

# 24<sup>TH</sup> ESAAG ANNUAL INTERNATIONAL CONFERENCE

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Ensuring transparency and accountability in  
Public Finance Management

## Transitioning from Cash to Accrual

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**national treasury**

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# Topics of this presentation

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- **Accrual Accounting?**
- **IPSASs - Cash or accrual?**
- **What does Accrual IPSAS implementation involve in a developing country context?**
- **Initial conditions?**
- **Implementation approaches – lessons learnt, some significant issues and roadmap?**
- **Case Study - Example?**

# Accrual Accounting (IMF TNM 2016)

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The term accrual accounting has come to be associated with four related innovations in government accounting over the last several decades:

- The recognition of economic events in flow reports at the time at which they occur;
- The recording of all stocks of assets and liabilities, in balance sheets;
- Enhanced monitoring of liabilities and contingent liabilities; and,
- The consolidation of all entities under government control.

# Why use IPSAS?

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*IPSASs are high quality global financial reporting standards for application by public sector entities other than Government Business Enterprises (GBEs)”*

- Savings on own production/benefits of international experience
- Quality and transparency of financial reporting enhanced (the Greece Example)
  - Comprehensive reporting of assets and liabilities and consolidated whole-of-government information
- Financial reports more readily understood and comparable world-wide
- Financial reports have more credibility

# What issues do IPSASs cover (1/)

Number	Name
IPSAS 1	Presentation of Financial Statements
IPSAS 2	Cash Flow Statements
IPSAS 3	Net Surplus or Deficit for the Period - Fundamental Errors and Changing in Accounting Policies
IPSAS 4	The Effects of changes in Foreign Exchange Rates
IPSAS 5	Borrowing Costs
<del>IPSAS 6</del>	<del>Consolidated Financial Statements – Accounting for Controlled Entities</del>
<del>IPSAS 7</del>	<del>Accounting for Investments in Associates</del>
<del>IPSAS 8</del>	<del>Financial Reporting of Interests in Joint Ventures</del>
IPSAS 9	Revenue from Exchange Transactions
IPSAS 10	Financial Reporting in Hyperinflationary Economies
IPSAS 11	Construction Contracts
IPSAS 12	Inventories
IPSAS 13	Leases

# What issues do IPSASs cover (2/4)

Number	Title
IPSAS 14	Events after the Reporting Date
<del>IPSAS 15</del>	<del>Financial Instruments: Disclosure and Presentation</del>
IPSAS 16	Investment Property
IPSAS 17	Property, Plant and Equipment
IPSAS 18	Segment Reporting
IPSAS 19	Provisions, Contingent Liabilities, Contingent Assets
IPSAS 20	Related Party Disclosures
IPSAS 21	Impairment of Noncash- generating Assets
IPSAS 22	Disclosure of Financial Information about the General Government Sector
IPSAS 23	Revenue from Non-Exchange Transactions (Taxes and Transfers)
IPSAS 24	Presentation of Budget Information in Financial Statements
IPSAS 25	Employee Benefits

