International trends in public sector accounting reforms
April 18 – 22, 2011; Ljubljana, Slovenia
Report

1. Background

The Center of Excellence in Finance (CEF) in partnership with the World Bank (WB) and the International Monetary Fund (IMF), organized two back to back events in Ljubljana, Slovenia from April 18 to 22, 2011, both dealing with challenges in the implementation of reforms in public sector accounting and reporting.

One event was a workshop, held from April 18-22, 2011, for 41 participants from Ministries of Finance and Treasuries from 15 European and Central Asian countries (Albania, Azerbaijan, Armenia, Croatia, Georgia, Kazakhstan, Kyrgyz Republic, Macedonia, Moldova, Russian Federation, Serbia, Tajikistan, Turkey, Ukraine and Uzbekistan). The workshop was part of the Treasury Community of Practice (T COP) program in the framework of the Public Expenditure Management Peer Assisted Learning (PEM PAL) program[1]. The main objective of the TCoP workshop was to offer an opportunity to the TCoP members to exchange experiences in designing and implementing public sector accounting reforms.

The TCOP workshop was linked to a conference, held on April 20-22, 2011, on international trends in public sector accounting reforms. In addition to the 41 T COP workshop participants, some 100 experts attended the conference. The conference was aimed to 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 lessons learned, and offer recommendations on the design of future public sector accounting reforms. During the first two days (April 20-21), the conference focused on issues relevant for a number of countries, and reviewed, on the third day (April 22), topics that are closely related to the Slovenian reform. The conference followed earlier policy conferences organized by the CEF: on taxation (February 2006), pension (June 2007), education (April 2008) and health (June 2009).

This report highlights the main topics addressed in the workshop and conference discussions.

2. Crisis has underscored the need to put more focus on fiscal challenges and to provide timely and reliable information ….

… or, as **Prof. Frans van Schaik**, International Public Sector Accounting Standards (IPSAS) Board[2] member has noted in his opening speech, fiscal accountability of governments is essential for enhancing

[1] In response to huge capacity development needs and severe institutional and human resource constraints, the World Bank and DFID launched the PEM PAL initiative in 2006 to develop a network of practitioners and institutions involved in public financial management reforms. The network now consists of three Communities of Practice (COPs), for budget (B COP), internal audit (IA COP) and treasury (T COP). They are led by leadership groups, committed to coordinate and promote activities and change. The COPs' activities include plenary events, workshops, study visits attended by the COP members as well as face-to-face and video conference meetings attended by their leadership groups. See more at www.pempal.org.

[2] IPSAS Board consists of 18 members accross the globe: three from North America, one from South America, six from Europe, two from Africa, four from Asia and two from Oceania; of 18, 15 members are nominated by accounting profession and three are public members. The IPSAS Board holds four meeting per year, and its members spend app. 600 hours per year on IPSASB. International institutions, including the WB, IMF, INTOSAI, Asian Development Bank,

economic growth and development worldwide and is important for building and maintaining confidence, in particular because in most countries general government sector accounts for more than 30 percent of GDP, and, together with public enterprises, more than 50 percent of GDP. It is for this reason that there is a growing demand for a sound accounting framework with appropriate accounting basis (cash, accrual), principles, standards (such as IPSAS) and policies. The IPSASB recently published guidance for public sector entities aimed to facilitate transition to accrual based accounting. In the same vein, **Gerard Byam**, Director in the World Bank's ECA region underscored that "we should not allow the crisis to go to waste", especially in light of heavy fiscal burden for ECA countries related to aging population, infrastructure, large deficits. If ECA wants to protect its social network, then fiscal programs need to get more timely, reliable and transparent. Most importantly, public at large needs to understand them, as going forward it will require more and more information.

Accounting and reporting can play a critical role in providing reliable information. Therefore, as **Peter Murphy** of the IMF stressed, a comprehensive coverage in fiscal reporting is essential. It is not enough to only report on the budget sector, because, as the financial crisis has shown, extra-budgetary and public entities often incorporate significant fiscal risks. Similarly, reporting on cash payments and receipts does not provide a full picture; what is also needed is a comprehensive asset and liabilities accounting and reporting, which incorporates contingent liabilities, valuation gains and losses, etc.. The US, UK and Australia, for example, have provided extensive information on these categories, including losses related to impaired financial assets as a result of the financial crisis and government interventions. In contrast, governments that have a predominately cash accounting framework do not recognize and show valuation gains and losses in their accounts. The third important accounting and reporting component is information on taxation and social policy obligations. These obligations are normally not covered in conventional financial statements, but are essential for measuring long-term fiscal sustainability and for the quality of reporting.

