

# A Structured Approach to Modernising Government Financial Reporting

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## Introduction

Many countries have embarked on the modernisation of their government financial reporting; few have yet been able to publish financial reports that comply with the accrual International Public Sector Reporting Standards (IPSAS). For most countries, the process of modernising financial reporting presents multiple issues, including:

- Whether to start with the Cash Basis IPSAS or move directly to accrual IPSAS?
- Which entities to consolidate within the Government financial reports?
- Timing and sequencing of reforms?
- How to address legal and compliance issues during the transition?
- How to comply with both IPSAS and GFS reporting requirements?
- How to plan, manage and resource the transition process?

The IPSAS Board Website ([www.ipsasb.org](http://www.ipsasb.org)) contains valuable resources to help this process including Study 14 “Transition to the Accrual Basis of Accounting” and reports on the experience of several countries on reforming financial reporting. Also, the IPSAS Board has issued IPSAS 33 “First-time Adoption of Accrual Basis International Public Sector Accounting Standards”<sup>1</sup>. The IMF has also published “Implementing Accrual Accounting in the Public Sector”<sup>2</sup>.

The above resources should be studied by anyone involved in modernising government financial reporting. However, as their title indicates, all the above publications focus primarily on the move to accrual accounting. The issues of consolidation and the reporting entity is not addressed, nor are many of the practical problems of a modernising financial reporting.

The International Consortium on Government Financial Management (ICGFM) recognised the challenges facing countries modernising financial reporting and developed an “IPSAS Compilation Guide” and Certification Programme in 2013<sup>3</sup>. This had some success, but has been overtaken by changes to IPSAS and the Compilation Guide has now been withdrawn.

This Paper is the successor to the Compilation Guide. It describes a structured but flexible approach to sequencing the modernisation of government financial reporting. The paper recognises the dual issues of moving to accrual accounting and expanding the reporting entity

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<sup>1</sup> All IPSAS are published in the “Handbook of International Public Sector Pronouncements 2016” published by the IPSAS Board and available from the website [www.ipsasb.org](http://www.ipsasb.org). The other referenced IPSASB publications are available from the same website.

<sup>2</sup> “Transition to Accrual Accounting”, Abdul Khan and Stephen Mayes, IMF, Washington 2009

<sup>3</sup> “A Compilation and Certification Program for Developing Countries” Jesse Hughes, International Journal of Government Financial Management, Volume XIII, No. 1, 2013 at <http://www.icgfm.org/journal/2013/vol1/1.pdf>

(consolidation), and the fact that such modernisation of financial reporting is likely to extend over many years.

Therefore, this paper provides a general framework from which each country can select the most appropriate modernisation path and timescale. Combining this framework with the platform approach to Public Financial Management (PFM) reforms enables a monitorable modernisation strategy for each country.

The paper also describes the updated support and certification programme available from ICGFM to help countries through the process of modernising financial reporting.

### A two-dimensional approach to modernising government financial reporting

Our approach is based on the premise that although the situation of each country is different, there is a general direction of travel in modernising government financial reporting along two dimensions:

**Dimension 1**      Phased expansion of the reporting entity (i.e. consolidation) to meet the GFS and IPSAS reporting entity requirements.

**Dimension 2**      Phased adoption of accrual reporting

These two dimensions and the general direction of travel are summarised in Figure 1 below.

**Figure 1: Two-dimensional sequence of government financial reporting**

Platforms		Reporting Entity				
		A. Government budget entities	B. Government budget entities + extra budget entities within GGS	C. GGS at Central Government Level	D. All of GGS (IPSAS 22)	E. IPSAS Consolidation
Basis of accounting	1 Cash Basis	X				
	2 Cash + Financial Assets & liabilities					
	3 As 2 including tangible assets except historic & infrastructure					
	4 Full IPSAS and GFS accrual				X	X

**Note:** the shaded areas indicate combinations of accounting base and reporting entity that are not feasible.

Thus, under this approach there is a general direction of reform and a clear end, but each country can select the stages representing combinations of the reporting entity and the stage of accrual (the cells in the diagram) that will represent the reform stages.

### Timescale and the platform approach

Whilst there is widespread agreement that whilst a move to full IPSAS and GFS compliant accrual reporting of reporting entities that comply, respectively, with GFS and IPSAS requirements should be the long-term goal, the timescale is likely to vary considerably between countries. Some wealthy countries may be able to manage the transition in a few years, as suggested in the above referenced IMF publication. But for some countries the timescale may be measured in decades, with lengthy pauses at different stages.

The combination of specific accrual stages and reporting entity stages, represented by the cells in the matrix, can be envisaged as “platforms” in the financial reporting modernisation process. Such platforms may be identified in terms of (i) the scope of the reporting entity and (ii) the progress towards full accrual.

The platform approach to PFM reforms envisages a series of realistic step changes, referred to as platforms, defined in terms of government financial reporting outcomes. Each platform establishes a clear basis for moving to the next platform. Sequencing can be addressed by articulating the goals for each platform<sup>4</sup>.

Combining the matrix as described in Figure 1 with the platform approach as described above, it is possible for each country to identify a series of platforms within the process of modernising government financial reporting. The exact sequence and combination of the two dimensions for each platform will vary between countries. The matrix allows individual governments to identify their own platforms in terms of both dimensions appropriate to each country.

Before explaining how these dimensions can be combined to identify the reform platforms for a specific country, the different reform stages of each dimension are explained in more detail below.

### **Dimension 1 - the government reporting entity**

The scope of the government reporting entity must be progressively expanded until it meets the requirements of both GFS and IPSAS. This involves consolidating the different entities within government that maintain their own accounting records.

