ISSUES IN PUBLIC SECTOR ACCOUNTING

PEMPAL

BAKU

NOVEMBER 5 – 8, 2012
Coverage of presentation

1. Standards and financial reporting
2. The role of cash and accrual
3. Combining cash and accrual accounting
4. Automation and consolidation
Issue 1: Standards and Financial Reporting
Standards define reports

IPAS, GFS & ESA 95 are reporting standards
Only indirectly define accounting processes & systems

Budget & accounting processes

Compliant with IPSAS
Key element to achieve accountability & transparency
Audited & published

Financial Statements

Compliant with GFS 2001 or ESA 95
Unaudited but provide important information for analysis

Statistical reports
Characteristics of double entry accrual accounting

1. The accounting entity
2. Accounting transactions recorded in a single monetary unit
3. Accounting relates the following opposites:
   - Increases and decreases in physical holdings of cash and goods
   - Increases or decreases in debt to or by other individuals or entities
   - Increases and decreases the entity’s own assets and liabilities
4. Equity as the difference between the entity’s assets and liabilities
5. Surplus (deficit) as the net increase or decrease in equity
6. The accounting period over which surplus or deficit is measured
Why accrual?

- Basis of a universal and inclusive accounting model
  - Assets and liabilities
  - Cash and other economic flows
  - Financing balances and flows
- Enhanced control
  - Double entry
- Transparency and accountability
  - Enables comprehensive financial statements
  - That can be audited
Why standards?

• Standards define reporting

• Always exist
  – Explicit – standards
  – Implicit – rules and regulations

• International standards
  – Enable comparability
  – Embody best practice
Relationship between IPSAS, IFRS, GFS and ESA 95

**Accounting Standards**

- International Financial reporting standards (IFRS)
  - All commercial entities & GBEs
  - All countries where adopted
  - General Purpose Financial Statements

- International Public Sector accounting standards (IPSAS)
  - All public sector entities except GBEs
  - All countries where adopted

**Statistical Reporting Systems**

- UN System of National Accounts (SNA)
- European System of national and regional Accounts (ESA) 95
- IMF Government Finance Statistics (GFS) 2001
- EU Countries
- All countries except EU

All countries except EU

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Share common Information
Issue 2: The role of cash and accrual
Multiple functions accounting

Revenue & financing -> Budget & accounting processes -> Service delivery

- Purposive system
  - Budget execution
  - Cash
  - Accrual

- Control system
  - Assets, liabilities, revenues, expenditure, financing
  - Cash
  - Accrual

- Information system
  - Budget reports
  - Financial statements & statistical reports

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Cash & accrual required

• Only an issue for public sector
  – Public sector budgets cash basis
  – Commercial entity budgets accrual basis

• Public sector entities require:
  – Line item reporting on both cash and accrual basis
  – Not part of the design of most accounting packages
Issue 3: How to combine cash and accrual accounting?
Options

1. Cash only
2. Accrual only
3. Two separate systems
4. Combine cash & accrual in one system
Option 1: Cash only

Cash accounting (or modified cash) only

Reporting under cash basis IPSAS. IMF have indicated cash basis acceptable for GFS reporting if accrual data not available

**Advantages**
1. Simple
2. Consistent with budget
3. Modified cash also holds information on financial assets & liabilities

**Disadvantage**
1. Assets, liabilities & related flows not recorded, managed or controlled through accounting system
2. Existing accrual systems and information lost
3. Can only report under cash basis IPSAS
Option 2: Accrual only

Accrual accounting system

Reporting under accrual basis IPSAS and for GFS or ESA 95

Advantages
1. Reporting under GFS, ESA 95 & accrual IPSAS
2. Retains and builds on existing accrual expertise & information
3. Comprehensive – includes all flows, assets & liabilities
4. Possible to design reports approximating to cash basis

Disadvantages
1. Implementation involves major system implementation and business process reengineering of accounting processes
2. Only aggregate cash flow information available
3. Problem of controlling the execution of a cash budget
4. Difficulty of budget reporting (IPSAS 24 compliance)
### Reports approximating to cash from accrual accounting

