

The International Consortium on  
Governmental Financial Management



# Public Fund Digest

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# International Consortium on Governmental Financial Management

Working globally with governments, organizations and individuals, the International Consortium on Governmental Financial Management is dedicated to improving financial management so that governments may better serve their citizens.

The Consortium's international activities include:

1. Encouraging collaboration and communication among professionals involved with government accounting, auditing, budgeting, information systems, cash management, debt administration, and financial management;
2. Contributing to the advancement of government financial management principles and standards, and through educational events, promoting best practices in government financial to improve management control and accountability to the public;
3. Disseminating, to its members and to the public, information concerning government financial management;
4. Promoting the development and application of professional standards to support government financial management activities;

In addressing issues, the Consortium embraces many disciplines of governmental financial management including: accounting, auditing, budgeting, debt administration, information technology, tax administration and treasury management. These areas provide the general frame of reference for the programs, activities and operations of the Consortium.

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The editor invites submission of articles, research papers, letters and reviews of books and documents. Please submit articles to the editorial office indicated below. Also, requests for information on the Consortium should be addressed to:

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# International Consortium on Governmental Financial Management General Information

*“Working globally with governments, organizations, and individuals, the International Consortium on Governmental Financial Management is dedicated to improving financial management by providing opportunities for professional development and information exchange.”*

Our **mission** includes three key elements. First, it highlights that, within the international community, the Consortium is unique—it serves as an “umbrella” bringing together diverse governmental entities, organizations (including universities, firms, and other professional associations), and individuals. At the same time, it welcomes a broad array of financial management practitioners (accountants, auditors, comptrollers, information technology specialists, treasurers, and others) working in all levels of government (local/municipal, state/provincial, and national). Additionally the mission statement emphasizes the organization’s focus on activities to promote professional development and the exchange of information.

Our **programs** provide activities and products to advance governmental financial management principles and standards and promote their implementation and application. Internationally, the Consortium (1) sponsors meetings, conferences, and training that bring together government financial managers from around the world to share information about and experiences in governmental financial management, and (2) promotes best practices and professional standards in governmental financial management and disseminates information about them to our members and the public.

The International Consortium on Governmental Financial Management provides three options for **membership**.

- 1. Sustaining Members:** organizations promoting professional development, training, research or technical assistance in financial management; willing to assume responsibility for and to actively participate in the affairs of the Consortium. Each Sustaining Member has a seat on the ICGFM’s Board of Directors and receives 10 copies of all ICGFM publications to be distributed within their organization. (Dues: \$1,000)
- 2. Organization Members:** government entities with financial management responsibilities, educational institutions, firms, regional and governmental organizations, and other professional associations. Six organization members serve on the ICGFM’s Board of Directors and organization members receive 5 copies of publications to be distributed to their members. (Dues: \$250/\$150\*)
- 3. Individual Members:** persons interested in, dedicated to, or working with activities directly related to financial management and who wish to be members in their own right. Six members of the ICGFM Board of Directors will be selected from among all individual members. Each individual member will receive a copy of all ICGFM publications. (Dues: \$100/\$50\*)

\* A special discount is offered to developing countries, countries with economies in transition and regional groups and organizations in such countries to encourage their participation. This discount is available to **all countries other than** Australia, Canada, China, Egypt, European countries (**except transition economies**) India, Iran, Israel, Japan, Kuwait, Libya, Mexico, New Zealand, Nigeria, Oman, Saudi Arabia, United Arab Emirates, USA, Russia, and Venezuela.

# Foreword

At our annual Miami Conference this year, we completed the third year of our three year training program. Since this year's emphasis was on auditing and accountability, we were fortunate to have Ms. Prinsloo, a senior technical manager for the auditing board at IFAC, as our keynote speaker. The major points from her presentation are reflected in the leadoff article and her full presentation is available at our [www.icgfm.org](http://www.icgfm.org) website. Another speaker (Ms. Tseyen-Oidov) at the Conference was from the Ministry of Finance in Mongolia to identify their experiences during the implementation of a Government Financial Management Information System. This is an excellent case study that others can use to avoid or anticipate some of the difficulties that they encountered. Another excellent case study was written by Dr. Bezdek and pertains to the vesting of assets in a country (Iraq) during a period of conflict. It provides excellent insight into some of the difficulties that one encounters during such stressful periods and how one might establish procedures to overcome those difficulties.

Professor Ouda has provided us with an article dealing with the transition to accrual accounting. This article provides great insight to the practical and conceptual problems that one can anticipate as they develop their transition strategy. A separate article by Dr. Parry addresses the questions that one should ask as national governments consider implementing accrual accounting. Another article (by Dr. Hughes) suggests one method by which the database in the accounting system could be designed to meet the reporting requirements of both the IPSASs and the GFS Manual. A suggested work plan to move from the cash to the accrual basis of accounting follows this Foreword for those entities that desire further guidance.

Over the years, we have provided many articles concerning the advantages and disadvantages of moving from the cash to the accrual basis of accounting. However, we have not looked at accrual budgeting, the other side of the coin. Mr. Blondal has filled that void with his article that was first published in the OECD Journal on Budgeting. We thought it would be of interest to reproduce his article here so that our readership could be informed on this debate.

