CROWN AGENTS
ACCELERATING SELF-SUFFICIENCY & PROSPERITY

FINANCIAL MANAGEMENT OF DEVELOPMENT PROJECTS

13 – 24 May 2019

Programme Introduction

Course Aim

This course provides a detailed look at the financial management components within the project life cycle and provides an overview of the tools available for assessing financial management systems. It covers budgeting, accounting policies, financial management staffing considerations, procurement and contract management, audit and internal controls.

Objectives – by the end of this course, you will be able to:

- Adopt appropriate systems for managing projects and finances
- Assess weaknesses in your own financial systems
- Draw up and maintain financial plans and project financial accounts and reports
- Align financial management of procurement in accordance with international best practice
- Evaluate risks and establish an appropriate financial control environment

Course Time-table – see hand-out

Daily Agenda

Day 6

1. Accounting concepts & conventions
2. Financial Accounting
3. Management Accounting
4. CIPFA FM Framework

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Financial Management of Development Projects

20 May 2019

ACCOUNTING CONCEPTS - CASH VS ACCRUAL ACCOUNTING

Session Introduction

Session Aim

- Highlight accounting conventions and concepts, and their bases for accrual accounting

Session Learning Objectives – by the end of this course, you will be able to:

1. Understand accounting conventions and concepts that underpin financial management
2. Appreciate the basic principles of accrual accounting and the differences between accrual and cash accounting

Session Agenda

Our Learning Journey – how we will achieve our objectives:

1. Identify and discuss accounting bases, concepts and conventions
2. Define accounting policies
3. Discuss the principles for recognition of revenue and expenses
4. Explain the differences between cash and accrual accounting

Accounting Policies

"Accounting policies are the specific ***principles****,* ***bases****,* ***conventions****,* ***rules*** *and* ***practices*** *adopted by an entity in preparing and presenting financial statements"*

- IPSAS 1 Presentation of Financial Statements

Accounting Policies - Definitions

Principles

- Framework of guidelines of accounting best practice (e.g. GAAP: Generally accepted accounting principles (UK GAAP, International Financial Reporting Standards (IFRS), International Public Sector Accounting Standards (IPSAS))

Bases

- Accrual vs. cash accounting

Rules

- Legal / regulatory framework (Companies Acts, Stock Exchange Rules)

Three Sets of Standards

IFRS

- Applies to the private sector and government business entities

IPSAS

- Cash Based
  - Or IPSAS Light!
  - Cash accounting
  - Seen as a transition to accrual based IPSAS
  - Revised in 2017
- Accrual Based
  - Full IPSAS

What route is your organisation following?

What are you doing now?

- Cash based
- Cash IPSAS
- Non compliant accruals

Cash Basis – What is Cash?

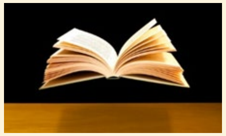
- Recognises transactions only when cash or cash equivalents are received or paid
- Definitions
  - Cash - cash on hand and demand deposits
  - Cash equivalents
    - Short term highly liquid investments (say less than 3 months)
    - Insignificant risk of change in value
- Excludes movements between items that are regarded as cash or cash equivalents. These are considered cash management
- Cash is controlled by an entity when (it) can use the cash for its own objectives or otherwise benefit from it and exclude or regulate the access of others to that benefit

IPSAS Cash – Financial Statements

- Statement of cash receipts and payments:
  - Recognises all cash receipts, payments and balances
  - Separately identifies payments made by third parties on the entity's behalf
- Accounting policies and explanatory notes
- Where there is a budget, a comparison between actual and budget
- May also report
  - Cash receipts, cash payments and cash balances for major fund categories (e.g. Consolidated Revenue Fund)
  - Additional information on sources and deployment of borrowings and the nature and type of cash payments
- Statements can be by function or by nature of transaction
  - Objective
  - Subjective
- Range of other disclosure requirements

Cash Basis – Encouraged Additional Disclosures

- An assessment of ability to continue as a going concern
- Extraordinary items – either on the face of the statements or separately
- Transactions administered as an agent for another entity
- Related Party Disclosures (as per IPSAS 20)
- Information about the assets and liabilities of the entity
- Proportion of ownership interest in controlled entities
- Information on external assistance received
- If intention is to migrate to Accrual Basis, the entity is encouraged to present a statement of cash receipts and payments in the same format as IPSAS 2 "Cash Flow Statements"



