 23).

\(^{33}\) Materiality is very subjective because it depends on many factors such as amounts, context, time and whether an item is fraudulent or not.
According to IAID, it ultimately boils down to costs: the more precision you have in the accounts, the more costly it becomes.

4.6 OTHER ISSUES

4.6.1 THE CONTEXT FOR FINANCIAL FIGURES

The majority of the interviewees agree with the inclusion of non-financial information as mentioned by the framework. IAID argue that businesses measure their performance using share value or profit per share, but governments can only assess their performance in terms of KPIs, which are derived from non-financial information\(^34\). For instance, Mater Dei is a cost centre sustained with funds from the central budget and offers services as output. According to the MP, one has to see the efficiency of this output, to analyse whether we are getting the maximum output of the funds allocated. This involves a measure that goes beyond the financial aspect.

For MFEI, non-financial information is important to detect any trends, for example, new trends in emotional intelligence at the workplace. It is also important for the evaluation of certain projects, such as its impact on the environment.

The NAO further remarked that certain EU projects require this information to be specified and there are financial implications if targets are not reached.

\(^{34}\) This observation was also made by GASB (2006) (Pg. 17).
For the academics and the Treasury, non-financial information would enhance financial reporting since it would include the context of the information provided. However, the PAC and the NAO did remark that it is important to include only essential non-financial information such as performance benchmarks. Therefore, non-financial information will depend upon the purpose of the report. On the other hand, one of the members of PAC argued that it is impossible to include non-financial information and that one has to focus on the financial aspect; agreeing with the comment submitted by the Auditor-General of South Africa\textsuperscript{35}.

One of the academics highlighted the fact that if non-financial information is included, then this must be audited. According to NAO, the role of the auditor is to substantiate the information, however, certain non-financial information is difficult to quantify; strengthening the concern of KPMG\textsuperscript{36}. With the inclusion of this information, national auditors will have to increase performance and VFM audits. However, IAID remarked that even the European Court of Auditors stresses the importance of these audits since it enhances precision.

4.6.2 THE SUSTAINABILITY CONCEPT

Businesses prepare their financial statements under the going concern assumption which is highlighted in the IASB framework. The MFEI,

\textsuperscript{35} Vide section 2.5 (Pg. 17).

\textsuperscript{36} Vide section 2.5 (Pg. 17).
government department, IAID, PAC and the Treasury consider the going concern assumption as being relevant for the public sector, although it is more implied than assumed.

“Greece, Ireland and Portugal are three countries with a very uncertain current situation, yet they are slowly recovery with the help of bailouts”

(Interviewee 4)

For the IAID this assumption is important because statements must reflect the real situation. A problematic cash flow must be reported in the accounts. However, the Treasury stated that even though this assumption is important in the public sector, one must consider also the social aspect. If the government fails then one of the biggest institutions in the country would have failed.

Two of the academics remarked that this assumption can only become relevant for a public sector entity if accrual accounting was introduced and if the entity operates like a private company. On the other hand, the NAO and an academic highlighted that this concept loses relevance when it is applied to the government as a whole. It becomes crucial when it is applied at lower levels, conforming to IPSAS 14\textsuperscript{37}. If an entity does not receive funds from the budget then it becomes a question of sustainability. Certain departments give

\textsuperscript{37} Vide section 2.7.1 (Pg. 24).
essential services which cannot be terminated, even though they are making losses for a long-term. What will happen is that these departments will be amalgamated with others. This view was supported by the MP who argued that in the public sector, going concern is more in terms of restructuring rather than bankruptcy.

4.6.3 THE BASIS FOR CONSOLIDATION

A reporting entity is an entity which issues financial statements. The Treasury highlighted that at present only the financial statements of the central government are prepared. However, statistical reporting covers the general government as defined by ESA 95. Tests have to be made to see whether an entity falls under the definition or not.

All the interviewees, with the exception of IAID, identified parliament or the executive as having the power to decide on the allocation of funds from the budget and other operating decisions. In the public sector, entities depend on public financing or financing from external sources, thus this should be the basis for consolidation. This conforms to the method of authorised allocation of funds identified by the PSC study (IFAC, 2000).

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38 Two of the academics and the ex-MFEI refrained from answering the question. Therefore this section will be based on the opinion of the other interviewees.

39 This indicates that some form of control exists in the public sector, however, it is defined in other ways. Therefore, the basis of control can be applied in the public sector, but, appropriate judgement must be applied according to the case presented.

40 Vide section 2.8.2 (Pg. 27).
IAID argued that parliament is elected by citizens to act as a steward. Thus, ownership in the public sector becomes collective; concurring with the accountability principle identified by the GASB\textsuperscript{41}.

The MP and an academic highlighted that another possible way for consolidation may be the exposure of an entity to the liabilities of another entity. If an entity is guaranteeing the loans made by another entity, then these entities should be consolidated.

The NAO stated that one has to analyse the situation presented, for instance, in certain cases it is the legislation or contractual arrangements that will decide; agreeing with Christiaens (1999)\textsuperscript{42}.

As one can see from the above, this is an area subject to many different interpretations and thus needs to be guided thoroughly. Hence, the IPSASB is correct in stating that the basis for consolidation should be treated more at standards level.

