Item 33 of the provisional agenda

FINANCIAL REPORT AND AUDITED FINANCIAL STATEMENTS
OF UNESCO FOR THE PERIOD ENDED 31 DECEMBER 2005
AND REPORT BY THE EXTERNAL AUDITOR

International Public Sector Accounting Standards

SUMMARY

This document is intended to inform Members of the Executive Board of the planned adoption of International Public Sector Accounting Standards (IPSAS) for reporting periods commencing 1 January 2010 by the United Nations, funds, programmes and specialized agencies.
I. INTRODUCTION

1. Within the United Nations system there has been a growing awareness in recent years of the need to comply with authoritative international accounting standards. This move is in line with the increasing need for both public and private entities, throughout the world, to base their reporting on more uniform and commonly accepted standards.

2. The International Public Sector Accounting Standards (IPSAS) are accounting standards that have been accepted internationally. They focus on the exhaustive reporting of all assets and liabilities and of all revenue and charges accrued at the close of a financial period. They improve and harmonize the regulations, accounting standards and procedures related to the way in which an organization presents its financial statements. They also provide a consistent standard for reporting of financial information in statutory financial reports. The credibility of international accounting standards is ensured because of their high quality, international recognition and the rigorous process that is followed in their development and interpretation. Comparability, harmonization and continuous improvement of financial reporting are among the benefits to be reaped from the adoption of IPSAS.

3. In November 2005, following a United Nations-wide review, the High-Level Committee of Management (HLCM), after receiving a recommendation of its Task Force on Accounting Standards, as endorsed by the Finance and Budget Network, made a decision for the United Nations system organizations to adopt IPSAS. It was also decided that IPSAS be effective no later than reporting periods beginning on 1 January 2010.

4. In June 2006, the General Assembly of the United Nations accepted the proposal to adopt IPSAS (Annex: Extract from a report of the Secretary-General dated 12/05/06 (A/60/846/Add.3 from paragraphs 7 to 22 and Annex)).

5. The purpose of this document is to outline the proposed change and describe at this early stage what this might mean for UNESCO (the Organization), bringing out the implications both during the preparatory phase leading up to the adoption of IPSAS and also the longer term impact thereafter on the Organization’s financial management including the production of financial statements.

II. CURRENT SITUATION

6. The Organization, like the United Nations and other specialized agencies, currently complies with United Nations System Accounting Standards (UNSAS). These standards were specifically designed within the United Nations system and while in many areas they are based on international standards, in the rapidly changing environment of accounting standards, they may no longer be recognized by the professional bodies and the public at large as providing objective financial reporting that fully conform to international standards or generally accepted accounting principles.

7. In addition to UNSAS there are also the Organization’s own Financial Regulations, and to a lesser extent the Financial Rules and Administrative procedures, which also have an impact on the way transactions may ultimately be reported in the official audited financial statements.

8. The above outlined reporting framework, comprising mainly UNSAS and the Organization’s Financial Regulations, will continue to apply as long as necessary up until 1 January 2010. UNSAS will not be updated to take account of any new international standards that might be issued during the period leading up to adoption. However, during this transitional period the following paragraph
has been included in UNSAS: “Where an organization departs from the practices set out below in order to apply an IPSAS standard or IPSAS standards the organization is deemed to comply with UNSAS”.

III. POTENTIAL IMPACTS ON FINANCIAL REPORTING

9. The introduction of IPSAS, as mentioned above, will permit the Organization to measure adequately the net financial situation and the cost of its operations and gives a basis to develop adequate short- and long-term financial policies.

10. It is not the intention of this document to cover all the changes to be made and the impact that these may have on the way we work and report in the future. This will require further discussion and working sessions within the Secretariat in the months to come and also exchanges with sister agencies in order to ensure consistency throughout the United Nations system. However, the following list of issues is presented in order to give some insight into the areas requiring examination and where indeed a change in the way of working may be required in the future.

   (a) Preparation of annual audited financial statements as opposed to biennial audited financial statements. This immediately raises the question of the allocation of the biennium budget to each annual financial period.