The complication is that IPSAS and GFS require consolidation of different reporting entities:

- IPSAS requires government financial reports to consolidate all controlled entities – this will include public corporations (IPSAS terminology is Commercial Public Sector Entities<sup>5</sup>) that meet the definition of controlled entities. Entities that are not controlled by central government are not consolidated in the IPSAS Government financial reports, even though such entities are part of the general government sector<sup>6</sup>. Examples of entities not consolidated with central government under IPSAS would include state and local governments.
- GFS requires consolidation of the entities within the general government sector, whether or not they are controlled by central government. Thus, state and local governments must be consolidated for GFS whether or not they are controlled by central government. However, none of the GFS reports require consolidation of Public Corporations with the general government sector.<sup>7</sup>

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<sup>4</sup> Brooke, P., 2003, “Study of Measures Used to Address Weaknesses in Public Financial Management in the Context of Policy-Based Support,” final report for the Public Expenditure and Financial Accountability (PEFA) Secretariat (Washington: PEFA Secretariat).

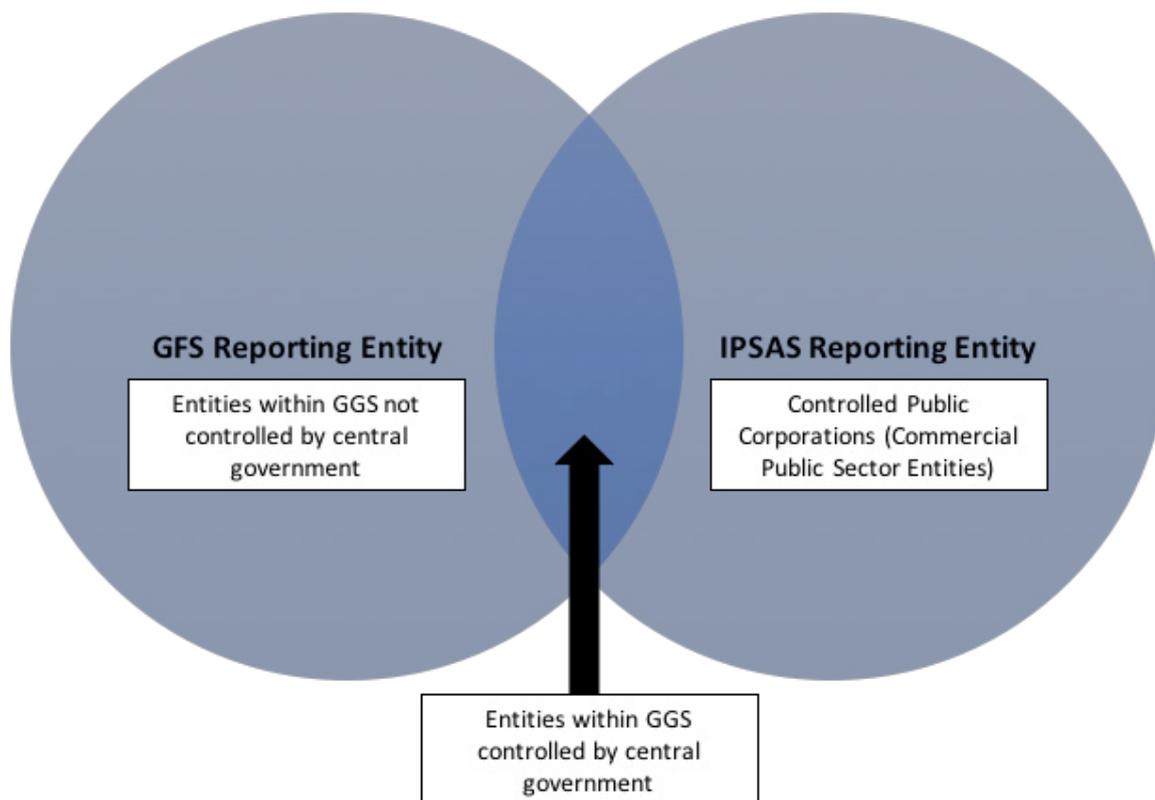
<sup>5</sup> “Commercial Public Sector Entities” replaces the previous IPSAS terminology “Government Business Enterprises” - see “The Applicability of IPSASs”, 2016 IPSASB [www.ipsasb.org](http://www.ipsasb.org). For practical purposes the GFS “Public Corporations and the IPSAS “Commercial Public Sector Entity” are synonymous. An alternative commonly used term is State Owned Enterprise (SOE), although some SOEs are so heavily subsidised that they do not meet the definition of a commercial public sector enterprise

<sup>6</sup> IPSAS 22 optionally allows a separate consolidation of all entities in the general government sector, see below

<sup>7</sup> Government Finance Statistics Manual (GFSM) 2012, Chapter 2.

From the above, GFS and IPSAS require the consolidation of two separate groups of entities, though with considerable overlap of the requirements. This can be envisaged as illustrated in the Venn diagram in Figure 2 below.

**Figure 2: Venn diagram illustrating different reporting entities for GFS and IPSAS**



Therefore, two separate consolidations are required for Government financial reporting:

- All entities within the general government sector for GFS reports (and IPSAS 22 reports if this option is adopted, see below)
- All controlled Government entities for IPSAS reporting

Preparing these two separate consolidations should not be a major problem. It simply requires that at the final stage of defining the reporting entities, there will be two sets of consolidated reports in accordance with, respectively, the requirements of GFS and IPSAS. This is further explained below.

Taking the above IPSAS and GFS requirements into account, the stages in expanding the government financial reporting entity are summarised below. Within a country there may be more than one government reporting entity, reflecting the levels of government. The explanations below are in terms of the central government of a country, but would be equally applicable to consolidated financial reporting at sub-national levels, e.g. state and/or local levels.

### **Reporting Entity Stage A - central government budget entities**

The minimum government reporting entity is defined by the scope of the government budget, i.e. it includes all entities directly funded through the government budget. This would not

include entities funded by budget transfers or grants. All budget revenues and expenditures will be included in the reporting entity.

This is the most basic scope of the reporting entity and should only be regarded as the first Reporting Entity Stage. Using the budget to define the reporting entity enables preparation of the Statement of Budget Comparison, as required under IPSAS 24 and the Cash Basis IPSAS.