### 4.7 CASH VERSUS ACCRUAL BASED CONCEPTUAL FRAMEWORK

The public sector framework was primarily developed for accrual accounting, however, it is a fact that the majority of governments, including Malta, officially prepare reports on a cash basis. All the interviewees agree that

\textsuperscript{41} Vide section 2.8.2 (Pg. 27).

\textsuperscript{42} Vide section 2.8.2 (Pg. 27).
accrual accounting would be a better system to use, however, cash accounting does have its merits. The interviewees highlighted that a cash-based system is simple and understandable by politicians who generally are not experts in financial matters; agreeing with Montesinos and Vela Bargues (1996)\textsuperscript{43}. According to MFEI, this may also be the main reason behind the fact that there are not enough professional accountants in the public sector.

“… you do not need accountants to manage cash”

(Interviewee 5)

Furthermore, academics highlighted the fact that unlike accrual accounting, cash accounting is a ‘soft measure’ and allows space for creative accounting. The PAC, MFEI and IAID stated that accountability can only be achieved if full accrual accounting was introduced, since this system induces precision. However, the IAID remarked that if there are countries, such as Malta, which are using a modified cash basis, then a framework for this basis would be useful. On the other hand, MFEI stated that even though the government in these last few years has worked on a cash basis, it is moving towards accrual basis and therefore an accrual based framework is important.

\textsuperscript{43} Vide section 2.10 (Pg. 30).
4.7.1 ACCRUAL-BASED FINANCIAL STATEMENTS FOR THE PUBLIC SECTOR

As highlighted by the public sector framework, GPFRs include GPFSs\textsuperscript{44}, however, the public sector is mainly characterised by budget reporting. Agreeing with Ernst and Young (2011), the NAO and MP did state that a balance sheet and an income statement would only be relevant if accrual accounting was introduced\textsuperscript{45}. The other interviewees further remarked that the public sector would find a complete set of financial statements useful, especially a cash flow statement, since they would provide better information for decision-making. According to NAO and the government department, these statements will enhance financial reporting and show the net worth owned by the state. Furthermore, they will also show the financial position and performance of the public sector and facilitate comparison between different periods and countries.

For the Treasury, the balance sheet would only account for financial assets and liabilities, since it would be difficult to include fixed assets. This was again strengthened by the academics in stating that it is difficult for the balance sheet of the public sector to be complete. Furthermore, the PAC and IAID highlighted the fact that it is difficult for governments to prepare these statements because of the huge financial situation being tackled here.

\textsuperscript{44} Vide Appendix IX (Pg. A. 20) for possible formats of GPFSs.

\textsuperscript{45} The study conducted by Ernst & Young (2011) revealed that countries using a cash based system did not see the need for a balance sheet and an income statement (Pg. 29).
Chapter 4
Findings & Discussion

However, they both stated that if these statements are prepared according to standards, then those preparing them will be guided on what to include. This would be impracticable if there is no structured framework, since there would be too many different interpretations.

4.7.2 THE GLOBAL FINANCIAL CRISIS

Agreeing with Ernst and Young (2011)\(^4\)\(^6\), eight interviewees did not consider the crisis as a factor that influences a change of the government accounting system. In Malta, the idea of conversion has been discussed since the 1980s.

According to the Treasury, the fact that Malta produces cash-based reports does not affect its credibility. However, the academics remarked that this does not justify the way government accounting is managed. Moreover, IAID stressed that Malta’s membership of the EU, calls for a more serious approach.

Ten interviewees were of the view that the crisis has made this conversion more urgent. Although accrual accounting is not the solution to the problem, the crisis has highlighted the need for governments to give a true picture. With accrual accounting, governments will be more accountable and this should ensure good stewardship of public finance. An MP and one member of the PAC stated that a crisis can only distract you from doing other things, because priorities change. The MFEI did not see this urgency since the EU accepted the figures presented in the budget.

\(^4\) Countries intending to change their accounting system stated that the crisis did not influence their intentions (Pg. 29).
4.8 THE CASE FOR STANDARDISATION AND THE FRAMEWORK

A major criticism of IPSASs is that many of them are designed on standards used for the private sector, however, only three interviewees were concerned about this issue. Two academics stated that this is not the correct way to set standards for the public sector but it is the easiest and cheapest way. The correct way is to start from scratch and see the needs of this sector without referring to the private sector.

The Treasury found some difficulty to answer this question

"... these standards (referring to IPSASs) are adequate for the public sector or else the committee would not have opted for them"

(Interviewee 3)

but agreed that there should be standards tailored for the public sector since it is different from the private sector, and that these should also be adapted by each country.

On the other hand, the other interviewees argued that the standards developed for the private sector have been researched by experienced professionals and also reflect good organisational practice. Therefore, as long as the standards for the public sector reflect its exigencies, then this can be a way to set standards for this sector.
“If we have to run the country as a corporation, taking into account the social implications, then we have to apply the criteria which were successful”

(Interviewee 8)

Even though IPSASs are based on IFRSs, eleven interviewees still considered them to be adequate for the public sector, hence, even for the Maltese public sector. The NAO, MFEI and an academic agreed that these standards are better than the local standards and that the terminology used is more public-sector friendly. On the other hand, the MP did not see the adequacy of these standards for the public sector, hence the Maltese public sector, however, he considered them as a good basis to move forward. An academic indicated that the main reason behind MGASs was not only to choose the best method but also to ensure it was the best way for Malta.