   (b) Use of the constant US dollar for the regular programme may not be in conformity with accounting for currency exchange differences.

   (c) Reconciliation of actual amounts on a budget basis with amounts presented in the financial statements will show how and why the current budget basis differs from the financial statements. Adoption of IPSAS might also provide the opportunity to align the budget preparation with full accruals accounting.

   (d) What should be the scope of operations reported in the financial statements and their presentation? For example, should staff funds be consolidated with programme activities?

   (e) Fixed assets will need to be capitalized and a charge for depreciation recorded in accordance with an agreed policy. Depreciation, while not a cash outlay, is a method used to attribute the cost of using a fixed asset over several financial reporting periods. Currently, from a budget point of view, capital expenditure is fully expensed in one reporting period.

   (f) Staff-related liabilities such as after-service health insurance will need to be reflected in the balance sheet and charges (not payments) will need to be recorded each year to bring the liabilities to their fair value at year end. A related and important issue is the funding of such liabilities, particularly those that have accumulated to date and for which no funding has been set aside.

   (g) A true “delivery principle” based on the recording of expenditure when services/goods are received would have an effect on the recording of accrued charges and unliquidated obligations.

11. Clearly, changes in the above areas will require different methods of recording in the books of account (including for some cases systems modifications) and will necessitate a significant revision of the Financial Regulations in order to be able to comply with IPSAS.
IV. THE WAY FORWARD

12. It is important that the governing bodies are fully kept abreast of developments in this area and of implications on the financial management of the Organization following the adoption of IPSAS. This paper is the first step of this very process.

13. A project team is to be assembled with representatives from the various sectors/sections concerned, together with the necessary outside expertise. A budget needs to be established and agreed. The changes to systems and the resulting cost are of particular importance during this phase.

14. Subsequent progress reports will be required leading to decisions by the General Conference involving changes to the Financial Regulations, probably in 2007 and certainly in 2009 at the latest. The task ahead is significant in terms of analysing the requirements, obtaining appropriate authorization from the governing bodies, and then implementing the changes necessary in order for the Organization to comply with IPSAS by 1 January 2010. In this context, the budget data for document 35 C/5 (2010-2011) might have to be presented differently and will need to be finalized in early 2009.

15. It is of paramount importance that the Organization works within the framework of the United Nations system. Support, coordination and leadership for this system-wide change should continue to be provided through the Task Force on Accounting Standards, under the auspices of the Finance and Budget Network, in order to ensure consistent interpretation and application of IPSAS requirements across the system.

16. It is far too early to provide an accurate estimate of what the implementation of IPSAS will cost the Organization since much depends on the extent to which the systems will need to be modified, on financial regulatory changes and on the impact that implementation will have on policies, procedures and processes. However, as a first estimate and in order to provide some indication, it may be considered that a project of this nature, involving changes to the rules and regulations, systems, use of consultants and training, etc. could cost in the region of $1.5 million to $2.5 million over the three year period from 2007 to 2009.

V. CONCLUSION

17. The move to IPSAS should not be underestimated as it represents a significant change with far-reaching impact for the Organization as a whole going well beyond the boundaries of pure financial reporting. It is important enough to be managed as a “change management project” and will be the subject of discussion at future sessions of the Executive Board up to and beyond 2010.

18. A detailed project plan will be presented to the 176th session of the Executive Board.
II. International Public Sector Accounting Standards

A. Background

7. In its resolution 60/1 of 16 September 2005, the General Assembly requested the Secretary-General, inter alia, to take a number of actions for strengthening the United Nations in the context of Secretariat and management reform.

8. The present section proposes that the United Nations adopt the International Public Sector Accounting Standards for its financial statements as part of a United Nations system-wide adoption of IPSAS by 2010. The Standards represent international best practices for public sector and not-for-profit organizations accounting. This management reform measure would support more efficient use of the financial and human resources available to the Organization; improve the extent to which financial policies, regulations and rules respond to the current needs of the Organization; support efficient and effective conduct of its work; and take account of the measures already under way for the reform of human resources management and the budgetary process. The adoption of IPSAS is a vital component of the United Nations drive to excel as a modern, progressive Organization that attains – and remains up to date with – best management practices: it would improve the quality of United Nations system financial reporting and result in benefits for governance, accountability and transparency.