# What issues do IPSASs cover (3/4)

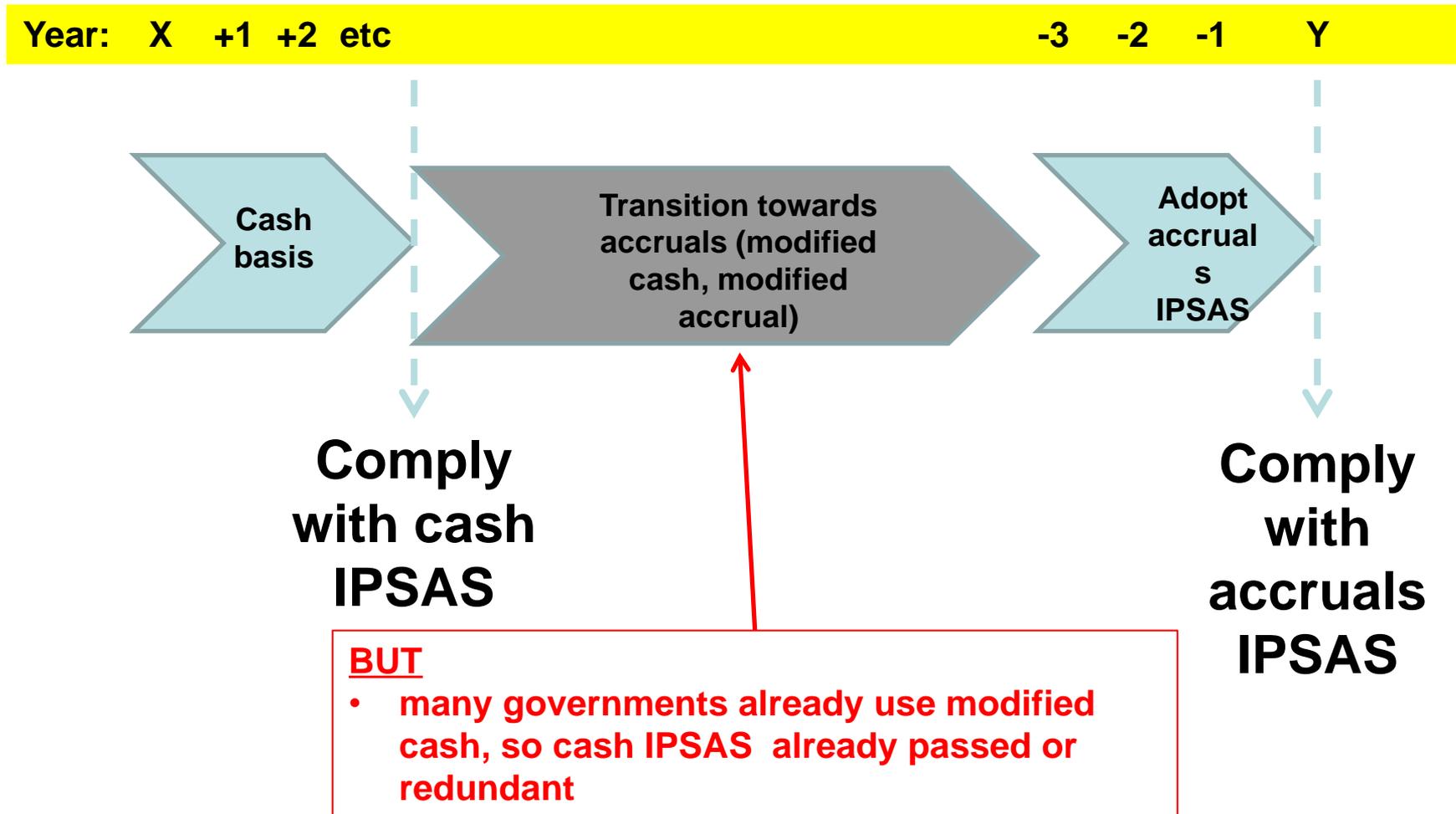
Number	Title
IPSAS 26	Impairment of Cash-Generating Assets
IPSAS 27	Agriculture
IPSAS 28	Financial Instruments: Presentation
IPSAS 29	Financial Instruments: Recognition and Measurement
IPSAS 30	Financial Instruments: Disclosures
IPSAS 31	Intangible Assets
IPSAS 32	Service Concession Agreements: Grantor
IPSAS 33	First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)
IPSAS 34	Separate Financial Statements
IPSAS 35	Consolidated Financial Statements

# What issues do IPSASs cover (4/4)

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<b>Number</b>	<b>Title</b>
IPSAS 36	Investments in Associates and Joint Ventures
IPSAS 37	Joint Arrangements
IPSAS 38	Disclosure of Interest in Other Entities

# Cash v Accrual IPSAS



# Countries that have implemented IPSAS or comparable standards

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- **New Zealand adopted IPSAS in 2014**
  - previously IFRS
- **Switzerland and Austria introduced IPSAS**
  - with some exceptions
- **U.K. and Australia adopted IFRS**
  - with some exceptions/enhancements
- **USA and others follow national standards that are broadly consistent with IPSAS**
- **Good progress in Latin America & SE Asia**
  - Brazil, Chile, Indonesia, Malaysia

