

**PEMPAL**

**ISSUES IN PUBLIC SECTOR  
ACCOUNTING**

**PEMPAL**

**BAKU**

**NOVEMBER 5 – 8, 2012**

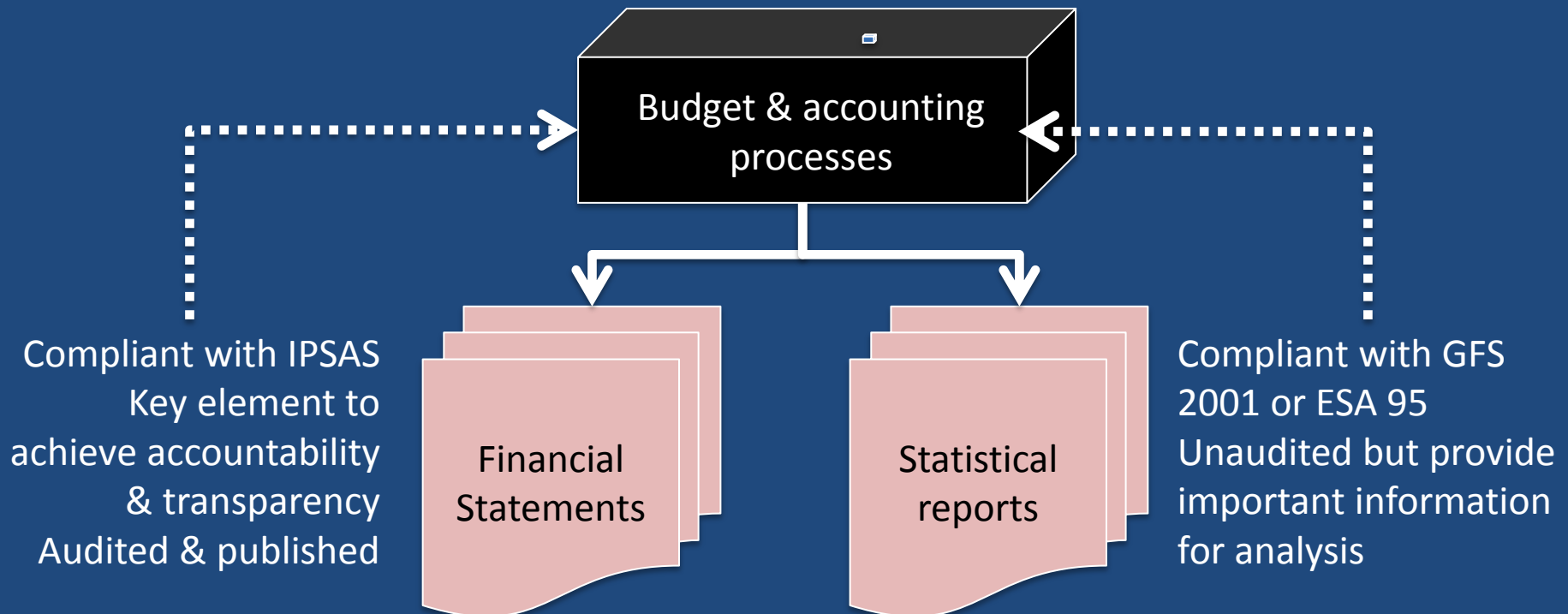
# Coverage of presentation

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