Cash Basis: Weaknesses

- Fails to accurately reflect the usage of resources
  - E.g. large capital acquisition will distort expenditure upward in the year of acquisition but no usage will not be recognised in subsequent years
- Presents limited information on assets and liabilities
- Lack of a comprehensive balance sheet to reflect true worth of the entity
- Fails to take account of future commitments, guarantees, or other contingent liabilities
- Concentrates on cash payments resulting in deterioration in fixed assets
- Encourages a focus on the control of the inputs purchased rather than the outputs produced

Accruals Standards

- Based on accrual accounting
  - Expenditure and income recorded as it is incurred not when the cash is spent or received
- Accounting for assets and liabilities
  - Presentation of “real” balance sheets
  - Clear distinction between capital and revenue
  - Application of depreciation
- International consistency and comparability
  - IFRS for private sector IPSAS for public sector (amended IFRS in the UK)
  - IPSAS closely aligned with IFRS
- Important aspect of improved financial management and accountability
- Complex and challenging in its scope and application

The Core Principles

- Accruals
- Going concern, matching and materiality principles
- Capital accounting
- Revaluation and impairment of assets and liabilities
- Consolidation
- Historical cost - *transactions recorded at cost*
- Monetary value – *accounts only concerned with items capable of conversion into money*
- Separate entity – *the entity is separate from its owners*
- Realisation – *transactions recognised when contracted*
- Consistency - *transactions and valuations on same basis from period to period*
- Prudence - *profits taken account of only a sale has realised / cost are proved for when reasonable chance that they will be*
- Substance over form – *accounts should reflect the true financial reality and not the strict legal form*

Expense

- Expense:
  - Cost incurred in relation to goods and services
  - Represents the cost of goods and services consumed in order to achieve the entity's objectives
  - Measured by the amount of an asset used (e.g. depreciation) or the amount of a liability incurred

Accruing Expenditure

- Expenditure should be accounted for according to the period to which it relates irrespective of when it is paid
  - Requirement to accrue unpaid invoices and liabilities relating to goods and services received but not yet paid for
- Applies to any other liabilities that have been incurred but not yet paid for e.g. Staff benefits such as untaken holidays
- Need to “reverse” the entries in the following year
  - Clears the balance in the “balance sheet”
  - Balances out the payment in the revenue account

An Accruals Example – Electricity Bills

Invoices rendered quarterly

At end of year 3 bills received and paid totalling £12,500

A further 20,000 units had been used but no invoice received

Cost is 10p a unit

Accrued amount = 20,000 x 10p = £2,000

Total Expenditure for the year £14,500

Accrual accounting entries

- Current year - debit revenue account -credit creditors
- Next year – debit creditors – credit revenue account

Revenue

- Gross inflow of economic benefits (cash, receivables, other assets) arising from the ordinary operating activities of an entity (such as sales of goods, sales of services, interest, royalties, and dividends)
- Measured at the fair value of the consideration received or receivable and recognised when prescribed conditions are met which depend on the nature of the revenue
- Conditions usually depend on the terms of the contract
- Revenue and related expenses should be recognised on an accrual basis (ideally)

Income

- Accounts should reflect the income that will be collected relating to the period in question
- Includes
  - income "invoiced" but not yet collected
  - Income earned but not yet invoiced
  - Work in progress
- Reflect provision for bad debt
- Major implications for the way that governments account for tax receipts
  - Accounted for on the basis of the "tax point" not the date of receipt

Going Concern Principle

- It is assumed that organisations will continue operating
- Different approaches will be taken if there is a liquidation because e.g.
  - Service or function ceases
  - An asset stops being used
- Can have significant effects on the accounts and the position against budget
- Must disclose if there are doubts as to being a going concern

The Matching Principle

- The expenses relating to a period are matched to the relevant income
  - To provide the real surplus or deficit
  - Critically important to show the expenditure required to derive a level of income
- Accrual of expenditure and recognition of income should be in “synch”
- The financing of an asset is related to the life of the asset to allow the revenue account to show the true cost of assets used in the organisation on an annual basis (eg through depreciation)
- A key principle in arriving at a “fair” view of the financial performance of an organisation

Private sector principle is to show the full costs of generating a level of income

Distinguish Capital and Revenue

- Capital is an asset that has an economic value over more than a year
- Can be tangible or intangible
- Following the matching principle the amount that should be charged to revenue should be the extent to which the value of the asset has been used up
  - Depreciation and amortisation
- Detailed principles as to how this should be done
- Rules developed and being developed over leased assets
- It means that something can be on your balance sheet that you do not own
  - And conversely if you are a finance company something might not be on your balance sheet that you do own!