In our attempt to give our readership some insight as to the laws that some countries have adopted pertaining to financial management, we included two laws in our last issue: budgeting (Armenia) and accounting (Azerbaijan). In this issue, we include another two laws: audit (Bosnia and Herzegovina) and procurement (proposed in Zambia). It is not intended that these examples serve as models laws to be adopted. Rather, it is hoped that each country will establish those laws that cover the basic aspects of budgeting and accounting as reflected in these laws.

As always, we invite your comments on these papers and any prior publications of the Public Fund Digest as we debate the issues. Contact me at [jhughes@odu.edu](mailto:jhughes@odu.edu) if you would like to contribute an article or discuss a government financial management issue. Or contact us by telephone, facsimile, and on the Internet at [www.icgfm.org](http://www.icgfm.org).

Jesse W. Hughes  
Publications Editor

Linda L. Weeks  
President

**Suggested Work Plan for Public Sector Accounting Reform  
In the Transition from Cash to Accrual Accounting**

Dr. Jesse W. Hughes, CPA, CIA, CGFM

	<i>Task</i>	<i>Begin Date</i>	<i>End Date</i>
1.	Monitor application for IFAC membership		
2.	Officially translate the IPSAS		
3.	Provide training for implementation of the work plan:		
a	Develop training plan with an emphasis on training of the trainers		
b	Work with training function to provide set of training material for program implementation		
c	Work with universities to incorporate training on IPSAS in their degree programs		
d	Coordinate with ACCA and CIPFA to determine if there can be linkage to certification programs		
4.	Identify all government entities		
5.	Define which entities are Government Business Entities (GBEs) using following criteria:		
a	Has power to contract in own name		
b	Is assigned financial and operational authority to carry on a business		
c	Sells goods and services to other entities at a profit or full cost recovery		
d	Not reliant on continuing government funding to be a going concern		
e	Is controlled by a public sector entity as defined in IPSAS 6		
6.	Review and assess the following for each GBE:		
a	Determine degree of compliance with IASs by review of Auditor's Opinion and Management Letter from external auditor		
b	Correct deficiencies noted in order to obtain an unqualified auditor's opinion		
c	Prepare Consolidated Financial Statements for all GBEs		
7.	Review and assess the following requirements per Part 1 of the Cash Basis IPSAS for each governmental entity other than a GBE		
a	Prepare Cash Receipts and Payments Statement for own revenues		

	<i>Task</i>	<i>Begin Date</i>	<i>End Date</i>
b	Contact donors to obtain third party settlements and include in Cash Receipts and Payments Statement		
c	Prepare Consolidated Cash Receipts and Payments Statement		
d	Incorporate disclosure requirements for recipients of external assistance (IPSAS ED)		
<b>8.</b>	Review and assess additional disclosures as encouraged by Part 2 of the Cash Basis IPSAS for each governmental entity other than a GBE:		
a	Budget to Actual Comparison (Draft ED)		
b	Cash Flow Statement in format prescribed by IPSAS 2		
c	Investments in Associates as Defined in IPSAS 7		
d	Interests in Joint Ventures as Defined in IPSAS 8		
e	Value of Inventories as Defined in IPSAS 12		
f	Value of Leases as Defined in IPSAS 13		
g	Value of Financial Instruments (includes all financial assets and financial liabilities) as Defined in IPSAS 15		
h	Value of Investment Property as Defined in IPSAS 16		
i	Value of Provisions as Defined in IPSAS 19		
j	Amount of Administered Transactions as an agent		
k	Related Parties as Defined in IPSAS 20		
l	Value of Property, Plant, and Equipment as Defined in IPSAS 17		
<b>9.</b>	Implement system of accrual accounting by adopting all IPSASs in effect, and prepare Consolidated Financial Statements as prescribed in IPSAS 6		
<b>10.</b>	Extract data from accounting system for presentation in the statistical reporting system prescribed by the GFS Manual		
<b>11.</b>	Review organizational structure to determine changes that might be necessary. Particularly important would be consideration of an Accounting organization headed by a Chief Accountant. Functions for such a department are as follows:		
a	Maintain Accounting Policy and Procedures Manual		

	<i>Task</i>	<i>Begin Date</i>	<i>End Date</i>
b	Provide Quality Assurance program for financial statements		
c	Maintain library of pertinent accounting standards		
d	Coordinate training needs with training function		
<b>12.</b>	Work with line ministries to improve the Corruption Perception Index through implementation of good internal control procedures.		
<b>13.</b>	Design and implement an integrated government financial management system		
<b>14.</b>	Change laws and regulations as necessary to implement this work plan		
<b>15.</b>	Coordinate with internal and external auditors on work plan		

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# APPROACHES TO MAXIMIZE ACCOUNTABILITY, MINIMIZE RISKS, IMPROVE TRANSPARENCY AND REDUCE FRAUD

**Keynote Address at the ICGFM Training Program**

**May 5, 2005 (Miami, Florida)**

*By: Alta Prinsloo, Senior Technical Manager, International Auditing and Assurance Standards Board, International Federation of Accountants*

## **Introduction**

Thank you very much for inviting me to speak today. It is a privilege to speak to public sector professionals who play such a vital role in ensuring the fiscal soundness of governments. Your role may be different from that of an external auditor, but we share a common challenge: how best to protect the public interest.

