Ministry of Finance SR

Project: Providing advisory services for improving accounting and reporting systems of public finance.

Comments to the proposed regulation on new public sector accounting principles and structure of the financial statements

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Contents

1 Introduction

From March 2006 to the present, intensive meetings of the project team and Ministry of Finance (hereafter "MF SR") have been taking place. The aim of these meetings was to identify differences between IPSAS and Slovak accounting legislation for the public sector.

While working on this project, we have had to take into account the following essential restrictions implemented by the MF SR for this project:

- IPSAS will not be implemented in full, which means they will not be treated as Slovak legal norms (such as in the case of selected accounting entities and IAS / IFRS – see section 17a of the Act on Accounting); IPSAS will only be implemented into the existing accounting legislation,

- IPSAS will first be compared with Slovak accounting legislation, identifying the main differences; afterwards, it will be decided which differences will be eliminated and which will not,

- The basis for decisions about which differences to eliminate and which not to will be the existing accounting legislation for entrepreneurs (which has already implemented IAS / IFRS). That means that differences between IPSAS and Slovak accounting legislation for the public sector which are not eliminated in the existing accounting legislation for entrepreneurs will not be eliminated in the accounting legislation for the public sector either.

While preparing this part of the report, we took into consideration the following legal norms and documents:

- Act no. 431/2002 Coll. on Accounting as amended (hereafter "Act"),

- Draft regulation of the Ministry of Finance of the Slovak Republic defining the details of the accounting procedures and the framework chart of accounts for budgetary organisations, state funds, contributory organisations, municipalities and higher territorial units (hereafter "Accounting principles proposal").

- Draft regulation of the Ministry of Finance of the Slovak Republic which defines the structure and content of the financial statements for budgetary organisations, state funds, contributory organisations, municipalities and higher territorial units (hereafter "Financial statements proposal"),

- Regulation of the Ministry of Finance of the Slovak Republic no. 24501/2003 – 92 which defines details on accounting principles and accounting framework for entrepreneurs (hereafter "Accounting principles for entrepreneurs") as amended,

- International Public Sector Accounting Standards IPSAS, including Exposure drafts (hereafter "IPSAS").

International Public Sector Accounting Standards determine the general accounting procedures and principles, together with some accounting rules, and the structure and content of financial statements. The concept of the accounting standards valid in the Slovak Republic is a bit different. General accounting procedures and principles are defined in the Act on Accounting. Details on accounting are set by the Accounting principles proposal and financial statements preparation rules are dealt with in the Financial statements proposal. According to the different structure of particular regulations, we have divided our analysis into 3 parts.

Part 2 “The structure of financial statements” is focused on basic principles as defined by IPSAS 1, 3, 6, 7 and 8, and subsequently on the structure of the financial statements. Since the structure of financial statements is directly and indirectly influenced by the extent to which identified differences included in the Act on Accounting and in the Accounting principles proposal are incorporated, it is not possible to suggest further improvements and adjustments with adequate certainty. This part contains the overview of these differences.

Part 3 “Regulations partially included in existing legislation” is focused on the accounting procedures, methods and principles. These are completely or partially incorporated in the Act on Accounting. Further harmonization of the accounting regulations for public sector with IPSAS will depend on the incorporation of defined differences to the Act on Accounting, with a direct impact on the Accounting principles proposal.

Part 4 “Proposed modifications” summarizes proposed amendments to the draft regulation. These are similar in structure to the current Accounting principles proposal. Particular sections were divided into the following parts:

- General rules (section 1 to 18)
- Specific regulations (section 19)
- Non-current assets (section 21 to 33)
- Inventory (section 34 to 37)
- Financial accounts (section 38 to 40)
- Account receivables and payables (section 41 to 50) from mutual transactions
- Capital accounts and non-current liabilities (section 51 to 54)
- Expenses (section 55 to 65)
- Revenues (section 66 to 74)
- Other (section 20, 75 to 77)

2 The structure of financial statements

2.1 The structure of individual financial statements

The structure of financial statements is generally defined in the Act on Accounting and described in details in the "Financial statements proposal", which adopted many parts from the financial statements for entrepreneurs. Since the goals and activities of the public sector entities are different from entrepreneurs, who are established as profit-making entities, we consider the disclosure and presentation of the result for the period through the proposed income statement to be insufficient.

In part 4, we present our suggestions for the Accounting principles proposal, which can directly influence the chart of accounts, and subsequently, the structure of the financial statements – the balance sheet, income statement and notes to the financial statement. Therefore, we do not present any changes to be incorporated into the "Financial statements proposal" in this part; we only present comments on these changes, which should be incorporated during the second phase after submission of the second, amended working version of the "Accounting principles proposal" (expected in October 2006).

Within IPSAS, the structure and content of financial statements is treated in IPSAS 1. The table below shows the principles that are not included in the current or draft legislation, i.e. in the Act on Accounting or the Accounting principles proposal:

IPSAS	**Existing or draft legislation treatment**	**Difference type / Proposal on incorporation or non-incorporation**
IPSAS 1.19-24, 37-42, 66-70, 75-100, 101-113, 128-133	The Act on Accounting defines the components of financial statements. The Financial statements proposal includes details on the structure and content of financial statements.	<u>Incorporation during the second phase</u> is suggested as a part of the Financial statements proposal (see above).
IPSAS 1.22 – Budgetary information (such as budgetary limits, approved budget, etc.)	Presentation of budgetary information is not regulated by the current legislation or the Financial statements proposal	<u>Incorporation during the second phase</u> is suggested as a part of the Financial statements proposal.
IPSAS 1.54 – 55 – Offsetting assets with liabilities	Dealt with in the Act on Accounting	<u>Do not incorporate.</u> The Act on Accounting in section 7, point 6 prohibits offsetting assets and liabilities, expenses with revenues. As this issue is regulated by a higher legislation norm, we do not propose to incorporate this section in the Accounting principles proposal.