9. The Board of Auditors and Panel of External Auditors of the United Nations, the specialized agencies and the International Atomic Energy Agency consider that IPSAS adoption would be a significant step forward to achieving the quality, consistency and comparability of United Nations system financial reporting. On 14 July 2005, the Chairman of the Panel of External Auditors wrote to the President of the General Assembly, in the context of deliberations of the 2005 World Summit, recommending that the United Nations system:

“... apply international accounting standards, policies and practices consistently in line with recognized good practices … with the objective of presenting stakeholders with adequate financial information uniformly and in a meaningful manner, while keeping abreast of the latest developments in financial matters”.

10. The financial statements of United Nations system organizations are currently prepared in accordance with the United Nations System Accounting Standards (UNSAS). For the United Nations, this requirement is set out in Rule 106.3 of the Financial Regulations and Rules. UNSAS were developed following the General Assembly’s consideration of a Panel of External Auditors study on the development of appropriate accounting principles and standards for consistent application in the United Nations system (A/46/341). In response to General Assembly decisions 46/445 of 20 December 1991 and 47/449 of 22 December 1992, the Secretary-General submitted a set of common accounting standards for the United Nations system, based on the International Accounting Standards (A/48/530). In its resolution 48/216 of 23 December 1993, the General Assembly took note of that report and requested the Secretary-General and the executive heads of the United Nations organizations and programmes to take those standards into account in the preparation of their financial statements for the period ending 31 December 1993.

11. When UNSAS were first approved, they were considered high-quality accounting standards in comparison to standards applied by comparable organizations. However, UNSAS have not been able to keep up with rapidly changing accounting developments. United Nations system accountants, managers and auditors have had concerns for several years about the continued viability of UNSAS. After an in-depth review, sponsored by the CEB High-level Committee on Management (HLCM), of the possibility of United Nations system organizations adopting external accounting standards, the Task Force on Accounting Standards recommended that the United Nations system adopt the International Public Sector Accounting Standards (IPSAS). HLCM accepted the recommendation, after endorsement by its Finance and Budget Network, on 30 November 2005 (see CEB/2005/HLCM/R.25).
12. In a letter to the Secretary-General dated 16 December 2005, the Chairman of the Panel of External Auditors stated that the decision by HLCM to adopt IPSAS was a welcome development. In April 2006, CEB endorsed a recommendation from HLCM for the adoption of IPSAS throughout the United Nations system.

B. Transparent financial reporting

Importance of accounting standards

13. The adoption of high-quality accounting standards is essential for transparent financial reporting, strong accountability and good governance. In its resolution 59/272 of 23 December 2004, the General Assembly emphasized the importance of establishing real, effective and efficient mechanisms for responsibility and accountability. In his report on accountability measures, the Secretary-General identified accounting standards as essential for achieving transparency in support of improved accountability (see A/60/312, para. 58). High-quality accounting standards are critical to the consistency and comparability of the financial statements prepared by organizations within the United Nations system. The credibility of United Nations financial statements depends on the quality of the accounting standards that regulate them and is important to ensure the confidence of Member States, donors and the general public in the United Nations.

14. IPSAS are credible, high-quality, independently produced accounting standards, underpinned by a strong due process and supported by Governments, professional accounting bodies and international organizations, such as the International Organization of Supreme Audit Institutions (INTOSAI), the Organization for Economic Cooperation and Development (OECD) and the World Bank. They represent the best international accounting practices of more than 30 Governments and a number of international organizations. OECD, the European Commission (EC) and the North Atlantic Treaty Organization (NATO) have also recently adopted IPSAS for their financial reporting. Additional information on IPSAS is provided in annex I.