In presenting the external auditing structure and standards, I would like to cover the following areas:

- The credibility in financial reporting
- The role of the International Federation of Accountants (IFAC) and its reforms
- The role of the International Auditing and Assurance Standards Board (IAASB)
- Convergence between national and international standards, including the development of standards that can be applied in the public sector
- Ethics.

Internal auditing and the auditing standard-setting activities of the International Organization of Supreme Audit Institutions (INTOSAI) will be covered in presentations that will follow mine.

I very much look forward to our discussions and the insights all of you bring to this conference.

## **Credibility in Financial Reporting**

Credibility in financial reporting is critical to the development of capital markets. When investors lack confidence in financial reporting, capital market growth is impeded. The publication *Restoring Public Confidence in Financial Reporting: An International Perspective*, prepared by an independent task force and issued by IFAC in 2003, summarizes the challenges facing all those involved in producing, analyzing, and reporting on an entity's financial data.

These challenges have become increasingly more significant in light of corporate scandals and the volatility in capital markets, leading to increased public skepticism about the financial reporting process.

The loss of credibility in financial reporting, having many causes, requires a multi-faceted solution—not just by external auditors, but by all those involved in the financial reporting process. Management and boards of directors, internal and external auditors, standard setters, regulators, and other participants in the financial reporting process, all have important and varying roles to play. To rebuild and maintain credibility, these groups must focus sharply on the public interest.

Let me take a moment to describe what I mean by “public interest.”

In the corporate sector, financial reporting decisions of entities affect investors, creditors, employees, and other stakeholders. As the financial reporting failures of Enron, WorldCom and Ahold have demonstrated, the groups and individuals affected by an entity’s financial reporting decisions extend well beyond who we have traditionally thought of as stakeholders. They include the average man and woman on the street. There is a clear public interest in the quality of financial reporting.

The public interest is also served by accountants creating wealth, by working for or within businesses to drive strategy, efficiency and financial integrity; by providing legally conforming taxation advice with full disclosure to revenue authorities; and by helping ailing businesses to turn around, thereby preserving ideas, jobs and the self-respect of employees and their families whose livelihoods are saved.

In the public sector, the financial reporting practices applied by governments in the areas of education, health, and social services affect how these services are provided, who receives them, and their cost. It affects the lives of each and every citizen at all stages of life. Thus, the day-to-day work performed and decisions made by many of you have far-reaching consequences.

At the international level, standards and guidance developed by organizations such as the IAASB, International Accounting Standards Board (IASB), International Public Sector Accounting Standards Board (IPSASB), and INTO-SAI influence how countries structure their capital markets and provide services to their citizens. They affect a country’s future prosperity.

## **The Role of IFAC and the IFAC Reforms**

### **MISSION**

Financial reporting practices clearly affect the economic and social health of the public. It is for this reason that IFAC, which comprises 163 member bodies in 119 countries, takes its public interest responsibilities seriously, and why they are embraced in its mission:

To serve the public interest, IFAC will continue to strengthen the worldwide accountancy profession and contribute to the development of strong international economies by establishing and promoting adherence to high-quality professional standards, furthering the international convergence of such standards,

and speaking out on public interest issues where the profession’s expertise is most relevant.

## REFORM PROPOSALS

This mission inspires the actions of IFAC's leadership, staff, boards, committees, and task forces, in particular the recent major reforms that have transformed IFAC and its international standard-setting processes. In March 2005, the most fundamental change in IFAC's 28-year history was announced: the formation of the international Public Interest Oversight Board (PIOB) to oversee international standard setting in the areas of auditing, ethics, education, and the IFAC Member Body Compliance Program. The PIOB currently comprises eight individuals of the highest standing, drawn from seven countries. Its formation was one element of a comprehensive reform package that IFAC's leadership and international regulators developed over a two-year period.

To provide you with some history, IFAC called a meeting with international regulators in February 2003 with a clear mandate: to determine how IFAC could strengthen its international standard-setting processes, and build confidence in financial reporting. Participants at that first meeting included representatives of the Basel Committee on Banking Supervision, the European Commission (EC), the Financial Stability Forum, the International Association of Insurance Supervisors, the International Organization of Securities Commissions (IOSCO), and the World Bank. IFAC's leadership held many discussions with these groups. IFAC's leadership also consulted with IFAC member bodies and other interested parties. The result of this extensive consultative effort was the Proposals for Reform, unanimously approved by IFAC's Council in November 2003 and widely supported by international regulators.

The reforms focus on three areas: (a) strengthening the standard-setting processes of IFAC's Public Interest Activity Committees, i.e., the IAASB, the Education Committee, and the Ethics Committee; (b) enhancing the transparency of those processes; and (c) providing for public interest oversight.

The PIOB will play a key role in several significant ways:

- It will evaluate the due process in IFAC standard-setting activities and report publicly.
- It will approve the process for nominating members to the Public Interest Activity Committees, and approve the appointment of the chairs and other members of these committees.
- It has the right to recommend that the work program or agenda of a Public Interest Activity Committee include a specific matter.
- It has the right to observe at IFAC Board and Nominating Committee meetings during discussions pertaining to the Public Interest Activity Committees.