To increase the quality of reporting, "accounting tricks" should be reduced warned **Brian Olden** of the IMF. More attention should be given to fiscal risks and long-term fiscal challenges – as highlighted in the November and April IMF Fiscal Monitors. Cash accounting and lax definition of debt can underestimate true extent of liabilities. There is clear evidence that some countries continue to circumvent the financial reporting standards through hidden borrowing, deferred spending, asymmetric pension assets and liabilities, off balance sheet positions (e.g., road company liabilities), disinvestments, etc. However, markets tend to punish the old tricks. To avoid this, countries should try to asses, even with cash accounting, long-term costs and risks, improve the quality of fiscal reporting, publish details in financial statements of the public sector entities, strengthen capacity of national audit institutions, request senior officials to sign charters of budget honesty, etc.

Old non-transparent concepts have become outdated, and enhanced information is required by the markets and public at large, was also the message of **Leslie Milne** of CIPFA, Chartered Institute of Public Finance and Accountancy. If the public accounts are trusted, then countries will do better in international markets. Accrual accounting provides a much better information on the public accounts (e.g., with regards to employee pensions and retirement health benefits, financial instruments, capital expenditure and depreciation), but transition to accrual might be risky and costly. Besides, it requires excellent accounting skills. In this context, **Peter Murphy** of the IMF noted that economists and public accountants should spend more time talking to each other, in particular, as there is a need for harmonization of accounting and statistical standards. To achieve this, institutions need to be there. As **Julia Attridge** from CIPFA remarked, the United Kingdom spent 125 years to build them and to set up adequate training possibilities with sufficient emphasis on practicalities and partnerships. **Karen Sanderson** from HM Treasury explained that in the UK, it was the Financial Reporting Advisory Board[3] that played the key role in

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European Commission, Eurostat, OECD, IASBV, United Nations, UNDP act as observers. IPSASB staff is based in Toronto, Canada.

[3] The Financial Reporting Advisory Board's role is to promote the highest possible standards in financial reporting by Government and to help to ensure that any adaptations of, or departures from, GAAP are justified and properly explained. The Board was established in 1996 to act as an independent review in the process of setting accounting standards for government during the development of resource accounting. The role of the Board was given statutory footing by the Government Resources and Accounts Act 2000, which requires the Treasury to consult on financial reporting principles and standards. The Board's remit has grown since 1996 and now includes advising on financial reporting across the UK for departments, executive agencies, executive non-departmental public bodies, trading funds

pushing for accrual accounting in the UK. Reform is a long process and needs a clear and ambitious plan to address the risks; besides, it requires constant monitoring and evaluation.

3. **Public sector accounting reforms lead to improved information on public sector accounts…**

As government affairs are becoming more complex, there is a clear need for more transparency, accountability, efficiency and effectiveness of public spending, and, therefore, for increased investment in public financial management (PFM) diagnostic work to support reforms in this area. The World Bank has increased its support to PFM diagnostics considerably, from 110 projects in the period from 1987 – 1999, to 202 in the period from 2000 to 2006. As **Moustapha Ndiaye**, Manager in the World Bank noted, there are always many challenges and constraints on the road from diagnostic to reform implementation. Solutions to technical problems might not be easy, but usually they can be found. Most important is finding a political will. If public officials do not act in good faith, every effort is wasted. Only if people agree that something is needed, then the reforms will work. But political will is often missing, so are resources and capacity to address costly and complex reforms. Prioritization and a comprehensive blue-print for reform implementation are essential (e.g., full accrual or partial; all or most relevant standards; big bang or pilot approach).

4. … and accrual accounting (together with IPSAS) is the ultimate goal of many reforms…

Accrual accounting enhances the quality of public finances by providing a full cost of government activities, and by increasing accountability and decision-making about all resources, not just cash. In light of this, the IPSAS accounting standards have recently been gaining on importance (although they are not legally binding). They cover all main activities of government, and include 31 accrual-basis standards and one cash-basis standard. International organizations, e.g. entire UN system, OECD, NATO, Interpol and EC, now use IPSAS standards. According to the 2010 E&Y survey, 37 percent of European countries use accrual. Of the OECD cohort, 23 percent maintain a full accrual, 30 percent a combination of cash and accrual, and 47 percent full cash basis.