# Accrual accounting for developing countries

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- **The rationale for accrual accounting applies also to developing countries**
- **However, this is a complex reform that has to be prioritized with other necessary reforms**
- **Countries need to ensure any basic deficiencies are addressed before trying to implement accruals.**

# Specific issues:

## Initial condition for a move to acc. IPSAS

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**The following basic challenges do not create a fertile ground for Accrual Accounting**

- Weak control over budget execution
- Inadequate budget classification/CoA
- Unreliable business processes, weak controls, including standard reconciliations
- Inaccurate fiscal data, including large unexplained differences
- Untimely and limited coverage fiscal reporting

# What does “implementing the Accrual IPSASs” entail?

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- **Implementation of IPSAS usually involves**
  - Objectives – Conceptual Framework
  - GAP analysis - “where we are?” Vs. “where do we wish to be?”
  - Preparing a plan to implement
  - Pilots and sequencing
  - Implementation
  - Preparation progressively of IPSAS compliant financial statements and disclosures

# Change management critical

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- **Need a well thought out strategy, including objectives, conceptual framework and costs**
- **Transition and change management**
- **Communication with key stakeholders, including parliament, ministers, key ministries/agencies and other key executives/officials.**
- **Organizational change and extensive training**
- **Systems changes operation of dual ledgers**
- **Phased plan of implementation**

# Implementation of IPSAS: Challenges

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- Lack of political (CoM & Legislature) support
- Skilled staff may be in short supply (Accounting, FMIS/IT & Analytical)
- Systems and processes may need to be changed
- Legal and regulatory changes may be necessary
- Costs of implementation
- Implications for the budget process

***Each country must carefully consider its own timetable for implementation***

# Lessons from international experience: A phased approach to implementation (1/2)

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- **Adopt some aspects of accrual IPSAS during first phase, others during subsequent phases; for example**
  - **Financial assets and liabilities may be done initial phase and non financial assets in later phase**
    - Financial assets and liabilities can also be recognized progressively in phases
    - For example, tax revenue recognition may pose some challenges – therefore can defer it to Phase 2
  - **Consolidated financial statements may also be implemented in phases**
    - Separate financial statements of central government can be done initially, partial and full consolidation can be done in later phases

# Possible phasing of implementation of accrual accounting and IPSAS

	Balance Sheet		Operating Statement			Controlled Institutions
	Assets	Liabilities	Revenues	Expenses	Other Flows	
<b>Phase 0 Cash Accounting</b>	Cash balances	Debt	Cash receipts	Cash payments	None	Budgetary Central Government
<b>Phase 1 Elementary Accrual Accounting</b>	Trade receivables	Account payables	Accrued trade revenue	Accrued expenses, <i>excluding depreciation</i>	Provisions for payables and doubtful receivables (e.g. bad debts)	Central Government
<b>Phase 2 Advanced Accrual Accounting</b>	Other financial assets	Other financial liabilities	Accrued trade revenue	Accrued expenses, <i>excluding depreciation</i>	Valuation changes in financial assets and liabilities	General Government
<b>Phase 3 Full Accrual Accounting</b>	Physical and intangible assets; Tax receivables	-	Accrued tax revenue	Accrued expenses including depreciation	Valuation changes in all assets and liabilities	Public Sector

