



What is the role of financial reporting in fiscal transparency and accountability?

Moscow Cross-CoP Meeting Fiscal Transparency and Accountability

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Structure of presentation

1. Theme
2. Definitions and concepts
3. Why financial statements are so powerful
4. Constraints to realising the power of financial statements
5. The way forward



Section 1. Theme

Audited, published financial statements of government activities have the potential to be a uniquely powerful tool of accountability and transparency



Section 2: Definitions and concepts

Definitions

Financial Reporting

- Financial statements – IPSAS defined
- Other financial reports

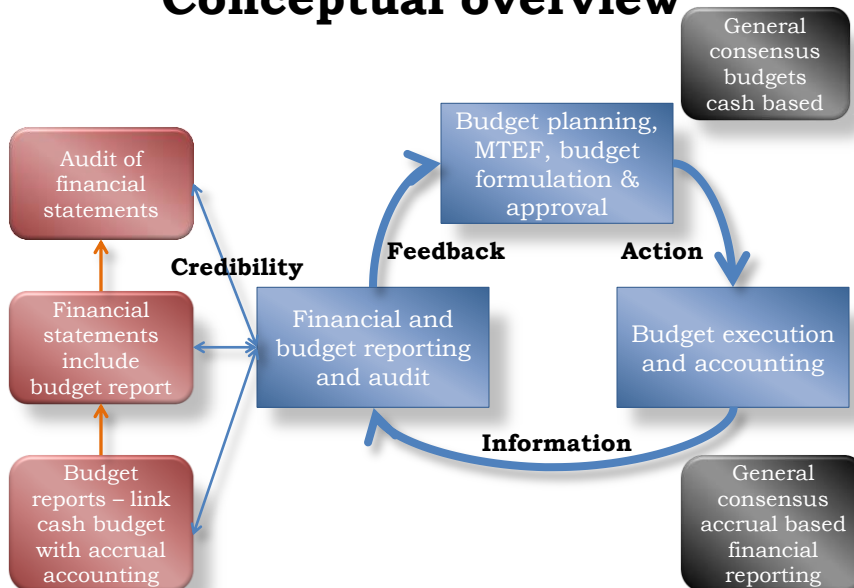
Budget reporting

- Budget compared to outturn
- Performance reports – service delivery

Accrual financial statements comprise:

1. Balance sheet
2. Operating statement
3. Cash flow statement
4. Comparison of budget to actual (reconciling differences between cash and accrual)
5. Policies and notes

Conceptual overview





Budget and financial reporting

- Linkage
 - Budget reporting links cash budget with accrual financial reporting **because**
 - Financial statements include a budget to actual comparison
 - Audit certificate lends credibility to financial statements including budget report
- Result
 - Budget reporting integrated with financial statements
 - Enhanced credibility through audit process
 - Enables consistent budget and financial reporting
- Feedback
 - Budget planning process informed by credible, reliable and consistent information on historic budget performance contained in financial statements



Section 3: Reasons for the power of financial statements



Seven reasons for the power of financial statements

1. Credibility
2. Information
3. Standardisation
4. Published
5. Hierarchy
6. Performance management
7. International recognition

Explained in the following slides



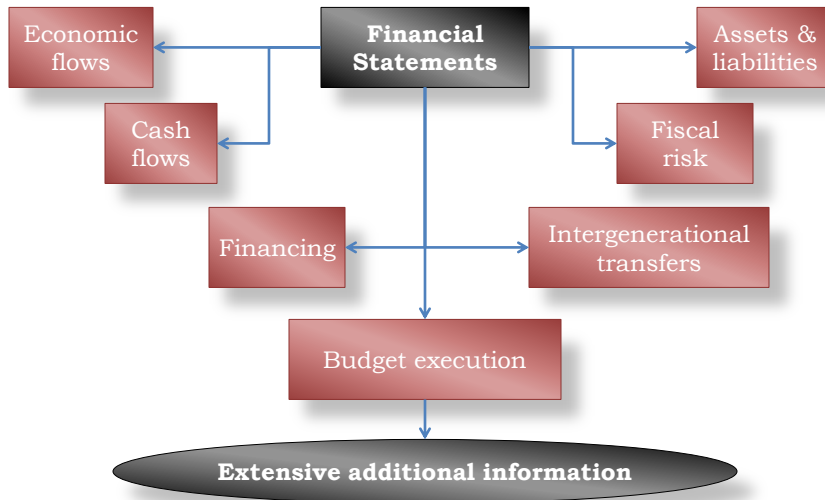
Reason 1: Credibility of financial statements