The IPSAS are in tune with some other internationally recognized accrual standards, such as GFS (Government Finance Statistics) and ESA95, although some discrepancies between them exist. Recently, efforts have been intensified to achieve greater convergence. The three frameworks use common financial information, but serve different purposes. IPSAS apply to financial statements of government controlled entities for auditing purposes; GFS and ESA95 apply to general government sector for statistical reporting purposes. **Denis Besnard** of Eurostat provided a helpful overview of differences and converging trends between ESA95 and IPSAS. He stressed that it is important to map differences between different frameworks and understand their conceptual origin. He added that the process of harmonization would be complex and long, probably never ending.

5…. although practical implementation is always demanding and complex.

There are, on the downside, many constraints to IPSAS practical implementation. They read nicely, but are difficult to understand, and the conceptual framework providing the definitions is only now being drafted. Besides, as **Noel Hepworth**, former CIPFA CEO, pointed out, accrual valuations have an element of subjectivity, potentially leading to imprecision of conclusions and even (intended or unintended) misinterpretation of information. He further noted that the full benefits of accounting reforms will not be realized without accompanying managerial accountability. Also, extensive accounting skills and adequate human capacities are required for its implementation, preferably before the transition to accrual starts. As many participants have stressed, it is important first to get the basics (e.g., full cash) right. This is also because cash flow information will, at all times and everywhere, remain essential for liquidity and debt management purposes. A shift to full accrual is in fact very demanding, but as **Michael Parry** of Parry Consulting suggested, modified (simplified) accrual framework with financial statement format that integrates IPSAS and GFS reporting requirements can meet both goals of accounting and financial reporting reforms. He stressed that t is important that information resulting from financial statements

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and health bodies. The Board also advise the Treasury on the implementation of accounting policies specific to Whole of Government Accounts

(IPSAS) and statistical reports (GFS or ESA95) is reconciled, credible, easy to understand, relevant and timely.

Sequencing of the reform steps will predominately depend on country specific conditions. Closely related to this is the question of legislation and standards. Is it important to adopt a policy, and to design a national legislative framework first to enable the reform? Should national public sector standards and Chart of Accounts (CoA) be developed in parallel? After the reform has been approved? For example, Kazakhstan developed accounting policy first and all standards, and then moved to develop the CoA. Should private sector accounting standards be adapted to be used in the public sector? The UK, for example, uses IFRS, which are adapted, and not IPSAS. Should countries simply adopt IPSAS (CoA is not part of IPSAS[4]), or should modified cash/modified accrual basis be used for some time, and full compliance postponed? **Gonzalo Caprirolo** of the Slovenian Institute of Macroeconomic Analysis and Development explained that in Slovenia fiscal targets are presented and adopted both in line with cash and accrual methodology, but a move to accrual is in the plans.

It is important to know what it is that countries want from a reform -- stressed many speakers. In the first place, ministers need to tell managers what they need to do, and set up a proper management organization. The managers need to define what information will be needed, bring institutions together and train their staff and other users of the information. A good communication strategy is also essential. As **Karmen Stariha** of the Sila Advertising ltd (Slovenia) maintained, for the reforms to succeed, public at large (taxpayers) need to be convinced and informed that the reform is bringing something new and positive. Taxpayers are normally interested in progress, but always have doubts. Right message structure and information channels, as well as revisions of the communication strategy, if needed, pay off.

6. In many countries the reforms are well underway….

Public sector accounting reforms are ongoing across Europe, and in the majority of Central Asia and South East Europe (PEM PAL) countries. Reform started in 2000 in Croatia, in 2004 in Azerbaijan, in 2005 in Armenia and Macedonia, in 2006 in Georgia, in 2007 in Ukraine, in 2008 in Albania, Kyrgyz Republic and Serbia, in 2009 in Kazakhstan, in 2010 in Tajikistan, in 2011 in Russia. Many of these reforms include a transition to accrual accounting (or at least some of its elements) and introduction of public sector accounting standards aligned with IPSAS. Some countries have already introduced IPSAS or IPSAS-compliant standards (Albania, Azerbaijan, Croatia, Kazakhstan, Macedonia, Montenegro, Serbia and Tajikistan), others (Armenia, Georgia, Kyrgyz Republic, Moldova, Russia, Ukraine) have included this step into their plans.

