

Unclassified

PUMA/SBO(2000)8



Organisation de Coopération et de Développement Economiques
Organisation for Economic Co-operation and Development

OLIS : 20-Apr-2000
Dist. : 21-Apr-2000

PARIS

Or. Eng.

PUBLIC MANAGEMENT SERVICE
PUBLIC MANAGEMENT COMMITTEE

PUMA/SBO(2000)8
Unclassified

ACCRUAL ACCOUNTING AND BUDGETING

**21st Annual Meeting of Senior Budget Officials
Paris, 29-30 May 2000**

This document contains the Preface and Executive Summary of the "Governmental Financial Reporting: Accounting Issues and Practices" report (the Study), prepared by the Public Sector Committee of the International Federation of Accountants. It discusses the development of International Public Sector Accounting Standard (IPSAS). Additional documentation will be made available at the meeting.

For further information, please contact Jon Blondal
Tel +33 1 45 24 76 59; Fax +33 1 45 24 87 96; E-mail: jon.blondal@oecd.org

90238

Document complet disponible sur OLIS dans son format d'origine
Complete document available on OLIS in its original format

Or. Eng.

PREFACE

Introduction

1. This preface:
 - provides some background information about the role of the Public Sector Committee (PSC), and an overview of accounting and financial reporting by governments;
 - outlines the purpose of this Study; and
 - describes the PSC's Standards Project, of which this Study is a key component.

Role of the PSC

2. IFAC is a worldwide organization for the accountancy profession. Its mission is the development and enhancement of the profession to enable it to provide services of consistently high quality in the public interest. The PSC is a standing committee of the Council of IFAC formed to address, on a co-ordinated worldwide basis, the needs of those involved in public sector financial management, reporting, accounting and auditing. In this context, the term "public sector" refers to national governments, regional (e.g., state, provincial, territorial) governments, local (e.g., city, town) governments and their component government entities (e.g., agencies, boards, commissions and enterprises). The PSC has a role in identifying and addressing specific public sector accounting and auditing issues and concerns.

3. The PSC has been given authority by the IFAC Council to issue standards, guidelines, studies and occasional papers on financial reporting, accounting and auditing in the public sector. Over the period 1989 to 1996 the PSC published a range of Studies covering topics such as the definition and recognition of assets, liabilities, revenues and expenses. These Studies were descriptive in nature. They were intended to provide international comparisons of current practices and to highlight conceptual issues underlying these topics. This Study provides an overview of the issues covered in prior Studies and extends the discussion of these issues. It is a link between the previous work of the PSC, and its development of accounting standards and guidance to assist entities making the transition from cash to accrual accounting.

4. The Exposure Draft of this document was published in March 1998. At that time it was entitled "Guideline for Governmental Financial Reporting" and identified issues associated with four bases of accounting (cash, modified cash, modified accrual and accrual). Following comments from respondents on the Guideline for Governmental Financial Reporting, the Exposure Drafts of International Public Sector Accounting Standards and the *Invitation to Comment: Which Bases of Accounting*, the Committee decided to establish accounting standards for the cash and accrual bases of accounting only. This document therefore focuses on the cash and accrual bases of accounting and its title has been changed to better reflect its status.

Purpose of the Study

5. The Study aims to assist governments at all levels in the identification of issues associated with financial reporting. Although some parts of the Study may relate to national governments only, other parts are applicable to all levels of government.

6. The Study contains a detailed description of both the accrual and cash bases of accounting and provides examples of actual financial statements prepared under each basis. The document explains common practice within each basis of accounting, and provides examples of the variations within those bases. Governments wishing to change their basis of accounting or modify their accounting policies will be able to use this document as a source of information about a basis of accounting, including accounting policy issues associated with that basis and the format of financial statements prepared under that basis. This may assist governments in changing their basis of accounting and ultimately contribute to greater comparability within and between financial statements of governments.

7. Other documents published by the PSC include standards, studies and occasional papers. Standards contain individual requirements on financial reporting, accounting and auditing in the public sector. Studies provide advice on financial reporting, accounting and auditing issues in the public sector, while occasional papers provide information that contributes to some segment of the body of public sector financial reporting, accounting and auditing knowledge.

The Standards Project

8. The PSC has embarked on the Standards Project to encourage improvements in the quality of the financial information typically provided by governments. The development of this Study is an initial phase of this medium-term project.

9. The other focus of the project is the development of a core set of Standards on accounting and financial reporting by governments - International Public Sector Accounting Standards (IPSASs).