I want to emphasize an additional point: the PIOB is responsible to the public and not to the IFAC Board or IFAC membership. Its operations are independent from that of IFAC. I believe that this independent oversight, combined with the independent standard-setting roles of the IFAC boards and committees, will demonstrate to the public that their interests are given paramount importance.

Although it is public interest oversight that captures the headlines, it is important to recognize other aspects of the reforms that have been introduced over the past two years. I will address those relating to the IAASB later in this presentation.

I would like to turn to the public sector for a moment.

## THE PUBLIC SECTOR

The public sector has not been ignored in the reform process. The IFAC

Public Sector Committee was established in 1986 with a broad mandate to develop programs for the improvement of public sector financial management and accountability. In October 2003, the IFAC Board commissioned an external review of the Committee. The purpose of the review was to make recommendations on the strategies to achieve the Committees' objectives in the long term, and to note any specific strategic initiatives that should be implemented in the short, medium and long terms.

The Review Panel was chaired by Sir Andrew Likierman, Head of the United Kingdom Government Accountancy Service. The Panel presented its report to the IFAC Board in July 2004. Recommendations included changing the Committee's name to the "International Public Sector Accounting Standards Board" to better reflect its significant standard-setting role.

Since the review report was issued, the International Public Sector Accounting Standards Board has taken action to increase public input in its standard-setting processes.

## **The Role of the IAASB**

### **THE IAASB**

The IAASB is a standard-setting body designated by and operating under the auspices of IFAC. The objective of the IAASB is to serve the public interest by setting, independently and under its own authority, high-quality standards for quality control, auditing and other assurance, and related services engagements, and by facilitating convergence with them. This enhances the quality and uniformity of practice throughout the world, and strengthens public confidence in the global auditing and assurance profession.

The IAASB consists of a chairman and 17 volunteer members from around the world. Most members are practitioners in public practice with significant experience in the field of auditing and other assurance services. Three of the 17 members are "public members," currently two Auditors-General and one academic. Members are appointed by the IFAC Board based on recommendations from the IFAC Nominating Committee. Their appointment is approved by the PIOB. The IAASB meets four to five times a year.

### **REFORM PROPOSALS**

The IAASB has embraced the IFAC reforms wholeheartedly in the belief that they will enhance its due process and working procedures, and lead to wider acceptance of its standards.

The IAASB has implemented a number of changes to make it one of the most transparent standard setters in the world. Meetings are open to the public, and agenda papers and meeting summaries are posted on the IFAC website. Visitors can also view project histories, and may download audio recordings of the IAASB meetings. They can also download IAASB exposure drafts and view all comments made on those drafts.

The IAASB now has a full-time chairman, John Kellas. It has also increased its technical support in order to channel energies into areas that most seriously affect the public interest.

Under John's leadership, the IAASB is taking a closer look at its due process. An exposure draft on the topic was issued in 2004. The exposure draft responded to the IFAC reforms that called for public hearings on standard-setting projects, enhanced responsiveness to comments received on exposure drafts, and an annual report on compliance with due process. The exposure draft also pro-

posed other changes to strengthen the IAASB's deliberative process, and to expand the present description of its due process and working procedures to reflect more fully the practices that it follows. The comments received on the exposure draft were reviewed at the March 2005 IAASB meeting. Once finalized, a description of the due process and working procedures will be posted on the IAASB website.

The IAASB has made public interest input into its standard-setting process a priority. In addition to including public members on its Board, the IAASB has a Consultative Advisory Group (CAG), which has recently revised its scope of activities and membership. In 2004, David Damant, an internationally renowned investment professional, was named the first independent chairman of the CAG. The 25-member CAG provides input on the IAASB's work program, project priorities, and technical issues. INTOSAI is a member of the CAG.

To further increase the avenues for direct input into the IAASB's standard-setting process, invitations for observer seats were sent to and accepted by the U.S. Public Company Accounting Oversight Board (PCAOB) and the Japanese Financial Services Agency. A response to a further invitation, sent to the EC, is pending.

In addition to these initiatives, the IAASB also makes it a priority to reach out to other stakeholders. In February 2005, it hosted its fifth meeting with national standard setters. Standard setters from ten countries attended the meeting. Extensive discussions were held on a number of topics: (a) how to improve coordination of work programs and agendas between the IAASB and national standard setters, (b) convergence between national and international standards, (c) how to improve the clarity of IAASB standards, (d) the translation of International Standards on Auditing (ISAs), and (e) the development of implementation guidance.

The IAASB engages in ongoing dialogue with the EC. In addition, it participates in meetings of IOSCO's Standing Committee No. 1, the US PCAOB Standing Advisory Committee, and the Basel Committee on Banking Supervision.

Clearly, open and transparent dialogue is critical to the development of high-quality international standards that serve the public interest. Adding public interest oversight to the IAASB standard-setting activities will, I believe, further strengthen the standards and enhance their credibility.

## **NEW ISAS RELEVANT TO THE PUBLIC INTEREST**

In 2004, the IAASB issued three standards that are particularly relevant to the topics considered at this conference.