IPSAS 1.71 – Reporting period	Treated by the Act on Accounting	Do not incorporate. As the public sector entities operate on the budgetary year basis, which is identical with the calendar year, having a different accounting period is forbidden by the Act on Accounting, except where there is the need to prepare extraordinary financial statements, which is covered by the Act on Accounting, as well.
IPSAS 1.72 – Change in reporting period	Treated by the Act on Accounting	Do not incorporate. As the public sector entities operate on the budgetary year basis, which is identical with the calendar year, change in the accounting period is forbidden by the Act on Accounting.
IPSAS 1.75-78 – Distinction of assets and liabilities	Distinction of assets and liabilities is partially treated in the Accounting principles proposal.	Suggestions regarding the incorporation of relevant differences are presented in section 4 in the particular part of the Accounting principles proposal.
IPSAS 1.114 – Statement of changes in equity IPSAS 1.121, IPSAS 2 – Cash flow Statements	Current legislation does not define Cash flow statements, respectively a statement of changes in equity, as separate statements. The current Financial statements proposal does not deal with these statements either.	Incorporation during the second phase is suggested as a part of the Financial statements proposal, where both statements should be incorporated into the notes to the financial statements, not as separate statements. We also suggest considering setting the method of cash flow preparation using the direct or indirect method.

2.2 Consolidated financial statements for public sector entities

Consolidated financial statements are dealt with in existing accounting legislation in the Act on Accounting, but only for entrepreneurs. As the Act on Accounting does not deal with the consolidated financial statements for public sector entities, a separate regulation concerning the preparation and presentation of these consolidated financial statements has not been presented.

These problems are treated in existing standards IPSAS 6, IPSAS 7 and IPSAS 8 and in the proposed new standards IPSAS 6, IPSAS 7 and IPSAS 8 (ED 26).

Therefore, the working group has presented a proposal to change the Act on Accounting to the Ministry of Finance of the Slovak Republic.

3 Regulations partially included in existing legislation

This part summarizes issues that are fully or partially covered in the Act on Accounting, such as the definition of basic terms, accounting principles, valuation methods, etc. (see following table):

IPSAS	**Existing accounting treatment**	**Our comment / Proposal on incorporation or non-incorporation**
IPSAS 1.25 – 36 – Principles of "True and fair view"	The Act on Accounting in section 7, point 1 and 2 defines the obligation of entities to use accounting policies to ensure a true and fair view, as stated in the Act on Accounting and in the accounting principles.	We do not recommend incorporation of further changes.
Definition of basic terms (assets, liabilities and others).	The Act on Accounting defines basic terms in section 2, point 4. The definition of an asset in the Act says "probably" instead of "virtually certain".	We recommend harmonization after the amendment of the Act on Accounting
IPSAS 1.37 – 42 Application of accounting principles and policies IPSAS 3.24 – Application of changes in accounting principles IPSAS 3.7 – Definition of impracticality. This is a situation where certain adjustments cannot be made, although the entity made appropriate efforts to do so.	The Act on Accounting, in section 7, point 3 defines the obligation of entities to use the same accounting policies and principles within the one accounting period. If an accounting entity changes its accounting policies or principles, the new ones should be applied from the first day of the accounting period, and this information should also be disclosed in the notes to the financial statements. However, in point 4 of this section, it is stated that any differences resulting from changes of the accounting principles and policies shall be deemed transactions of the subsequent accounting period, which contradicts point 3. The Act on Accounting does not define impracticality. However, definition of impracticality can be partially substituted by the cost-benefit principle (Section 17, point 9, the next to last sentence).	We recommend harmonization of point 4 with point 3, and eventually deleting part 4. We recommend implementation of the impracticality principle into the Accounting principles for entrepreneurs and also into the Accounting principles proposal, which can be useful for the transition period of application of new methodology.
IPSAS 1.60 – 63 – Comparative information for the prior accounting period	The Act on Accounting defines in section 18, points 3, 4 and 5 the obligation to present the information	We recommend amending the Act on Accounting or Accounting principle proposal, to ensure this

	for the current accounting period, as well as for previous accounting period in the ordinary and extraordinary financial statements. The Act on Accounting also defines the obligation to present comparative information in the financial statements. On the other side, the Act, in contrast to IPSAS, does not specify how this comparability should be ensured.	comparability. We also recommend implementation of this provision, a wider definition of obligatory information and disclosure of such a situation in the notes to the financial statements, together with specific items related to the first application of the new accounting regulation, during the second phase into the Financial statements proposal.
IPSAS 1.6 – Materiality. IPSAS 3.38 defines fundamental and insignificant	The Act on Accounting in section 17, point 9 indirectly defines materiality by considering the information's significance; this means that information is material if its non-disclosure in the financial statements or its incorrect disclosure can influence the judgement or decision of users of the financial statements.	The Act on Accounting has implemented the definition of materiality from IAS 8 valid at the time of adoption of this Act. However, the definition of materiality has been changed in the meantime, so we recommend implementing a new definition of materiality according to revised IAS 8, respectively IPSAS 3, into the Act.

4 Proposed modifications

4.1 General rules

The General rules are presented in sections 1 to 18 of the Accounting principles proposal. Some of the existing regulations do not need to be amended because they sufficiently cover the issues or directly cover an area that is already dealt with in the Accounting Act. The following sections do not require any changes:

- Section 1 – Elementary provisions
- Section 4 – Chart of accounts
- Section 8 – Internal accounting
- Section 9 and 10 – Opening and closing of the books
- Section 13 – Accounting for differences arising from reconciliation verification procedures

Section 2, 3 – Transaction date recognition

The regulation proposal strictly defines the date of transaction recognition. Existing legal regulations – in the Act on Accounting and Accounting principles proposal – do not define the substance over form principle, which emphasizes the qualitative characteristics of the accounting and financial statements presentation. Because this principle has not yet been implemented in the accounting principles for entrepreneurs (respectively only partially), we do not recommend, in accordance with the limitations as described in chapter 1, further implementation over the existing level as stated in the accounting principles for entrepreneurs.

Section 3 partially indicates adjusting and non-adjusting events at the balance sheet date, which follows the rules set by the Act on Accounting. Within International Standards, this issue is treated by IPSAS 14, which defines specific examples of adjusting and non-adjusting events.

For example, the following are adjusting events:

- The receipt of information after the reporting date indicating that an asset was impaired at reporting date, or that the amount of a previously recognized impairment loss for that asset needs to be adjusted. For example:

    - Announcement of debtor's bankruptcy after the balance sheet date, which confirms that the loss already existed at the reporting date on a receivable account.

    - Sale of inventory after the balance sheet date, which give evidence about their net realisable value.