### ***Reporting Entity Stage B - including extra budgetary entities***

In many countries, extra-budgetary entities exist which are properly regarded as part of central or sub-national government. Extra-budgetary entities operate under the authority of a central, state or local government and carry out certain functions of government. Such extra-budgetary entities may have their own revenue sources, which may be supplemented by grants (transfers) from the general budget or from other sources. Even though their budgets may be subject to approval by the legislature, extra-budgetary entities have discretion over the volume and composition of their spending.

There are many examples of extra budgetary entities, and many reasons for forming such entities. Some examples are as follows:

1. Entities established to carry out specific government functions, such as road construction, the provision of health or education services, registration of land rights.
2. In some countries military and intelligence spending is kept secret and outside the general budget
3. In some countries so-called “Trust Funds” with their own bank accounts are established to carry out government functions. The budget simply records transfers to such funds as grants and there is no further accounting for the expenditure.

Budgetary arrangements vary widely across countries, and various terms are used to describe these extra-budgetary entities, often referred to as “extra-budgetary funds” or “decentralised agencies.”

The consolidation of extra-budgetary entities in government financial reporting is required by both IPSAS and GFS. This consolidation is an important stage in enabling transparency and control of government activities. Consideration will need to be given to the budget comparison, since IPSAS 24 requires a budget comparison where the entity is “required or elect to make their approved budget(s) publicly available”<sup>8</sup>. At Stage 2 (and later reporting entity stages) by definition the reporting entity is broader than the published government budget, though separate budgets may be available for the different component entities. A decision will have to be made as to how to address this issue in the Statement of Budget Comparison, e.g. by a consolidated budget to coincide with the reporting entity even though such a consolidated budget is not published.

### ***Reporting Entity Stage C -General government sector at national level***

At Stage C the reporting entity will be further expanded to include social security funds and any other entities controlled by central government that are part of the general government sector not already included in Stage B. Revenues will reflect all central government revenues including any flowing directly to the entities within the overall Stage C reporting entity.

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<sup>8</sup> IPSAS 24, paragraph 3.

The same comments about the budget comparison report apply as under Reporting Entity Stage B.

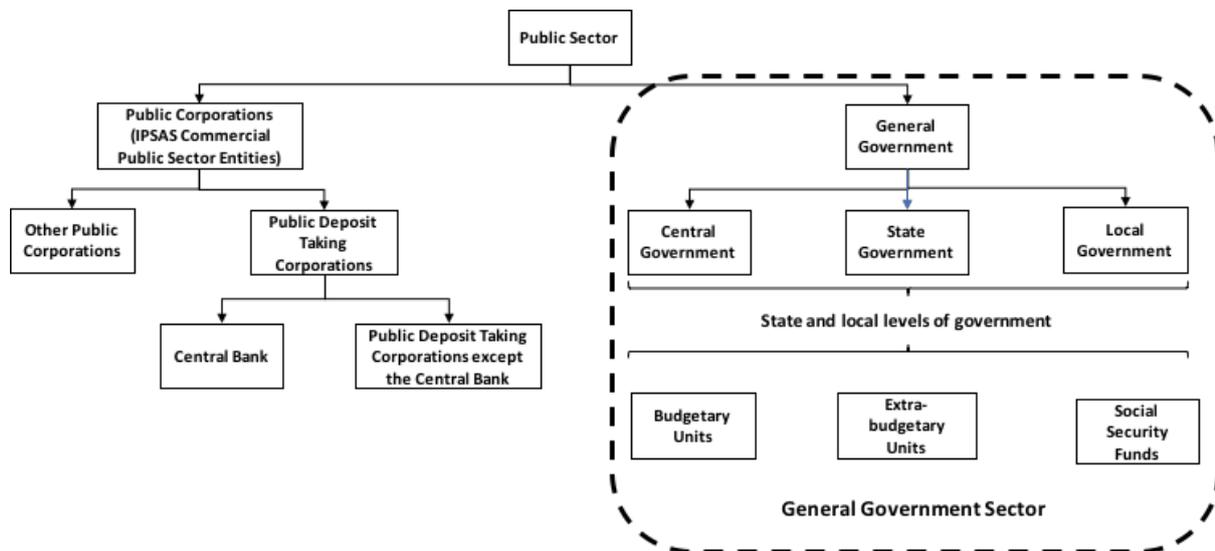
**Reporting Entity Stage D - GFS reporting - General government sector at all levels of government (also IPSAS 22)**

Stage D meets the GFS consolidation requirements to consolidate all entities within the general government sector at national and sub-national level. GFS reporting requires consolidation of all entities within the general government sector, irrespective of whether such entities are controlled by central government.

As indicated above, there is no IPSAS requirement for consolidated reporting of entities within the general government sector. However, such consolidation is allowed under IPSAS 22<sup>9</sup>. IPSAS 22 is an optional, not mandatory, IPSAS. Any reports provided in accordance with IPSAS 22 are in addition to, not instead of, consolidated financial reports under IPSAS 35. However, most counties will wish to implement Stage D to enable GFS reporting and in doing so will also facilitate the optional reports under IPSAS 22.

The concept of the general government sector reporting entity is illustrated in Figure 3 below.

**Figure 3: The Public Sector and sub-sectors**



Notes:

- Deposit taking institutions - a term defined in GFS to mean financial corporations controlled by general government units or other public corporations whose principal activity is financial intermediation and who have liabilities in the form of deposits or financial instruments that are close substitutes for deposits. Examples include state owned banks, savings and loan associations, pension funds.

Under Stage D, and in accordance with both GFS and IPSAS 22, the reporting entity is defined as the general government sector, enclosed within the dotted rectangle. This includes all general government sector entities at central, state and local government levels, but does not include any public corporations (Commercial Public Sector Entities).

<sup>9</sup> IPSAS 22 is an “optional” Standard that allows, but does not require, publication of consolidated financial reports for the general government sector, as defined in GFS.