### **New and Revised Quality Control Standards**

Quality control is fundamental to high-quality audit work. The IAASB issued two standards on quality control. First, the new International Standard on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements*, establishes a firm's responsibilities to establish and maintain a system of quality control for all audit, other assurance, and related services engagements.

Second, the revised ISA 220, *Quality Control for Audits of Historical Financial Information*, establishes standards and provides guidance on specific responsibilities of firm personnel regarding quality control procedures for audits of financial statements. Although auditors may find these new standards demand-

ing, they are necessary to meet public expectations. Not only will auditors have greater responsibility for quality control, but many audit firms will also need to strengthen and redesign their quality control systems.

The quality control standards are designed to help restore public confidence in auditing following the corporate scandals of recent years, and to ensure the highest level of quality in the delivery of services by professional accountants. Together, they reflect the IAASB's commitment to improve the quality of auditor performance throughout the world.

### **Revised Fraud Standard**

The revised ISA 240, *The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements*, builds on the new audit risk standards issued in 2003. It requires the auditor to direct more focused efforts on areas where there is a risk of material misstatement of the financial statements due to fraud, including management fraud. The standard also requires the auditor to design and perform audit procedures responsive to identified risks of material misstatement due to fraud, including procedures to address the risk of management override of controls. Although fraud, particularly management fraud, will always be inherently difficult to detect, the revised standard reinforces the auditor's responsibilities to identify and address the risks of material misstatement due to fraud. These new requirements will result in increased work for auditors.

### **THE ROAD AHEAD**

The IAASB is in no doubt that its primary focus should be on those issues that contribute to building confidence in the audit of financial statements. As it fulfills this role, the IAASB needs to recognize the pressures on the accountancy profession arising from changes in regulation, oversight, and financial reporting requirements.

In today's environment, the IAASB's actions must respond to perceived needs and be proportionate to them, if its standards are to achieve the acceptance and respect of investors, regulators, auditors, and others with an interest in financial reporting. A key priority is taking the necessary actions to support the completion of the IFAC reforms relating to the IAASB. The IAASB is also considering establishing a mechanism for issuing interpretive guidance to respond to urgent and emerging needs. Stakeholder relationships, particularly those with the EC, IOSCO, the Basel Committee on Banking Supervision, and other regulators, INTOSAI, and national standard setters, will continue to be maintained and, where possible, strengthened. In all these ways, the IAASB intends to maintain confidence in the quality and relevance of its standard-setting activities.

While the IAASB will maintain its focus on the development of ISAs, it will also consider possible projects for other assurance standards. It will also consider the needs of smaller practitioners and the audits of smaller entities.

## **Convergence between National and International Standards, including the Development of Standards that can be Applied in the Public Sector**

Although the development of standards has been a priority for the IAASB, a fundamental objective of both IFAC and the IAASB is achieving global convergence to its standards.

### **SUPPORT FOR INTERNATIONAL CONVERGENCE**

IFAC has committed itself to achieving global convergence of national standards with international standards. This is evidenced both in its mission statement and in its Statements of Membership Obligations. Published in April 2004, the Statements of Membership Obligations formally capture IFAC's longstanding requirement that its member bodies support the work of the IASB, IAASB and IPSASB by using their best endeavors to incorporate the respective international standards in their national requirements and to assist in implementing the international standards, or national standards that incorporate them.

The Financial Stability Forum included the IFRSs and ISAs in its 12 Key Standards for Sound Financial Systems. The Financial Stability Forum indicated that these 12 Key Standards are most likely to make the greatest contribution to reducing the vulnerabilities of financial systems and strengthening their resilience.

The report on Rebuilding Public Confidence in Financial Reporting – An International Perspective, which I referred to earlier, provides further support for IFRSs and ISAs becoming the worldwide standards. The report recommends achieving convergence of national and international standards as soon as possible, viewing this as a significant public interest issue.

INTOSAI has as a goal the development of Guidelines for Financial Audit that will provide its members with practical guidance on the application of the INTOSAI Auditing Standards to financial audits of public sector entities. The Auditing Standards Committee of INTOSAI has resolved that these guidelines should, as far as possible, draw upon the ISAs.

As organizations and countries increasingly commit to convergence of national and international standards, there is a need to ensure that international convergence is approached in a systematic and, where possible, consistent way across jurisdictions. Also, interested parties such as IFAC, standard setters, and regulators need to understand the challenges in adopting and implementing the international standards so that the challenges can be met at an early stage.

### **THE CHALLENGES**

In 2004, IFAC published a report entitled *Challenges and Successes in Implementing International Standards: Achieving Convergence to IFRSs and ISAs*. It was written by former IFAC Board member, Peter Wong, and identifies the following challenges to successful implementation of international standards:

- Understanding the meaning of international convergence.
- Translation of international standards.
- Complexity and structure of international standards.
- Frequency, volume and complexity of changes to the international standards.
- Challenges for small and medium-sized entities and accounting firms.

- Potential knowledge shortfall.
- Implication of endorsements of IFRSs.

## **THE WONG REPORT'S RECOMMENDATIONS**

The report emphasizes the fact that governments, regulators, standard setters, reporting entities and auditors, as well as other participants in the financial reporting process, have important roles to play in international convergence. IFAC and the IAASB have taken a number of initiatives to address the challenges to international convergence head on.

