

2011 Annual Policy Conference

International trends in public sector accounting reforms

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The global economic crisis has underscored the importance of accountable and transparent use of public funds, in particular in light of deteriorating fiscal positions and rising public debts. There is now a growing consensus that good information on government's activities matters. It can help policy makers better navigate their reform agenda. Public and financial institutions require it too, amid increased concerns over sustainability of public accounts. And businesses need it for their strategy planning. Overall, public sector accounting and budgeting can either strengthen or weaken the trust which underpins relations in a society. It is, for this reason, essential that explanation it provides on past and current trends is accurate and reliable. Some countries use a cash based approach, others have moved, in part or completely, to accrual because of the benefits it brings. But this move also entails risks and preparatory actions that need to be carefully planned and well understood, especially if the institutional setting is weak and capacities for proper implementation are missing. The conference will discuss the increased role of accounting in the public sector, especially in the post financial crisis era, revisit its evolution in the recent years and discuss lessons learned and offer recommendations on the design of future public sector accounting reforms.

Expected results and related costs: Experience is mixed

Accrual based system provides a more complete overview of government actions, because it focuses on revenue, cost, assets, liabilities and equity instead of cash flow only. Besides, it allows for a more informed reflection on alternative options. As such, it promotes accountability, enhances transparency and generates behavioral change in public finance management. Cash management is usually not abandoned with the introduction of an accrual based system, and remains an important part of it.

The accrual based system also involves considerable challenges – because it is more comprehensive - it requires advanced systems, financial knowledge and skills for proper management of information and interpretation of the results. Reporting assumes significant increase in the range and quality of accounting information available as well as cooperation of the participating institutions and good organization. It requires a more sophisticated understanding of accounting information, not just from report preparers but also from report users. The move to accrual has, for these reasons, been met with some reservation, especially considering also the significant additional cost involved.



Challenges of the transition from cash to accrual

Managing the transition to an efficient and transparent accrual framework is not easy. It requires a thorough consideration of the design, implementation plan and practical solutions in regards to various issues, such as the (i) level of centralization of financial reporting (finance ministry vs. line ministries); (ii) appropriate sequencing of the reform steps (e.g. accrual accounting first, accrual budgeting second); (iii) staged implementation with identified milestones for measuring the progress (e.g. starting with pilots, e.g. health sector); etc. Setting (iv) realistic time horizons (e.g. three to five, or even ten years) is also important in order to allow sufficient time for parallel steps in organization and regulation (e.g. reporting). Equally important is (v) developing a communication strategy that would make the process transparent and well understood by the public sector users, policy-makers and public at large. Finally, (vi) pre-conditions need to be in place before the start of the transition, including a robust cash accounting framework and absence of systemic corruption; sustained political support and willingness of the civil service to accept the change; high quality information on non-cash transactions and events; technical capacity with adequate IT systems; national professional accounting and control bodies; training programs and certification; etc.

Speaking the same language: International standards

Multiple accounting and statistical standards in the public sector, both within each country and among the countries, call for harmonization in order to enhance clarity and minimize costly duplications. All major international government finance compiling and reporting systems are now on accrual basis, and they are constantly being developed and modified. The core set includes the 1993 System of National Accounts (SNA), the 1995 European System of Accounts (ESA), the Government Finance Statistics Manual (GFSM 2001), and the International Public Sector Accounting Standards (IPSAS), which are modeled around the International Financial Reporting Standards (IFRS) that apply to the private sector. Efforts are underway to promote convergence between the accounting and statistical reporting models, but some differences will, nevertheless, remain over a longer term. Countries need to understand what is essential, what is optional, and the implications of possible choices.

Importance of accrual framework for macro-economic policy

Accrual framework provides a broader measure of the overall fiscal stance than cash accounting. It, therefore, allows for a better judgment of the sustainability of fiscal policy. For example, in addition to traditional debt, it also includes quasi-debt liabilities (e.g. future obligation to pay civil service pensions), depreciation, environmental liabilities, accounts payable, accrued interest, asset valuation changes, etc. Accrual reporting also enhances the quality of decision-making through improved balance and accuracy



of macro-economic forecasts and monitoring of the composition of fiscal accounts. Because it provides a longer term perspective for fiscal policy implications, and is more consistent with conventional accounting used in the private sector, credit agencies and financial markets also support it. Overall, accrual framework enhances confidence and transparency, and contributes to faster economic growth, although it can also give rise to false interpretation and manipulation of results.

Pondering benefits and costs

Transition to accrual accounting and budgeting is an important component of the public sector reform, although it does traditionally not top the agenda. Before embarking on the transition, it is vital that the expected results are well understood and the roadmap is carefully designed. Also, basics elements should be put in place before bringing in more sophisticated schemes. Besides, the timeframe for introducing change should be realistic.

Accrual framework is not a panacea, and despite the significant efforts and costs involved, it does not provide all the information that is often required by the public sector users, or can even lead to distortions if not introduced properly. Experience, however, suggests that it can boost accountability and enhance performance of the public finance management.

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