



A Global Outlook on Status of Adoption of Accrual Accounting

By Research and Publications Department, ICMA Pakistan

Preamble

In recent years, there has been a growing interest in the study of IPSASs' implementation around the globe. This paper attempts to appraise and analyze the status of adoption of accrual accounting and International Public Sector Accounting Standards (IPSAS) around the globe, especially in OECD, EU, ASEAN, SAARC and African countries. IPSAS has assumed much importance as far as financial reporting in public sector is concerned and as essential component of a strong Public Financial Management (PFM). The Governments in different jurisdictions are now attaching high priority to adopting IPSAS as a basis for preparing financial reports in order to achieve transparency, accountability and value for money of public funds. They have realized that IPSAS supports economic development and prosperity and therefore they are making investments in capacity building and training of staff that is responsible for implementing IPSAS.

If we look at the success stories on IPSAS implementation, we find that only few countries have been able to either fully or partially adopt IPSAS, whereas many countries have adopted IPSAS but not implemented them. Most of the countries are on the road to implementing IPSAS or national standards based on accrual accounting. Majority of these countries are experiencing some difficulties in smooth transition from cash-based

accounting to accrual-based accounting. As a step forward, most of the South Asian countries, including Pakistan, Bangladesh, India and Nepal, have adopted standards aligned to cash-based IPSAS - as a basis for moving towards accrual-based accounting. Simultaneously, financial management reforms are also being undertaken in these countries with the financial and technical assistance of World Bank and IMF.

Benefits of Accrual Accounting

The global political history lends credence to the fact failure of governments to manage finances have even led to social unrest and impairment of democracy. Hence, the requirement for efficient management of public sector resources and improved financial reporting by the governments has assumed much significance in recent years. The IPSAS Board has been encouraging governments around the globe to move towards full accrual accounting. Though IPSAS were first issued on a cash basis, subsequently IPSAS Board developed 40 accrual standards /IPSASs for the public sector to substitute for International Financial Reporting Standards (IFRS) of private sector in line with the New Public Management (NPM) trend. These IPSASs were mainly being adopted either fully or partially by those countries which are moving from cash-based to accrual accounting model.

Table 1: Accrual-based Accounting vs. Cash-based Accounting

Sr.	Accrual-based	Cash-based
1	Both the Cash and Credit transactions are recorded	Only Cash transactions are recorded
2	Considers both Cash flows and Accrual flows of company	Considers only total Cash flows of the company
3	It follows International Accounting Standards	It does not follow International Accounting Standards
4	It is part of GAAP	It is not part of GAAP
5	It presents company overall financial changes over a period	It does not present overall financial changes over a period
6	The basis of book keeping is 'Double Entry System'	The basis of book keeping is 'Single Entry System'
7	Revenues are reported when earned	Revenues are reported when cash is received
8	All Receivable are reported as Assets [when earned]	Receivables are not reported as Assets
9	All Payables are reported as Liabilities [when incurred]	Payables are not reported as Liabilities
10	Expenses are reported when consumed	Expenses are reported when cash is paid
11	Net Income on revenues earned and expenses incurred	Net Income based on cash receipts and disbursements
12	Balance Sheet is complete as far as reporting of assets, liabilities and stakeholders equity is concerned	Balance Sheet omits certain assets and liabilities. The amount of stakeholders' equity is also affected.
13	Tax assessed but not received is accounted for	Tax assessed but not received is not accounted for

We are highlighting below some of the benefits of using accrual based accounting in public sector, as derived from the experiences of the countries who have already adopted IPSAS:

- Provides a broader and fuller picture of government's financial position
- Enhances transparency and accountability in public governance
- Better decision-making by politicians and policy makers
- Improves financial management and leads to timely financial reporting
- Results in improved resource allocations and program management decisions
- Better reporting on true cost of government programs and activities and their matching with outputs
- Better understanding of operating costs and resource consumption during an accounting period
- Provides an allinclusive and accurate view of cost of capital leading to better assets management
- Provides comprehensive financial information required to manage public finances in efficient way
- Minimizes risk of errors in payments to beneficiaries
- Gives a better understanding of real cost of transactions in public sector on basis of daily information
- Gives a better understanding of past transactions on cash receipt and payments and future obligations to pay
- Gives the true picture of country's infrastructure assets, their life spans, valuation and how to ensure there are sufficient resources to maintain them for the longer term.
- Facilitate comparisons between the public sector and private sector