Albania's accounting reform started in 2009 as part of the public internal financial control reform. It involved two phases, extending over one and five years, respectively. The first phase was about identification of all controlled entities (budgetary and non-budgetary). The goal of the second is to introduce cash based IPSAS. This will be done in three steps, starting with consolidated cash receipts/payments for the general government, continuing with a full set of consolidated financial statements for a selected group of government institutions, and ending with a full set of financial statements for the whole government. The major component of the second phase will also be to collect information on assets, liabilities, revenues and expenses. Albania's experience suggests that the key ingredients needed for a successful reform implementation include: (i) technical support; (ii) training; (iii) monitoring; (iv) working together with auditors; (v) making sure people understand the new system to prevent reforms get reversed.

Armenia started its public accounting reform as part of PFM reform in 2005. The WB's help proved to be extremely valuable. The reform journey started with an assessment of the existing accounting and financial reporting framework and capacity. It continued with a development of an accounting framework, including a translation of 26 IPSAS, a manual for accountants, a new CoA and guidelines for the transition to it, as well as a draft law on public sector accounting. Preparation of an implementation strategy was another important step which contributed to improved understanding of the implementation challenges. Solutions were first tested with pilot ministries in order to avoid major mistakes.

[4] There is a mode CoA in the Annex 4 of the GFS.

Armenia offered many helpful hints. (i) Explore the existing situation before you move. (ii) Enable adequate and sufficient training given the constant lack of skills in the public sector accounting and absence of proper education programs in universities. (iii) Be realistic. A goal should not be a full compliance with IPSAS, rather adjust them to local circumstances. (v) Use pilots to make sure the change is implementable.

Getting stakeholders on board was the first important step in tracing the path for the accounting reform in **Austria.** The Parliament and the Court of Auditors both supported it from the start, which was not the case with the line ministries given the universal "natural conflict" between ministries of finance and line ministries. Agreement between the Ministry of Finance and the Chancellery eventually freed the way, and a bold statement of a charismatic top officials in 2007 assuring the line ministries that "there were no ways back as all bridges had been burned". Austria shared valuable experience about how to "sell" a reform to the public to get support for it. The following activities paid off: getting feedback from a wide range of stakeholders on important aspects of reform; establishing relations with media, civil society and other stakeholders; stimulating ownership among civil servants (training, incorporating their suggestions into reform design); activating in-house (budget department) knowledge for the reform design; refraining from the "perfect" reform design; making the reform process irreversible.

Azerbaijan developed a three-step accounting reform plan. The first, from 2005 to 2008, included adoption of a set of legislative acts to steer preparation of a regulatory and methodological framework for financial reporting in line with international standards (translation of IFRS standards, development of 37 national accounting standards for commercial entities and 24 IPSAS compliant national accounting standards for budget institutions and state funds). These preparations paved the road for the second step involving preparation of the institutional framework. Many practical challenges requiring immediate solution surfaced during this step, lack of trained staff being the major one. This lead to establishment of a Training Certification Center aimed to provide continuous training and upgrading of skills, including certification. Lack of qualified staff in the area of accounting and audit namely directly affects the quality of the reporting and eventually the results of the reform. The focus of the current, third, reform stage is on improvements of the current legal framework and strengthening of institutions for accounting and auditing.

Convergence with the EU regulation and desire to improve financial management and transparency were the main drivers of change in **Croatia**. Three EU negotiations chapters (Chapter 32: Financial control; Chapter 22: Regional policy and coordination of structural instruments; and, Chapter 13: Financial and budgetary provisions) encouraged significant changes in the public finance system and budgetary processes, including reforms in accounting.

Georgia drafted a six-phase reform agenda in 2006 to achieve full compliance with the IPSAS by 2020 leading to publication and uniform application of IPSAS compliant financial statements for central and sub-national levels of government across Georgia. The agenda includes a preparation of modified cash-based financial statements by 2013, accrual financial statements by 2016, and IPSAS- compliant financial statements by 2018. Shortage of qualified staff with experience in preparing financial statements is the biggest challenge. Advice from Georgia: make sure translations are done well in advance so that all institutions involved understand the content and procedure.