# Final Operating Statement

	YEAR N	YEAR N-1	ACCOUNTING BASIS
Tax revenue from direct taxes	240	225	<i>Accrual</i>
Tax revenue from indirect taxes	162	148	<i>Accrual</i>
Tax revenue from local taxes	51	44	<i>Accrual</i>
Grants received	24	26	<i>Accrual</i>
Revenue from sales of goods and services	37	32	<i>Accrual</i>
Dividends and interest received	11	8	
Gain (loss) on sale of investments	5	-2	<i>Accrual</i>
Gain (loss) on disposal of property, plant and equipment	9	-4	<i>Accrual</i>
Other revenue	8	9	<i>Accrual</i>
<b>Total Revenue</b>	<b>547</b>	<b>486</b>	
Salaries	289	271	<i>Accrual</i>
Purchase of goods and services	100	87	<i>Accrual</i>
Grants and subsidies	56	45	<i>Accrual</i>
Finance costs	39	33	<i>Accrual</i>
Depreciation and amortization of assets	89	78	<i>Accrual</i>
Impairment of assets	12	16	<i>Accrual</i>
Other expenses	32	35	<i>Accrual</i>
<b>Total Expenses</b>	<b>617</b>	<b>565</b>	
Gain (or loss) on foreign exchange transactions	1	2	<i>Accrual</i>
Unrealized gain (or loss) on fair value of investments	-12	3	<i>Accrual</i>
Actuarial gain (or loss) on pension liabilities	-10	-28	<i>Accrual</i>
<b>Other gains (or losses)</b>	<b>-21</b>	<b>-23</b>	
<b>Surplus or Deficit</b>	<b>-91</b>	<b>-103</b>	

# Final Balance Sheet

	YEAR N	YEAR N-1
<b>Non-current Assets</b>	<b>20</b>	<b>21</b>
Equity investments	20	21
<b>Current Assets</b>	<b>96</b>	<b>93</b>
Cash and cash equivalents	32	25
Grants receivable	3	3
Trade receivables	5	3
Equity investments held-for-sale	56	62
<b>Total Assets</b>	<b>116</b>	<b>114</b>
<b>Non-current Liabilities</b>	<b>2,505</b>	<b>2,484</b>
Borrowing and financing	767	741
Public service pensions	1,357	1,256
Post-employment and other social benefits	258	235
Other financial liabilities	123	252
<b>Current Liabilities</b>	<b>259</b>	<b>265</b>
Borrowing and financing	214	224
Salaries and wages payables	12	11
Grants and subsidies payables	4	3
Trade payables	11	9
Provisions	18	18
<b>Total Liabilities</b>	<b>2,764</b>	<b>2,749</b>
<b>Net Assets</b>	<b>-2,648</b>	<b>-2,635</b>

## Lessons from international experience: A phased approach to implementation (2/2)

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- **Pilot implementation with some agencies may be considered**
  - Helps identify issues and challenges before launching into full implementation
- **IPSAS based financial statements may initially be produced on a trial basis**
  - SAI can review but not audit trial statements;
  - Full audit during a subsequent “official” phase

# Accounting Policies need to be developed

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- **Revenues and Expenditures;**
- **Cash and cash equivalent;**
- **Payables and receivables (timing, valuation etc.);**
- **Financial Assets and Liabilities;**
- **Non Financial Assets;**
- **Chart of Accounts;**
- **Consolidation rules; and**
- **Opening balances and reconciliation with existing records.**

# Some specific issues

## Non-exchange transactions

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- **Public Sector is dominated by transactions that do not involve equal value exchange these**
  - Tax revenues, Social benefits are examples
- **Recognition and measurement challenges**
- **IPSAS on non-exchange transactions:**
  - Revenues: IPSAS 23 (Probability, Reliability of Measurement)
  - Social benefits: CP issued 2015; ED expected 2017
  - Other non-exchange expenses: CP expected 2017

# **Some specific Issues**

## **Assets and Liabilities**

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- **Classification – current & non-current; financial & non-financial**
- **Inventory and valuation of assets and Liabilities:**
  - PP&E, Leases, Intangibles, Inventories, Concession arrangements, Investments, Financial Instruments, Tax receivables, etc.
- **Future standards on assets and liabilities:**
  - Infrastructure assets
  - Heritage assets
  - Social Benefits