We recommend therefore the implementation of a detailed description of adjusting and non-adjusting events into the Accounting principles proposal, eventually to include specific examples from IPSAS 14.

Section 5 – Creation of analytical accounts to the synthetic accounts

Part 4.2.1 describes in detail the method of accounting for transfers, split into capital and operational transfers, whereas the proposed accounting treatment may vary, depending on whether the transferor is a third party, founder or other public sector entity. This part also explains the need for reconciliation of the closing balances and turnover arising from mutual transactions between particular public sector entities.

Therefore we recommend amending the regulations in respect of the use of analytical accounts by the following items:

- Split of transfers within the analytical evidence into operational and capital,

- Split of receivables and payables by particular public sector entities to ensure the reconciliation of the closing balance of mutual transactions,

- Split of non-current assets within the analytical evidence by entities from which they were acquired.

Section 6 – Accruals and deferrals

International Standards do not deal with accruals and deferrals explicitly, but emphasize only the accrual principle for recording revenues and expenses. As they are connected with the accounting for liabilities, respectively provisions, our recommendations are stated in section 14 – Principles for setting up and use of provisions.

In the case of deferrals, we have not identified any significant differences between IPSAS and Accounting principles proposal.

Section 7 – Accounting for exchange rate differences

Accounting for exchange rate differences is primarily set by the Act on Accounting; the Accounting principles proposal only amends the Act. The regulation included in the proposal is comparable to the regulation in the Accounting principles for entrepreneurs.

Accounting for exchange rate differences is treated by IPSAS 4, which also defines the concept of functional currency and presentation currency. The existing Slovak accounting legislation does not cover this concept. Our analysis shows that a different functional currency would be applicable only for particular entities, e.g. Ministry of Foreign Affairs of the Slovak Republic or the embassies.

IPSAS 4 also permits the use of spot exchange rates when converting items of the assets and liabilities items, and of an average rate when converting items of statement of financial performances, which has an impact on preparing the consolidated financial statements.

Our existing legislation only permits the use of rates set by the National Bank of Slovakia, except for purchases or sales of foreign currency for Slovak crowns. In such cases, it is possible to use the rate at which these transactions have been realized. The Accounting policies proposal does specify exactly whether the exchange rate differences should be recalculated for prepayments (received, paid) and for deferred expenses, which have already been paid (the receipt / payment has already been realised). According to IPSAS, there is no need to recalculate exchange rate differences for these transactions, because they are classified as non-monetary items.

We recommend amending the regulation regarding the recalculation of exchange rate differences for prepayments, deferrals and accruals mentioned above.

We also recommend omitting the word “provisions” from the following sentence in point 6: “Calculation of exchange rate differences is the same for provisions and reserves”. We believe that the creation and release of accruals is sufficiently covered in the relevant regulation.

Section 11 – Determination of the result of the financial performance

This issue is covered by the international standard IPSAS 1, which is described in section 2.1. As described above, the Accounting policies proposal and the Financial statements proposal were based on the Accounting policies for entrepreneurs.

Point 4 split the result of the financial performance into the result from operating activities, financial activities and extraordinary activities. Due to the fact that it is currently not known which of our proposed adjustments will be implemented into the Accounting policies proposal (especially provisions concerning the exchange and non-exchange transactions), we are not able to propose any change in the structure of the result of the financial performance, nor accept the current proposal. Therefore, we recommend the implementation of possible changes during the second phase, which will be based on the amended Accounting policies proposal.

Point 8 of this section defines the extraordinary activities, as well as the result from the extraordinary activities, which is calculated as the difference between revenues and expenses accounted for on account groups 68 and 58. IPSAS 1 does not use these terms and IAS 1 explicitly prohibits these items. Since the regulation proposal is based on the accounting policies for entrepreneurs, we recommend retaining the existing treatment.

Section 12 - Accounting for Income taxes

IPSAS do not cover the recognition and disclosure of current and deferred income tax, but the standards refer to IAS 12.

The Accounting principles proposal covers only accounting for current income tax, but does not cover accounting for deferred income tax. As we assume temporary differences in tax deductible and non-deductible items will arise also in public sector entities, we propose implementation of the accounting for deferred income tax based on the Accounting principles for entrepreneurs, explicitly Section 10, into the Accounting principles proposal.

Section 14 – Principles for setting up and use of provisions (reserves)

This issue is covered within international standards in IPSAS 19. By comparing them with the Accounting principles proposal, we have identified the following significant differences:

- Definition of provisions

Point 1 defines the provisions as a liability representing a current obligation of the accounting entity arising from the past event, and it is probable that it will result in an outflow of economic benefits of the accounting entity in the future, whereas when the value of the provision is not exactly known, it should be recognized in an amount sufficient to cover the liability existing at the balance sheet date, considering all risks and uncertainties. The liability with certain timing and amount is not recognised as a provision, but as a particular liability.

In contrast to the Accounting principles proposal, IPSAS 19.19 distinguishes between the accruals, provisions and other liabilities based on the level of their uncertainty (it also considers a certain level of uncertainty relating to accruals, unlike the Slovak accounting legislation which, based on the 4th directive of the EU on individual financial statements, does not admit the uncertainty of accruals). The decision criteria are defined by the level of uncertainty (accuracy of estimate) about the timing and amount of the particular liability. Within the Financial statements proposal, these items are to be disclosed separately.

We do not recommend implementation of a different definition of provisions at this stage until the change of definition is amended in the Act on Accounting and Accounting principles for entrepreneurs.

- Types of provisions

Unlike the Accounting principles for entrepreneurs, the Accounting principles proposal does not define in Section 14, point 8 the following types of provisions:

- Bonuses, discounts, rebates, etc. related to products, goods and services sold before the balance sheet date,

- Commissions to sales representatives.

This section does not cover the types of provisions, which are not covered by the Accounting principles for entrepreneurs, but are defined under IPSAS 19 as follows:

- Provision for an asset retirement obligation,

- Restructuring provision.

The Accounting principles proposal defines the provisions for expenses related to asset retirement obligation of leased assets. Accordingly, Section 28, point 3 states that the lessee's expenses related to asset retirement are charged into the expenses after termination of the leasing period. However, IPSAS 19.27 and 17.26 allows the creation of provisions for asset retirement which is included into the acquisition costs of the asset.