Kazakhstan started its public sector accounting reform in 2009, based on significant experience with the private sector reform, which started in 1994. The first step, in 2010, included drafting IPSAS-compliant regulations on accounting and financial reporting in public institutions. The plan is to test the regulation first in the pilot public institutions, before applying it to all public institutions in 2013. At present, the focus of activities is on training of accountants, as well as external and internal auditors. Experience shared with the peers: (i) Reforms are a never-ending story: Action plans need to be constantly revised; (ii) Ask experts for help: the WB's help with regulation in 2008 and 2009 was extremely valuable; (iii) Political decision is crucial for any reform implementation; (iv) Kazakhstan translated the IPSAS into Russian in 2010: subject to IFAC's confirmation, the Russian version could be shared with the PEM PAL peers.

Latvia has accrual in place although it never announced any reform. The changes were driven by the expected benefits from the EU accession process and the ESA95 compliance requirement. Currently underway is the preparation of IPSAS-compliant national standards. No additional training will be required because accountants are more or less familiar with the accrual concept.

In **Macedonia,** budget accounting and reporting are based on cash, and are published on the Ministry of Finance website. A move to accrual is part of the long-term plans, as there are some other priorities to be addressed first, given the stage of development of Macedonia's administration. Training and public consultation process are two major pre-conditions for any reform, so is a detailed examination of all reform related steps and procedures.

The reform of public accounting in **Romania** started in 2002 with the ambition to move from a modified cash/accrual system to accrual. The reform has since then been implemented in phases including a preparation of methodological norms and instructions in 2005, and a new budget classification and CoA in 2006. Work is now focusing on refinements in financial statements of public institutions, further upgrades and unification of the IT systems, and comprehensive training activities (involving app. 13.000 pubic institutions), in particular on IPSAS.

The design of fiscal policy, budgeting, budget execution and accounting in **Slovenia** is based on cash methodology (with some elements of accrual). Slovenia is thinking of moving to accrual in order to increase transparency and accountability in public financial management. The ambition is to provide a real-time information on all costs, including depreciation (which for the time being is not considered as an expense). Two dilemmas the experts are pondering now are weather (i) to apply a big bang approach or to move gradually, and (ii) to base the framework on national accounting policies and standards or on IPSAS. Main implementation challenges include: (i) preparing good legislation; (ii) providing software to link budget users at the state and local levels; (iii) making accounting staff, including managers, accept and understand the changes. Slovenia has been, since 2004, reporting its deficit and debt to Eurostat in line with the ESA95 methodology. Financial statements in line with IPSAS, as compared with ESA95 reporting, would also include institutions, such as a Slovenian highway company, Slovenian Export and Development Bank, and exclude local municipalities. They would, in addition, include liabilities related to PPP contracts for infrastructure projects. Accounting reporting based on IPSAS or national IPSAS compliant standards would thus significantly enhance the quality and timeliness of information.

Turkey's IT reform in public accounting, started in 2009, relied on in-house staff that did all the programming related to public expenditure and accounting information system. This proved to be a very good experience that Turkey would also recommend to other PEM PAL countries implementing reforms. Local staff can consult with peers, immediately fix the mistakes and train a strong operational team. Systems should be developed by own staff, and be used for all public entities so that they do not need to establish their own systems. The project team for the IT system was established in the Treasury that managed and coordinated the project.

Ukraine plans to implement its public sector accounting reform in two steps until 2015. The first step, started in 2007 and to be completed this year, includes adjustments of regulation and preparation of national public sector accounting standards. The second, until 2015, will focus on institution building and strengthening, as well as implementation of national public sector accounting standards. For the time being, the Treasury is in charge of cash accounting for the central and local budget execution; accrual accounting is used for certain operations only. Key elements of Ukraine's reform include: (i) strengthening accounting and reporting framework (in compliance with IPSAS, creating a unified CoA for government institutions harmonized with budget classification; consolidating reporting by using modern IT systems), (ii) establishing a unified accounting system for all government; (iii) strengthening the Treasury's control; (iv) creating an integrated informational and analytical PFM framework, based on the unified CoA and national public sector accounting standards.

7. **In sum, there is no uniform recipe for a successful accounting reform, but key ingredients of any are the following:**

- Political will;
- A vision and an ambitious plan (with clearly spelled out priorities) about expected goals and benefits of the reform;
- Training: involve all public sector institutions (but not everybody needs to know everything);
- Translation of international standards;

- Communication strategy: develop a positive attitude towards a change;
- Sufficient human and financial resources for implementation: involve in-house experts;
- Adequate IT and software programs;
- Monitoring and evaluation: revise the reform plan if needed.