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ASSESSING THE QUALITY OF IPSAS-BASED FINANCIAL REPORTS OF THE SUPRANATIONAL ORGANIZATIONS

Abstract. The study aims at accessing the quality of IPSAS-based financial reports of intergovernmental organizations, which have fully adopted the accrual basis of accounting. The quality assessment contemplates the empirical estimation of the financial reports' conformity with qualitative characteristics proclaimed in the Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities. The research database encompasses 20 financial reports estimated by 190 disclosure requirements aggregated in 31 indicators. The score assessment of financial reports has provided the data to build a multiple linear regression model that depicts the relation between the quality and the qualitative characteristics of the IPSAS-based financial reports. Adequacy checking has shown that the model meets the adequacy requirements, while the *F*-testing and *T*-testing have proven the statistical significance of independent variables and β-parameters, respectively. In particular, qualitative characteristics of predictive value, completeness, neutrality, absence of material errors, timeliness, and verifiability have substantiated their significance, while the qualitative characteristics of confirmatory value, understandability, and comparability were identified as insignificant and, therefore, excluded from the model. The model can be applied for estimating whether financial reports prepared under the IPSAS comply with the qualitative characteristics of public sector financial reporting. These findings enable making judgments on transparency and relevance of information disclosed by public sector organizations in their financial reports. Findings meet up-to-date demand for estimating the financial reports' quality in terms of the recent transition to IPSAS-based principles of accounting and reporting by governments and supranational organizations worldwide.

Keywords: accounting, public sector, IPSAS, financial reporting quality, qualitative characteristics, regression model.

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ОЦІНКА ЯКОСТІ ФІНАНСОВОЇ ЗВІТНОСТІ МІЖНАРОДНИХ ОРГАНІЗАЦІЙ, ЩО ЗАСТОСОВУЮТЬ МСБОДС

Анотація. Дослідження присвячене оцінці якості фінансових звітів міжнародних організації, що складені відповідно до Міжнародних стандартів бухгалтерського обліку в державному секторі. Оцінка якості фінансових звітів передбачає проведення емпіричної оцінки їхньої відповідності якісним характеристикам, що встановлені Концептуальною

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основою фінансової звітності для суб'єктів державного сектору. Інформаційна база дослідження охоплює 20 фінансових звітів міжнародних організацій, що оцінені за 190 критеріями у формі 31 індикатора. Бальна оцінка фінансових звітів дозволила отримати потрібні дані для побудови багатофакторної лінійної регресійної моделі, яка визначає зв'язок між якістю і якісними характеристиками фінансових звітів, що складені за міжнародними стандартами обліку в державному секторі. За результатами оцінки адекватності встановлено, що модель є адекватною. Використовуючи критерії Фішера і Стьюдента, оцінено статистичну значущість незалежних змінних і β-параметрів відповідно. Зокрема, якісні характеристики можливості прогнозування, повноти, нейтральності, відсутності помилок, своєчасності та можливості перевірки визнані статистично значущими. У свою чергу, якісні характеристики підтверджуючої цінності, зрозумілості та порівнюваності визнані незначущими і виключені з моделі. Розроблена модель може застосовуватися для оцінки відповідності складених фінансових звітів міжнародним стандартам фінансової звітності в державному секторі. Отримані результати дозволяють робити судження щодо прозорості та доречності інформації, яка розкривається у фінансових звітах суб'єктів державного сектору. Результати дослідження відповідають сучасним потребам оцінки якості фінансових звітів в умовах переходу до облікового методу нарахування у процесі складання фінансової звітності суб'єктами державного сектору і міжнародними організаціями.

Ключові слова: облік, державний сектор, МСБОДС, якість фінансової звітності, якісні властивості, регресійна модель.

Формул: 3; рис.: 0; табл.: 3; бібл.: 35.

Introduction. The public sector of a national economy encompasses the general government sector, public financial corporations, and public non-financial corporations. Financial corporations, partly or fully owned by either local or state governments, have been applying accrual-based accounting standards developed for the commercial companies. Simultaneously, institutions operating within the general government sector were recommended to follow the national accounting standards.