IPSAS 19.18, 81, 83, 93, 94 also defines the provisions for restructuring which is set up for direct expenses related to the restructuring. These provisions can only be set up if certain criteria are met.

We recommend amending the list of provisions according to the currently valid Accounting principles for entrepreneurs, section 19 point 8. We also recommend implementing the provisions for asset retirement (after previous implementation into the Accounting principles for entrepreneurs) into the Accounting principles proposal. Due to the complex criteria for recognition of a restructuring provision, we do not recommend its incorporation within this phase.

- Accounting for provisions

Point 3 of the regulation defines the set-up of provisions by debiting a particular expense account, and the use and release of provisions by creating a revenue account. Section 61, point 3, and Section 71, points 1 and 2, of the Accounting principles proposal defines separate accounts 552 and 554 for provision set-up and accounts 652 and 654 for provision use and release. The Accounting principles for entrepreneurs, valid from 1 January 2007, in Section 9, point 19, change the rule for setting up and using a provision which will be accounted for to expense and revenue accounts directly related to a particular liability and with a double entry on a related liability account.

Accounting principles as stated in IPSAS are identical to the accounting principles stated in the Accounting principles for entrepreneurs valid from 1 January 2007. Considering the fact there are several open questions and a lack of experience with setting up and releasing provisions according to the new accounting principles, we do not recommend the implementation of a similar regulation into the Accounting principles proposal at this stage.

- The method of valuing and discounting provisions

The accounting principles proposal does not specify methods for valuing particular provisions, such as provisions for gratuity and retirement benefits. The accounting principles for entrepreneurs in Section 19, point 2, define the method for valuing a provision for employee benefits using actuarial methods, where the value of the provision should be adjusted to its net present value when recording it. We recommend the implementation of this regulation into the Accounting principles proposal.

The accounting principles proposal does not contain rules for discounting provisions. This principle is also not included in the Accounting principles for entrepreneurs, except for using actuarial methods. Where the impact of discounting is material, IPSAS 19.53 and 56 requires discounting provisions to their present value.

We recommend incorporating a rule for discounting provisions into the Accounting principles proposal in accordance with IPSAS, subsequent to its implementation into the Accounting principles for entrepreneurs.

Section 15 – Principles for setting up and releasing provisions (adjustments)

IPSAS does not deal separately with the principles for setting up and releasing provisions and adjustments to receivables, inventory, etc. We have not identified any significant differences comparing the principles for setting up and releasing provisions with IPSAS. Additionally, the Accounting principles proposal has also adopted the regulation from the Accounting principles for entrepreneurs in full.

We do not recommend the implementation of changes made in the Accounting principles for entrepreneurs into the Accounting principles proposal, listed below:

- Change in Section 18, point 1, of the Accounting principles for entrepreneurs concerning the setting up of provisions, valid from 1 January 2006,

- Change in Section 18, point 6, of the Accounting principles for entrepreneurs concerning the setting up of provisions for receivables, valid from 1 January 2006,

- Change in Section 18, point 12, of the Accounting principles for entrepreneurs concerning the set-up and release of provisions for non-current assets and related accounts, valid from 1 January 2007.

Section 16 – General principles for the distinction of assets and liabilities

The Accounting principles proposal has adopted the regulations concerning general principles for the distinction of assets and liabilities from the Accounting principles for entrepreneurs, but has not adopted in full the regulation on the distinction of current assets. This is further defined within other regulations of the Accounting principles proposal. The assets and liabilities distinction issue is described in IPSAS 1. We have not identified any significant differences comparing IPSAS with the Accounting principles proposal.

Neither the Accounting principles for entrepreneurs, nor the Accounting principles proposal deals with specific areas, such as accounting for immovable assets with an economic useful life up to one year or non-current assets held for sale. We recommend defining such instances more clearly in the Accounting principles proposal, subsequent to their incorporation into the Accounting principles for entrepreneurs.

Section 17 – Principles for the classification of bills of exchange and their accounting and Section 18 – Principles for the classification of derivatives and their accounting

The Accounting principles proposal has adopted the regulations from the Accounting principles for entrepreneurs. As there are many differences between the Accounting principles for entrepreneurs and IFRS/IAS, and subsequently also between IPSAS and the Accounting principles proposal, we do not recommend the further incorporation of changes until the Act on Accounting and the Accounting principles for entrepreneurs is amended.

Here is an overview of the proposed changes:

Area	**Accounting principles proposal**	**IPSAS**	**Proposed changes, recommendations**
Post-balance-sheet date events	3	14	Explain in more detail, give examples.
Analytical evidence	5	Not applicable	Amend further regulations.
Accounting for exchange rate differences – concept of functional currency, use of spot and average rate	7	4	We recommend the amendment, only when the Act on Accounting and Accounting principles for entrepreneurs are amended as well.

Accounting for exchange rate differences – recalculation of exchange rate differences arising from prepayments and accruals.	7	4	We recommend the amendment of point 2 for received and provided prepayments and accruals, if these were paid.
Accounting for exchange rate differences – recalculation of exchange rate differences arising from provisions and accruals	7	4	We recommend omitting the word “provisions” from the following sentence in point 6: “The method of calculation of exchange rate differences are the same for provisions and accruals”.
Result of the financial performance	11	1	The changes will be proposed during the second phase.
Income tax	12	Not applicable, refers to IAS 12	We recommend the implementation of section 10 of the Accounting principles for entrepreneurs.
Principles for setting up and releasing provisions (reserves) – amendment of the list of provisions	14.8		We recommend harmonization with the Accounting principles for entrepreneurs (section 19, point 8).
Principles for setting up and releasing provisions – provisions for asset retirement	Not applicable	19.27	We recommend eliminating this difference after amendment of the Accounting principles for entrepreneurs.
Principles for setting up and releasing provisions – actuarial methods	Not applicable		We recommend harmonization with the Accounting principles for entrepreneurs (section 19, point 2).
Principles for setting up and release of provisions – Discounting provisions	Not applicable	19.53	We recommend the implementation of the change after amendment of the Accounting principles for entrepreneurs.
General principles for the distinction of assets and liabilities	16	1	We recommend amending the specification for particular cases.

4.2 Specific regulations

4.2.1 Section 19 – Accounting for subsidies, grants, budgetary payments and receipts

The Accounting for and presentation of non-exchange transactions (subsidies, grants, budgetary payments and receipts) was identified as the most important difference between IPSAS and Accounting principles proposal within the international accounting standards of non-exchange transactions, are defined in Exposure Draft 29.