10. The accrual standards will be developed by reviewing existing International Accounting Standards (IASs) issued by the International Accounting Standards Committee (IASC), and adapting them as appropriate for the public sector. The cash basis standard will incorporate any relevant aspects of the accrual standards. The PSC decided to use IASs as the starting point for its public sector Standards in an effort to be consistent, where possible, with existing international guidance, as well as avoiding the need to “reinvent the wheel” for the public sector. Although the public sector context is different, the overriding objective of financial reporting, which is to provide information which meets user needs, is the same across both public and private sectors. Using IASs as the basis for the PSC Standards will lead to a consistent approach to similar issues within public and private sector standards. There will, of course, be other areas where issues specific to public sector entities and governments will not have been addressed by the IASs.

11. Over time, the PSC intends to extend the scope of the Standards Project to address some of the gaps in the initial set of standards and to provide further guidance on financial reporting issues within the public sector.

Focus on Two Bases of Accounting

12. In its previous Studies the PSC described four specific bases of accounting used by governments, being the cash basis, modified cash basis, modified accrual basis and accrual basis. The four bases of accounting described in previous PSC Studies accorded with the bases of accounting used by the

Committee on Accounting Standards of the International Organization of Supreme Audit Institutions in its *Accounting Standards Framework* and the associated *Accounting Standards Framework Implementation Guide – Departmental and Government-wide Financial Reporting*. This Study focuses on two bases of accounting, the cash basis and the accrual basis. It provides a detailed explanation of the accounting practices and issues associated with the cash and accrual bases and a brief description of the range of practices between these points. It incorporates discussion on other practices adopted by governments as variations to either the cash or accrual bases.

13. There are multiple points along the spectrum between cash accounting and accrual accounting and considerable diversity in the practices of governments. Given the difficulty of defining points with universal significance, the PSC has found it more appropriate to focus on setting standards for the cash and accrual bases. In recognition of the diversity that exists in practice, the PSC will develop and promulgate additional guidance for governments to assist in the transition between these two points. This additional guidance will recognize that there are a variety of different transition paths, depending upon the circumstances of each individual jurisdiction.

EXECUTIVE SUMMARY

Objectives of the Study

14. This Study provides a detailed description of the cash and accrual accounting bases and variations on these bases, as used by governments. The Study also provides practical examples of financial reporting under each basis. The objective of the Study is to provide information that will be a useful reference source for governments which wish to change their basis of accounting or review their accounting practices in relation to those of other governments.

15. The descriptions of the cash and accrual bases and modification to those bases are intended to:

- facilitate the choice and adoption of a particular basis of accounting by a government; and
- provide information to ensure that standard setters and preparers of financial statements have a common understanding of the accounting policy issues associated with that basis.

Bases of Accounting

16. The public sector financial reporting environment is characterized by a spectrum of practice between cash accounting and accrual accounting. Governments around the world adopt a variety of reporting practices along the spectrum, and may indeed combine aspects from both ends of the spectrum. The Study provides guidance on the application of the cash basis and the accrual bases of accounting, and describes variations on these bases as used by governments.

17. The Study focuses on the cash basis and the accrual basis, and the PSC intends to develop international public sector accounting standards that are structured around these two bases. However, the PSC recognizes that governments may in practice adopt modified versions of these bases and that they may follow different transition paths as they move along the spectrum from cash to accrual accounting. The PSC intends to address this issue by way of transitional provisions within individual accrual accounting standards and by developing guidance to assist entities in making the transition from cash to accrual accounting.

Scope of the Study

18. The Study is intended to assist governments at all levels in the preparation of their financial reports. Although some parts relate to national governments only, other parts are applicable to all levels of government.

19. The PSC has previously advised that Government Business Enterprises should use accrual accounting and follow International Accounting Standards (PSC Guideline 1, *Financial Reporting by Government Business Enterprises*). However, Government Business Enterprises may still find the information within this document useful.

20. This Study neither prescribes nor recommends particular accounting treatments. The main purpose of the Study is to describe and illustrate the accounting practices of governments, and to identify the accounting policy issues that arise in the context of governmental financial reporting.

21. This Study focuses on the issues that governments face in the preparation of general purpose financial reports for external users (also referred to as governmental financial reports). They are reports

which are prepared for external users who are unable to require or to contract for the provision of special reports to meet their specific information needs. External users include the electorate (and its elected representatives) financial analysts/economists, lenders, suppliers and the media. These reports are often the only source of information for external users.