Benefits of IPSAS adoption

15. The benefits of IPSAS adoption include:

(a) Improved internal control and transparency with respect to assets and liabilities generally;
(b) The alignment of United Nations accounting with best accounting practices through the application of credible, independent accounting standards on a full accruals basis;
(c) More comprehensive information about costs that will better support results-based management;
(d) The integration of non-expendable equipment into the accounting system, with resulting improvements in the accuracy and completeness of non-expendable equipment records;
(e) Improved consistency and comparability of financial statements as a result of the detailed requirements and guidance provided in each standard.

16. IPSAS adoption would result in increased transparency with respect to, for example, accounting for assets and liabilities. This increase in transparency is expected to result in better knowledge and disclosure and therefore better management of assets. The IPSAS requirement for full recognition of employee benefit obligations, such as annual leave, repatriation grants and health insurance, would support better management of these employee-related costs. Above all, the adoption of IPSAS would enable the General Assembly to hold the Secretariat to a higher level of accountability for the proper management and tracking of its financial and non-financial assets.

C. Implementation

17. The United Nations system-wide IPSAS adoption strategy has two key elements: a “two-level” approach and phased implementation. The first element, the two-level approach, involves providing resources at both the system-wide level and the individual organization level. At the system-wide level, the resources provide system-wide IPSAS adoption support, coordination and leadership, and ensure the consistent and efficient resolution of common implementation issues. At the individual organization level, dedicated organization-specific resources will be responsible for ensuring successful IPSAS implementation within each organization. Each organization must have sufficient resources to run its own internal project; implement any necessary changes to systems, procedures and financial regulations; and provide necessary staff training. The second element – phased implementation – allows a few pilot organizations or, “early adopters”, to implement effective 1 January 2008, while the majority of organizations will implement effective 1 January 2010. Phased implementation is responsive to different levels of implementation.
readiness among organizations, and reduces costs and risks. The United Nations implementation strategy, timetable and estimated cost, as described below, are consistent with the system-wide strategy and timetable.

18. The United Nations strategy is to integrate IPSAS adoption into the proposed upgrade of its information technology systems. Implementation is expected to take four years, with the first set of IPSAS-compliant financial statements for the United Nations available for the year ending 31 December 2010, when it is anticipated that the United Nations Controller would be in a position to formally attest to the effectiveness of the internal financial controls of the Organization. This is a cost-effective strategy, which also allows the United Nations to learn from the experience of early adopters, while contributing expertise to efficiently resolve system-wide issues. In addition, the feasibility of linking the United Nations enterprise resource planning (ERP) project with the ERP projects of other United Nations system organizations that have current plans to upgrade their information systems is being pursued.

19. It is recalled that the Integrated Management Information System (IMIS) of the United Nations was custom developed for the United Nations in 1994. A project recently completed has determined that future United Nations ERP needs would be best met through a replacement of IMIS. To meet UNSAS accounting requirements, off-the-shelf software packages required substantial, expensive customization. A decision to adopt IPSAS would place the United Nations in a better position with respect to the cost-efficient acquisition of a high-quality ERP system because IPSAS accounting requirements are compatible with off-the-shelf accounting software packages. Future ERP upgrades should also be more cost-effective because of the relative ease with which off-the-shelf software can be upgraded, in comparison with the costs of upgrading custom-developed software, such as IMIS, for one organization.

20. A provisional implementation timetable for United Nations adoption of IPSAS, including key milestones, is provided in annex II. The timetable is conditional on the availability of necessary funding and approval.

D. Conclusions and recommendations

21. High-quality accounting standards are critical to the consistency and comparability of the financial statements prepared by organizations within the United Nations system. The credibility of United Nations financial statements depends on the quality of the accounting standards that regulate them and is important to ensure the confidence of Member States, donors and the general public in the United Nations. For the biennium 2006-2007, the estimated requirements of $1,537,500 would provide for four posts (1 P-5, 1 P-4, 1 P-3 and 1 General Service (Other level)) and related costs under section 28B, Office of Programme Planning, Budget and Accounts ($1,428,900), section 28D, Office of Central Support Services ($108,600) and section 35, Staff assessment ($48,200), to be offset by an equivalent amount under income section 1, Income from staff assessment, under the programme budget for the biennium 2006-2007. In addition, estimated requirements amounting to $424,000 would provide for the portion of cost-shared of system-wide activities under section 30, Jointly financed administrative activities. It is recalled that resource requirements in the amount of $692,000 for the development and implementation of IPSAS for peacekeeping operations were proposed in the context of the report of the Secretary-General on the peacekeeping support account for 2006-2007 (A/60/727) that is currently under consideration by the General Assembly.