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



# 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

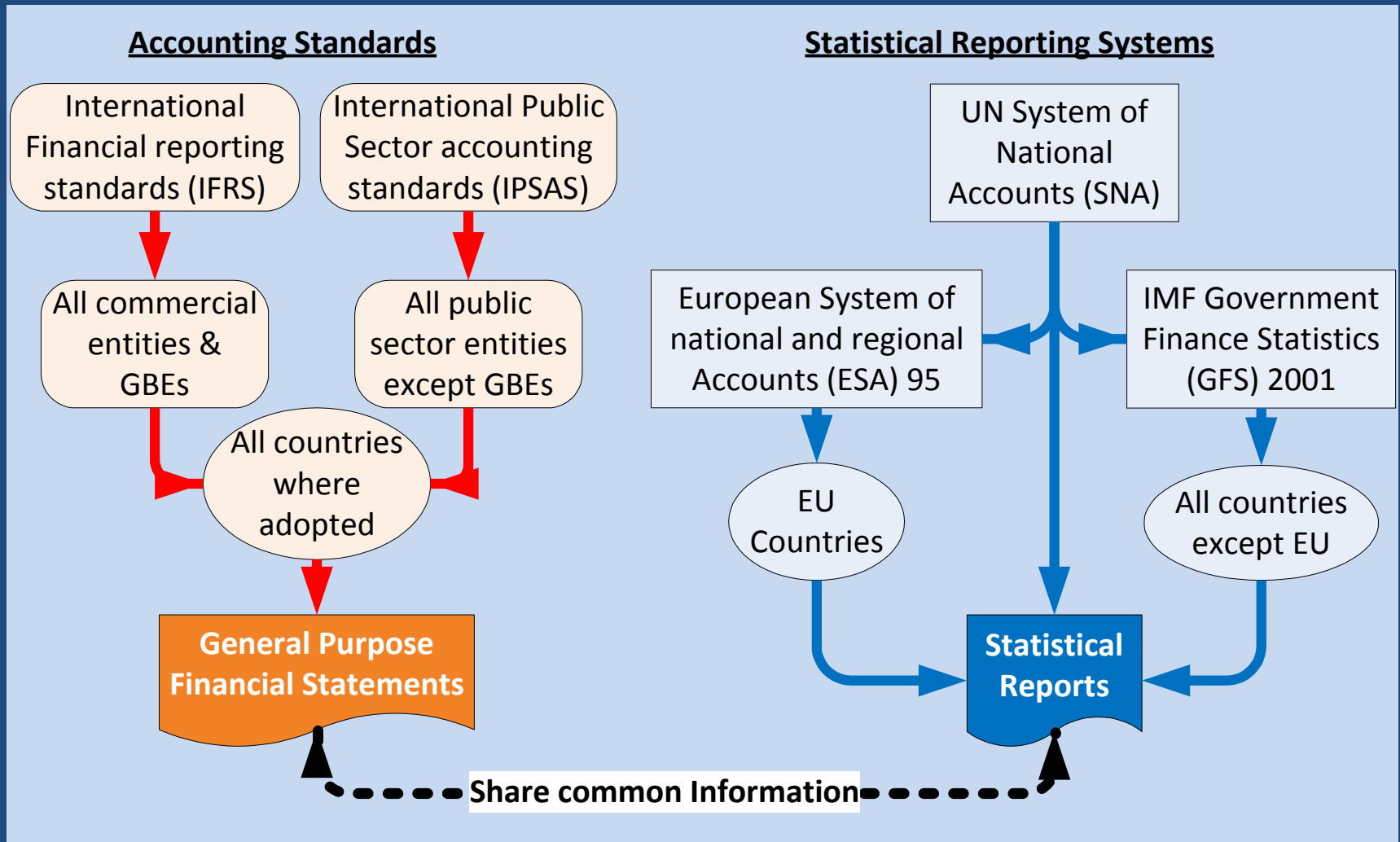
# Why accrual?