The methodology on accounting for non-exchange transactions presented by us significantly differs from the Accounting principles proposal. Therefore, we recommend incorporating the principle described below, as well as the detailed accounting treatment, which could also influence other sections of the Accounting principles proposal as well.

We have divided public sector entities into two categories, based on the accounting treatment of subsidies, grants, budgetary payments and receipts (hereafter “transfers”):

- State administration – MF SR (state), state budget chapters and their budgetary and contributory organizations (“Group 1”)

- Local self-administration – municipalities, higher territorial units and their budgetary and contributory organizations (“Group 2”)

The following types of transfers are considered:

- Transfers within Group 1,

- Transfers within Group 2,

- Transfers from Group 1 to Group 2.

The transactions within Group 1 are under state control. Thus, each transaction is eliminated when consolidated into the state budget chapter, respectively state administration.

Transactions within Group 2 are under the municipality or higher territorial unit control. Thus, each transaction will be eliminated when consolidated into the municipality or higher territorial unit.

We propose the amendment of the Accounting principles proposal for accounting for transfers within Group 1 and Group 2 in the following way:

- Account for and disclose the period end balances of transfer transactions through mutual receivables and payables

- Recognize revenue from non-exchange transfers to reimburse operational expenses to the extent of actual expenditure

- Recognize revenue from non-exchange transfers to reimburse capital expenditure to the extent of actual expenses

Based on the introduction of a new term "Revenue from non-exchange transactions", we propose introducing a new accounting group to the proposed chart of accounts as described in part 4.7.

We believe that transfers from Group 1 to Group 2 should be presented differently from transfers within Group 1 or within Group 2, as Group 1 does not control the entities within Group 2. Transfers from Group 1 to Group 2 should be accounted for and presented as transfers to third parties, similar to transfers from the state to entrepreneurs.

Accordingly, we recommend the following treatment of transfers from Group 1 to Group 2:

- To disclose period end balances of transfer transactions through deferred revenues and deferred expenses

- Recognize revenue from non-exchange transfers to reimburse operational expenses with time-related factual pertinence of expenses to the extent of actual expenses

- Recognize revenue from non-exchange transfers to reimburse capital expenditure with time-related factual pertinence of expenses to the extent of actual expenses

We propose amending section 19 by the regulation that the accounting treatment of transfers from third parties is the same as accounting for transfers from Group 1 to Group 2.

The date of recognition of particular transfer should be specified in the Accounting principles proposal. We suggest amending section 19 or section 2 (Transaction rate recognition) of the Accounting principles proposal by the date of recognition of the receivable/payable resulting from transfers.

Paragraph 19 states that an entity accounts for transfers based on the budgetary payment schedule, contribution or donation. We propose accounting for payables and receivables (e.g. a receivable from a founder and payable towards a budgetary organization) when:

- the founder of payment for acquisition of asset or service in the state budgetary organization,

- the transfer of funds from municipality to municipal budgetary organization,

and at the same time, account for deferred income

- when the right for the transfer arises with respect to the transfers from state to municipality (e.g. for the execution of state competencies)

Within section 19, we propose defining and distinguishing between operational transfers (to reimburse the operational expenses) and capital transfers (reimburse capital expenditures).

We also suggest omitting the alternative method of accounting for transfers, i.e. accounting through account 411.

Accounting for revenues from transfers – compensation of operational expenses

We have considered five alternatives for accounting for revenues from transfers relating to operational expenses and capital expenditures which are covered in more detail in Progress Report 2. Finally, the alternative described below was chosen as most suitable. Revenues from operational transfers are recognized as follows:

- In a state budgetary organization, to the extent of payments (not expenses),
- In a municipal budgetary organization, with respect to transfers to a municipality, to the extent of payments.

By applying the proposed alternative, the entities of Group 1 and Group 2 will present the results of financial performance as a difference between accrued expenses and revenues that correspond to cash used for reimbursement of these costs.

Municipalities and higher territorial units will recognize the revenues from operational transfers on an accrual basis in the period and the extent of incurred operational cost.

We propose to incorporate into section 34 of the Accounting principles proposal, which deals with the inventories, the accrual concept for the transfer of inventories. We suggest accounting for the transfer of inventories as a credit entry to deferred income account, which will be released into current revenues to the extent of the amount of inventory consumed.

Accounting for revenues from transfers – compensation of capital expenditures

We suggest accounting for revenues from transfers as compensation of capital expenditures the extent of expenses relating to capital expenditure, such as depreciation expenses and setting up provisions to non-current assets in all public sector entities.

In the event of a transfer of non-depreciated non-current assets, we recommend considering the option of recognizing revenues from the transfer immediately in the accounting period of the transfer, or the option of deferring the revenue in the period of transfer. We would prefer the same treatment as in entrepreneur's accounting, i.e. accounting for it as deferred revenues.

Accounting records of mutual transactions from transfers between entities, where control over this exists

For consolidation purposes of state entities, and consolidation of municipalities and higher territorial units, it is crucial to record receivables and payables from transfers between entities, where control exists, split in analytical accounts to at least the following extent (see part 4.1):

- State (MF SR) – budget chapter
- State (MF SR) – budgetary and contributory organization of budget chapter (budget chapter disclose the relationship from mediation of transfer)
- Municipality – budgetary and contributory organization of municipality
- Higher territorial unit – budgetary and contributory organization of higher territorial unit

All transfers will be split in analytical accounts as stated in part 4.1 into:

- Operational
- Capital

Receivables and payables should be confirmed and reconciled at the balance sheet date.

Accounting records of mutual transactions from transfers between entities, where control does not exists

It covers relationship between the following entities:

- State (MF SR) – municipality and its budgetary and contributory organization
- State (MF SR) – higher territorial unit and its budgetary and contributory organization
- Between municipality and higher territorial unit and their budgetary and contributory organizations

Transfers are accounted for as deferred income in the books of the recipient of the transfer, and as a current expense in the books of the transferor. Payables and receivables do not need to be confirmed and reconciled at the balance sheet date.

Accounting for budgetary receipts

Based on the Accounting principles proposal, the state budgetary organization recognizes a receivable from a budgetary receipt and a payable towards a founder in the amount of the budgetary receipt.