The IAID and the PAC both agreed that since the public sector is not profit orientated and government expenditure mainly involves social security benefits and pensions, then preparers need guidance on how to treat certain issues. However, an academic remarked that some of the IPSASs are difficult to link with the local scenario. Many of the examples used are based on countries divided into states and are also difficult to understand. Furthermore, the NAO and the Treasury are concerned that these standards yield too many options.

47 Interviewee 9 failed to give better alternatives than these standards for the Maltese public sector.
Even though all the interviewees agreed that the public sector should have its own conceptual framework, the MP remarked that this framework is still at an early stage and does not tackle certain issues. Moreover, the government department did remark that since IPSASs are based on IFRSs then one can opt for the IASB framework. According to an academic the problem with the public sector framework is that the IPSASB has already issued many standards that lack the conceptual basis. Moreover, this framework is similar to the IASB framework, agreeing with Lüder (2008)\textsuperscript{48}. This similarity between the two frameworks can be attributed to IFAC’s intentions to harmonise the public and the private sector accounting standards.

The IAID stated that a body of trained professionals would be needed to understand the underlying principles, but nonetheless it is a good basis to start with since it will introduce an element of standardisation.

4.8.1 THE FRAMEWORK AS GUIDANCE

Nine interviewees disagreed with the HoTARAC\textsuperscript{49} that this framework should be authoritative. In fact, MFEI, IAID and an academic were concerned that if this becomes authoritative then it would undermine a government’s sovereignty. The EU Commission and other international organisations prepare financial statements that are compliant with IPSASs. However, international organisations are not sovereign like governments.

\textsuperscript{48} Vide section 2.5 (Pg. 15).

\textsuperscript{49} Vide section 2.10 (Pg. 30).
According to NAO and an academic this framework can only become authoritative if it caters for small countries such as Malta. However, the Treasury and the PAC did remark that Malta is not an exception, and its small size facilitates IPSASs adoption. They argued that if other countries can use standards, so can Malta. According to PAC, if standards (and thus the framework) become authoritative then this will enhance comparability.\(^{50}\)

Another problem is that the framework should follow usage. According to NAO and ex-MFEI, there has to be a review of the financial legislation to see what changes are needed to convert the current system and ensure that IPSASs are followed. Until then, this framework should be treated as guidance.

Those interviewees who were in favour of the IPSASs being made compulsory failed to indicate how these can be made compulsory. IAID stated that the only way how they can become authoritative is if the government itself takes this decision. Another way is for the EU\(^ {51}\) to require IPSASs adoption by each member state; but this requires time.

### 4.9 CONCLUSION

This study highlights the fact that many interviewees are in favour of standardisation and the framework. However, as noted by an academic, the

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\(^{50}\) Ernst & Young (2011) did find out that the main reason for countries to apply IPSASs is the comparability of financial information (Pg. 29).

reform of government accrual accounting has been prolonged and the decision to adopt IPSASs is still unofficial. It is ultimately up to the government and how much it is willing to be transparent.
CHAPTER 5

CONCLUSION AND RECOMMENDATIONS

“To every start there is an end”
5.1 SUMMARY

The first objective of this study was to highlight the differences between the conceptual framework being proposed by the IPSASB and the one issued by the IASB. This objective was achieved in the literature review. After an in-depth analysis of the two conceptual frameworks, the identified differences are summarised in Figure 13.

Figure 13: Differences between the IASB and IPSASB framework

<table>
<thead>
<tr>
<th>IASB Framework</th>
<th>IPSASB Framework</th>
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<tbody>
<tr>
<td>• Concepts used for the preparation of financial statements for external users</td>
<td>• Concepts used to guide governmental financial reporting</td>
</tr>
<tr>
<td>• One objective identified: To provide information for decision usefulness</td>
<td>• Two objectives of financial reporting: To provide information for decision usefulness and accountability purposes</td>
</tr>
<tr>
<td>• Users identified were potential and existing investors, lenders and other creditors</td>
<td>• Users identified were service recipients, resource providers and their representatives</td>
</tr>
<tr>
<td>• Distinction between fundamental and enhancing characteristics</td>
<td>• No distinction between fundamental and enhancing qualitative characteristics</td>
</tr>
<tr>
<td>• Materiality as a fundamental characteristic</td>
<td>• Materiality as a constraint on information</td>
</tr>
<tr>
<td>• Reference to the going concern assumption</td>
<td>• No reference to the going concern assumption</td>
</tr>
</tbody>
</table>
Chapter 5 Conclusion & Recommendations

The IPSASB framework makes reference to GPFRs which are reports that include both financial and non-financial information. Another interesting aspect of the IPSASB framework is the identification of the reporting entity. However, since it is an area subject to different interpretations, even in Malta, this should be treated more at standards level.

The second objective of this study, addressed in Chapter 4, was to analyse the arguments in favour and against the IPSASB framework, including the local perceptions. The findings are summarised in Figure 14.
Moreover, local opinion considers going concern to be more implied rather than assumed in the public sector. The drawback of the IPSASB framework is that the IPSASB has already issued many IPSASs that lack a conceptual basis. Another important conclusion from this study is that local opinion supports...
the accrual-based framework and the standards, even though they are based on standards designed for the private sector. Only the minority are concerned that if this framework becomes authoritative then it would undermine government sovereignty. However, the framework lacks the legal and professional basis before it can be applied in the Maltese public sector.