- 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

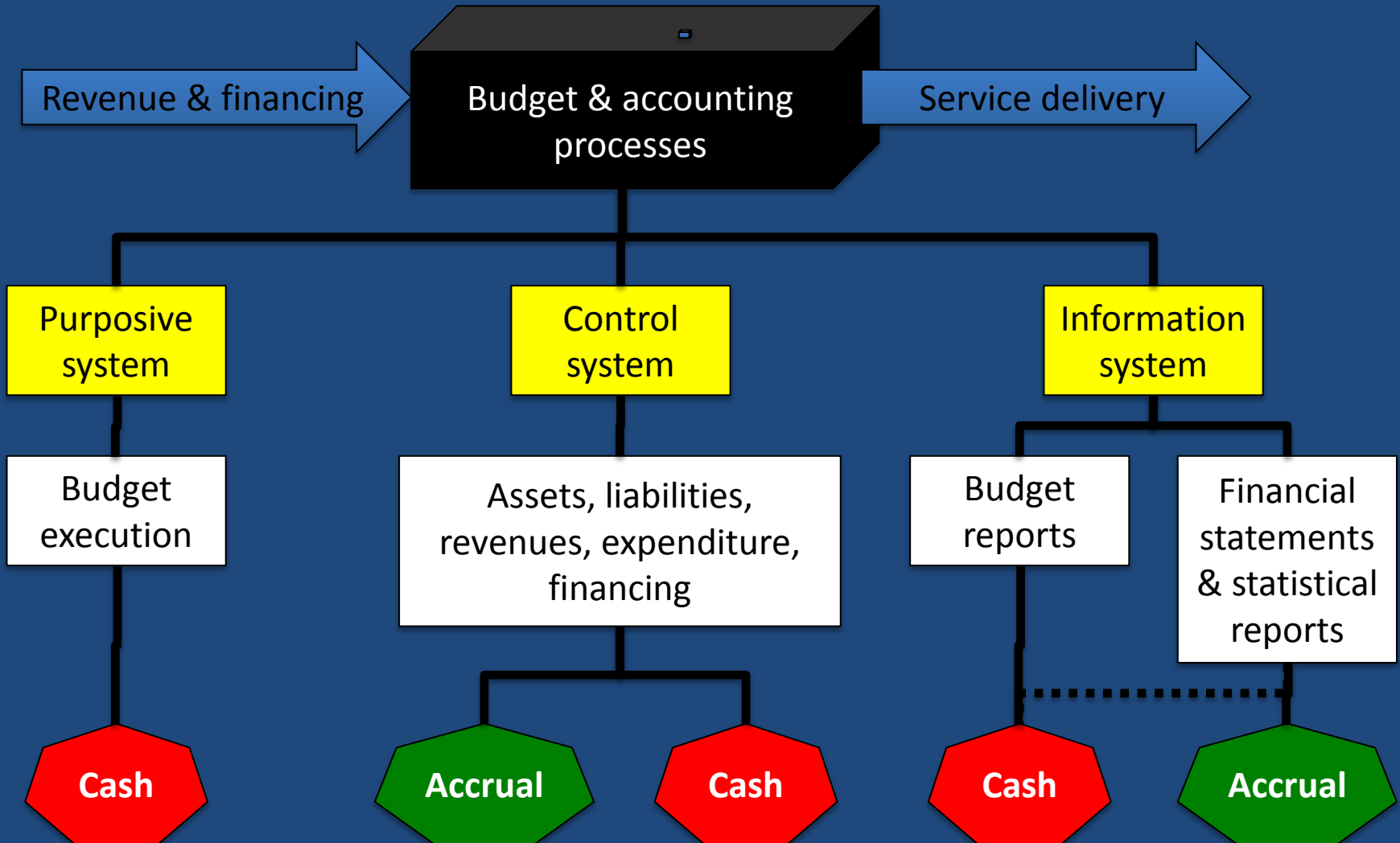
# Relationship between IPSAS, IFRS, GFS and ESA 95