Four factors provide credibility

- 1. Indicate what actually happened – hard facts not just plans**
- 2. Derived from structured accounting systems and processes**
- 3. Supported by internal controls and internal audit**
- 4. Independently verified and certified by external audit**



Reason 2: Extensive information content of financial statements

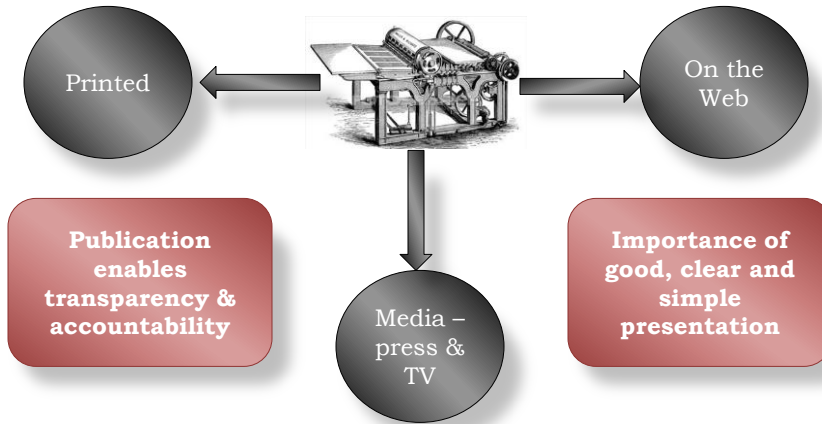


Reason 3: Standardisation of financial statements

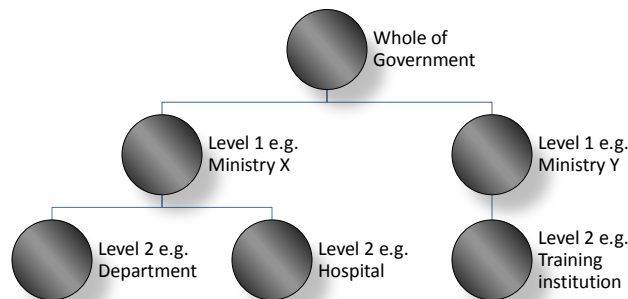
Standardisation of content, measurement, valuation and presentation facilitates comparison

- **Standardised reporting between different entities within a country**
- **Standardised reporting between different countries**
- **Standardisation between different reporting systems, e.g. statistical & financial**
- **Consistency over time enables traceability between reporting periods**

Reason 4: Financial statements are published



Reason 5: Hierarchy of financial statements



Benefits of hierarchy:

1. Published audited financial reports for all significant public sector economic entities
2. Consolidation enables different levels of overview
3. Consolidation process ensures no omission or duplication of information between entities



Reason 6: Financial statements enable performance management

4 ½ Important performance measures

1. Fiscal performance
2. Budget performance
3. Financial control performance
4. Expenditure efficiency performance

½ of measuring value for money

- Amount spent compared to outcomes achieved



Reason 7: International recognition of financial statements

- International Public Sector Accounting Standards (IPSAS)
 - Wholly concerned with financial statements
- Assessment frameworks
 - PEFA, ROSC
- International comparisons
 - Transparency evaluations, e.g. GIFT, IMF
 - Civil society participation
- Sovereign/entity risk assessment
 - Credit rating agencies
- Requirements supranational bodies
 - Planned EU public sector financial reporting standards
 - Multilateral agencies, e.g. World Bank, IMF requirements for IPSAS compliant financial statements