5.2 RECOMMENDATIONS

For a long time, the Maltese government has been considering the introduction of accrual accounting at central level. However, the lack of accounting professionals in the public service does not augur well for its introduction.

Two academics indicated difficulty in applying certain concepts to the public sector; a case in point was the basis for consolidation. I personally found it difficult to understand certain issues since I lack the educational background in public sector accounting.

The following recommendations are being suggested:

- The University of Malta offers accountancy courses for civil servants. It is recommended that the Bachelor of Commerce course includes public sector accounting topics, at least as elective units. The Bachelor of Accountancy course only offers a two hour lecture on public sector accounting, which is insufficient for understanding the underlying principles.
• Even though the majority of graduates start working within the private sector, there are students who pursue a career in the public sector. Another way how to help graduates understand public sector accounting is to offer Continuing Professional Education (CPE) activities on this subject.

5.2.1 AREAS FOR FURTHER RESEARCH

• This study addressed the first phase of the conceptual framework project undertaken by the IPSASB; therefore, it would be interesting to see other studies addressing the remaining phases.

• This study explored local perceptions on standardisation and the framework in the Maltese public sector. Further research could focus on the effects of standardisation, once applied in the Maltese public sector, on the information presented to users of governmental financial reports.

5.3 CONCLUSION

*Learning from the Greek experience*

Although the public sector is not profit orientated, it cannot spend the money without proper planning. On the other, it needs to take even more care because it deals with public funds, derived from taxes paid by the citizens.
Accountability and transparency are, therefore, paramount. The public has the right to know how their money is being used—after all, money is money!

The current sovereign debt crisis has revealed many weaknesses in public sector accounting and the need for more guidance in financial reporting. A conceptual framework can provide a way forward.
APPENDIX I: GLOSSARY

**Going Concern:** Financial statements are normally prepared on the assumption that an entity is a going concern and will continue to operate in the foreseeable future.

**Materiality:** Information is material when if omitted or misstated, it could influence decisions that users make on the basis of financial information about a specific reporting entity.

**Reliability:** Information is reliable when it is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent.

**Reporting Entity:** This is the entity which users rely for financial statements as their major source of financial information about the entity.

**Stewardship:** This refers to the assessment of the management’s competence and integrity, including their success in managing the entity.
APPENDIX II: SUMMARY TABLE OF RESULTS FROM THE SURVEY OF IPSASB MEMBERS RE CONCEPTUAL FRAMEWORKS IN THEIR JURISDICTIONS-MARCH 2006

| Country | A | R | U | S | N | D | I | L | A | M | E | X | H | N | O | R | S | A | U |
| 1. Is there a conceptual framework (CF) for accounting standards? | Y | Y | Y | Y | Y | Y | Y | Y | Y | Y | Y | Y | Y | Y | Y | Y | Y | Y |
| 2. If yes, does it: |   | N | Y | Y | N | N | Y | N | N | Y | Y | N | Y | N | N | Y | N | Y | N |
| a) apply to public sector? | Y | Y | N | N | Y | N | Y | Y | Y | Y | Y | Y | N | N | Y | N | Y | N | Y |
| b) also apply to private sector? | N | Y | N | N | Y | N | Y | Y | Y | Y | Y | Y | N | N | Y | N | N | Y | N |
| Are there separate CFs for the public and private sectors? | Y | Y | N | Y | N | Y | N | Y | N | Y | Y | Y | Y | N | N | N | N | Y | N |
| 3. Are there plans for further developments which impact the public sector? | Y | Y | Y | N | Y | Y | N | N | Y | N | Y | N | Y | Y | Y | Y | Y | N | N |
| 4. Is the CF (A) authoritative or (B) a guide only? | A | A | D | A | A | A | A | A | A | B | B | B | B | B | B | B | B | B | B |
| 5. Does the CF deal with: |   |   |   |   |   |   |   |   |   |   |   |   |   |   |   |   |   |   |   |
| a) the cash basis? | N | N | N | Y | N | N | N | N | N | N | N | N | N | N | N | N | N | N | N |
| b) the accrual basis? | Y | Y | Y | Y | Y | Y | Y | Y | Y | Y | Y | Y | Y | Y | Y | Y | Y | Y | Y |
| c) both cash and accrual bases | N | N | N | N | N | N | N | N | N | N | N | N | N | N | N | N | N | N | N |
### Appendices

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<td>Y</td>
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</tr>
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<td>Equity/net assets</td>
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<td>Y</td>
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</tr>
<tr>
<td>e) Recognition Criteria</td>
<td>Y</td>
<td>Y</td>
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<td>Y</td>
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<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
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<tr>
<td>f) Measurement bases</td>
<td>N</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
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<tr>
<td>g) Financial Statements</td>
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<td>N</td>
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<td>Y</td>
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<td>N</td>
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<td>h) Scope of financial reporting</td>
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<td>N</td>
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<td>i) Frequency of presentation</td>
<td>N</td>
<td>N</td>
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<td>N</td>
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<td>N</td>
<td>Y</td>
<td>Y</td>
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<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
</tr>
</tbody>
</table>

| 7) Are other Matters addressed | Y | Y | N | N | N | Y | Y | N | Y | Y |

Y-Yes, N-No, DP-Discussion Paper.