## **Developing the Concept of International Convergence**

IFAC staff, in consultation with relevant interested parties, are further developing the concept of "international convergence." The objective is to develop guidance to accompany IFAC's Statements of Membership Obligations.

### **Translations and Availability of Pronouncements**

To encourage high quality translations of IFAC pronouncements, and to assist organizations with translation, IFAC approved in July 2004 a new policy statement that outlines the procedures to be followed in translating its pronouncements. This new policy statement, Translation of Standards and Guidance Issued by the International Federation of Accountants, will improve the consistency and quality of translations of IFAC's pronouncements by its member bodies and others.

To date, ISAs have been translated by IFAC member bodies and others into more than 25 languages, including French, German, Russian and Spanish.

To encourage the use of international standards throughout the world, IFAC makes its pronouncements available on its website free-of-charge.

### **IFAC Member Body Compliance Program**

Statements of Membership Obligations serve as the foundation for the IFAC Member Body Compliance Program, which is overseen by IFAC's Compliance Advisory Panel. Statements of Membership Obligations provide current and potential member bodies with clear benchmarks to assist them in ensuring high-quality performance by professional accountants.

### **Improving the Clarity of IAASB Pronouncements**

In 2003, the IAASB undertook a review of the drafting conventions used in its standards with the objective of identifying ways to improve the clarity of IAASB standards, which will aid their consistent application. This project reached a milestone in September 2004 with the issue of the exposure draft, Clarifying Professional Requirements in International Standards Issued by the IAASB. The exposure draft and accompanying consultation paper deal with the IAASB's drafting conventions and some suggestions for resolving issues surrounding the structure, length, and perceived complexity of its standards. These are surprisingly controversial matters on which strong but differing views are held. Reaching agreement on future actions will not be easy, but acceptable solutions are needed to achieve global convergence of standards.

### **Small and Medium-Sized Enterprises and Accounting Firms**

Recognizing the importance of small and medium-sized enterprises (SMEs) and accounting firms (SMPs), the IAASB actively solicits the input and support of the IFAC SMP Permanent Task Force at all key stages of each of its projects, beginning with the project proposal stage. To facilitate the IAASB's partnership

with SMPs, the IAASB has appointed its Deputy Chair, Denise Esdon, to act as liaison with the SMP Permanent Task Force.

## **DEVELOPING STANDARDS THAT CAN BE APPLIED IN THE PUBLIC SECTOR**

The IAASB is also continuing to focus on the applicability of its standards to the public sector. In 2004, the IAASB approved a Memorandum of Understanding (MoU) with the Auditing Standards Committee (ASC) of INTOSAI that formalizes a project structure and cooperation process enabling the INTOSAI ASC to use ISAs as a basis for its proposed Guidelines for Financial Audit. Under the MoU, the INTOSAI ASC designates experts in the field of public sector auditing to work with the IAASB to facilitate the incorporation of public sector perspectives into the body of ISAs. INTOSAI nominees have been appointed to several IAASB task forces.

The IAASB's cooperative efforts with the INTOSAI ASC and its Working Group on Financial Audit Guidelines represent an important contribution to the development of standards that can be applied in both the private and public sectors.

## **Ethics**

Before I close today, I would like to acknowledge that the accountancy profession has been built on the public's trust, requiring a commitment to high ethical standards, and most especially to integrity. One of the key findings of the report on *Rebuilding Public Confidence in Financial Reporting—An International Perspective* is the need for effective codes of ethics for all participants in the financial reporting process. Not only must these codes be put in place, they must also be monitored, enforced, and complemented by actions to reduce opportunities to misstate financial information.

IFAC's Ethics Committee is now finalizing important revisions to the Code of Ethics for Professional Accountants, which applies to all professional accountants. The Code establishes a conceptual framework supported by fundamental principles of ethical behavior that aims to guide members of the profession in identifying and assessing threats to ethical behavior, and in establishing appropriate safeguards to reduce such threats. It is also considering specific public-sector related issues.

## **Conclusion**

The Budapest Accords adopted at the conclusion of the 2004 Congress of the International Council of Supreme Audit Institutions were based on the fundamental principle that "cooperation is the cornerstone of development and common well-being in the world." It is by working together that stronger societies are created, common core values are reinforced, cultural identities are promoted, and knowledge is shared.

In developing professional standards and understanding the differences between public and private sector auditing, the INTOSAI Strategic Plan 2005-2010 recognizes that working with other external accountability partners to establish standards and guidelines produce mutual benefits.

Similarly, IFAC and the IAASB will continue to work with participants in the financial reporting process in its quest to develop high-quality standards that serve the public interest and are globally accepted.

Thank you for your attention.



# World Bank of Mongolia Government Financial Management Information System (GFMIS) Standard Software FreeBalance 4.6.2

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We would like to express our gratitude to the organizers of this conference. My purpose today is to inform you of our experiences in changing our financial accounting and reporting system from the old ways of doing things to a modern method of gathering and reporting financial data.

Perhaps some of the countries represented here today have yet to make such a transition—we hope you can learn from both our mistakes and our successes. Some of you have already either started or completed a similar transition. You will be able to identify and take comfort in hearing about our mistakes and successes that you have already experienced. Others here are considering or may consider the costs and benefits of a transition to modern methods of financial accounting and reporting. We hope that upon hearing what we have done and are continuing to develop you will be encouraged to pursue a similar path.