To enable this top level consolidated reporting entity, a series of consolidation sub-entities must be defined at each level of government as under Stage C above. Under Stage D these separate sub-national government entities will be consolidated with central government to include the whole of the general government sector. This consolidation may present problems of obtaining information, since sub-national levels of government may not be under the direct control of central government. National level legislation may be required to ensure sub-national levels provide the required information in time for the national level consolidated reporting.

Similar issues as above apply to developing a consolidated general government sector budget to enable budget comparison.

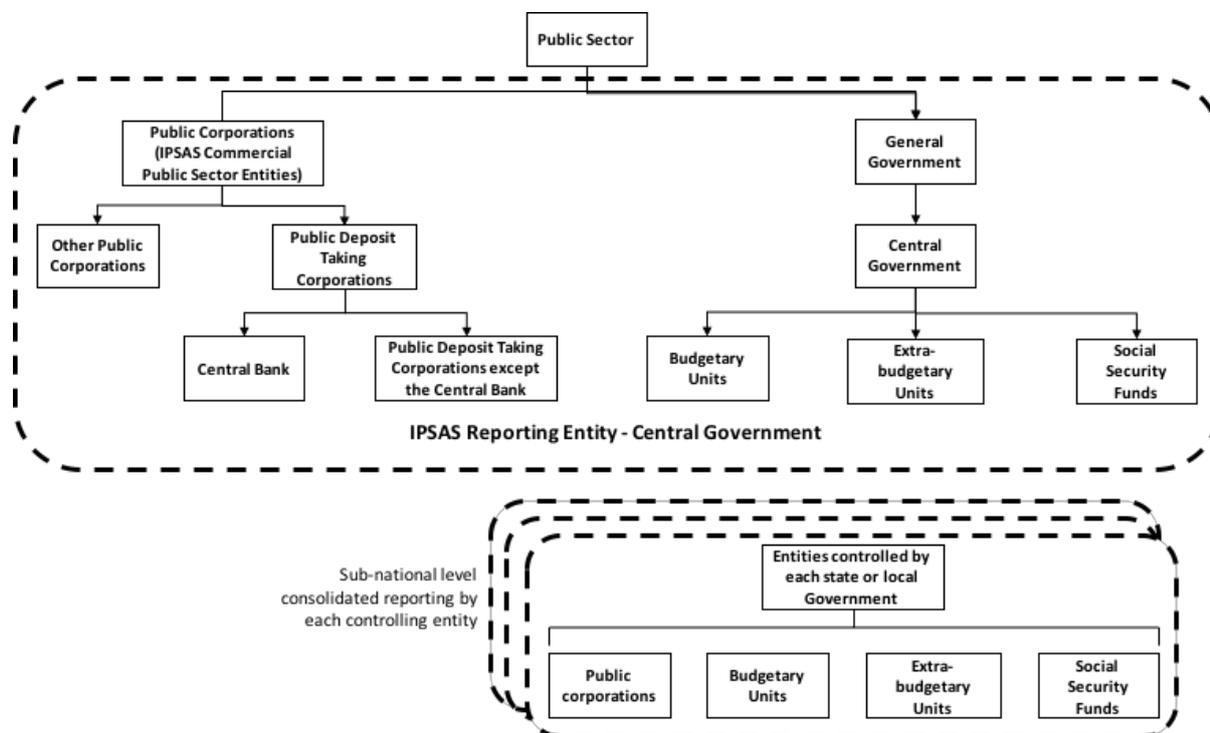
### Reporting Entity Stage E - reporting entity as required by IPSAS

Stage E is mandatory for IPSAS reporting according to IPSAS<sup>10</sup>, but is not required under GFS.

As indicated above, the IPSAS definition of the reporting entity is based on control. Thus, the consolidation will include controlled Public Corporations (Commercial Public Sector Entities). On the other hand, state and local levels of government that are not controlled by central government will not be included in the IPSAS reporting entity. Instead, sub-national levels of government will be required to publish their own consolidated reports, including any entities under their control.

This reporting structure is illustrated in Figure 44 below. Under the IPSAS requirements, there will be a consolidated reporting entity for central government; this will not include state and local governments that are not controlled by central government. There will be a separate reporting entity for each state and local government.

Figure 4: IPSAS government reporting entities



<sup>10</sup> Under IPSAS certain other entities, e.g. associate entities, must also be included according to the procedures in IPSAS 36 through 38. These requirements are not addressed in the paper.

## Dimension 2 - Basis of accounting

### Accrual Stage 1 - Cash Basis

Under Stage 1, reporting is performed according to the mandatory component of the Cash Basis IPSAS. There is at present an Exposure Draft (61)<sup>11</sup> containing various amendments to the Cash Basis IPSAS. When these amendments are adopted, the Cash Basis IPSAS should be feasible for implementation by all countries not implementing the accrual IPSAS.

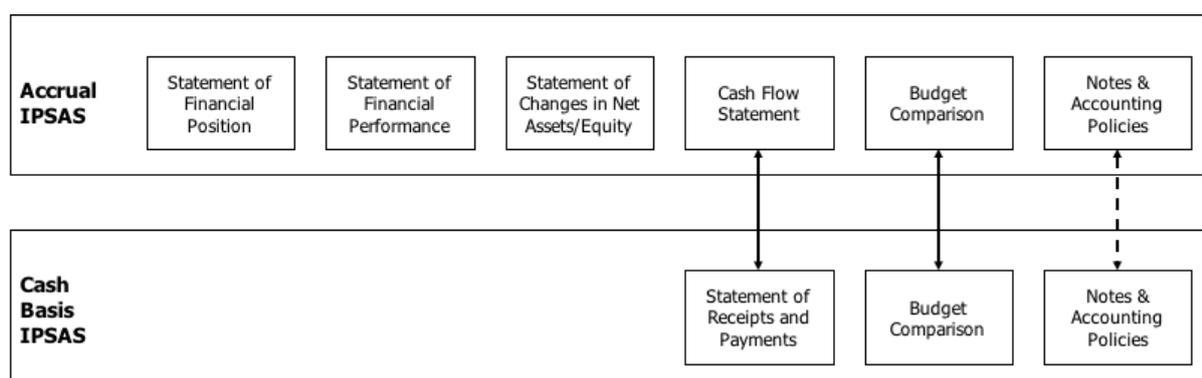
Where countries are initiating modernisation of government financial reporting, there is a strong argument for commencing with the Cash Basis IPSAS even where existing reporting contains elements of accrual reporting, for the reasons explained below.