APPENDIX III: CONSOLIDATED FINANCIAL STATEMENTS

According to Jones and Pendlebury (2010), for consolidation, one has to analyse three different dimensions in government accounting. The first dimension is the boundary of the reporting entity, which includes the issue of which entity to include when reporting matters. The issue here is that consolidation would not be based on ownership but rather on the economic substance of the relations between organisations (Jones and Pendlebury, 2010: 118). These tend to be wider for governments, since they can incorporate for example relations with quasi-autonomous non-governmental organisations (Quangos). Also, another aspect is that the term ‘control’ is used differently than in the case of companies. This is because in the case of companies ‘control’ is linked with share ownership, which is non-existent for governments. For instance, in the United Kingdom (UK), the government restricts the use of control. It also makes a distinction between ‘strategic control’ and control through the government’s budget, up to the point that it leaves out from consolidation certain organisations. This is not the practice with private companies, since when a particular company receives a substantial amount of money, this would signify that the company, in financial terms, is dependent upon the parent company and therefore cannot be left out from consolidation (Jones and Pendlebury, 2010: 119).

The second dimension relates, to the consolidation of departmental or agency consolidated financial statements for the government as a whole. In both the
UK and the United States (US) governments, each department has to produce a set of consolidated financial statements (Jones and Pendlebury, 2010: 119). The question which arises is whether these should be consolidated for government as a whole. This is practised in the US where they are known as government-wide financial statements. The problems associated with the reporting entity mentioned above, still have to be addressed, because government has more organisations to consider than a company and considerably more expenses and revenues to deal with, such as grants and subsidies (Jones and Pendlebury, 2010: 118). The UK consolidation has to include also local governments, which in other countries are considered, according to their legal framework, as to be separate entities (Jones and Pendlebury, 2010: 119). Another issue to contend with is that there are no accounting rules for the government’s budget, though there are for national accounts, these are different from the ones practised by accountants. This leads to the challenge of reconciling since there are many different accounting bases (Jones and Pendlebury, 2010: 120).

The third and last dimension is the consolidation of a set of funds. The question which arises here is whether or not to produce a consolidation of these fund financial statements, and whether these should be an addition or even replace the fund financial statements. Since governments, companies and other non-profit organisations make a very limited use of funds, what would be a solution is to produce one set of consolidated financial statements sparing some notes on the matter. The US is the country which has most
Appendices

effectively achieved this objective in fund accounting (Jones and Pendlebury, 2010: 121).
APPENDIX IV: SYSTEM OF NATIONAL ACCOUNTS

It is important to note that there are two other forms of government accountings, which are national accounting and government budgeting (Jones and Pendlebury, 2010: 50). National accounting is more of a statistical system where economic measures are calculated for each country. The system of national accounts (SNA) is a standard used to calculate these economic measures in order to make the results more comparable and are required by international organisations such as the International Monetary Fund, the Organisation for Economic Co-operation and Development and the United Nations. Some data required for these economic measures can be very easily obtained from government accounting.

The national accounts report on five sectors which include:

- The General Government,
- Non-financial corporations,
- Financial corporations,
- Non-profit institutions serving households (NPISHs), and

This system can be easily applied in government entities and units. Everyone knows that general governments have different objectives from private
Appendices

businesses. These objectives include the ultimate provision of goods and services, for which there is no market, and to redistribute income and wealth (Pitzer and Dupuis, 2006: 3). The SNA has its own definitions and they are more related to macro-economic variables.

The major source of revenue for general governments is taxes and social contributions. One has to keep in mind that these are imposed by governments unlike businesses which do not have this capacity. As with regards to expenditure this mainly consists of compensation of employees, intermediate consumption and capital services. The government is also a service provider. In some cases these services are provided free of charge or even below cost (Pitzer and Dupuis, 2006: 10). Technically speaking, citizens would have paid for these services indirectly through taxes paid.

Concepts and principles included in this system should be applied by general governments and the public sector as a whole, as they are applied by other sectors (Pitzer and Dupuis, 2006: 23). However due to certain characteristics one can find in governments, for instance the fact that some of the activities performed by the government can be considered non-market activities, more guidance is needed in the transactions performed by governments (Pitzer and Dupuis, 2006: 10). The system acknowledges the fact that governments use accrual accounting. Under this method transactions are recorded when they are incurred and not when they are paid. However the recording of transactions applying this method can be difficult since these transactions
may be on a cash basis. Another particularity about governments are operations related to debt. These operations are important since they are a way to provide assistance (Pitzer and Dupuis, 2006: 24, 30).

One may find many differences between the two systems. For instance, the reporting entity as defined by the SNA is different from the definition found in the standards (Dupuis et al, 2006: 5). A project has been undertaken to harmonise standards required for national accounting and accounting standards for the public sector. The aim is to highlight the various relationships the government has with other public corporations and institutions. Areas for further harmonisation include performance reporting and recognition of flows (Dupuis et al, 2006: 16).
16th September 2011

Dear Madam/Sir,

Ms Bernardette Zammit is a Bachelor of Accountancy (Hons.) student reading through the last year of her course. As part of her academic studies and assessment, she is preparing a dissertation concerning 'The Maltese perspective on the Public Sector Conceptual Framework issued by the IPSASB'.