Challenges in transition to accrual accounting

Accrual accounting is considered globally as the key driver of better financial management. The countries which have initiated public sector reforms towards implementation of accrual accounting or national standards based on IPSAS are faced with many technical challenges such as the following, in addition to cultural barriers, which impeded them from taking benefit of using the business-style accounting reports for policy making:

- Legal and political support for implementation
- Building awareness in politicians to change their mindset on benefits and use of accrued accounts
- Alignment of regulatory structure and procedures
- Technical capacity and capability of public servants to produce and use accruals
- Need for orientation and training of staff to make them skilled accrual accounting practitioners
- Integrating systems to easily use accrual accounting e.g. configuration of IT/ERP systems
- Overhauling of financial systems and processes to log income and expenditure on daily basis

- Treatment of non-cash items under an accrual appropriations framework
- Treatment of capital charging in the budget
- Cash management system
- Substantial cost of implementation

Accrual Accounting - A historical context

The Republic of Chile was the first country to introduce the accrual based accounting during mid-1970s. New Zealand was the second country to adopt accrual accounting in mid-1990s. Subsequently, Australia joined the list in 1993 followed by USA in 1997. However, both Australia and USA initially introduced accruals in their central government administrations whereas it took several years to fully implement accrual system in the local administration. Canada and UK adopted the accrual accounts in 2001.

In 2004, Estonia was the first country in Europe to have fully adopted IPSAS whereas the public sector accounting reforms in Estonia was completed by 2005. In 2007, Latvia also adopted accrual accounting and was able to complete IPSAS implementation by 2015. Similarly, Lithuania introduced accrual accounts for its public bodies in 2010 whereas it completed IPSAS implementation process by 2014. In 2014, New Zealand moved its public sector accounting system from IFRS to IPSAS. Subsequently, other countries gradually adopted accrual accounting, especially OEC countries for instance Austria adopted in 2013.

Global Adoption of Accrual Accounting: Current Status

Joe Cavanagh, Suzanne Flynn and Delphine Moretti of Fiscal Affairs Department of International Monetary Fund (IMF) in a Technical Guidance Note titled 'Implementing Accrual Accounting in the Public Sector', released in September 2016, says that almost 57 percent of jurisdictions are still following pure cash accounting whereas 41 governments have completed the transition from cash to accrual based accounting.

Table 2: Adoption of Accrual Accounting Global Status

Sr. No.	No. of Jurisdictions	Status of Transition from cash based to accrual based accounting	% age
1	41	Completed transition process	21%
2	16	Modified Accrual based Accounting	08%
3	28	Modified Cash based Accounting	14%
4	114	Pure Cash Accounting	57%

OECD countries



The Organisation for Economic Cooperation and Development (OECD) in collaboration with the International Federation of Accountants (IFAC) and the Accountability conducted a survey of selected financial reporting

practices of 34 OECD countries viz. Australia, Austria, Belgium, Canada, Chile, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, UK and USA. The Survey Report titled “Accrual Practices and Reform Experiences in OECD Countries” released in early 2017 concluded that over 40 countries apply Accrual IPSAS, out of which some countries apply it directly whereas others apply indirectly through National Standards. A brief summary of findings are as under:

- Around three quarters [75%] of OECD countries have adopted accrual accounting
- More than quarter [>25%] of OECD countries prepare their Annual Budgets on an Accrual basis
- Only 15% of OECD countries provide an overview of public sector as a whole in financial statements
- Majority of OECD countries have completed their public sector accounting reform programs
- Twenty five (25) countries indicated that their annual financial reports are based on accrual accounting
- Three (3) countries indicated that they are in the process of transition to accrual accounting
- Six (6) countries indicated that they follow cash accounting