We suggest recognizing revenues related to budgetary receipts that a budgetary organization transfers to a founder on an accrual basis. At the same moment, the budgetary organization accounts for the expenses and payable towards the founder in the amount of revenues recognized (not expenditures).

Accounting for transfer with a condition

ED 29 defines a situation when there are one or more conditions imposed on the usage or time of the transfer. If those conditions are not met, then the transfer has to be returned and a liability towards the provider has to be recognized. Section 19 does not deal with transfers with conditions.

ED 29.8, 16, 18, 20, 45 defines the conditions and restrictions on transfers. Unless the condition that would require return of the transfer is met, the recipient has to account for the transfer as a liability towards the provider, and not for revenues. The conditions have to be enforceable.

Although provisions of transfers with conditions to public sector entities are very specific and rare, we recommend including the suggested treatment into the Accounting principles proposal.

4.3 Non-current assets

Non-current assets are covered within the Accounting principles proposal in Sections 21 to 33. Within IPSAS, non-current tangible assets are treated by IPSAS 17 – Long-term property, plant and equipment, and IPSAS 16 – Investment property. Accounting for leasing is covered in IPSAS 13. Non-current intangible assets are not treated by a separate IPSAS. Non-current financial assets are partially included in IPSAS 15. Non-current receivables are not included in any of the existing IPSAS. The impairment of assets is included in IPSAS 21.

4.3.1 Non-current tangible and intangible assets

Non-current tangible and intangible assets are covered by Sections 21, 22, 25, 26, 27, 28, 29, 30, 32 and 33. Regulations of the Accounting principles proposal concerning non-current assets are broadly adopted from the Accounting principles for entrepreneurs.

Section 21 – Principles for non-current assets segmentation and accounting

The basic definition of assets is set by the Act on Accounting and is comparable with the definition in IPSAS. Unlike IPSAS 17, it includes items such as biological assets (e.g. breeding), mineral resources (e.g. quarries, clay pits, sandpits) and partially investment property. On the other hand, the definition in the Act on Accounting does not include separate rules for infrastructure, special military equipment, and heritage.

When comparing the Accounting principles proposal with the Accounting principles for entrepreneurs, we found several references in Section 13, point 2, to the Act on Income Tax that allows accounting for intangible assets with a value equal to or lower than the limit set by the Act on Income Tax, such as for “Other services”. Similarly, it is allowed to account for tangible assets with a value equal to or lower than the limit set by the Act on Income Tax, such as for “Material consumption”. We propose implementing the relevant regulations into the Accounting principles proposal.

Section 22 – Details about accounting procedures for valuing non-current intangible and non-current tangible assets

The basic valuation principles are stated in the Act on Accounting; and the Accounting principles proposal specifies some of these areas.

IPSAS 17, in comparison with the Accounting principles proposal, defines 2 valuation models:

- At cost, non-current tangible assets are valued at the balance sheet date, using the acquisition price decreased by accumulated depreciation and any provision (respectively, impairment losses). This model fully corresponds to the Accounting principles proposal.

- At a revalued amount, which is based on the revaluation of non-current assets at the balance sheet date at fair value, decreased by any subsequent accumulated depreciation and impairment losses. The revaluation is posted to equity. Since this model is not incorporated in the Accounting principles for entrepreneurs, and would also need to be implemented into the Act on Accounting, we do not recommend its implementation into the Accounting principles proposal.

No other significant differences concerning this Section have been identified.

Section 25

It defines the types of assets that are accounted for in class 0. No amendment is needed.

Section 26 – Accounting for the acquisition of non-current assets

The Accounting principles proposal is based on the Accounting principles for entrepreneurs. In respect to the transfer problems described in part 4.2.1, we recommend amending point 3 of the Accounting principles proposal in accordance with the recommendations related to transfers. We also propose omitting point 5, which deals with the use of the reproduction fund, which is not considered yet.

We recommend incorporating Section 33, points 1, 2 and 7, of the Accounting principals for entrepreneurs into the Accounting principles proposal.

Section 27 – Accounting for non-current intangible assets acquisition

This part is based on the Accounting principles for entrepreneurs, and we do not have any further comments in respect to this section. We do not recommend the incorporation of the amendment to the Accounting principles for entrepreneurs valid since 1 January 2006 concerning the possibility to capitalize interest expenses. This is because the method for calculating interest expenses is complicated, and because IPSAS prefers not to capitalize them.

Section 28 – Accounting for the acquisition of non-current tangible assets

This part is partially adopted from the Accounting principles for entrepreneurs. When comparing the Accounting principles proposal with the Accounting principles for entrepreneurs, we have identified the following differences which we suggest incorporating into this section:

- Section 35, point1 letter f) and g)
- Section 35, point 3 concerning accounting for technical enhancement performed by a lessee

We also recommend omitting the word “payments” in point 2, letters c), d), e), f), g) and h) and to remove the brackets from the word “expenses”.

When comparing the Accounting principles proposal with IPSAS, we have only identified a difference in the capitalization of interest expenses, which is prohibited by the Accounting principles proposal. IPSAS allows the capitalization of interest expenses.

Section 29 – Accounting for disposal of non-current intangible and tangible assets

This part is partly adopted from the Accounting principles for entrepreneurs. Our only comment is to amend point 6, where we propose incorporating relevant sections concerning the accounting for transfers (which is described in part 4.2.1).

Section 30 – Depreciation of non-current intangible and tangible assets

In the event of the depreciation of non-current intangible and tangible assets, the general rules are comparable with IPSAS or the Accounting principles for entrepreneurs. We recommend the adoption of Section 20, point 4, of the Accounting principles for entrepreneurs which treats the preparation of a depreciation plan, and of Section 20, point 5, which sets the need to reassess the depreciation plan in case of changing conditions.

We also recommend that the MF SR suggest useful lives for particular assets in the form of a Methodological guideline, since many public sector entities do not have sufficient experience with the depreciation of non-current assets.

Section 32

This part treats accounting for non-current intangible assets, which is not treated separately in any IPSAS standards. Some regulations from the Accounting principles for entrepreneurs were adopted by the Accounting principles proposal. Since the Accounting principles for entrepreneurs treats this issue in more detail, we recommend implementation of Section 37, points 3, 4, 5, 6 and 7, of the Accounting principles for entrepreneurs concerning accounting for capitalization of development expenses into the Accounting principles proposal. We also recommend harmonization of points 2 and 3 of the Accounting principles proposal with Section 37, points 8 and 9, of the Accounting principles for entrepreneurs.