As part of her dissertation project, she is required to carry out a number of interviews. This is the purpose of this letter. You are kindly being asked to help Ms Zammit and provide her with any information you can offer.

Ms Zammit would appreciate your collaboration and ensures that all information will be treated with strict confidentiality.

Yours sincerely,

[Signature]

Joanette Caruana
Dissertation Supervisor

---

52 The original approved title was replaced by the new title since the latter better reflected the study undertaken.
Appendices

APPENDIX VI: PROFILE OF INTERVIEWEES

Interviewee 1: Mr. B. Vella, Assistant Auditor General.

Interviewee 2: Ms. T. Mercieca, Audit Manager, Financial and Compliance at the NAO.

Interviewee 3: Mr. N. Camilleri, the Accountant General, preparer of the government financial reports.

Interviewee 4: Mr. C. Cuschieri, Director General Strategy and Operations Support at MFEI.

Interviewee 5: Dr. E. Camilleri, Ex-Director General Strategy and Operations Support at MFEI and ex-member of the accrual accounting task force in 1999 to 2009.

Interviewee 6: Hon. R. Arrigo MP, Member of the PAC.

Interviewee 7: Mr. A. Magro, Director General Corporate Services, Office of the Prime Minister.

Interviewee 8: Hon. C. Mangion MP, Member of the PAC.

Interviewee 9: Hon. A. Sant MP, Member of Parliament, Economist and user of governmental financial reports.

Interviewee 10: Ms. J. Caruana, assistant lecturer at the University of Malta.

Interviewee 11: Mr. C. Francalanza, senior lecturer at the University of Malta.
Appendices

Interviewee 12: Mr. I. Grixti, assistant lecturer at the University of Malta.

Interviewee 13: Ms. R. Schembri, Director General IAID.
Appendices

APPENDIX VII: THE RESEARCH QUESTIONS

BACKGROUND INFORMATION:

Companies in the private sector prepare financial statements based on accounting standards. These standards are issued by the International Accounting Standards Board (IASB) and they are supported by a Conceptual framework. The purpose of this framework is to guide the IASB as it develops new or revised standards and to assist preparers of financial standards in applying standards and in dealing with topics that are not addressed by an accounting standard.

Governments are encouraged to prepare accrual based financial reports. The International Public Sector Accounting Standards Board (IPSASB) has been issuing accounting standards applicable to the Public Sector for guidance. In December 2010, the IPSASB issued an Exposure Draft entitled ‘A Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities’. The main insights of this conceptual framework are its role, authority and scope; objectives of financial reporting and users; qualitative characteristics and the reporting entity. This Conceptual Framework gave rise to many issues, and at the moment there is a wide debate on this exposure draft. This dissertation will tackle these issues including the Maltese perspective.
QUESTIONS

1. OBJECTIVES OF FINANCIAL REPORTING

1.1 A government should prepare a set of financial statements in accordance with generally accepted accounting standards. Such financial reporting would make the government more accountable, besides providing useful information for decision making.

Do you agree with these objectives? Can you identify other objectives of financial reporting in the public sector? What about “stewardship”? “Stewardship” refers to the assessment of management's competence and integrity including their success in managing the entity. Do you consider that “stewardship” is any different from “accountability”?

2. USERS

2.1 In your opinion, who are the main users of financial reports prepared by the government?

What are their information needs?

Are the needs of all these users important, or can you place them in some kind of “ladder” of priority?

2.2 In your opinion, do you think that investors actually use government financial statements when making investment decision? Given that they would have no effective control over
public sector operations (as they would have when buying shares in a private company) do you think that a conceptual framework for the public sector would be of any particular interest to them?

3. QUALITATIVE CHARACTERISTICS

3.1 The draft conceptual framework for the public sector is suggesting that financial reports prepared by a government should have the following qualities:
faithful representation, understandability, timeliness, comparability and verifiability.

“Reliability” has been omitted from this list. “Reliability” is when information is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent.

Do you think that this characteristic is significant? In your opinion, is the term “reliability” more understandable than “faithful representation” in the public sector?

3.2 The conceptual framework for the private sector makes a distinction between fundamental characteristics and enhancing characteristics. Fundamental characteristics refer to information being both relevant and faithfully represented if it is to be useful. Comparability, verifiability, timeliness and
understandability are characteristics that enhance the usefulness of information that is relevant and faithfully represented. Fundamental characteristics are considered to be more important than enhancing characteristics.

In your opinion, do you think that such a classification would be suitable for the public sector framework? Would it make the framework more useful and/or understandable?

3.3 Information is material when if omitted or misstated could influence decisions that users make on the basis of financial information about a specific reporting entity. Materiality is seen by the IPSASB as a constraint on information. In your opinion, should this be treated as a constraint on information or as an entity-specific component of relevance?

4. CONTENTS

4.1 It is being suggested that government reports should include non-financial information as well. How important is the disclosure of non-financial information? Do you think there will be any audit implications?