# Issue 2: The role of cash and accrual

# Multiple functions accounting

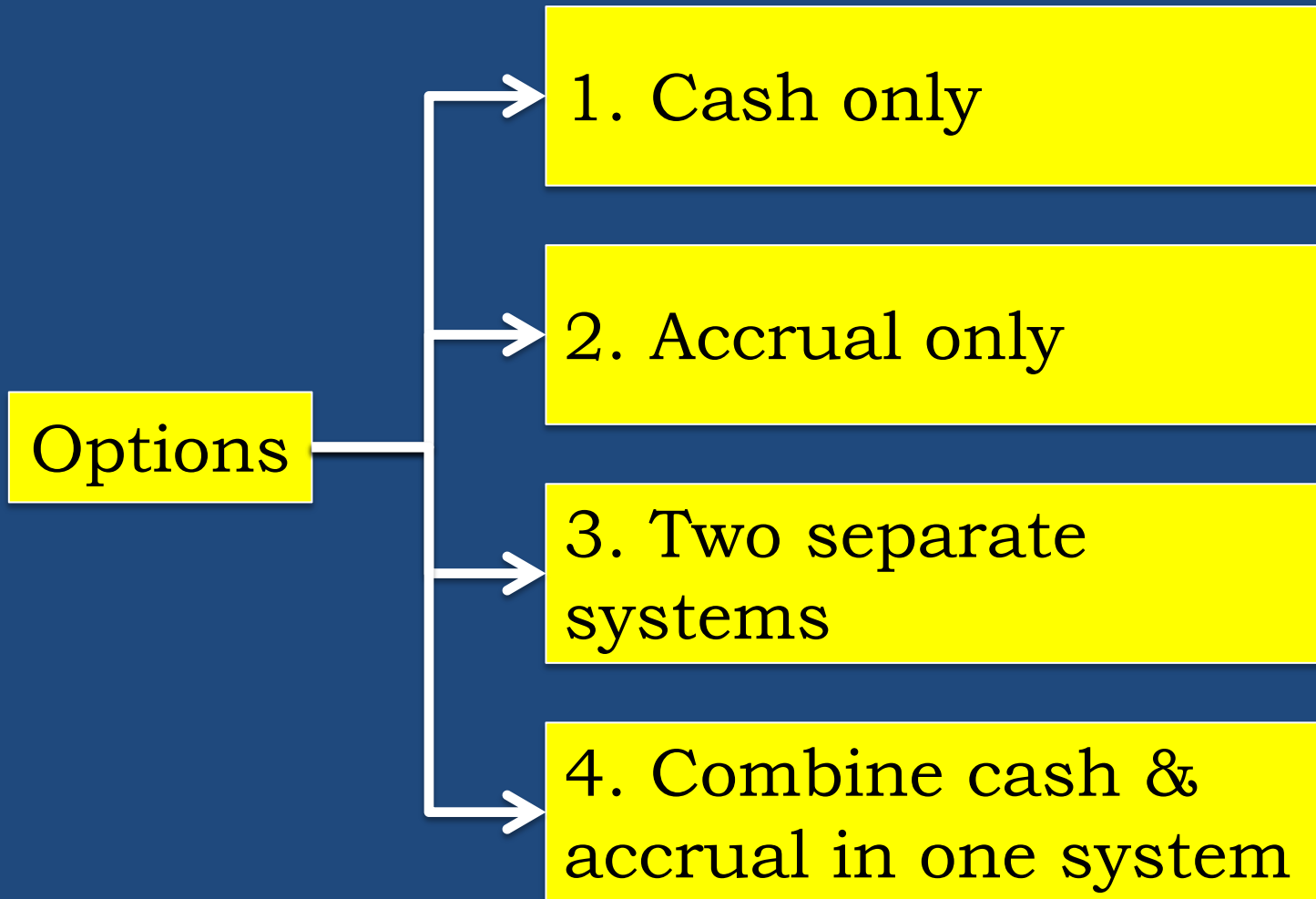


# Cash & accrual required

- 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



# 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

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



# Option 3: Two separate systems

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



Cash basis system operational Treasury for budget execution and reporting