# Implications for the Budget process (1/2)

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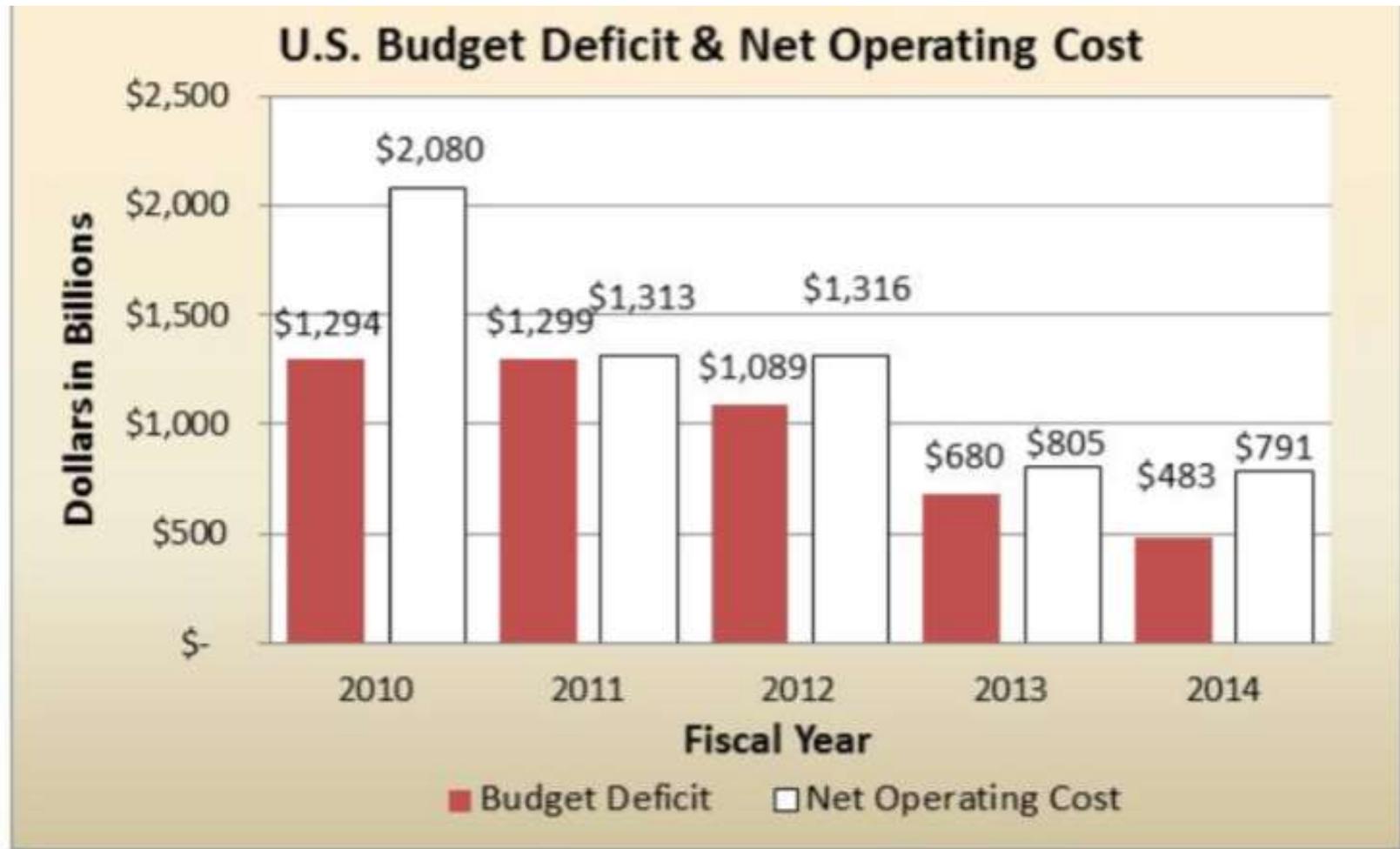
- **Accrual accounting and cash budgeting:**
  - France, Finland, Kazakhstan, Sweden, US
  - Important to use accrual information to inform budget and policy decisions
- **Cash budget execution records and reports. Cash budget should include a cash flow statement as in IPSAS 2**
  - Facilitates Budget Vs. Actual comparison
- **Should reconcile and explain key cash and accrual indicators**
  - US does this very well