22. Governmental financial reports may also be used by internal users such as government decision makers (principally managers within individual government sub-entities), and government ministers (or equivalent) at both the portfolio level and the whole of government level. However, internal users are usually able to request specialized internal reports that are specifically designed to meet their needs. In practice both types of reports are usually prepared from the same accounting system, although different classifications may be used, or a greater level of detail may be provided.

23. Special purpose financial reports are financial reports tailored to meet the specific information needs of a particular user. Examples include reports prepared for major lenders and internal reports prepared for the managers and governing body of a reporting entity. The level of disclosure and type of information presented in these reports is determined by the specific user. Internal management reports will usually contain very detailed information, particularly with respect to the items under management's control. Due to the specialized needs of internal users, the scope and content of reports prepared for internal management purposes vary enormously. It is beyond the scope of this Study to discuss the wide range of special purpose reports which may be produced.

Structure

24. The Study is in five parts:

- Part I Introduction
- Part II Cash Basis
- Part III Accrual Basis
- Part IV Measurement Bases
- Part V System of National Accounts and Government Finance Statistics

25. Parts II and III include a discussion of how well the information produced under each basis of accounting meets the needs of users, a description of the financial elements recognized under each basis of accounting, and some general recognition and measurement issues associated with these elements. The descriptions also include possible classifications of financial elements and a discussion of external financial reports produced under these bases.

Cash Accounting

26. Part II describes the elements recognized under cash accounting: cash balances, cash receipts and cash payments. The Study defines each of these elements, describes types of cash receipts and payments, and discusses the recognition, reporting, and classification issues associated with these elements. It discusses the benefits associated with cash information, such as the links between cash-based financial statements and traditional cash-based appropriations and the fact that preparers and users of cash-based information do not require any detailed accounting knowledge. It discusses the limitations of using cash accounting when more complex information is desired. It also describes the types of financial reports which are commonly prepared under cash accounting and identifies additional disclosures which may be made as part of the financial statements.

27. Many governments using the cash basis supplement the data available under this basis with additional information, such as information on commitments or government debt. In addition, some

governments hold the books open for a specified period after the end of the reporting period. Refer to Part II for a discussion of common modifications to the cash basis. Although many modifications to the cash basis are observed in practice, this Study focuses on the “pure” cash basis in order to establish a base for discussion of financial reporting issues and to establish a framework for preparers and auditors as they consider the implications of various transition paths.

Accrual Accounting

28. Part III discusses the strengths and weaknesses of accrual accounting and provides an explanation of the reasons given by various countries for adopting accrual accounting. It contains a description of the elements recognized under accrual accounting: assets, liabilities, net assets/equity, revenue and expenses. For each element, the Study discusses the definition and recognition criteria, describes the types of items recognized within each element and discusses the application of the definition and recognition criteria to those items. Where appropriate, reference is made to relevant discussion in International Accounting Standards (IASs).

29. The Study discusses the types of financial statements commonly prepared under accrual accounting and describes other information that may also be disclosed in the financial statements.

30. Some governments which have moved towards the adoption of accrual accounting have decided not to recognize particular categories of assets or liabilities. They may have made these variations from the accrual basis as part of a planned progression to accrual accounting, or because they consider that the variations represent appropriate arrangements for their jurisdiction. For example, a government may not have recognized all its physical assets. This could be because complete records of asset holdings were not available at the time, or because the government considered that certain categories of physical assets did not satisfy the recognition criteria for assets. In addition, the accounting practices of a jurisdiction may be prescribed by regulation or statute that are developed independently of the government. Common modifications to the accrual basis are discussed within Part III.

Measurement Bases

31. The Study contains a description of various measurement bases. Although it does not recommend particular measurement bases, it identifies which bases are commonly used in the measurement of certain assets and liabilities.

System of National Accounts and Government Finance Statistics

32. Governments often prepare financial information for three purposes: the compilation of governmental financial statements, national accounts in accordance with the United Nations System of National Accounts (SNA) and the International Monetary Fund (IMF) Government Finance Statistics (GFS). The Study explains the relationship between these three reporting systems and examines some of the differences between them. One historic difference between these systems has been the different measurement bases used. However, the measurement differences are already diminishing. The SNA is already on an accrual basis (with assets and liabilities at market value). The GFS is considering the adoption of the accrual basis and governmental financial reports are moving toward adopting accrual accounting (although in some jurisdictions assets and liabilities are reported at historical cost).