5. ISSUES

5.1 Financial statements are normally prepared on the assumption that an entity is a going concern and will continue in operation in the foreseeable future. In your opinion, is this assumption relevant to the public sector?
Appendices

5.2 A reporting entity is an entity for which there are users who rely on the financial statements as their major source of financial information about the entity. In the private sector it is easy to identify the controlling entity because the entities it controls can be identified according to equity ownership. In your opinion, what basis can be used in the public sector?

5.3 This Framework was developed for accrual-based financial statements, however cash accounting is considered to be simpler to understand. Do you think a framework for cash-based financial statements would be more appropriate? Do you think a balance sheet and an income statement are necessary in the Central Government?

5.4 Do you think that the global financial crisis is a factor that contributes towards the implementation of an accrual based system by governments? Does it make it more an urgent matter?

5.5 Most of the IPSAS have been based on standards designed for the private sector, and then adjusted to reflect the particularities of the public sector. In your opinion, do you think that this is a correct way to go about setting standards for the public sector? Since the majority of IPSAS are based on IFRSs/IASs, in your opinion, are they adequate for the public sector? Are these standards adequate for the Maltese public
sector, or can you identify better alternatives? Based on the above information, should the public sector have its own conceptual framework?

5.6 In your opinion, do you think that this conceptual framework for the public sector should be authoritative in countries making use of IPSAS or should it just provide guidance? Should the application of IPSAS be made compulsory, and if yes, how is this possible?
APPENDIX VIII: ABSTRACT OF THE RECEIPTS AND PAYMENTS OF THE PUBLIC ACCOUNT FOR 2010

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<th>2010</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>£</td>
<td>£</td>
</tr>
<tr>
<td>Opening Balance</td>
<td>136,629,436</td>
<td>96,216,411</td>
</tr>
<tr>
<td>Add Receipts</td>
<td>4,340,568,772</td>
<td>4,689,829,012</td>
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<tr>
<td></td>
<td>4,497,198,208</td>
<td>4,786,045,423</td>
</tr>
<tr>
<td>Less Payments</td>
<td>4,266,499,044</td>
<td>4,649,415,987</td>
</tr>
<tr>
<td>Closing Balance</td>
<td>130,699,164</td>
<td>136,629,436</td>
</tr>
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</table>

### Name of Governmental Unit

Combined Balance Sheet—All Fund Types, Account Groups, and Discretely Presented Component Units

December 31, 20x2

Primary Government's Fund Types and Account Groups

<table>
<thead>
<tr>
<th>Assets:</th>
<th>General</th>
<th>Special Revenue</th>
<th>Debt Service</th>
<th>Capital Projects</th>
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</thead>
<tbody>
<tr>
<td>Investments</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Receivables, net</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investment in joint venture</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Due from component units</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lease receivable from primary government</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed assets, net</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Amount available</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Amounts to be provided</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<p>| Liabilities:                                                           |         |                 |              |                 |
| Accounts payable                                                      |         |                 |              |                 |
| Due to primary government                                             |         |                 |              |                 |</p>
<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
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</thead>
<tbody>
<tr>
<td>Lease payable to component unit</td>
<td></td>
</tr>
<tr>
<td>Revenue bonds payable</td>
<td></td>
</tr>
<tr>
<td>Tax-supported bonds payable</td>
<td></td>
</tr>
<tr>
<td><strong>Total Liabilities</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Equity:</strong></td>
<td></td>
</tr>
<tr>
<td>Investment in general fixed assets</td>
<td></td>
</tr>
<tr>
<td>Contributed capital</td>
<td></td>
</tr>
<tr>
<td>Retained earnings</td>
<td></td>
</tr>
<tr>
<td>Fund Balances:</td>
<td></td>
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<td>Reserved</td>
<td></td>
</tr>
<tr>
<td>Unreserved</td>
<td></td>
</tr>
<tr>
<td><strong>Total Equity</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Total Liabilities and Equity</strong></td>
<td></td>
</tr>
<tr>
<td>Proprietary Fund Types</td>
<td>Fiduciary Fund Types</td>
</tr>
<tr>
<td>------------------------</td>
<td>----------------------</td>
</tr>
<tr>
<td>Enterprise</td>
<td>Internal Service</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Assets:**

- Investments
- Receivables, net
- Investment in joint venture
- Due from component units
- Lease receivable from primary government
- Fixed assets, net
- Amount available
- Amounts to be provided

Total Assets

**Liabilities:**

- Accounts payable
- Due to primary government
- Lease payable to component unit
- Revenue bonds payable
- Tax-supported bonds payable

Total Liabilities

**Equity:**

- Investment in general fixed assets
<table>
<thead>
<tr>
<th>Contributed capital</th>
<th>Retained earnings</th>
<th>Fund Balances:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Reserved</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Unreserved</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Total Equity</th>
<th></th>
<th></th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Total Liabilities and Equity</th>
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</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Totals - Memorandum</th>
<th>Only Primary Government</th>
<th>Component Units</th>
<th>Only Reporting Entity</th>
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<td>December 31, 19x2</td>
<td>December 31, 19x2</td>
<td>December 31, 19x2</td>
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</tbody>
</table>

**Assets:**

- Investments
- Receivables, net
- Investment in joint venture
- Due from component units
- Lease receivable from primary government
- Fixed assets, net
- Amount available
- Amounts to be provided

<table>
<thead>
<tr>
<th>Total Assets</th>
<th></th>
<th></th>
</tr>
</thead>
</table>

**Liabilities:**

- Accounts payable
- Due to primary government
- Lease payable to component unit
- Revenue bonds payable

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
</table>
Based on Example 1, GASB Codification Sec. 2600.905.

