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ADOPTION OF NEW ACCOUNTING STANDARDS

Note by the Director

Summary:	At its October 2007 session, the Assembly noted that the representative of the External Auditor in his Report on the 2006 Financial Statements recommended that the Secretariat should submit a proposal to the Assembly, by its 2008 regular session, seeking its approval of the adoption, in principle, of the International Public Sector Accounting Standards (IPSAS) by the Funds from the financial year 2010. This document provides an initial overview of the impact of the move over to IPSAS for the Funds and also provides a tentative timescale for the implementation of IPSAS.
Action to be taken:	To approve the adoption, in principle, of the International Public Sector Accounting Standards (IPSAS) by the IOPC Funds from the financial year 2010.

1 <u>Introduction</u>

1.1 The IOPC Funds are not part of the United Nations system and therefore not obliged to follow the United Nations accounting standards in the preparation of its financial statements. However, each of the IOPC Funds governing bodies in the past have approved the use of the United Nations accounting standards, where appropriate, for the preparation of its Financial Statements. The Financial Regulations of the three Funds are identical in relation to this and by way of example the 1992 Fund's Financial Regulation 12.1 is set out below:

> *'The 1992 Fund shall maintain such books of accounts and prepare such financial statements as are necessary for each financial period in accordance with the 1992 Fund's Financial Regulations and stated accounting policies and in compliance with United Nations accounting standards, where appropriate.'*

1.2 The United Nations System Accounting Standards (UNSAS) were developed during the early 1990's to provide clear and consistent guidelines by which financial statements and accounts could be prepared for all organisations in the UN system. However, it has become increasingly apparent that maintaining a separate system of UN accounting standards would not be practical and would leave the UN system accounts out of step in format, content and accounting treatment with those applied elsewhere in the world in the profit and non-profit sectors. At its October 2007 session, the Assembly noted that the representative of the External Auditor in his Report on the 2006 Financial Statements recommended that the Secretariat should submit a proposal to the Assembly, by its 2008 regular session, which seeks the adoption, in principle, of International Public Sector Accounting Standards (IPSAS) by the Funds from the financial year 2010 (document 92FUND/A.12/28, paragraph 9.5).

2 Why International Public Sector Accounting Standards (IPSAS)?

2.1 The United Nations task force given the responsibility to determine what accounting standards would be appropriate for the UN system considered the following standards:

(a) International Financial Reporting Standards (IFRS**)** – these are the primary global standards applied by commercial entities. They are developed purely with commercial activities in mind and do not reflect public sector concerns. The standards-setting body is the International Accounting Standards Board (IASB);

(b) International Public Sector Accounting Standards (IPSAS) – IPSAS has been developed to be consistent with IFRS where possible, but to address specific non-profit sector concerns where necessary. The standards-setting body is the IPSAS Board (IPSASB); and

(c) National public-sector accounting standards – many countries have their own public-sector accounting standards, modified from commercial standards where necessary, and require their own governmental bodies to report by them. These standards are determined by the appropriate professional body in consultation with national governments.

2.2 The UN task force determined that a national set of accounting standards, developed and controlled by a specific national government, would not be appropriate, as a key requirement is that any new accounting standards be international in nature and application to achieve comparability in reporting.

2.3 Other key requirements were more accurate reporting, greater consistency and greater transparency. IPSAS and IFRS were evaluated by the UN task force, based on the following criteria:

(a) Due process – both IPSAS and IFRS are developed through a transparent, independent due process that provides the opportunity for comment by interested parties;

(b) Full accruals basis – this is the generally-accepted accounting principle worldwide to achieve more accurate reporting by matching activities to the reporting period, and is a fundamental principle of both IPSAS and IFRS;

(c) Consistent with future trends – since IPSAS and IFRS are closely related, and both are the only internationally-accepted accounting standards in their respective markets, both may be considered as being consistent with future trends;

(d) Topic coverage – IFRS has a greater coverage of topics than IPSAS. However, IPSAS also states that, where there is no relevant IPSAS, IFRS should be applied, thus addressing this issue. IPSAS is designed to be complementary to IFRS;

(e) Not-for-profit applicable – IFRS is primarily designed for the private sector, and a direct application of IFRS may lead to misleading accounts, eg in accounting for non-revenue generating assets and for 'donated' income, neither of which would be recognised properly under IFRS. IPSAS specifically addresses these issues, and consequently would be more relevant. This was considered to be the primary reason for selecting IPSAS over IFRS as it could be adopted without amendment; and

(f) Compatible training and education materials available – there is a much broader and more comprehensive set of training and education materials available for IFRS as compared to IPSAS. However, much of the material is also applicable to IPSAS.

2.4 Based on the above, the task force recommended the adoption of IPSAS and further recommended that IPSAS should replace UNSAS for all UN system organisations from 1 January 2010.

2.5 At its 98th session in June 2006, the International Maritime Organization (IMO) Council approved, in principle, the adoption of IPSAS from 2010. Work on the implementation of IPSAS in IMO has been ongoing since then.

3 The implementation of IPSAS by the IOPC Funds

With the assistance of the External Auditor, the Audit Body and IMO, the IOPC Funds' Secretariat has begun the process of determining the impact for the Funds of adopting IPSAS, namely:

- A review of IPSAS guidance issued to date, on a topic-by-topic basis, and its implications for the Funds.