The transition to the accrual accounting in the public sector has been proclaimed by many countries, but under internally set mechanisms. Certain countires use their own national accounting standards being compliant with the IPSAS recommendations, while others apply IPSAS-developed financial reporting techniques in conjunction with national rules of accounting [1]. Cavanagh et al., analyzing the implementation of accrual accounting worldwide, have divided all the countries into four categories according to stages of transition from the cash-based to accrual-based method: cash accounting, elementary accrual accounting, advanced accrual accounting, and full accrual accounting [2].

In 2014, the International Public Sector Accounting Standards Board issued the Conceptual Framework for General Purpose Financial Reporting, which provides concepts that underpin the IPSAS. Chapter 3 of the Conceptual Framework discloses the qualitative, non-financial characteristics of information included in financial reports prepared under the IPSAS. These include relevance, faithful representation, understandability, timeliness, comparability, and verifiability [4]. Each qualitative characteristic has firmly determined sub-characteristics, which enables to assess the quality of financial reporting of particular public sector entity.

As for 2019, the majority of countries, which have declared transition to the international standards of financial reporting, still continue applying national regulations, bringing them in coincidence with the IPSAS recommendations. According to the Report of the IFAC on international standards application, only 11% of 130 jurisdictions have fully adopted the accrual-based method, while the rest 89% are divided between countries with partly adopted and those, which have not adopted the IPSAS — 52% and 38%, respectively.

While governments estimate all advantages and drawbacks of the IPSAS, the majority of international non-commercial organizations have fully adopted the accrual basis in the preparation of financial reports. The European Commission, NATO organizations, the OECD, and United

Nations system organization have made the transition from the cash-basis or modified cash-basis accounting to full accrual one [3]. This makes them adequate objects to analyse the quality of financial reporting.

Research analysis and problem formulation. In the last two decades, the estimation of the financial reports' quality has become subject to the discussion in numerous scientific papers. In particular, Cohen measures the quality of financial reporting by the precision of information disclosed [5; 6]. Karğın and Iatridis consider the quality of financial reports as a major driver of attraction for investors and the cornerstone of the capital market [7; 8]. Another approach to evaluate of the quality of financial reporting implies the construction of a 21-item index applying scoring assessments for qualitative characteristics divided into two groups — fundamental (relevance and faithful representation) and enhancing (understandability, verifiability, comparability, and timeliness) ones [9]. Thus, the vast majority of studies are devoted to qualitative analysis of financial reports prepared under the IFRS rather than the IPSAS. This fact is explained by relatively recent approval of the Conceptual Framework for General Purpose Financial Reporting by public sector entities.

Turning to the IPSAS-based financial reports, their quality is measured using various assessment techniques. Particularly, Opanyi estimates the quality of financial reports by five qualitative characteristics under the IPSAS, namely, relevance, faithful presentation, understandability, comparability, and timeliness [10]. Akinleye and Alaran-Ajewole examine the effect of the IPSAS adoption on the quality of information disclosed in financial reports by interviewing the personnel engaged in accounting data gathering and processing at public sector entities [11]. Another approach of quality assessment implies the application of the methods of horizontal and vertical analysis, as well as the analysis of ratios [12].

Despite the fact that the substantial number of scientists focused their research on the quality assessment of financial reports, the aforementioned approached do not correspond with the definition of the quality of financial reporting information in terms of the conceptual framework for the public sector financial reporting. Therefore, the issues of evaluating the quality of financial reporting demand further consideration.

The study aims at development of the approach to estimate the quality of IPSAS-based financial reports, which contemplates conformity of information in financial reports with the qualitative characteristics of financial reporting proclaimed in the Conceptual Framework. To achieve this objective, the authors have considered the qualitative characteristics of financial reporting as prescribed in the Conceptual Framework and distinguished 31 indicators of the financial reports' quality. Then, applying the scoring method of empirical research, the financial reports of 20 supranational organizations are evaluated for compliance with the indicators. The received scores of each organization are adjusted for the level of significance of each indicator. At a final stage, the authors have built the linear regression model to determine the relationship between the qualitative characteristics and the evaluated quality of information in financial reports. The study provides the comprehensive analysis of the quality of information disclosed in financial reports prepared in conformity with the IPSAS recommendations.