Table 3: Adoption status of Accrual Accounting in OECD Countries

Sr. No.	No. of Countries	Name of Countries	Accounting Basis
1	25 (73%)	Australia, Austria, Belgium, Canada, Chile, Czech Republic, Denmark, Estonia, Finland, France, Hungary, Iceland, Israel, Japan, Korea, Mexico, New Zealand, Poland, Slovakia, Spain, Sweden, Switzerland, Turkey, UK and USA.	Based on Accrual Accounting
2	03 (09%)	Greece, Portugal, Slovenia	Transition to Accrual Accounting
3	06 (18%)	Germany, Ireland, Italy, Luxembourg, Netherlands, Norway	Based on Cash Accounting

ASEAN countries



The Association of Southeast Asian Nations (ASEAN) is a regional grouping that comprises ten members viz. Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam. As far

as the adoption of accrual based accounting is concerned, not all of them have adopted IPSAS.

Table 4: Adoption status of Accrual Accounting in ASEAN countries

Sr.	Country	Current Status of adoption
1	Brunei	Brunei has not adopted IPSAS type standards and does not have accounting standards for public sector.
2	Cambodia	Cambodia follows a blend of accrual and cash accounting with many transactions recorded on accrual basis. In 2012, the Cambodian government decided to move from cash-basis IPSAS to accrual-basis standards, however till date IPSAS has not been fully adopted and implemented in the public sector.
3	Indonesia	Indonesia has adopted IPSAS type standards, however, the central and local government accounts in Indonesia are currently prepared on a modified cash and partial accrual basis.
4	Malaysia	Malaysia adopted accrual IPSAS standards for central government in 2015 and state governments in 2016.
5	Myanmar	Myanmar has not yet adopted IPSAS type standards and is planning to adopt IPSAS in due course of time.
6	Philippines	Philippine is in the process of adopting modified accrual based accounting for its public sector.
7	Singapore	Singapore has adopted its own Public Sector Accounting Standards based on accrual-based accounting. All financial statements in public sector organizations are prepared on the accrual basis of accounting.
8	Thailand	Thailand has adopted its national Public Sector Accounting Standards in 2017, which have been developed in line with IPSAS issued in 2011. The remaining 10 IPSAS shall be adopted in due course of time.
9	Vietnam	Vietnam has just begun the process for IPSAS type standards adoption. In this context, a revised Accounting Law has been promulgated in January 2017 that mandates the adoption of accrual based standards.

Caribbean and African Union countries

There are 26 Caribbean countries which include Anguilla; Antigua and Barbuda; Aruba; Bahamas; Barbados; British Virgin Islands; Cayman Islands; Cuba; Dominica; Dominican Republic; Grenada; Guadeloupe; Haiti; Jamaica; Martinique; Montserrat; Netherlands Antilles; Puerto Rico; Saint Barthelemy; Saint Kitts & Nevis; Saint Lucia; Saint Martin; Saint Vincent; Trinidad & Tobago; Turks & Caicos Islands; and US Virgin Islands.



According to a recent study titled 'Accrual Practices and Reform Expectations in the Caribbean' conducted by IFAC jointly with the Institute of Chartered Accountants of the Caribbean (ICAC), nearly 60 percent of the Caribbean countries have already adopted IPSAS or national accounting standards based on IPSAS. Anguilla and Cayman Islands are the only Caribbean countries that have fully implemented IPSAS. The remaining 40 percent countries are at various stages of implementation process. Most of them have initiated reforms for modernizing

their financial reporting, budgeting and auditing practices. However, many countries are facing challenges in implementation.

There are 55 member states of the African Union (AU) out of which only Ghana; South-Africa; Zimbabwe and Botswana have adopted accrual-based IPSAS.

European Union (EU) countries



There are 28 members states of European Union (EU) out of which majority have already implemented accrual based accounting practices for public sector entities, in consonance with the national standards across the government sector, whereas many EU countries are in the process of adoption.

Germany is one the EU countries where public sector is using both the cash-based and accrual-based accounting.

In 2015, the European Commission (EC) announced the formal adoption of European Public Sector Accounting Standards (EPSAS) in EU as the European equivalent of IPSAS. However, specific date of adoption of EPSAS by each country has not been specified by the EU. The primary motive of EPSAS is to achieve deeper economic and financial integration within the EU bloc as well as to encourage uniform and comparable accrual-based accounting practices for all sectors of general government within the EU.