The Accounting principles proposal says in point 4 that goodwill is accounted for on account 019, but it does not state the definition of goodwill. We therefore recommend the adoption of

Section 37, points 11, 12, 13, 14, 15 and 16, of the Accounting principles for entrepreneurs to the extent relevant to public sector entities.

We also recommend the implementation of Section 37, point 17, of the Accounting principles for entrepreneurs, which defines items that cannot be capitalized as non-current intangible assets.

Following part in Section 32 contains the details about accounting for works of art.

Section 33

This section defines details about accounting for technical appreciation depreciated by a lessee at the end of a leasing contract.

We recommend omitting the words “or account 470” because account 470 is not defined in the proposed accounting framework.

Other identified differences

As mentioned in part 4.3, the Accounting principles proposal does not deal with the issue of heritage. Heritage represents assets of specific cultural, environmental or historical importance, such as historical buildings and monuments, archaeological excavations, protected natural areas and works of art, where their cultural, environmental or historical value is not reflected in their financial value. The heritage is not reparable and its value can rise in spite of worsening technical condition. It is hard to determine its useful life, which can be up to several hundred years.

IPSAS 17 does not require accounting for heritage that meets the definition of an asset. If an entity decides to account for heritage, it must present additional information (including the valuation method) in the notes.

We do not recommend implementation of this difference into the Accounting principles proposal.

IPSAS 16 treats a special category of assets – investment property – which represents buildings and land owned (or acquired through financial leasing) held to earn rentals or for capital appreciation. Investment property can be:

- Land held for long-term capital appreciation,
- Land held for currently undetermined future use,
- Buildings owned and leased out under operational leases,
- Buildings held to be leased.

The Accounting principles proposal does not define “investment property”. The Accounting principles for entrepreneurs do not define the term “investment property” either, and assets with similar characteristics are not presented separately.

This kind of asset is valued in accordance with IPSAS at cost or fair value (as described above). Since we did not recommend the use of fair value for non-current assets valuation, we do not recommend incorporating this difference into the Accounting principles proposal.

The Accounting principles proposal does not deal with accounting for financial leasing. Operational leasing is covered by particular regulations on accounting on particular ledger accounts. These issues are completely covered by IPSAS 13, which has adopted the regulations from IAS 17. Within the Accounting principles for entrepreneurs, financial leasing is covered by Section 30a.

When comparing the Accounting principles for entrepreneurs with IPSAS 13 (IAS 17) we have identified the following significant differences:

- According to the current legislation for entrepreneurs, only financial leasing contracts concerning non-current assets can be considered and accounted for as financial leasing, where an option to purchase the leased asset has been agreed in the contract. The leasing period must be at least 60% of the period over which the property is being depreciated (for tax purposes). Yet the period should not be shorter than 3 years (12 years for land leasing). This means that not all transactions considered a financial lease in IPSAS or IAS would be considered such in the Slovak accounting legislation.

- Identity has to be assured, which means that both the lessor and the lessee must use the same method for calculating the interest rate. The existing Slovak legislation does not cover a non-guaranteed value, specifics for producer / seller, nor initial direct expenses (with some exceptions).

- The existing Slovak legislation does not cover transactions like sale and lease back, connected transactions in the form of leasing contract, or leasing transactions without the legal form of a leasing contract. The legal form always prevails over the economic substance.

- We therefore recommend the implementation of Section 30a of the Accounting principles for entrepreneurs into the Accounting principles proposal.

As stated in the introduction, impairment issues are covered by IPSAS 21, which lays down external and internal impairment indicators, together with a detailed description of an impairment loss calculation (including examples).

The Accounting principles proposal contains only a general reference concerning the need for accounting for permanent or temporary impairment of non-current assets, based on Section 25, point 2 of the Act on Accounting. Since the Accounting principles for entrepreneurs do not contain a detailed description on how to determine the impairment of non-current assets, we do not recommend the implementation of relevant IPSAS regulations into the Accounting principles proposal.

We present short review on proposed amendments:

Area	**Accounting principles proposal**	**IPSAS**	**Proposed changes, recommendations**
Principles for non-current assets segmentation and accounting	21	17	We recommend harmonization with the Accounting principles for entrepreneurs (Section13, points 2 and 7).
Accounting for non-current assets acquisition	26	17	We recommend harmonization with the Accounting principles for entrepreneurs (Section33, points 1, 2 and 7).
Accounting for non-current tangible assets acquisition	28	17	We recommend harmonization with the Accounting principles for entrepreneurs (Section35, point 1f and g, point 3). We recommend omitting the word “payments” in points 2c), d), e), f), g) and h); and not allowing the capitalisation of exchange rate differences
Accounting for disposal of non-current tangible assets	29	Does not cover	We recommend harmonization of point 6 with a proposed change in accounting for transfers, as stated in part 4.2.1.
Depreciation of non-current tangible and intangible assets	30	17	We recommend harmonization with the Accounting principles for entrepreneurs (Section 20, points 4 and 5). We also recommend publishing a new Methodological guideline concerning the suggested useful life of non-current assets.
Other	32	17	We recommend harmonization with the Accounting principles for entrepreneurs (Section 37, points 3-7, 8,9 and 11-17).

Other	33	Does not cover	We recommend omitting the words "or account 470".
Heritage	Does not cover	17	We do not recommend incorporation.
Investment into property	Does not cover	16	We do not recommend incorporation.
Financial leasing	Does not cover	13	We recommend harmonization with the Accounting principles for entrepreneurs (Section 30a).
Impairment of assets	15 or the Act on Accounting	21	We do not recommend the incorporation of further regulations

4.3.2 Non-current financial assets

Non-current financial assets are covered in sections 23, 24 and 31. Regulations of the Accounting principles proposal concerning the non-current financial assets are adopted from the Accounting principles for entrepreneurs.