Methodology and methods. The Conceptual Framework for General Purpose Financial Reporting discloses the qualitative characteristics of information included in financial reports.

The Conceptual Framework indicates 6 qualitative characteristics of information included in financial reports: relevance — availability of the confirmatory and predictive value of the information; faithful representation — complete, neutral and error-free description of the economic fact; understandability — presenting information in a manner understandable by users; timeliness — access to information before it losses it's capacity; comparability — presentation of information in a way that enables to compare all the similarities in and differences between two or more economic facts; verifiability — assurance in the faithful representation of the economic fact in the financial report [4].

To collect the data necessary to do the analysis, the article's authors have processed financial reports of 20 international non-for-profit organizations for the year 2018 [13—32]. The

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financial reports are prepared in accordance with the International Financial Reporting Standards, which assumes the coherence of the information disclosed with the qualitative characteristics prescribed in the Conceptual Framework for General Purpose Financial Reporting. The sample size is limited by the number of financial reports of the supranational organizations prepared under the IPSAS and their availability for the public in open access.

Estimating the financial reports' quality is based on an assertion that the better the information in a financial report complies with the qualitative characteristics, the higher its quality is. Therefore, qualitative characteristics are considered as the independent variables, which impact the overall quality of financial report. Each qualitative characteristic is assessed by its compliance with the indicators of financial reports' quality (*Table 1*).

Table 1

Indicators of the financial reports' qualitative characteristics

№	**Qualitative characteristic**		**Indicator**		**Number of disclosure requirement**
1.	Relevance	Confirmatory value	R1	Director's confirmation that financial statements are prepared fairly in compliance with the IPSAS	4
		Predictive value	R2	Information about the existence of any multi-year funding arrangements and contributions in advance within the financial reports	1
2.	Faithful presentation	Information is complete	F3	Statement of financial position	17
			F4	Statement of financial performance	6
			F5	Statement of changes in net assets/equity	5
			F6	Significant accounting policies	8
			F7	Cash flow statements	2
			F8	Accounting policies	4
			F9	The effect of changes in foreign exchange rates	2
			F10	Revenue from exchange transactions	2
			F11	Inventories	2
			F12	Leases	4
			F13	Events after the reporting date	2
			F14	Property, plant and equipment	9
			F15	Segment reporting	4
			F16	Provisions, contingent liabilities and assets	11
			F17	Related party disclosures	6
			F18	Impairment of non-cash generating assets	5
			F19	Revenue from non-exchange transactions	8
			F20	Presentation of budget information in financial statements	9
			F21	Impairment of cash-generating assets	3
			F22	Financial instruments: disclosures	20
			F23	Intangible assets	8
			F24	Employee benefits	17
		Information is neutral	F25	Financial reports contain statements on management judgments and estimates used when preparing financial statements	1
		Information is free from material errors	F26	Full Report of the External Auditor	1
3.	Understandability		U27	Confirmation of the External Auditor that financial statements are prepared in coherence with IPSAS	4
4.	Timeliness		T28	Financial and budgetary analysis as a part of the Director's report	9
5.	Verifiability		V29	Opinion of the External Auditor	4
			V30	Statement of Internal Control	9
6.	Comparability		C31	Information is given for both current and previous reporting periods	3
	Total				190

Source: developed by the authors.