The European Commission is also encouraging member states to switch to accrual accounting by adopting IPSAS while the EPSAS adoption is still in process. In April 2017, as an initial step [Phase 1] towards increased fiscal transparency in the short to medium term, the EPSAS Working Group provided the Guidance for the First Time Implementation of accrual accounting (EC, 2017). Under Phase 1, the member states of EU have been encouraged to adopt accrual accounting e.g. IPSAS, in the period 2016 to 2020, while EPSAS framework is being developed in parallel. Under Phase 2 it is being planned that EPSAS will be gradually implemented within the EU countries by 2025 through addressing comparability within and between the member States in the medium to longer term.

SAARC countries



a) Bangladesh - IPSAS have not so far been adopted in Bangladesh; however, some concrete initiatives have been taken at government level, including passing of legislation that signifies national commitment towards transition

from cash accounting to cash-basis IPSAS as an intermediate step prior to adopting accrual-basis IPSAS. The public sector entities in Bangladesh apply cash accounting based on IPSAS for reporting purposes. The public sector entities and individual government departments do not manage their own cash which is held by central government. The public sector accounting function consists of a consolidated fund and a treasury single account. There are many implementation challenges towards full compliance with IPSAS.

b) India - IPSAS have not so far been adopted in India and the public sector entities in India are presently using cash-based accounting with certain accrual disclosures made in

financial statements. The Government Accounting Standards Advisory Board in India has commissioned reports on the adoption of accrual accounting for public sector entities and has also issued accrual-based standards using IPSAS which are yet to be approved by the government. There are differing states of readiness of entities within the Indian government and across different public sector entities for IPSAS adoption.

- c) Nepal** - Nepal has not yet adopted IPSAS, however, since 2009 the public sector entities and government ministries are using the Nepal Public Sector Accounting Standards (NPSAS) which are similar to cash-based IPSAS and contain mandatory and non-mandatory parts for enhanced disclosures. There are challenges in implementation due to lack of trained finance staff in the public sector.
- d) Pakistan** - Pakistan is presently in the process of adopting IPSAS standard on cash accounting and will gradually move towards accrual-based accounting. The World Bank PIFRA project also supports this change. The government is taking initiatives to converge with IPSAS for which cash based accounting standards are being aligned with cash-basis IPSAS. A New Accounting Model (NAM) has been developed and implemented. Presently, the financial statements in government departments and entities are being prepared under NAM and IPSAS cash basis and focus on budget compliance for the financial year. Some of the major challenges being faced in moving to IPSAS are inconsistency of processes across government entities in recognizing and recording transactions; capacity of finance staff to deal with requirements of standards; accuracy, reliability, completeness and timeliness of information.
- d) Sri Lanka** - Sri Lanka has adopted cashbased IPSAS and intends to gradually adopt other IPSASs. A phased approach is being followed towards the implementation of IPSAS. Since 2004, Sri Lanka has been moving towards accrual accounting based on IPSAS. Since 2016, IPSAS have been adopted as Sri Lanka Public Sector Accounting Standards (SLPSAS) with minor modifications made to IPSAS. So far ten SLPSA Standards have been issued which are equivalent to IPSAS and not currently mandatory and therefore most of the financial statements of public sector do not fully comply with national standards (SLPSAS). Earlier, Sri Lanka had announced that it would adopt 21 IPSAS-equivalent standards by 2012 which was not achieved.

Conclusion

The paper concludes that though the developed nations have been able to successfully adopt accrual accounting with the exception of few countries, the developing and emerging countries are lagging behind due to various inherent challenges and risks in moving from cash-based to accrual-based accounting. Majority of the countries have adopted cash-based IPSAS and moving gradually towards accrual based accounting.

The professional accounting bodies in these countries need to play role in supplementing the efforts of their respective governments in smooth and expeditious transition toward full adoption of IPSAS so as the reap the benefits in shape of increased efficiency, transparency and accountability in public sector entities.