Under accrual accounting, financial reports will still require cash information for:

1. The Cash Flow Statement, and
2. The Comparison of Budget and Actual (IPSAS 24 requires presentation of budget and actual information on a comparable basis, i.e. cash or accrual; it is unlikely that a country that has not implemented full accrual financial reporting would budget on an accrual basis).

Therefore, the Cash Basis IPSAS can be viewed as a sub-set of full accrual financial reporting, as illustrated in Figure 5 below.

**Figure 5: Cash Basis reports as a sub-set of accrual reports**



#### **Note:**

- The Cash Basis IPSAS specifically encourages the Statement of Receipts and Payments to be in the form of the IPSAS 2 Cash Flow Statement where the entity is intending to migrate to the accrual basis of accounting (Para. 2.2.1).
- The linkage between “Notes and Accounting Policies” is shown as a dotted line because the Notes and Accounting Policies will expand and require some changes when accrual accounting is implemented.

Thus, compliance with the Cash Basis IPSAS generates three of the six Reports that will eventually be required under accrual accounting. In doing so, the entity can immediately also report that it is compliant with the Cash Basis IPSAS.

<sup>11</sup> “Exposure Draft 61, Amendments to Financial Reporting under the Cash Basis of Accounting” 2016, [www.ipsasb.org](http://www.ipsasb.org)

From the above analysis, it follows that if a government has some elements of accrual financial reporting, but is not fully compliant with the accrual IPSAS, that government should plan (as a first stage in moving to IPSAS compliance) to publish a Cash Flow Statement and a Budget Comparison, together with Notes and Accounting Policies. This publication will mean that the government financial reports comply with the mandatory requirements (Part 1) of the Cash Basis IPSAS. The Financial Report can also include in additional statements such accrual information as is available in a format of that country's choosing, as encouraged in Part 2 of the Cash Basis Standard.

Therefore, all countries which have not published financial reports of the government fully compliant with accrual IPSAS should commence the process of modernisation of financial reporting by ensuring compliance with the Cash Basis IPSAS because this:

1. Ensures two of the six Statements required for IPSAS Accrual Reporting are IPSAS compliant,
2. Enables the government to state, and the auditor to confirm, that the Financial Reports comply with the Cash Basis IPSAS, and
3. Allows additional accrual information (e.g. a schedule of loans) to be published with the Financial reports in accordance with Part 2 of the Cash Basis IPSAS.

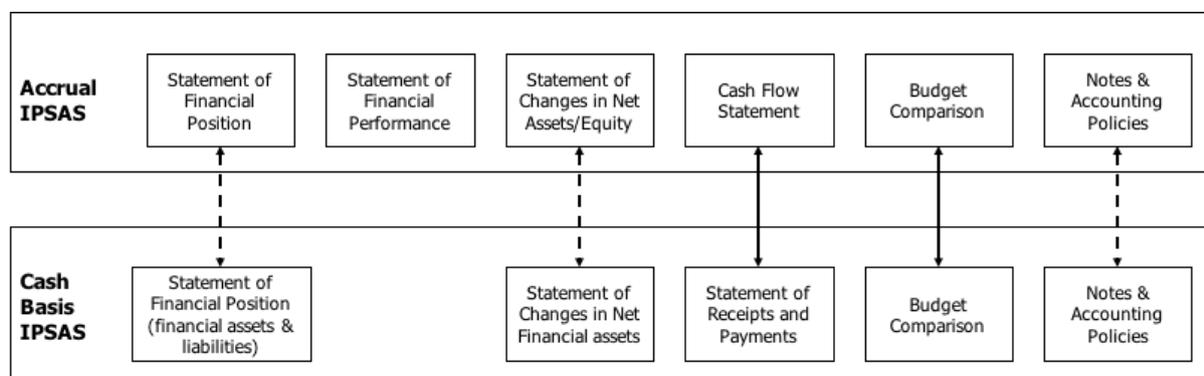
In our experience, countries often find reporting in compliance with the Cash Basis IPSAS much more difficult than anticipated. Typical problems include accounting systems that confuse accrual and cash flows, basic problems with cash recording, reconciliation and the definition of cash and cash flows. Resolving these issues is an important discipline and should be a precursor to the introduction of accrual reporting.

**Accrual Stage 2 - incorporating financial assets and liabilities**

Incorporating financial assets and liabilities is sometimes referred to as the modified cash or modified accrual basis of accounting. All governments should have information on financial assets and liabilities, but such information is either not published, or published as separate statements not combined with the financial report. Stage 2 as described above incorporates this information into a Statement of Financial Position (i.e. a financial balance sheet) and a Statement of Changes in Net Financial Assets. This latter Statement is not specified in IPSAS, but is necessary at this stage to explain financial flows other than cash flows.

The Statements published at this stage can be related to accrual IPSAS financial reports as illustrated in Figure 6 below.

**Figure 6: Reporting on financial assets and liabilities**



**Note:**

- The Statement of Financial Position at this stage only reports financial assets and liabilities,
- Therefore, it is almost inevitable that the Statement of Financial Position will indicate negative net equity, since the non-financial assets of the entity are not included,
- The Statement of Receipts and Payments can be in the IPSAS 2 cash flow format (see above), and
- The Statement of Changes in Net Financial Flows records flows in financial assets and liabilities other than cash.

Under Accrual Stage 2 all financial assets and liabilities, other than intergenerational<sup>12</sup>, should be reported. These include:

- Financial assets (investments, taxes, and other receivables), recognised as soon as the entity has a contractual right to that asset.
- Liabilities (accounts payable, long-term debt, etc.), recognised as soon as the entity becomes legally responsible for paying the obligation.
- Contingent liabilities will be reported in the notes to the accounts in accordance with IPSAS 19.