The characteristic of relevance is explained by two indicators representing confirmatory and predictive value. Faithful representation is assessed in terms of 18 indicators of completeness, based on IPSAS requirements for information disclosure [33—35], one indicator of neutrality and one indicator of the absence of material errors. Understandability, timeliness, and comparability are evaluated by one indicator per each characteristic, while verifiability is determined by two indicators. Each indicator receives scores between «0» and «4» which depends on the degree of conformity with the disclosure requirements. The quantity of the disclosure requirements varies for each indicator. The total number of the disclosure requirements is 190. Therefore, the characteristics of understandability, timeliness, and comparability are identified as single-indicated variables. Characteristics of relevance, verifiability, and faithful representation are estimated by several indicators.

The developed procedure for assessing the financial reports' quality is a staggered approach shaping 5 phases. At the first stage, the authors measure all the 31 indicators within a scale from «0» to «4» points. An indicator receives «0» if it doesn't respond to any of disclosure requirements. An indicator receives the score «1», when the percentage of compliance with the disclosure requirements varies between 1% and 25% inclusive. An indicator obtains the score «2», when meets from 25% to 50% of disclosure requirements. An indicator receives the scores «3» and «4», when meets from 50% to 75% and from 75% to 100% of disclosure requirements, respectively. It's necessary to highlight that the assessment procedure is based on assumption that the information about a phenomenon disclosed when financial report confirms its presence or absence. Thus, even if an organization doesn't perform certain business activity within the scope of the IPSAS and this fact is stated in notes, the information about such phenomenon is considered as disclosed one.

At the second stage, all the scores are summed up for each indicator. These indexes vary between 0 and 80 points. An indicator obtains a zero point if it isn't disclosed in any financial report, while 80 points goes to an indicator fully disclosed in all the financial reports. The next stage refers to calculating the total band score of each financial report based on 31-indicator scoring. It is worth mentioning that the frequency of disclosure is different for different indicators. Therefore, some indicators are more valuable for the purpose of financial reporting quality estimation, comparing to the others. The significance of particular indicator is assessed through the calculation of a significance index — the maximum possible frequency of appearance (20) is divided by the frequency of appearance of a particular indicator (from 0 to 20 times) in financial reports. The significance index and the frequency of appearance are adversely related: indicator with the lowest frequency of appearance has the highest significance of appearance and vice versa. The final stage contemplates the calculation of the rating of financial reports as the sum of scores received by 31 indicators and the standardized scores previously adjusted for the level of significance.

The research result. The process of indicator scoring shows that the indicator F4 «Statement of financial performance» obtains the highest point of 80. In turn, the lowest estimate of 4 points is gained by the indicator F21 «Impairment of cash-generating assets», as soon as information on impairment and loss recognition of cash-generating assets is partly represented in financial reports of only two organizations — the International Criminal Court and the International Labour Organization. Scoring of financial reports shows that the International Labour Organization showed the highest result — 96 out of 124 possible. The International Institute for Democracy and Electoral Assistance received the lowest estimate of 49 points, which demonstrates significant discrepancy between the qualitative characteristic of the financial report and the IPSAS recommendations. Hence, none of the analysed reports fully conforms to the qualitative characteristics of financial information under the IPSAS.

The calculations show that indicators F3, F4, F5, F6, F7, F10, F14, F19, F22, F24, U27, V29, C31 are disclosed in all the financial reports and, therefore, received the lowest significance index — 1, while the indicator F21 «Impairment of cash-generating assets» is the rarest as disclosed in only two reports (*Table 2*).