# Implications for the Budget process (2/2)

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- **Need to continue with cash budget execution records and reports**
  - Systems may have to be reconfigured
- **Ideally, the cash budget should include a cash flow statement as in IPSAS 2**
  - Would facilitate Budget Vs. Actual comparison
- **Should reconcile and explain key cash and accrual indicators**
  - US does this very well

# U.S.A: Cash Budget and Accrual Accounts



# U.S.A.: Reconciliation of Cash Budget and Accrual Accounts

Dollars in Billions	2014	2013
<b>Net Operating Cost</b>	<b>\$ (791.3)</b>	<b>\$ (805.1)</b>
Change in:		
Federal Employee and Veteran Benefits Payable	\$ 134.3	\$ 264.3
Environmental and Disposal Liabilities	\$ 20.0	\$ 10.1
Property, Plant, and Equipment, Net <sup>1</sup>	\$ 18.4	\$ (41.7)
Investments in Government-Sponsored Enterprises (GSEs)	\$ 44.4	\$ (30.9)
Insurance and Guarantee Program Liabilities	\$ 28.3	\$ (26.4)
Yearend Upward/(Downward) Credit Reform Subsidy Reestimates, Net <sup>2</sup>	\$ 22.9	\$ (23.1)
Other, Net	\$ 39.6	\$ (27.5)
Subtotal - Net Difference:	<u>\$ 307.9</u>	<u>\$ 124.8</u>
<b>Budget Deficit</b>	<b>\$ (483.4)</b>	<b>\$ (680.3)</b>

1 Net effect of: capitalized fixed assets, depreciation expense, and asset disposals and revaluations

2 Net effect of: yearend upward/(downward) credit reform subsidy reestimates and effect of prior year (upward)/downward credit reform subsidy reestimates.

# Developing a Roadmap

## A sound implementation approach

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- **Evaluate state of preparedness of country to successfully implement**
  - This is the “where are we” part of the GAP analysis
- **Determine phasing of implementation that is practical and likely to lead to success**
  - Other reforms may be more urgent
- **Proceed with implementation**
  - Effective project management incl. change management is important

## Case Study – Current framework

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- Cash accounting with supplementary annual statements of assets (i.e. Cash, Advances, Investments) and liabilities (accrued interest, debt, deposits);
- Modern Treasury Accounting System (Cash accounting set-up) in place for more than 10 years:
- Latest PEFA rated quality of in-year reports and financial statements as “A” and recent Auditor General reports suggested accounting system sound.
- Treasury has several qualified accountants and experienced ICT professionals.
- Relatively strong TAS local service provider;