Financial Instruments

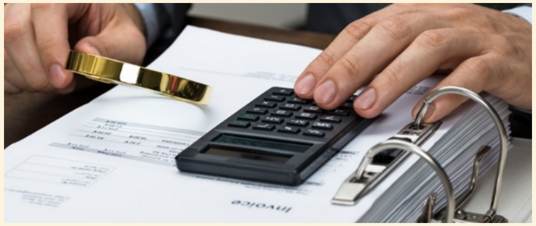
- Not the most exciting subject
- But very important
- Detailed principles to follow covering:
  - Identification an recognition of assets and liabilities
  - Valuation
  - Impairment
- Many organisations will have financial instruments but not know that they do
  - e.g, guarantees and warranties
- The banking crisis caused a major rethink in the world of IFRS
  - Most organisations not affected greatly by in IFRS 9 but some will be
  - A difficult area
  - Its not clear if the new accounting rules are part of the solution or the background music to, hopefully, improved practices

We Are Telling a Story

- Trying to communicate the financial performance and position of the organisation
- Assisting others and ourselves to assess the future prospects of the organisation
- The concept of “true and fair view” or “fair presentation”
  - Cash Based accounting did not do that – one dimensional in nature
  - But cash accounting was simple - in or out – little room for manoeuvre
- Under IAS we need to make interpretations and judgements
  - How long will an asset last, what proportion of our debts will we collect……
- The standards set out the way in which these interpretations and judgements should be made
  - Aiming for consistency – between organisations and over time
  - Enabling confidence in the basis upon which financial information is based
  - But still plenty room for different approaches
- The standards are ***principle based*** though it sometimes not feel like it!

The Auditor

- A vital role in assuring the integrity of the accounts
  - Checks that the data the accounts are based on is accurate
  - Interpretations and judgements are in accordance with the standards
  - Provides trust that the accounts “tell the story” accurately
- It is not the auditor’s role to decide on the most appropriate accounting standard
  - Though, again, it sometimes feels like it
  - That is the preparing organisation’s job
- Ongoing examples of poor accounting and poor audit practice do not help



Disclosure and Transparency

- If it matters disclose it
- Tell the story
- Many disclosure requirements
- In the UK part of a wider transparency agenda
- Some (many? most?) organisations are uncomfortable with so much dirty or clean linen being washed in public
- Should improve and widen accountability
- Will your organisation embrace that as a core part of organisational behaviour?
- Or will it be minimal and grudging compliance?

Cash vs Accrual Accounting

- Cash accounting
  - revenue recognised when cash is received
  - expenses recognized when bills are paid
  - focus is on movement of cash
- Accrual accounting
  - revenue recognised when goods or services are provided
  - expenses when resources have been used
  - focus is on when revenues are earned or resources are consumed

Accrual Accounting Effects

- Capital assets are reported in the financial statements
- Non cash transactions adjustment need to be effected
  - depreciation, amortisation, provisions, accruals, receivables are recorded
- Recognition of long-term liability
  - retirement and pension benefits, accumulated leave, employee benefits

Cash Accounting: Example of Capital Expenditure

Purchase of a computer system at a cost of $2,000,000

Capital Item	2016-17	2017-18
Computer System	1,750,000	250,000

Question: How would this be recorded under accrual accounting assuming a useful life of 5 years?

Cash vs Accrual Accounting Effects

Event	*Cash Basis*	*Accrual Basis*
Item ordered from supplier	-	-
Item arrives in stock	-	• Increase accounts payable • Increase stock
Item is used	-	• Decrease inventory • Decrease in retained funds
Item is paid for	• Decrease cash • Decrease in retained funds	• Decrease cash • Decrease accounts payable

Accrual Accounting: Benefits

- Better measurement of costs and revenues and facilitates comparison over time
- Full cost of service provision can be computed
- Focus on outputs rather than inputs
- Greater comparability of management performance
- Provides a better picture of the entity’s financial position
- Improvement in asset-liability management

THANK YOU /

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