<table>
<thead>
<tr>
<th>Item</th>
<th>Required adjustment from accrual to cash reporting</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital expenditure</td>
<td>Show actual cash flow</td>
<td>Easily available from asset accounts – manual adjustment</td>
</tr>
<tr>
<td>Depreciation/amortization</td>
<td>Eliminate from reports</td>
<td>Depreciation ledger accounts omitted from cash reports</td>
</tr>
<tr>
<td>Revenue</td>
<td>Cash basis</td>
<td>Acceptable under accrual IPSAS</td>
</tr>
<tr>
<td>Financing flows</td>
<td>Report actual flows</td>
<td>Available from loan accounts – manual adjustment</td>
</tr>
<tr>
<td>Expenditures</td>
<td>Use accrual information</td>
<td>Difference to cash only material if large changes in working capital</td>
</tr>
<tr>
<td>Other economic flows</td>
<td>Eliminate from reports</td>
<td>Usually easily identified from ledger accounts – omit from cash reports</td>
</tr>
</tbody>
</table>
Option 3: Two separate systems

Two separate systems, e.g. cash treasury accounting and accrual budget institution accounting

**Advantages**
1. Reporting under GFS, ESA 95 & accrual IPSAS
2. Retains and builds on existing accrual expertise & information
3. Comprehensive – includes all flows, assets & liabilities
4. Enables cash control and reporting

**Disadvantages**
1. Complexity, confusion, duplication of work having two separate systems and methodologies
2. Information entered twice – once in each system
3. Increased risk errors, duplicate or omitted information
4. Problem of reconciling information from two systems

Cash basis system operational Treasury for budget execution and reporting
Option 4: Combine cash & accrual in one system

Single methodology combining cash and accrual operational in Treasury & all budget institutions

Cash basis used for budget execution, monitoring and reporting. Accrual information for control, IPSAS accrual financial statements, GFS/ESA 95

**Advantages**
1. Meets all requirements
2. Avoids complexity, confusion & duplication
3. All information in single system no reconciliation issues

**Limitations**
1. Complex to design and implement
2. May be more difficult to manage
3. May not be feasible in some Commercial Off The Shelf (COTS) accounting packages
Combining cash & accrual in one system – methodologies

<table>
<thead>
<tr>
<th>Methodology 1</th>
<th>Methodology 2</th>
<th>Methodology 3</th>
</tr>
</thead>
</table>
| **Enable through design of processes**
  e.g. Tajikistan cash sub-ledger | **Specify as mandatory requirement when procuring accounting software** | **Custom develop accounting software to meet requirement** |

**Issues**
- Difficult to design and operate
- Multiple data entry required
- May not work in some COTS packages
- May not be properly understood/implemented by software suppliers
- May not be feasible in some packages
- Difficult to specify & design may be beyond developer capability
- Other disadvantages of custom software
Conclusions on combining cash and accrual

• Ideal solution – Option 4
  – one system combining accrual and cash information
  – May be infeasible to implement through COTS package

• Alternative – Option 2
  – one system accrual based
  – Use reports to provide approximate cash basis data
Issue 4: Automation and consolidation
Consolidation concepts

**Consolidation Entity:**
Whole of Government

Consolidated reports & financial statements on whole of government:
- Important information on government revenues, borrowings, expenditure allocations, etc.
- Transparency & accountability

**Public interest entities**
- Financial statements of individual entities:
- Enhance transparency and accountability where there is a sub-set of civil society with specific interest in that entity, e.g. citizens of Rayon X
The process of consolidation

Department X

Pays $1,000 tax

Department of Taxation

External tax receipts

$2,000

Aggregate expenditure

$2,000 + $1,000

$3,000

Aggregate revenue

$2,000 + $1,000

$3,000

Consolidated expenditure

$2,000

Consolidated revenue

$2,000

But consolidation eliminates $1,000 tax paid by Department X
Application of consolidation principles

• Necessary under cash or accrual accounting

• Very difficult to programme into computer systems
  – Must be manual intervention

• Usually not feasible to eliminate all inter-entity transfers
  – Focus on material items