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Table 2

Significance index of the quality indicators

Indicator		Frequency	Level of significance
R1	Director's confirmation that financial statements are prepared fairly in compliance with IPSAS	15	1.33
R2	Information about existence of any multi-year funding arrangements and contributions in advance within the financial reports	12	1.67
F3	Statement of financial position	20	1
F4	Statement of financial performance	20	1
F5	Statement of changes in net assets/equity	20	1
F6	Significant accounting policies	20	1
F7	Cash flow statements	20	1
F8	Accounting policies	9	2.22
F9	The effect of changes in foreign exchange rates	19	1.05
F10	Revenue from exchange transactions	20	1
F11	Inventories	17	1.18
F12	Leases	18	1.11
F13	Events after the reporting date	14	1.43
F14	Property, plant and equipment	20	1
F15	Segment reporting	18	1.11
F16	Provisions, contingent liabilities and contingent assets	16	1.25
F17	Related party disclosures	19	1.05
F18	Impairment of non-cash generating assets	4	5
F19	Revenue from non-exchange transactions	20	1
F20	Presentation of budget information in financial statements	19	1.05
F21	Impairment of cash-generating assets	2	10
F22	Financial instruments: disclosures	20	1
F23	Intangible assets	17	1.18
F24	Employee benefits	20	1
F25	Financial reports contain statements on management judgments and estimates that were used when preparing financial statements	15	1.33
F26	Full Report of the External Auditor	9	2.22
U27	Confirmation of the External Auditor that the financial statements are prepared in coherence with IPSAS	20	1
T28	Financial and budgetary analysis as a part of the Director's report	13	1.54
V29	Opinion of the External Auditor	20	1
V30	Statement of Internal Control	11	1.82
C31	Information is given for both current and previous reporting periods	20	1

Source: calculated by the authors, using [13—32].

To calculate the adjusted scores, each score received by a particular indicator, is multiplied by the significance index. Then, the adjusted scores are summarized for each financial report (*Table 3*). It is worth mentioning that the scores based on the indicators of qualitative characteristics and the adjusted scores are calculated, using different approaches. Therefore, the adjusted scores should be adapted to the same measurement framework as the indicator-based scores. The initial adjusted scores are standardized, applying the ranking method: a financial report with the lowest score takes the lowest position in the rating with the score «1»; financial report with the second lowest score number gets mark «2», etc.

Table 3

Scores for assessing the financial reports' quality

No.	Organization	Indicator-based scores	Adjusted scores		Total scores
			Initial	Standardized	
1	2	3	4	5	6=3+5
1	International Civil Aviation Organization	87	103.87	11	98
2	The European Centre for Medium-Range Forecast	61	65.86	2	63
3	Pan American Health Organization	91	108.22	15	106
4	International Criminal Court	82	119.84	18	100

Table 3 (continued)

No.	Organization	Indicator-based scores	Adjusted scores		Total scores
			Initial	Standardized	
1	2	3	4	5	6=3+5
5	World Health Organization	93	106.87	13	106
6	United Nations Relief and Works Agency for Palestine Refugees in the Near East	86	100.64	10	96
7	International Organization for Migration	86	97.2	9	95
8	World Tourism Organization	85	93.23	7	92
9	Organization for the Prohibition of Chemical Weapons	93	121.08	19	112
10	International Institute for Democracy and Electoral Assistance	49	53.26	1	50
11	International Maritime Organization	88	104.16	12	100
12	International Agency for Research on Cancer	70	79.58	4	74
13	Food and Agriculture Organization of the United Nations	94	112.33	17	111
14	United Nations Industrial Development Organization	83	91.59	6	89
15	International Atomic Energy Agency	93	111.79	16	109
16	Pacific Community	72	86.62	5	77
17	Joint United Nations Programme on HIV/AIDS	81	95.28	8	89
18	International Labour Organization	96	137.64	20	116
19	International Federation of Accountants	61	66.98	3	64
20	International Criminal Police Organization	90	107.73	14	104

Source: calculated by the authors, using [13—32].

To estimate the dependence of the quality of financial reports on the qualitative characteristics, the authors built a 9-factor linear regression model, where the quality of financial reports is a response variable, while the qualitative characteristics of financial reporting under the Conceptual Framework are explanatory variables. The regression model is as follows (1):

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \beta_6 X_6 + \beta_7 X_7 + \beta_8 X_8 + \beta_9 X_9, \qquad (1)$$

where Y — the quality index of financial report; X_1 — confirmatory value, X_2 — predictive value, X_3 — completeness of the information, X_4 — neutrality of the information, X_5 — information is free from material errors, X_6 — understandability, X_7 — timeliness, X_8 — verifiability, X_9 — comparability.