The Accounting principles proposal has adopted relevant regulations from the Accounting principles for entrepreneurs (besides section 23, point 2, about a controlled entity and an entity with substantial influence, which has already been removed from the Accounting principles for entrepreneurs). As there are still many differences between the Accounting principles for entrepreneurs and IAS and also between IPSAS and Accounting principles proposal, we do not recommend the incorporation of further differences (besides harmonization with the Accounting principles for entrepreneurs) before the Act on Accounting and the Accounting principles for entrepreneurs are amended.

We propose changing section 31, point 8, concerning the disposal of non-current financial assets acquired for free, according to the proposed methodology for accounting for transfers, as described in part 4.2.1.

The Accounting principles proposal in section 22 lacks regulations on non-current financial assets, which have not been adopted from section 21 of the Accounting principles for entrepreneurs. We recommend amendment of these regulations.

4.4 Inventory

Inventory is covered within the Accounting principles proposal in sections 34 to 37 and within IPSAS 12. When comparing the regulations, no significant differences were identified, only minor differences such as inventory held for distribution at no charge or for a nominal amount. According to IPSAS, these should be valued at the amount that the entity would need to pay to achieve its objectives. If this amount cannot be determined, then replacement costs should be used. The accounting principles proposal does not explicitly define this group of inventory, but the principles for inventory valuation (set by the Act on Accounting and the Accounting principles proposal) are not in contradiction with IPSAS. Therefore, we think it is not necessary to implement changes into the Accounting principles proposal.

When comparing the Accounting principles proposal with the Accounting principles for entrepreneurs, we have identified the following differences, to be implemented into section 34:

- We suggest implementing section 22, points 2, 3, 4, and 6, from the Accounting principles for entrepreneurs, which lay down further details about accounting for inventory, such as accounting for marginal acquisition costs, the capitalization of intra-company services and financial expenses, and accounting for discounts, bonuses and rebates,

- We propose incorporating section 23, point 1, from the Accounting principles for entrepreneurs (net realizable value),

- We recommend amending the following text: “and therefore they are almost consistent with actual expenses” in section 34, point 5.

Although the Inventory account (in entrepreneurs’ accounting) does include work in progress for construction contracts, the Accounting principles proposal does not contain this issue. Within international standards, work in progress for construction contracts is covered by IPSAS 11, which has adopted many components from IAS 11.

Work in progress for construction contracts is covered in existing legislation in the Accounting principles for entrepreneurs. Some of the basic principles have been adopted from IAS 11, but some components are different, particularly the definition of construction contracts. The existing accounting principles for entrepreneurs allow accounting for construction contracts only if the output is a tangible asset or a combination of tangible assets. According to IAS 11 or IPSAS 11, this criterion is not relevant: this means that the provision of services can also be treated as a construction contract.

It should be considered whether these issues are relevant for the public sector entities. If so, we propose the implementation of construction contracts as covered by the Accounting principles for entrepreneurs into the Accounting principles proposal.

Area	**Accounting principles proposal**	**IPSAS**	**Proposed changes, recommendations**
Inventory	34 - 37	12	We recommend amendment of Section 22, points 2, 3, 4, 6, and of Section 23, point 1, from the Accounting principles for entrepreneurs
Construction contracts	Does not cover	11	We recommend considering if the construction contracts are relevant for public sector entities. If so, we recommend the incorporation of relevant regulations from the

			Accounting principles for entrepreneurs

4.5 Financial accounts and payables and receivables accounts

Financial accounts and payables and receivables accounts are covered in Sections 38 to 40 and 41 to 50 of the Accounting principles proposal, setting the accounting techniques and contents.

As mentioned above, IPSAS covers general principles and rules, not detailed accounting procedures. The recommendations introduced in this part have arisen from the differences identified within previous sections.

In part 4.2.1, we described the problems of accounting for transfers, which represents the most significant difference between the Accounting principles proposal and IPSAS. In accordance with proposed consolidation within the public sector and accounting for transfers between public sector entities, we suggest making a separate accounting class for payables and receivables accounts. This classification of accounts would simplify the reconciliation of closing balances of payables and receivables accounts.

In the Accounting principles proposal and the proposed framework chart of accounts, these accounts could be incorporated into accounting groups 35 and 36. This would require reassessing the content of the following accounts:

- 344 – Settlement with provider's budget (Section 45, point 6)

- 346 – Subsidies and other settlements with state budget (Section 45, point 8)

- 348 – Subsidies and other settlement with a municipality's or higher territorial unit's budget (Section 45, point 9)

- 349 – Contributions from the European Community budget and settlement with the European Community budget (Section 45, point 10)

- We also propose amending Section 49 – Deferrals of expenses and revenues (accruals), points 2, 8 and 11 (concerning account 381 – Deferred expenses and account 384 – Deferred income), related with accounting for transfers.

4.6 Equity accounts and non-current liabilities

Equity accounts and non-current liabilities are covered within the Accounting principles proposed in sections 51, 52, 53 and 54.

The equity accounts are divided in the Accounting principles proposal into three accounting groups:

- Funds / Reserves (41)

- Funds created from profit and Retained earnings (42)
- Result for the period (43)

Based on recommended changes, we propose omitting point 3 of section 52, as the alternative for accounting for transfers. We also recommend assessing the relevance of section 52, point 4, concerning funds of municipalities and higher territorial units.

We do not have comments on accounting for non-current liabilities, besides accounting for transfers. Since capital expenditure transfers are designated for the acquisition of non-current assets, and the remaining repayment period can be longer than one year, these transfers are considered non-current liabilities. Therefore, we propose the creation of a separate accounting group for non-current payables and receivables, as stated in part 1.3.5 of this report. The alternative approach is to divide receivables and payables into current and non-current within the analytical evidence, and present them separately only in the financial statements.

4.7 Expenses and revenues

Expenses are covered in the Accounting principles proposal in sections 57 to 65, while revenues are covered in sections 66 to 74.

The Accounting principles proposal has adopted many regulations from the Accounting principles for entrepreneurs, which appears in the proposed framework chart of accounts and the content of individual accounts. Since specific activities and goals of the public sector entities are different from entrepreneurs, it is necessary to amend expenses and revenues with other accounting groups arising from proposed principles for accounting for transfers.

As a result, we propose singling out a group of accounts from accounting groups 5 – Expenses, and 6 – Revenues accounts, in which entities would account for revenues from non-exchange transactions, and for accruals and deferrals concerning transfers.

4.8 Other

Other regulations contain only general rules, which we do not have special comments on.