It is not our intent to promote or discourage the purchase of any products or services we mention in our presentation today.

So, what we have chosen to be the course we will run to win the race is a Governmental Financial Management System we shall refer to as GFMIS. In Mongolia, this system is championed by the Treasury Department because there was a recognized need to increase controls of government receipts and expenditures. The GFMIS does a lot more than provide controls for government spending. Therefore, other departments of the government must be involved when it comes to risk management, accountability and transparency. Debt Management, Accounting, Fiscal, and Budget are other departments closely involved with inputs and outputs of the GFMIS. But Treasury has established the system and controls receipts and expenditures.

Mongolia is in a race. Our competition is you and other countries like you. Mongolia needs financing to further our economic development so that we might provide more and better services for our people. A race we can win only if we maximize accountability of governmental managers, maximize risk management and maximize transparency in our financial operations and reporting. We must hold our managers accountable, but more importantly we must train our managers to want to be held accountable. We must manage the risks we encounter every day. But to manage those risks we must be aware of them as they occur—not weeks or months later. And not only must we be able to see how our managers are performing we must be able to show that performance to those we look to for financial support. Transparency—let us see what we have done so that others can see what we have done and they will be able to hold us

accountable. We will all see how well we have managed the risks we face each day. The race? To be better than the competition!

This all started several years ago when the IMF convinced the Ministry of Finance (MOF) that we needed to change our methods of operations in the Treasury. There are 21 provinces, a capital city and 9 districts comprising Mongolia. In the past each of these provinces had their own bank account and no real integration of the accounting with that of the Central Treasury – which accounted for all government organizations such as Ministries, Parliament, etc. Central Treasury also did all payment processing, accounting and reporting for the districts around Ulaanbaatar and the city itself. Our system was fragmented because of distance as well as function.

The World Bank looked at our financials and accounting system. They agreed to establish a loan to finance the implementation of an integrated governmental financial accounting and reporting system.

We went through the usual two stage international bidding process, bid evaluation and awarding with World Bank cooperation. We took ownership of the project and proceeded with World Bank supervision and control. The award went to IBM Consulting, Canada using FreeBalance software and MCS Company of Mongolia for IT and Communications support. Work began in late 2003.

It was a relatively easy decision to use Oracle as the data base driver since we already were using it to drive some of the software we were using at Central Treasury. IBM promoted FreeBalance primarily because they had experience with it in other countries. It was not unimportant to us that FreeBalance was neither as expensive to purchase nor as complex to operate as many of the other software applications we considered.

As I refer to this as a fully integrated system, I realize I should explain how we see it as fully integrated. The GFMIS is installed in all Government Groups and every province as well as in Ulaanbaatar City, Districts around the City and Central Treasury itself. There are some 70 such organizations. However, the accounting for transactions in the GFMIS is executed only in the treasuries located in the provinces, Ulaanbaatar City, districts and Central Treasury—a total of 32 treasuries. Essentially these 32 treasuries do all the disbursement and receipt accounting for the government of Mongolia. The territorial divisions of Mongolia are Provinces, Soums and Bags. We are however a very small country of about 3 million people. So by the time one gets to the Bag and Soum level we are not talking about a significant number of entities of any great size. In fact even today the Central Treasury accounts for almost 70 percent of all government of Mongolia transactions. Each of these Soums and Bags go to the Province for disbursing of funds. All receipts (no matter where they come from) go to a bank authorized by the Bank of Mongolia (BOM) to receive funds and they are wire transferred daily to the BOM. And all disbursements are recorded at the provinces into GFMIS as far as all transactions are concerned—but financial statements are prepared in MOF from a variety of inputs (accounting, fiscal, budget and debt management).

We are presently operating the system on a cash basis—we must walk before we can run. But the plan is to be on full accrual before long.

There are small governments that use FreeBalance such as Kosovo and East Timor. Other users include departments in large governments including several in Canada and the U.S. The software is adaptable to special circumstances or client preferences but it was created as an off the shelf software. Because it sup-

ports both cash and accrual accounting the software has significant capacity for drill down analysis, and flexibility in reporting. It is capable of utilizing an ample chart of accounts and it is especially suitable for small countries.

The modules which we have purchased are shown below:

The following slide illustrates the most basic stages of implementation primarily in chronological order but, of course, overlapping of the processes occurred. We decided to create simultaneously a separate test basis and separate production data base. This was indeed a wise and recommended choice since we did have some difficulties in operating the system in such a manner that the data base was corrupted and had to be recreated. We used the test data base for training and experimenting in configuration and the production data base for actual implementation. We chose to delay training so that it took place immediately before go-live. Consequently, there would not be a lot of time for the staff to forget what they had learned. Hindsight tells us train early and retrain often. Most importantly have the staff practice on the test data base under supervision long before go-live. With help from consultants, the configuration for the system took quite a while because we have some unusual needs that required time and effort to accomplish.