At Stage 2, any relevant rules of the accrual IPSAS should be followed in identifying, valuing and reporting financial assets and liabilities, e.g. IPSAS 28-30 on financial instruments.

Most governments will maintain records of loans, but some other financial assets and liabilities may not be recorded in any formal system:

- **Taxes** – information will be available on tax receipts, but not tax receivable. It may be necessary to develop a statistical model to estimate tax receivable at the aggregate level.
- **Bills payable** – unless there is an accounting system that records bills payable when the invoice is received, information on bills payable will have to be obtained outside the accounting system and incorporated at the aggregate level.
- **Accruals and prepayments** – unless these vary significantly from year to year, these could be ignored. This approach is not of course strictly correct, but may be a practical interim solution.
- **Investments in controlled and associate entities** – this is linked to the issue of the reporting entity in the next section. Where such entities are not consolidated, then they should be reported as a financial asset. Valuation should be in accordance with the IPSAS rules for such investments.
- **Provisions for anticipated losses** - should only be reported for financial assets, since it would be meaningless to provide for losses on assets not included in the Statement of Financial Position.

There are two approaches to be compliant with IPSAS whilst reporting under Accrual Stage 2.

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<sup>12</sup> For example, unfunded pension liabilities would not be reported at Stage 2

**Either:**

1. Continue to report Cash Flow and Budget Comparison in compliance with Part 1 of the Cash Basis Standard. All other reports and information will be disclosed as additional voluntary disclosures under Part 2 of the Cash Basis Standard – this is the simplest solution.

**Or**

2. Develop national standards which incorporate those elements of the IPSAS required and appropriate for reporting in accordance with Platform 2. The Financial Reports can then be stated to be compliant with adopted national public sector accounting standards. This approach requires a detailed understanding of the IPSAS and their incorporation into national standards.

It is apparent that Accrual Stage 2 is much more complex than Stage 1 and presents multiple challenges. However, achieving Accrual Stage 2 provides significantly enhanced information for fiscal control and transparency.

***Accrual Stage 3 - simplified accrual accounting***

Under Platform 3, all the “straightforward” tangible assets are included in the financial reports, i.e.

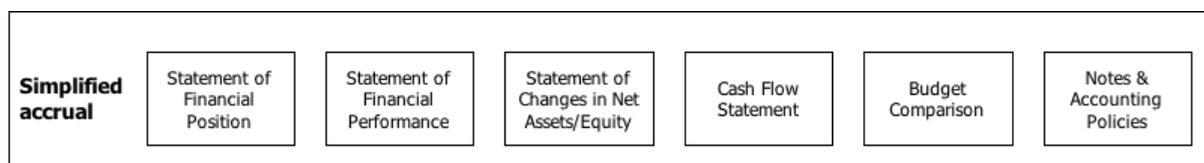
- **Fixed assets** – property, plant, equipment, etc.
- **Current assets** – stock of goods held for use by the government

However, Platform 3 avoids the more challenging issues relating to assets and liabilities. The following are excluded at Stage 3:

- Heritage assets,
- Infrastructure assets for which there is no readily available market, e.g. roads, parks and open spaces,
- Intangible assets, and
- Inter-generational assets and liabilities, e.g. pension liabilities.

At Stage 3 it is possible to publish a full set of financial statements as in Figure 7 below.

**Figure 7: Financial Statements under simplified accrual**



**Note:**

- Although all of the financial reports are present, they will not comply with full accrual IPSAS reporting because of the omission of some assets and liabilities.

As with Accrual Stage 2 where assets or liabilities are included, they should be identified, valued and reported in accordance with the relevant IPSAS. There will of course be many detailed problems on which assets and liabilities to include and exclude at this stage. But the principle is clear – include tangible assets and liabilities that can be identified and easily valued.

#### **Accrual Stage 4 - accrual IPSAS compliant financial reports for the government**

Accrual Stage 4 is full IPSAS compliant financial reporting for the government of the country. This may be achieved by either:

- Incorporating the IPSAS within the reporting requirements of the country, or
- Implementing national standards that are consistent with the requirement of IPSAS.

Most countries which have reached this stage have adopted the second of these two approaches.

Accrual Stages 1 through 3 have applied to the government reporting entity, defined in accordance with the reporting entity dimension above. In order to complete the process of modernising government financial reporting, it is necessary that all entities within the public sector report in accordance with the applicable accounting standards:

- IPSAS for public sector entities that meet the requirements of Paragraph 10 of the Preface to IPSAS<sup>13</sup> – in practice this will usually be all entities within the general government sector, and
- IFRS for all other entities in the public sector – in general this will apply to entities within the public corporations sector (referred to in IPSAS as Commercial Public Sector Entities).

This reporting compliance must be achieved for all entities within the public sector so that such entities may be consolidated. IPSAS/IFRS reporting compliance should be indicated in the financial reports of each entity and confirmed by the audit report.

There are a number of differences in the measurement of flows and valuation of assets and liabilities between IPSAS and GFS. The detail of these differences is beyond the scope of this paper<sup>14</sup>. However, if accounting systems enable IPSAS compliant reporting, and with careful design of the chart of accounts, it will be feasible to make such adjustments as are required to provide the reports required by GFS.

#### **Developed sequenced platforms in modernising government financial reporting**

From the above description, a government may select a series of combinations of (i) reporting entity stage and (ii) accrual stage from the matrix in Figure 1 to define platforms in the reporting modernisation process. These platforms are defined by the cells in the matrix.

There is no single sequence of the accrual and reporting entity stages appropriate for all governments, only a general direction of travel. Within the matrix in Figure 1 above, each government can identify the sequence most appropriate for their country.

Thus, there are multiple feasible reform paths through the matrix. The following provides an explanation and some general rules on the direction of travel.

