International Federation of Accountants

International Public Sector Accounting Standards Board

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Accrual Accounting & Improved Financial Management

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Agenda for session

- Benefits of accrual accounting
- Mechanics
- Success factors for transition
- Transition: A staged approach

Benefits of accrual accounting: The high level

- IPSASB view that objectives of financial reporting are accountability and decision-making
  - Emphasis on accountability a key difference with private sector
- Accrual-based reports provide information allowing users to:

  (a) Hold entity accountable for all resources it controls and the deployment of those resources;

  (b) Assess the financial position, financial performance, and cash flows of the entity; and

  (c) Make decisions about providing resources to, or doing business with, the entity.

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Benefits of accrual accounting: More detailed advantages

Reporting on accrual basis also:

(a) Shows how an entity financed its activities and met its cash requirements;

(b) Allows users to evaluate an entity's ongoing ability to finance its activities and to meet its liabilities and commitments;

(c) Shows the financial position of an entity and changes in financial position;

(d) Provides an entity with the opportunity to demonstrate successful management of its resources; and

(e) Is useful in evaluating an entity's performance in terms of its service costs, efficiency, and accomplishments.

Cash to Accruals

- Key ‘bottom-line’ differences
  a) Employee pensions and retirement health benefits
  b) Other provisions, e.g. environmental
  c) Interest on debt
  d) Capital expenditure and depreciation

The ‘more comprehensive’ scope of financial reporting

- Some key characteristics of public sector entities require a more comprehensive reporting scope including:
  - Service performance information
    - Economy, efficiency, outputs and outcomes
  - Fiscal sustainability information
    - Prospective inflows and outflows
  - Compliance with budget
  - Narrative reports
    - Additional information on major factors underlying financial performance and service performance and assumptions underpinning expectations on future performance
- Accrual based information must be the starting point for all this more comprehensive scope information

Discussion

- What are your views on the benefits of accrual accounting?

Transition

- Transition to Accrual Accounting will require more complete records of :
  - Assets
  - Liabilities
  - Expenses
  - Revenue
- IPSASB Study 14 guidance
- CIPFA developing supporting material

Complete records of assets: Asset registers (1)

- Probably the most time consuming and complex aspect of transition
- Features of a good asset register include data which is:
  a) updated as transactions and events occur
  b) regularly reconciled with acquisition data, any subsidiary systems, and the general ledger
  c) readily available to asset managers, at the level of detail they require, preferably “on-line”
  d) structured to allow different classifications of assets to be distinguished

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Complete records of assets: Asset registers (2)

- Possible sources of data for asset registers include:
  a) Existing asset lists and systems (details of vehicles and computer equipment may be available
  b) Insurance lists;
  c) Lists of properties where the entity pays property taxes, electricity, water, or other utilities
  d) Information on land and buildings held by government entities responsible for cleaning or maintenance

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Complete records of assets: Asset registers (3)

- A well compiled asset register facilitates:
  a) Better management of assets, including better maintenance;
  b) More appropriate replacement policies;
  c) Identification and disposal of surplus assets; and

- A well compiled asset register allows public sector entity to:
  a) Plan for future funding requirements of asset maintenance and replacement
  b) Demonstrate accountability to the public for their asset management
  c) More accurately calculate the depreciation charge

- Need also to consider financial assets and intangible assets

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Liabilities: What they are likely to comprise

a) Accounts payable arising from the purchases of goods and services
b) Accrued vested vacation pay or other accrued compensated absences
c) Accrued payables including interest, salaries and wages
d) Employee pension obligations and other accrued employee benefits, including any accrued termination benefits
e) Amounts payable under guarantees and indemnities (where sufficient evidence is available to indicate that it is more likely than not that the amounts will be payable)
f) Liabilities relating to advance receipts;
g) Transfer payments payable;
h) Lease obligations related to finance leases;
i) Bank loans, short-term borrowings and Long-term debt (both to the private sector and to other government entities);
j) Provisions such as for Environmental liabilities; and Obligations under accident compensation schemes.

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How identification and recognition of liabilities can improve financial management

a) Compels public sector entities to acknowledge and plan for the settlement of all recognized liabilities;

b) Provides information on the impact of existing liabilities on future resources;

c) Means that it is possible to allocate responsibility for the management of all liabilities; and

d) Allows public sector entities to assess whether they can continue to provide current services and the extent to which they can afford new programs and services.

Expenses

- Common types of expenses include:
  a) Personnel (employee-related) expenses;
  b) Cost of goods sold/services provided;
  c) Physical asset use (depreciation and loss of service potential);
  d) Rental, leasing and maintenance costs;
  e) Interest;
  f) Expenses relating to financial assets;
  g) Transfers (including grants and donations) to other governments, organizations, and individuals;
  h) Losses:
     (i) Decreases in market value;
     (ii) Foreign exchange losses; and
     (iii) Other losses.

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Revenue

- Common types of revenue for national governments include:
  a) Non-exchange revenues:
     (i) Direct and indirect taxes;
     (ii) Fees and fines;
  b) Exchange revenues:
     (iii) Sales of goods or services;
     (iv) Dividends;
     (v) Interest;
  c) Gains:
     (vi) Increases in market value of property, plant and equipment;
     (vii) Foreign exchange gains.

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Importance of information about expenses and revenue

- Public sector entities need information about expenses and revenue to assess:
  a) their revenue requirements;
  b) the sustainability of existing programs;
  c) the likely cost of proposed activities and services;
  d) the cost of alternative mechanisms for meeting these objectives;
  e) whether current resources are sufficient to sustain the level of service delivery.

Cash Flows

- Misapprehension that accrual basis neglects cash
- Accrual accounting provides comprehensive information on:
  - Current cash flows and certain projected cash flows
  - Cash flows associated with debtors and creditors
- Can lead to better cash management and may assist in preparation of more accurate cash budgets

Discussion

- What are your views on assimilating the information required for transition?
- Experiences of developing an asset register?

Successful transition

- Key factors for successful transition include:
  a) A clear mandate;
  b) Political commitment
  c) Strong leadership of accrual transition initiative
  d) The commitment of central entities and key officials;
  e) Adequate resources (human and financial);
  f) An effective project management and coordination structure;
  g) Adequate technological capacity and information systems; and
  h) The use of legislation

Importance of linkage with other professions

- Successful introduction of accrual accounting requires support and interaction of other bodies and professions:
  - Audit office
    - » Critical but constructive friend
  - Actuaries
    - » Information on liabilities related to pension plans
  - Valuers
    - » Initial valuations of assets and ongoing revaluations if revaluation model adopted

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Transition : A Staged Approach

- Based on milestones
- Ensure continuation of high quality cash accounts while accrual preparations are underway
- Go live with a mix of cash and accrual
- Post Go Live-full accrual and continue to implement adopted standards (IPSASs)

Suggested milestones: Pre-Go Live

- Milestone 1: Assess the entity's transactions
- Milestone 2: Which functions to transition and when
- Milestone 3: Opening Statement of Financial Performance
- Milestone 4: Assess System requirements
- Milestone 5: Training and Guidance

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Suggested Milestones Post Go Live

- Milestone 6: Go Live – “Hybrid” Period
- Milestone 7: Accrual Period
  - Some IPSAS implementation
- Milestone 8: Further IPSAS implementation

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Questions Discussion & Further Information

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