Conclusions on the potential power of financial statements

- Financial statements have the potential to be a uniquely powerful tool of accountability and transparency
- **But** the potential of financial statements not as yet fully realised



Section 4 Constraints to realising the power of financial reporting



The five key constraints

1. Still evolving
2. Inconsistent standards
3. Inadequate hierarchy of financial statements
4. Delays
5. Lack of user understanding



Constraint 1: Public sector financial reporting new and still evolving

A. Concept of public sector financial statements derived from private sector



- Early examples e.g. New Zealand 1993
- IPSAS commenced 1997

B. Public sector lacks skills and experience publishing financial statements



- Limited numbers of qualified accountants in public sector

C. Civil society organisations unfamiliar with public sector financial statements



- Low quality of media coverage

Constraint 2: Inconsistent reporting standards

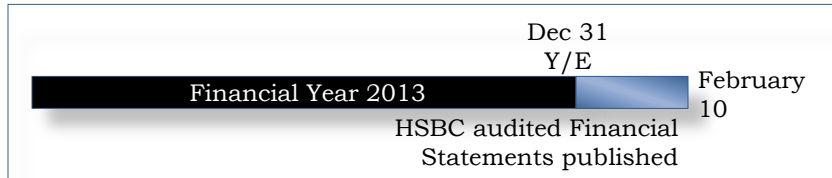
International Public Sector Accounting Standards (IPSAS)	<ul style="list-style-type: none">• Promulgated by IPSAS Board• Based on IFRS• Controlled by private sector accountants• Limited funding for research
IMF Government Finance Statistics (GFS)	<ul style="list-style-type: none">• Promulgated by IMF• Consistent UN System of National accounts (SNA)• Significant differences of coverage, valuation, measurement and definitions to IPSAS
European System of National Accounts (ESA)	<ul style="list-style-type: none">• Consistent with UN SNA• Hence same rules for valuation, measurement and definitions as GFS
European Public Sector Accounting Standards (EPSAS)	<ul style="list-style-type: none">• Not yet in existence• Will add to duplication of standards

Constraint 3: Inadequate hierarchy of financial statements

- Hierarchy often incomplete
- In many cases no audited financial statements for entities under national governments, e.g.
 - Ministries, agencies, other legal entities controlled by government
- Hence consolidated reporting often based on unaudited internal reports

Constraint 4: Delays

- Private sector reports quickly
 - Example HSBC major international bank
 - Turnover >US\$12 billion
 - Assets >US\$2,600 billion



- Similar timescale feasible in public sector
 - Accrual accounting facilitates quick reporting
- Interim reporting required

Constraint 5: Lack of user understanding

- Financial statements typically complex and difficult to understand
- Potential users, media and civil society organisations not trained to analyse and use information



Conclusions on constraints

- Potential of financial reporting for accountability and transparency not yet being fully achieved



Section 5 The way forward



Action 1: Continued improvement of financial statements

- Goal of published financial statements
 - Fully compliant international accrual standards
 - Published for all significant public sector entities
 - “Clean” audit report
 - Published quickly
 - Plus interim financial reporting



Action 2: Better user understanding financial statements

- PFM experts
 - Should give equal importance to ex ante and ex post reporting
- Government officials
 - Should be held accountable for information in financial reports
- Media
 - Should analyse, interpret and report on financial performance of government entities



Action 3: Convergence between reporting standards

- At present significant differences between IPSAS and GFS/ESA
- Goal should be minimising and rationalising differences
 - Common language
 - Common measurement and valuation rules
 - Common classification structures
- Differences should only be of presentation
- Different standards should be mutually reinforcing

Audited financial statements should provide credibility to GFS/ESA reports



The End

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