Appendices

33. The appendices contain a glossary of terms used throughout the Study, and examples of financial statements prepared by various governments. Readers should note that the financial statements in the appendices are for illustrative purposes only. They represent current practice, but are not necessarily representative of best practice. They are intended to facilitate understanding and to provide a context for the examples used throughout the text of the Study.

Cost/Benefits

34. The choice of a particular basis of accounting will be made by each government on the basis of the costs and benefits associated with that option. Different bases of accounting have different strengths and some may be more appropriate than others in particular circumstances (refer to Chapters 4 and 11 for a discussion of the benefits of each basis of accounting). The most appropriate basis will depend on the characteristics and nature of the entity, the type and purpose of the report and the value of the information to users. The decision may also be influenced by whether whole of government financial statements are to be prepared and, if so, the basis of accounting which will be used in such statements. It will also depend on the costs of developing and maintaining the necessary financial information systems.

35. A number of issues become more complex as entities move towards accrual accounting. These issues include the range of elements and financial performance measures which may be reported, the definition of elements and the establishment of measures for those elements. Consequently the importance of judgments concerning the transactions and events reflected in the financial statements increases with accrual accounting. Similarly, the cost of developing and maintaining accounting systems may increase. The actual costs of adopting a particular basis will depend upon the existing capacity of personnel in terms of experience and training, and the reliability and completeness of existing systems. The costs and benefits may also be influenced by the degree of political commitment and amount of resource devoted to a change in basis. A system change which has a high degree of political commitment and is adequately resourced is more likely to provide short-term benefits than a system change which occurs without such support.

36. Making such cost/benefit decisions is always difficult; the costs are borne by the reporting entity and can be determined with some precision. However, the benefits are often enjoyed by third parties as well as the entity itself and can only be assessed subjectively. A comprehensive assessment would consider the incremental benefits that are likely to flow from moving from one basis of accounting to another and the improved decision making which is expected to result from the availability of more comprehensive financial information. They should also include consideration of whether the government has an obligation to be accountable for all the resources it controls and the result of that control. A decision not to provide certain information should take into account the opportunity cost associated with not having that information available for decision makers.

Transition between the Bases of Accounting

37. The PSC intends to explore issues associated with the transition between the bases of accounting by way of occasional papers describing the transition process within individual jurisdictions (e.g., *Perspectives on Accrual Accounting* available at www.ifac.org) and specific guidance on the transition from cash accounting to accrual accounting. This Study provides information on the definition and recognition of elements under each accounting basis, and the disclosure of information in external financial statements, it does not specifically address the process of transition from one accounting basis to another.

38. This is for the following reasons:

- The nature of the progression may differ between governments. Some governments may choose a gradual progression along the continuum of accounting bases, while others may move directly from, say, cash accounting to accrual accounting.
- The transitional steps will be unique to each government. The nature of the transition will depend on the current accounting basis used, the quality and range of information already available, the resources allocated to the transition and the time period allowed for transition.

GOVERNMENTAL FINANCIAL REPORTING: ACCOUNTING ISSUES AND PRACTICES

Draft Contents page

PREFACE

PART I -- INTRODUCTION

- Chapter 1 Executive Summary
- Chapter 2 Objectives of Financial Reporting

PART II -- CASH BASIS

- Chapter 3 Cash Basis - Description
- Chapter 4 Cash Basis – Benefits and Limitations
- Chapter 5 Cash Basis – Cash Balances
- Chapter 6 Cash Basis – Cash Receipts
- Chapter 7 Cash Basis – Cash Payments
- Chapter 8 Cash Basis – External Reporting
- Chapter 9 Modification to the Cash Basis

PART III -- ACCRUAL BASIS

- Chapter 10 Accrual Basis - Description
- Chapter 11 Accrual Basis – Benefits and Limitations
- Chapter 12 Accrual Basis - Assets
- Chapter 13 Accrual Basis - Liabilities
- Chapter 14 Accrual Basis - Revenues
- Chapter 15 Accrual Basis - Expenses
- Chapter 16 Accrual Basis – External Reporting
- Chapter 17 Modification to the Accrual Basis

PART IV -- MEASUREMENT BASES

- Chapter 18 Measurement Bases

**PART V -- SYSTEM OF NATIONAL ACCOUNTS AND
GOVERNMENT FINANCE STATISTICS**

- Chapter 19 System of National Accounts and Government Finance Statistics

APPENDICES

BIBLIOGRAPHY