# Conceptual Design

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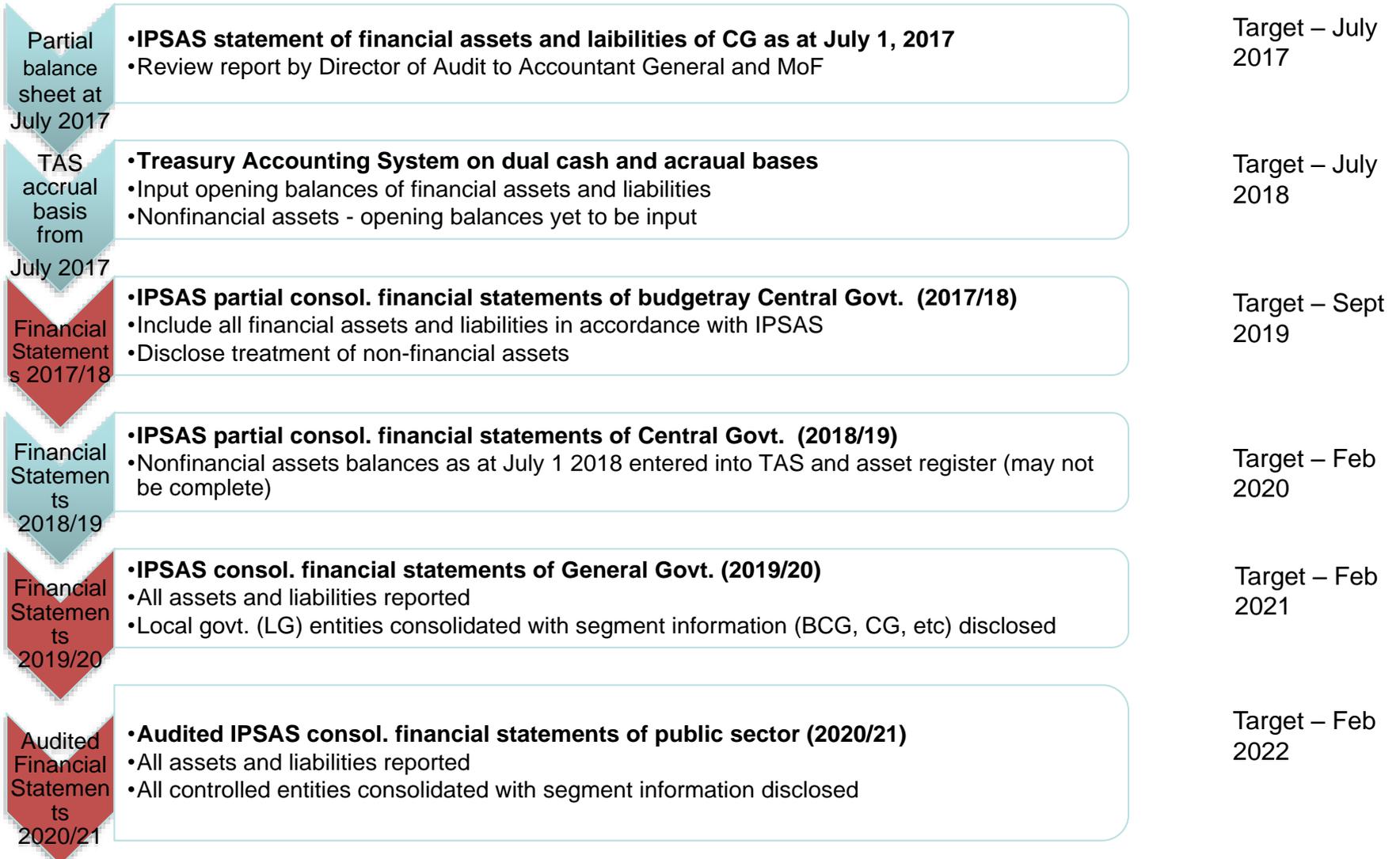
- Financial statements (and legal framework) should provide for a true and fair view in all material respects of its financial position, financial performance, and cash flows.
- The government financial statements should be prepared in compliance with IPSAS principles (this may take a number of years to achieve - provide disclosures where necessary)
- IPSASs should be applied by the public sector controlled economic entities. (Currently some entities using IFRS)
- Financial Statements should recognize and report all assets, liabilities, revenues and expenses (definition and measurement reliability);
- Include a budget v actual comparison on a comparable basis;
- Provide for reconciliation between accrual and cash surplus/deficit
- Consistent with legislative requirements. (Consolidated fund)

# Significant Changes

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- **Financial Statement/Notes Templates**
- **Accounting Policies and procedures** including Chart of Accounts/Budget Classification
- **TAS update** – Dual cash and accrual recording
- **Non financial Assets identified, quantified & recognized** (major exercise), asset valuation and accounting treatment for complex transactions (PPPs) ;
- **Liabilities including employee pension benefits liability** (actuarial evaluation needed) identified, quantified & recognized;
- **List of Public Sector Entities**
- **Consolidated Financial Statements** ( timely and reliable extra budgetary unit statements; eliminations and consolidation processes);

# Phased Approach



## Questions?

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- **What experience from the region and beyond could E&Y share with respect to cash-to-accrual migration?**
- **What were the key successes / challenges in those examples?**
- **What are the most important considerations, in our view, in planning for the migration?**
- **What is the most critical success factor for migrating to accrual accounting?**

# **Raodmap**

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**Detailed Road Map (Separate File)**