- It is not a requirement to start at matrix cell A1 (Cash Basis Reporting under Stage 1 for the budget entity stage A). The first platform could instead be some level of accrual

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<sup>13</sup> See “Handbook of International Public Sector Pronouncements 2016” published by the IPSAS Board available from [www.ipsasb.org](http://www.ipsasb.org)

<sup>14</sup> See for example “International Public Sector Accounting Standards (IPSASs) and Statistical Bases of Financial Reporting: An Analysis of Differences and Recommendations for Convergence “, IPSASB, 2004 [www.ipsasb.org](http://www.ipsasb.org)

(though there must still be a cash flow statement and a comparison with the budget) and/or some broader reporting entity,

- The only rule for each new Platform is that it must move from the previous Platform either left to right, or down the matrix, or both,
- Each platform must be completed before starting the move to the next platform, and
- More than five platforms in a modernisation plan become unmanageable.

Figure 8 below suggests a possible sequence, but it is emphasised that this is only for illustrative purposes.

**Figure 8: Examples of possible reform sequence for Country X**

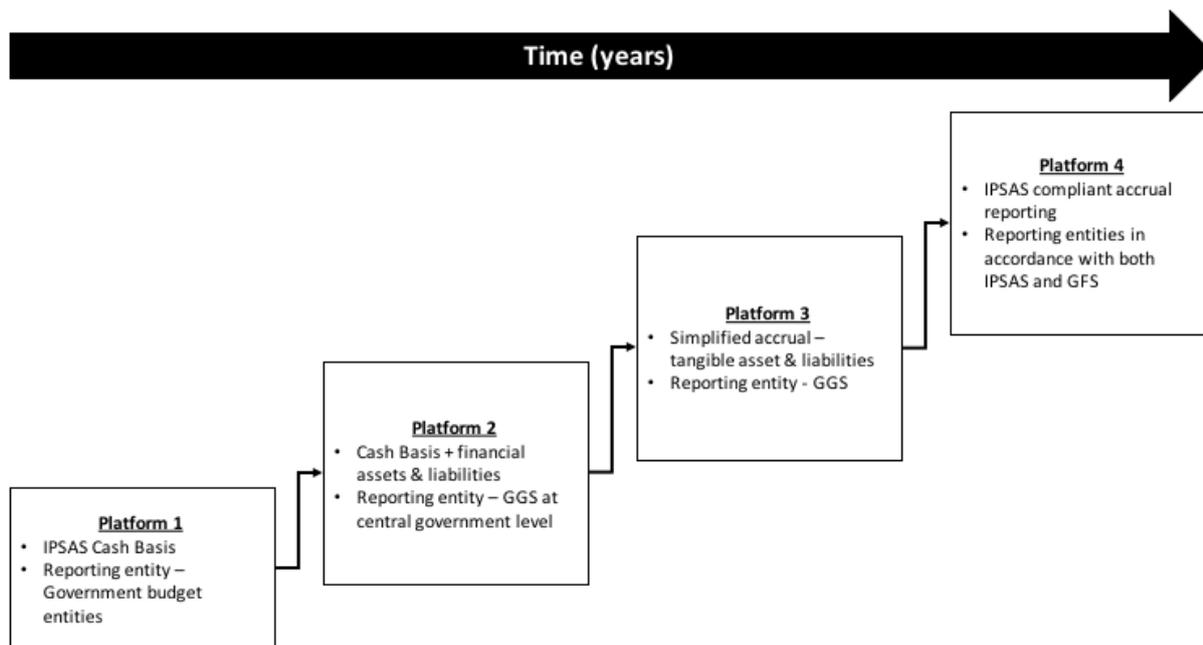
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		A. Government budget entities	B. Government budget entities + extra budget entities within GGS	C. GGS at Central Government Level	D. All of GGS (IPSAS 22)	E. IPSAS Consolidation
Basis of accounting	1 Cash Basis	Platform 1				
	2 Cash + Financial Assets & liabilities			Platform 2		
	3 As 2 including tangible assets except historic & infrastructure				Platform 3	
	4 Full IPSAS and GFS accrual					Platform 4

Thus, under the above sequence there are four platforms in the reform plan defined as follows:

- Platform 1** Reporting entity Stage A + basis of accounting Stage 1
- Platform 2** Reporting entity Stage C + Basis of accounting Stage 2
- Platform 3** Reporting entity Stage D + Basis of accounting Stage 3
- Platform 4** Reporting entities Stages C and D (GFS and IPSAS compliant) + Basis of accounting Stage 4 (full accrual)

The reform platforms and sequence for the Government of Country X in Figure 8 can then be represented using the platform approach in Figure 9 below.

**Figure 9: Country X government financial reporting reform platforms**



The timescale will define the target for the completion of each platform. The overall timeline may be years, or even decades. The timings should be decided by each government based on feasibility and resources available.

Thus, the matrix model as described in Figure 1 enables the development of a unique reform sequence for each country and government. This approach recognises the parallel reforms relating to the reporting entity and accrual as well as the GFS and IPSAS reporting requirements.

There are of course further issues to be considered in planning reforms to the financial reporting, some of which are indicated below.

### **Financial Reporting reform considerations**

The following sub-sections indicate some of the other issues that need to be addressed as part of the modernisation of financial reporting. This is not intended to be an exhaustive guide, rather an indication of issues to be considered.

#### ***Broader PFM reforms***

It is probable that modernising financial reporting will form part of a broader PFM reform process, e.g. reforms to fiscal forecasting and management, budget reforms and more general reforms to governance within a country. Sequencing and timing may be dependent on other reforms, e.g. moves to a treasury single account and new budget classifications will impact on the modernisation of financial reporting.

During the reform process the opportunity of enhanced reporting should also be used to enhance the information for management control and decisions. For example, a form of commitment accounting where the cost and timing of cash flows resulting from existing obligations (e.g. long term contracts) is recorded and reported.

### ***Accounting systems and process***

A major element of PFM reforms will probably include updating or replacing the IT systems used for budget and accounting. Very often technical changes will both enable and drive accounting reforms. For example, implementing a new Financial Management Information System (FMIS) based on Commercial Off the Shelf (COTS) software will fit very well with the implementation of accrual accounting (since most COTS packages assume accrual accounting) and will encourage the recording of transactions at an earlier stage, e.g. when goods or invoices are received by subsidiary accounting units.