## **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

# 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

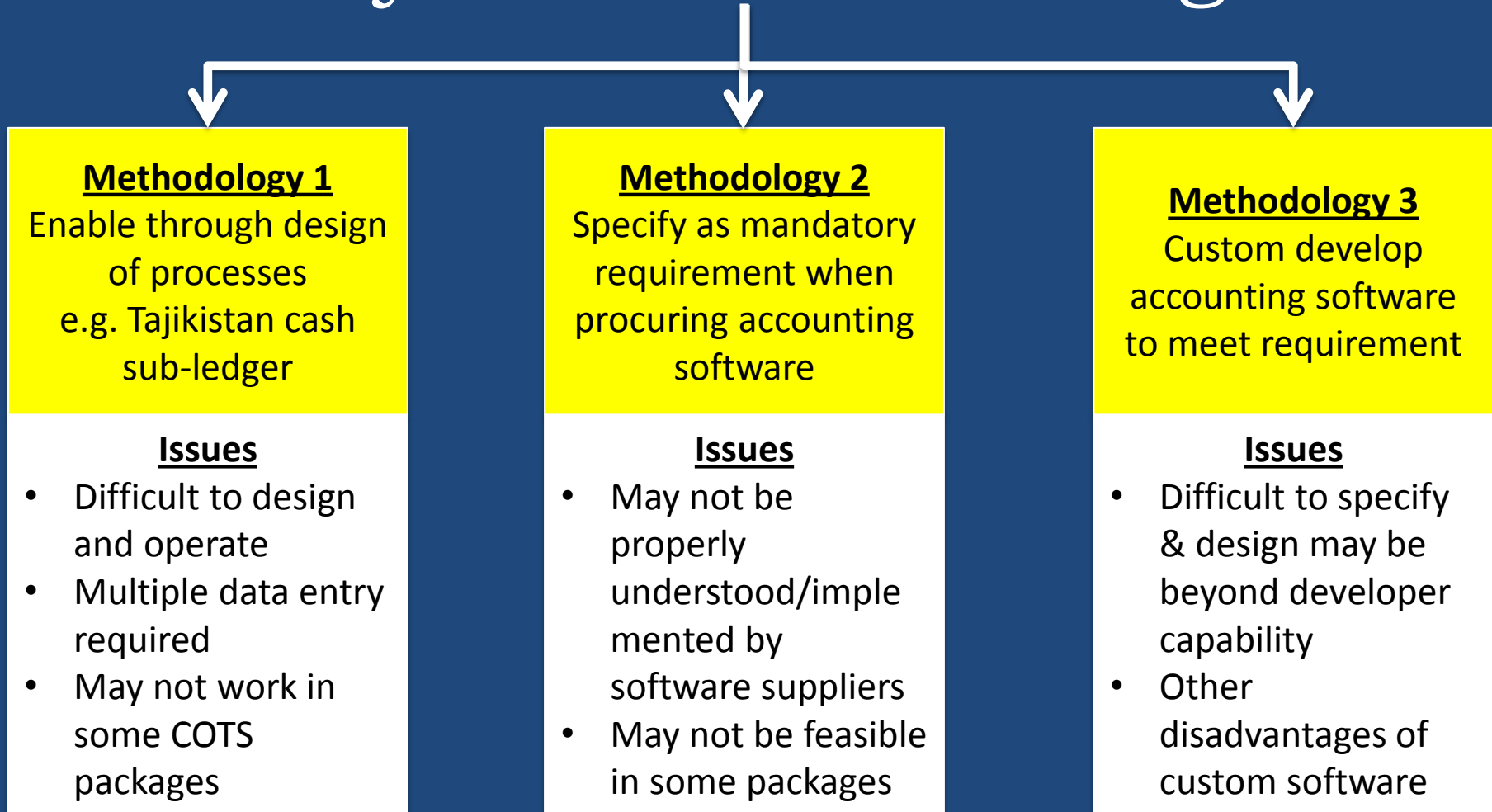
## **Advantages**

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

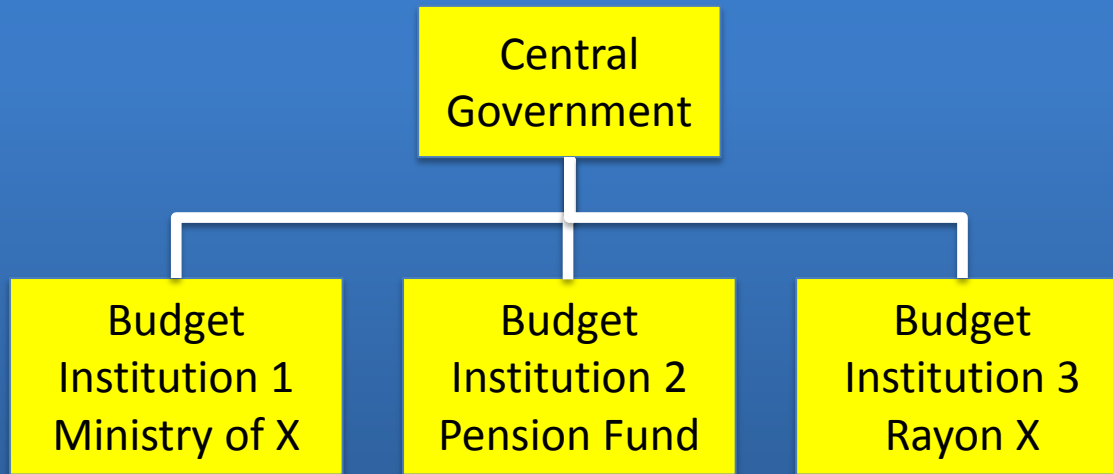


# Conclusions on combining cash and accrual

- 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

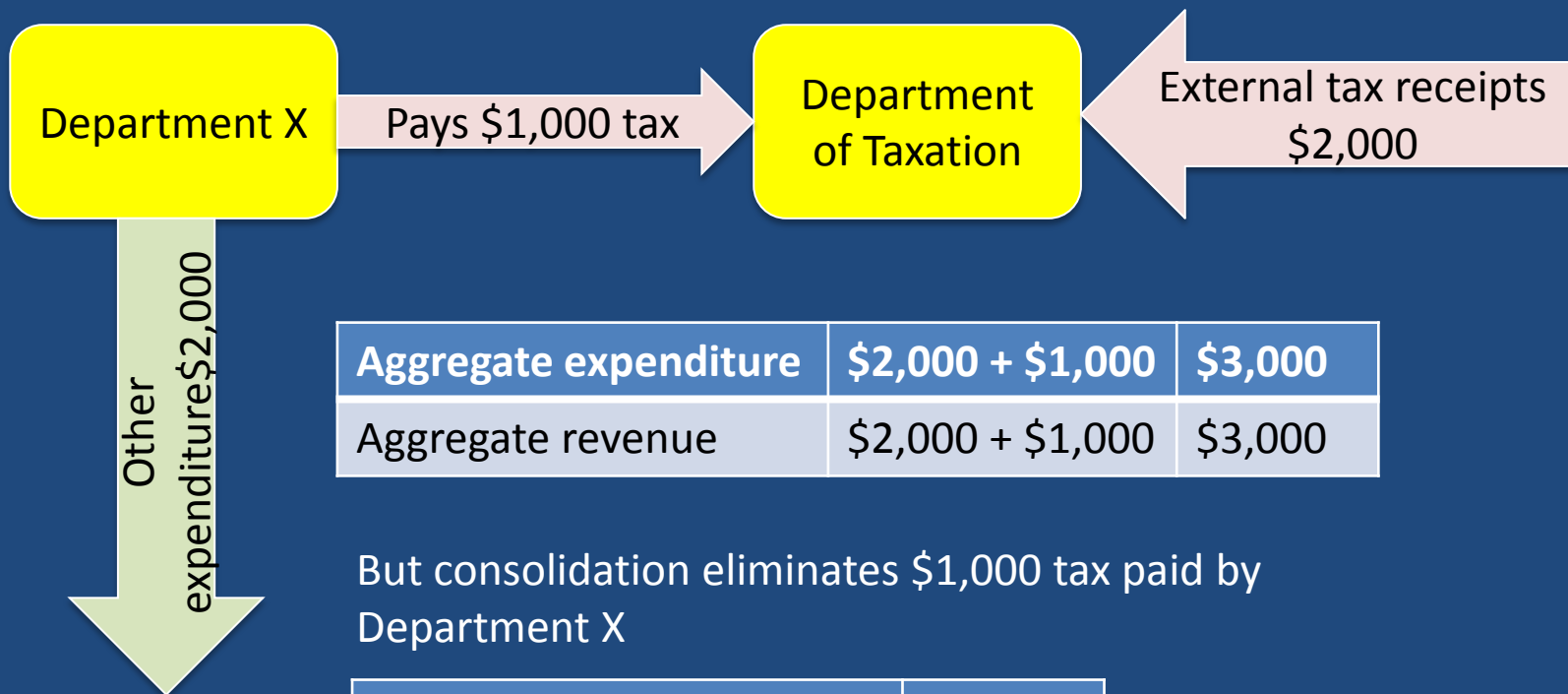
Consolidated reports & financial statements on whole of government:

- 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



<b>Aggregate expenditure</b>	<b>\$2,000 + \$1,000</b>	<b>\$3,000</b>
Aggregate revenue	\$2,000 + \$1,000	\$3,000

But consolidation eliminates \$1,000 tax paid by Department X

<b>Consolidated expenditure</b>	<b>\$2,000</b>
Consolidated revenue	\$2,000

# 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