E. Action to be taken by the General Assembly

22. The General Assembly may wish to:

(a) Approve the adoption of the International Public Sector Accounting Standards by the United Nations for its financial statements, as part of a United Nations system-wide adoption of IPSAS by 2010 at the latest;

(b) Appropriate a total amount of $2,009,700, comprising $1,428,900 under section 28B, Office of Programme Planning, Budget and Accounts, $108,600 under section 28D, Office of Central Support Services, $424,000 under section 30, Jointly financed administrative activities, and $48,200 under section 35, Staff assessment, to be offset by an equivalent amount under income section 1, Income from staff assessment, under the programme budget for the biennium 2006-2007.
International Public Sector Accounting Standards

1. When United Nations system accounting standards were first developed, international accounting standards for not-for-profit organizations did not exist. Because of this gap, the Panel of External Auditors recommended that the United Nations system develop its own accounting standards. Since then, the International Public Sector Accounting Standards (IPSAS) have been developed for not-for-profit public sector organizations. IPSAS are a set of high-quality, independently developed accounting standards that require accounting on a “full accruals” basis, which is considered the best accounting practice by international organizations for the public as well as the private sector. IPSAS include detailed requirements and guidance that provide considerable support for financial statement consistency and comparability. They are the only international accounting standards applicable to public sector and other not-for-profit organizations.

2. The IPSAS standards are produced by the International Public Sector Accounting Standards Board, which is part of the International Federation of Accountants (IFAC), an international organization that represents 163 professional accounting institutions from 120 different countries. The development of new accounting standards requires a significant investment in people and time. The IPSAS Board is a dedicated independent international standard-setting body that uses strong due process, including public consultation and public meetings. It acts for the public interest rather than the interest of organizations preparing financial statements and provides benefits to public sector financial management and good governance, which depend on the existence of high-quality international public sector accounting standards.

3. The IPSAS Board currently includes representatives of Argentina, Australia, Canada, France, India, Israel, Japan, Malaysia, Mexico, the Netherlands, New Zealand, Norway, South Africa, the United Kingdom of Great Britain and Northern Ireland and the United States of America. It considers United Nations system issues when developing accounting standards. The United Nations system secretariats hold two observer places (United Nations and United Nations Development Programme) on the Board. Board observers participate fully in discussions and receive all meeting papers at the same time as other Board members. They have “full rights of the floor”.

4. The IPSAS Board applies a policy that IPSAS standards will be the same as the International Financial Reporting Standards (the former International Accounting Standards) (IAS/IFRS) unless there are demonstrable reasons for public sector/not-for-profit differences. This policy is consistent with the principle of accounting standards convergence. The effect of this policy, combined with the generally accepted practice of applying IAS/IFRS where no equivalent IPSAS exists, is that approximately two thirds of the accounting standards under IPSAS adoption are the same as those that would apply under IAS/IFRS adoption. Although the not-for-profit differences in the other third of the applicable standards are important, the majority of the requirements in these standards remain the same as those in the equivalent IAS/IFRS standards. This means that the guidance and software developed for IAS/IFRS accounting is applicable to IPSAS accounting with no or little amendment. It also means that the financial information produced and standards applied are understandable and largely comparable between public and private sector organizations. This facilitates movement of accounting expertise between the two sectors.

5. More than 30 countries have either already adopted or are in process of adopting IPSAS for financial reporting by all or part of their public sectors. In addition, OECD, EC and NATO organizations have adopted IPSAS for their financial reporting. Where a public sector organization operates as a financial institution, IPSAS requires that the organization apply IAS/IFRS. Consistent with that requirement, development banks, such as the World Bank, the Asian Development Bank and the International Fund for Agricultural Development, apply IAS/IFRS.