- Formulation of IPSAS-compliant accounting policies for the Funds along with an analysis/review of the Funds' Financial Regulations and Internal Regulations. Proposed changes will be discussed with the External Auditor and the Audit Body prior to proposals being put forward to the governing bodies for adoption.

4 Implications of moving to IPSAS

A change in the Funds' accounting standards from UNSAS to IPSAS will result in changes in different areas. Following an initial review some of the key areas identified are set out in the following paragraphs:

(a) Change in format and content of accounts

(i) Fixed Assets – Presently, the purchase of fixed assets (that is, those assets which have a useful life of more than one year), are shown as expenditure in the year of purchase. IPSAS, in common with generally-accepted accounting practice, requires that these assets be shown on the balance sheet, and an annual charge for depreciation of the assets be made in the expenditure statement, effectively spreading the cost of the assets over their useful life. A threshold for capitalisation of assets will have to be determined;

(ii) Intangible Assets – A valuation methodology will need to be decided which takes into account fully the cost of developing any of the Funds bespoke IT packages eg the web-based claims management system;

(iii) Financial instruments – These are currently explained by way of note to the Financial Statements. Accounting, disclosure and presentation requirements will need to follow International Accounting Standards and International Financial Reporting Standards under IPSAS in terms of recognising and measuring any value changes and accounting and reporting these changes in the financial statements;

(iv) Recognition of income from investments – Investment income under IPSAS will not be recorded on maturity of the investment as is current practice, but accrued during the financial period;

(v) Recognition of interest on outstanding contributions – Interest on outstanding contributions will need to be accrued as income up to the financial year end and not when outstanding contributions are received, as is the present treatment;

(vi) Liabilities – There is likely to be a requirement to show as a liability on the Balance Sheet items which are presently simply disclosed in notes to the accounts. This will have the impact of directly reducing the Fund's accumulated surplus, to more accurately show the position of the various Funds. Examples of those which may require inclusion in the Balance Sheet are accrued annual leave and repatriation costs for existing staff;

(vii) Recognition of expenditure – Expenditure will be recorded on the basis of services (or goods) actually received or due to be received in the accounting period, rather than at the time of contracting as was the case under UNSAS. This will simplify the existing Unliquidated Obligation (ULO) recording procedure; and

(viii) With respect to claims-related expenditure eg technical fees, lawyers' fees etc, recording of expenditure on the basis of services (or goods) actually received in the accounting period should not pose a problem. However, the recording of compensation payments actually made in the accounting period will require further review and discussions are taking place with the External Auditor and the Audit Body on this issue.

(b) Review of contract documents – A review needs to be made of all existing and future contractual documents in order to determine correct accounting treatment. This applies, in particular, to lease documents, etc.

(c) Budgeting changes – the change in the accounting for fixed assets noted above may require some re-thinking of the process for budgeting for fixed assets. The Funds' budget is based on cash requirements, ie requirements to purchase assets in the year, whilst the expenditure report in the financial statements will reflect not the cost of purchases but the depreciation charge on all assets held.

(d) System changes (the bespoke accounting/contribution package (FUNDMAN**))** – in order to gather and control the information required for the above, particularly with regard to the fixed assets, it may be necessary to make some changes to FUNDMAN and account codes. Realising the need for greater flexibility, this has been built into the recent upgrade of FUNDMAN which will therefore likely require only minimal and manageable changes.

(e) Financial Regulations, Internal Regulations and accounting policies – the Fund's Financial Regulations, Internal Regulations and accounting policies will need to be reviewed and appropriate amendments will have to be made with the approval of the governing bodies to ensure accounting treatment is consistent with IPSAS.

5 Tentative timescale for implementation of IPSAS

The proposed schedule for the implementation is set out below:

Mid 2008 – 2009

(a) Development of IPSAS-compliant Financial Regulations, Internal Regulations and accounting policies as appropriate for the Funds;

(b) Recommended changes to be put to the Audit Body for its consideration and approval during 2008 and 2009 prior to being put forward for approval by the governing bodies at their autumn sessions in 2009; and

(c) An accounts manual will be produced to provide guidance on the appropriate accounting treatment of income, expenditure, assets and liabilities in addition to procedures and controls already in place.

<u>From 1 January 2010</u>

(d) Re-working of 2009 Financial Statements in IPSAS format for comparative purposes. It should be noted that under IPSAS, organisations are not compelled to report prior year comparative figures in the first year of application. However, it is the Director's intention to have comparative 2009 figures in order to provide a better understanding of the financial statements.

(e) With the new systems and procedures in place, transactions will be recorded in accordance with the revised Financial Regulations, Internal Regulations and accounting policies and in compliance with IPSAS where appropriate.

6 Action requested of the governing bodies

The governing bodies are invited:

(a) to take note of the information contained in this document;

(b) to note the timescale set out in paragraph 5 above and to further note that the Audit Body will consider any changes proposed by the Secretariat to the Financial Regulations, Internal Regulations and accounting policies of the Funds prior to requesting approval by the governing bodies; and

(c) to approve the adoption, in principle, of the International Public Sector Accounting Standards (IPSAS) by the Funds from the financial year 2010.