## Name of Governmental Unit

Combined Statement of Revenue, Expenses, and Changes in Fund Equity-All Proprietary Fund Types, Similar Trust Funds, and Discretely Presented Component Units

Year Ended December 31, 20x2

### Primary Government

<table>
<thead>
<tr>
<th>Proprietary Fund Types</th>
<th>Fiduciary Fund Types</th>
<th>Totals-Memorandum</th>
<th>Totals-Memorandum</th>
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</thead>
<tbody>
<tr>
<td>Enterprise</td>
<td>Internal Service</td>
<td>Nonexpendable Trust</td>
<td>Pension Trust</td>
</tr>
</tbody>
</table>

Operating Revenues:

Charges for Services

Interest

Contributions

Total Operating Revenues:
<table>
<thead>
<tr>
<th>Operating Expenses:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of Services</td>
</tr>
<tr>
<td>General and Administrative</td>
</tr>
<tr>
<td>Depreciation</td>
</tr>
<tr>
<td>Benefit Payments</td>
</tr>
<tr>
<td>Refunds</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Total Operating Expenses</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Operating Income/(Loss)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-operating Revenues</td>
</tr>
<tr>
<td>(Expenses):</td>
</tr>
<tr>
<td>Operating Grants</td>
</tr>
<tr>
<td>Net Income from</td>
</tr>
<tr>
<td>Joint venture</td>
</tr>
<tr>
<td>Interest Revenue</td>
</tr>
<tr>
<td>Interest Expense and</td>
</tr>
<tr>
<td>Fiscal Charges</td>
</tr>
<tr>
<td>Tax Revenues</td>
</tr>
</tbody>
</table>

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Total Non-operating Revenue

(Expenses):

Operating Grants
Net Income from Joint venture
Interest Revenue
Interest Expense and Fiscal Charges
Tax Revenues

Total Non-operating Revenue (Expenses)

Income (Loss) before Operating Transfers
Operating Transfers In
Operating Transfers from Primary Government
Operating Transfers Out

Net Income
Fund Equity Beginning
<table>
<thead>
<tr>
<th>Contributions-Capital</th>
<th>Grants</th>
<th>Fund Equity-Ending</th>
</tr>
</thead>
</table>

Based on Example 4, GASB Codification Sec. 2200.906.

Name of Governmental Unit

Combined Statement of Cash Flows—All Proprietary Fund Types, and Discretely Presented Component Units

Year Ended December 31, 20x2

Primary Government

<table>
<thead>
<tr>
<th>Proprietary Fund Types</th>
<th>Fiduciary Fund</th>
<th>Totals—</th>
<th>Totals—</th>
</tr>
</thead>
<tbody>
<tr>
<td>Type</td>
<td>Type</td>
<td>Memorandum Only</td>
<td>Memorandum Only</td>
</tr>
<tr>
<td>Enterprise</td>
<td>Internal Service</td>
<td>Nonexpendable</td>
<td>Primary</td>
</tr>
<tr>
<td>Trust</td>
<td>Government</td>
<td></td>
<td>Units</td>
</tr>
</tbody>
</table>

Cash Flows from Operating

Activities:

Cash Received from Customers

Cash Paid to Suppliers and Employees

Net Cash Provided by Operating

Activities

Cash Flows from Noncapital Financing

Activities:
Operating Grants
Operating Transfers in from Other Funds
Operating Transfers out to Other Funds
Operating Transfer from Primary Government

Net Cash Provided (Used) by (for)
Noncapital Financing Activities

Cash Flows from Capital and Related Financing Activities:
Purchase of Capital Assets
Principal Payments-Capital Leases
Interest Payments-Capital Leases
Interest Payments-Revenue Bonds
Contributions from State Government

Net Cash Provided (Used) by (for)
Capital and Related Financing Activities
<table>
<thead>
<tr>
<th>Cash Flows from Investing Activities:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Receipt of Interest</td>
</tr>
<tr>
<td>Net Income from Joint Venture</td>
</tr>
<tr>
<td>Net Cash Provided by Investing</td>
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<tr>
<td>Activities</td>
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<tr>
<td>Net Increase (Decrease) in Cash and</td>
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<tr>
<td>Cash Equivalents</td>
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<td>Cash and Cash Equivalents at End of</td>
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<td>Year</td>
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<table>
<thead>
<tr>
<th>Reconciliation of Operating Income to</th>
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<tr>
<td>Net Cash Provided by Operating Activities:</td>
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<tr>
<td>Operating Income (Loss)</td>
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<tr>
<td>Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:</td>
</tr>
<tr>
<td>Depreciation</td>
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Format based on GASB Codification Sec. 2450.901.


References


References


Ernst and Young Study (2011). Towards transparency. Roundtable-Overview of the first results. A study conducted by Ernst & Young and the Institute of Public Management at Zurich University of Applied Sciences.


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