Under the above scenario modernised financial reporting becomes a component within the reform of accounting processes. However, in such a scenario it is important to ensure that the goal of improved finance reporting is not subsumed to other technical reforms.

The use of accounting software enables frequent financial reporting, both internally and externally, during the course of the financial year. It is essential that all financial reports consistently apply the same consolidation, measurement and valuation rules and the same approaches to presentation of information. If this is not the case, evaluations (and even decisions) may be based on interim information which is not consistent with agreed reporting policies.

### ***Budget classification and the chart of accounts***

It is important to develop a budget classification and chart of accounts for the accounting system consistent with requirements specified in both IPSAS and GFS Manual. The IMF has developed a model budget classification compliant with GFS,<sup>15</sup> but this does not meet all of the requirements of IPSAS, and will also need to be adapted to the requirements of an individual country. A unified core<sup>16</sup> chart of accounts for all entities reporting according to IPSAS/GFS rules is fundamental to being able to consolidate information. The unified chart of accounts should be designed to meet the requirements of full accrual accounting even if this is not to be immediately implemented.

If a new computer system is being implemented, it is essential that this is based on the chart of accounts designed as above to enable reporting in accordance with IPSAS and GFS, as well as other requirements of government. An initial task will be translating existing assets and liabilities into the new chart of accounts to provide opening balances, and also to provide previous years' comparative information in a consistent format.

### ***Developing inventories of assets and liabilities***

A major challenge is to identify and value government assets and liabilities, including contingent liabilities. Even identifying all cash balances of the government can sometimes be difficult when these are spread over different agencies and institutions. There will normally be a register of central government loans, but this may not include all loans by or to agencies, explicit or implicit loan guarantees, bills payable and so on. The problems become greater as the range of assets and liabilities included expands. For example, long term contracts, pension liabilities, intellectual property rights and infrastructure assets all present problems of valuation even when identified.

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<sup>15</sup> Government Finance Statistics Manual, 2012 (Appendix 4: Classifications).

<sup>16</sup> It may be necessary to have additional special codes for the analysis required by different types of entities, e.g. hospitals. Furthermore, Public Corporations will require charts of accounts appropriate to IFRS reporting as well as the entities specific operational situation.

### ***Legal and institutional reforms***

There should be a legal and institutional framework for the adoption of IPSAS compliant financial reporting. This may take the form of legislation to establish national public sector accounting standards, or simply a legislative requirement to report in accordance with international standards.

There must also be an institutional base for the reforms to the financial reporting. It is desirable that a body is established which includes representatives of government, the accounting profession, academia and civil society to manage public sector accounting standards. This body would be responsible for overseeing the reform process and dealing with technical issues as they arise and updating the standards in accordance with IPSAS.

### ***Communication and building support for the reforms***

It is important to build broad support for and understanding of the reforms to financial reporting. This involves communication both within and outside government:

- Explaining why the reforms are being undertaken,
- The sequence and impact on individuals and organisations, and
- The benefits that will flow from improved financial reporting.

Building support may involve awareness training of external users in using and interpreting the expanded financial information.

### ***Audit and audit reports***

The Supreme Audit Institution (SAI) of the country will need to express an opinion on the fair presentation of financial information in the financial statements of the government. This means the SAI must have the technical expertise and resources to report on consolidated accrual financial reports. Auditors must be familiar with both IPSAS and GFS in order to report on compliance. The auditor will require new tools to report on new accounting systems and processes.

There is a balance to be struck on the involvement of the SAI in the reform progress. On the one hand the SAI must retain its independence, and therefore cannot define or control the new systems and reports. On the other hand, the SAI should have the opportunity to review proposed reforms in advance so as to be able to comment on the changes and indicate areas that will give problems to the auditor.

### ***Resource requirements and training***

Technical expertise is required to modernise government financial reporting, which will involve some training:

- A small group with technical IPSAS and GFS expertise (probably qualified accountants) to lead the process and provide technical guidance,
- Capability to ensure IT systems, e.g. an FMIS, enables IPSAS and GFS compliant reporting
- One or more individuals within each reporting entity with sufficient expertise to be able to manage the reforms and take responsibility for reporting within that entity,
- All staff involved in accounting functions trained in new procedures, and

- As indicated above, a wider programme of awareness training in the reforms and utilisation of the modernised reports.

Managing the training requires planning so that it is linked to the implementation of the reforms. This should form part of the project management discussed below.

### ***Management of the reform process***

From the above, it is apparent that modernising government financial reporting is a project that must be managed. It is very likely that this will be a top-down process initiated by central government, so project management must be at the same level.

Project planning and management are subjects in their own right and outside the scope of this paper, but should include:

- Planning the reform project,
- Identifying reform platforms,
- Identifying resource requirements – financial, human and other,
- Planning training,
- Identifying required legal and institutional reforms,
- Identifying stakeholders inside and outside government and plan how to communicate with and build support of stakeholders,
- Identify risks and develop a risk management strategy, and
- Implement effective project management, monitoring and reporting.

### **How ICGFM can help**

ICGFM can support countries through the process of modernising government financial reporting in a number of areas, as indicated below:

- Advice and support through our network of members and through the ICGFM Innovation Lab,
- A “toolbox” of detailed advice and guidance for each stage with the financial reporting modernisation process,
- In-country and/or remote training and guidance – ICGFM does not itself provide training but works with a network of training providers that are able to design specific advice and training programmes for individual countries or groups of countries. Advice and training can be delivered in-country or remotely using web based conference and training tools, and
- Certification of the completion of Platforms – once a country has established the reform platforms as described in this paper, ICGFM can carry out a desk based assessment to certify that the country has completed a particular platform.

Anyone interested in obtaining further information is invited to contact ICGFM via the website at [www.icgfm.org](http://www.icgfm.org) or by e-mail to [icgfm@icgfm.org](mailto:icgfm@icgfm.org).