The independent variables X_3, X_4, X_5, and X_8 comprise of several indicators of the information quality. Thus, they are calculated as the weighted arithmetic of the particular indicators. To compute the parameters of multiple linear regression, the authors apply the least squares method. The regression model is as follows (2):

$$Y = -25.007 + 0.182X_1 + 1.121X_2 + 29.594X_3 + 1.795X_4 + 2.311X_5 + \\ + 0.446X_6 + 1.359X_7 + 4.034X_8 + 3.210X_9. \qquad (2)$$

To determine whether the linear regression model is relevant and correctly predicts the response variable, the authors have assessed its adequacy, using the statistical criteria. The regression model is considered as an adequate one so far as the means of the random errors are nil and the equality dispersion test is passed successfully. The coefficient of determination R^2 equals 0.998, which means that the response variable of the financial report's quality can be predicted by the explanatory variables for 99.5%. The Fisher's exact test of independence shows that the Fisher criterion ($F^* = 222.574$) significantly surpasses the critical value ($F_{(\alpha=0.05,\ f1=9,\ f2=10)} = 3.68$), which approves statistical significance of explanatory variables of the model. The statistical significance of the β-parameters is confirmed by the Student's t-test: t_β for 3 β-parameters ($t_{\beta 1} = 0.384$,

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$t_{\beta6}$ = 0.289; $t_{\beta9}$ = 1.6) are more extreme than the critical value of the distribution ($t''_{\beta(0.025;18)} = -2.101$; $t'_{\beta(0.025;18)} = 2.101$). Therefore, the β-parameters for the indicators of confirmatory value ($\beta_1 = 0.182$), understandability ($\beta_6 = 0.446$), and comparability ($\beta_9 = 3.210$) do not impact significantly the quality of financial reports of international organizations and can be excluded from the model. It is also important to notice that the intercept term β_0 accounts for (–25.007) and shows the meaning of response variable when all the explanatory variables are nil. Taking into consideration that the scores for all the qualitative characteristics can be obtained solely in terms of absence of any financial report and, hence, of the source of analysis, such hypothesis is denied and the intercept term is excluded from the model. Consequently, the multiple regression model is rebuilt as follows (3):

$$Y = 1.121X_2 + 29.594X_3 + 1.795X_4 + 2.311X_5 + 1.359X_7 + 4.034X_8. \qquad (3)$$

The model explains the dependence of the financial reports' quality on the indicators of qualitative characteristics. In particular, a 1-point increase of the predictive value of reporting information leads to a 1.121-points increase of the quality of financial report, etc. The least influential explanatory variable is the indicator of confirmatory value. The independent variable of faithful presentation makes the greatest impact — a 1-point increment of the given index results in a 29.594-points increase of the financial report's quality index.

Conclusions and prospects for further research. The results of the empirical estimation of the financial reporting quality indicate that none of the considered financial reports fully responds to the qualitative characteristics so far as the highest obtained score is 96 out of 124 possible. The average quality score based on indicators of qualitative characteristics is 82, which makes 66% compliance with the IPSAS recommendations. Among 31 indicators, 13 are disclosed in all financial reports, while two — F18 «Impairment of non-cash generating assets» and F21 «Impairment of cash-generating assets» are partly disclosed only in 4 and 2 financial reports, respectively. As for indicators of quality, only one — F4 «Statement of financial position» is presented in all the examined financial reports in full coherence with all the 6 disclosure requirements under the IPSAS 1 «Presentation of Financial Statements» and, therefore, gains the maximum 80 scores. Despite the proclaimed transition to IPSAS-based financial reporting, none of the considered organizations completely follows the disclosure requirements.

The need for transition to the accrual accounting in public sector is stipulated by the increasing stakeholders' demand in relevant, faithful, and verifiable information on efficiency and earmarking of public finances. The developed approach provides interested parties with an efficient instrument for assessing the quality of financial reporting, which encompasses all the disclosure requirements under the IPSAS and supplementary documents of the management and auditors. Applying the elaborated estimating techniques stakeholders can make judgments on efficiency, credibility, and transparency of a certain institution.

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