## **Implementation**

- Test and Production data bases established
- Training
- System Configuration
- Establishing connectivity, communication
- Developing budget allocations
- Training of the Treasuries

The communications aspect was so complex that we were pushing hard to keep on schedule of having go-live take place on January 1, 2005. Testing was inadequate, training too little and VSAT was not fully established until in January after go-live!

Much of the following slide has already been described but it clearly illustrates that we have a large task ahead. We have a consultant on site developing a transition into full commitment accounting, we already use accounts payable for offsetting of expenditures and revenue is not perceived to be a complex issue. But fixed asset accounting is another matter. While our accounting department has excellent records of all assets there is much to be done in this area – fortunately International Public Sector Accounting Standards (IPSASs) provide a sufficient transitional period.

### **Further Implementation 2005**

- Commitment accounting
- Purchasing, Accounts Payable
- Fixed Asset Management
- Revenue and Accounts Receivable
- IPSAS (International Public Sector Accounting Standards) reporting

The three modules (appropriations, expenditures and General Ledger) that we implemented on January 3, 2005 were the minimum needed to continue cash accounting and reporting—the primary requirements of the Treasury. We had also purchased three other modules—procurements/accounts payable, fixed assets and revenue with the plan that these modules would be added this year as we became experienced using the first three. We did not consider revenue to be a particularly essential module during the initial learning period because of the way the Ministry operates and receivables are not critical at this stage of implementation. The same was true for fixed assets and accounts payable – issues important to government but not critical for Treasury.

We did not have adequate Oracle expertise available and suffered down time when the Oracle data base crashed—not only down time but Treasury had to re-enter data at considerable extra effort by staff. While FreeBalance consultants were available through January, we had insufficient well-trained staff to deal with unusual problems that occurred. We had only a few people to develop reports from the Crystal reports software that we had selected.

A help desk was established in the Central Treasury. During January the level of call activity was extremely high and we had insufficient staff to handle all the calls timely. One hundred calls in a day were not unusual. But by February calls had dwindled to 7-10 in a normal day—but more when communications were suffering glitches. Insufficient staffing is an issue in all governments and we are no exception.

We were unprepared for the increased workload experienced in the beginning. And on top of all that, the VSAT communications were the biggest cause of down time and other problems. The distances, extreme weather, poor technical training and awareness all contributed to the lack of a smooth transition to GFMS.

The most technically complex part of the GFMIS is that of communications across great distances under extreme weather conditions to places with difficult accessibility. The roads in winter are often impassable and always very cold. Winter temperatures can get as low as minus 50 centigrade and average minus 30 in many areas of the country. Cold in winter, sandy in summer make for true test conditions for highly technical apparatus. One manufacturer guaranteed that the equipment would withstand the cold – only to discover that it could not! Fortunately we were able to replace parts quickly. One choice made in the contracting was that of a communications consultant – a local contractor that was well experienced in dealing with the technical complexities of our climate. Through the combination of an experienced Treasury staff of the Ministry of Finance, an internationally experienced primary contractor such as IBM, off the shelf proven Free Balance software designed for small governments and a local communications provider like MCS Electronics, we were able to go-live January 3, 2005.

While there are 32 Treasuries—one in each province and one at Central – we have only one Treasury bank account and that is with the Bank of Mongolia. All government receipts are deposited to local banks authorized by the BOM to receive government funds and the deposits are wired to the BOM each evening. All government disbursements are wired from the BOM to the recipient's bank account. Each treasury has a commercial account that receives petty cash for their area. Upon receipt of a petty cash reimbursement request the expense and asset accounts are debited as the petty cash account is reimbursed.

The principle motivating factor for the implementation of a Treasury Single Account (TSA) was donor recommendation; both IMF and World Bank believe that increased controls, reliability, transparency and accountability are possible with the TSA. Instead of having expenditures processed at thousands of bank accounts around the country, now (with the TSA) the expenditures are processed through just one! If any one of our more than 5,000 budget entities wishes to pay a vendor, they complete an expense voucher and enter the data into the GFMIS. After system controls and supervisor approvals, the Central Treasury staff review the voucher; after their approvals, it is sent to the BOM for wire transfer to the vendor. All this is done on a daily basis. Before BOM disbursement, every expenditure must pass numerous controls including budget

controls, supervisor reviews, cash availability, etc. And the process is fully auditable.

It was clear to the Ministry of Finance of Mongolia that, to compete for donor funding, Mongolia needed to be at least one step ahead of the competition – and three made it even better – accountability, risk management, and transparency.

Allotment 1 is the annual budget amount approved by the Parliament and allocated to government groups and budget entities. On entering a voucher, the system first of all compares the item to allotment one amounts – no expenditure is allowed to exceed this amount. Secondly, the system reviews allotment 2 amounts – these may or may not be exceeded depending on management decisions. Thirdly the system reviews data at the summary, line item and check control levels. These also may or may not be exceeded depending on the level of control deemed necessary by Treasury. The better managers get a greater degree of freedom while those deemed in need of control get the control.

## **Controls**

- Allotment 1
- Allotment 2
- Summary level
- Line item level
- Check controls

Experience has shown that the system budget controls are most effective and involve no judgment—therefore errors are fewer. We have only 30 staff in Treasury and thousands of transactions every day to be reviewed and approved—we must be able to rely on system input and output to achieve an acceptable level of risk management and reliability.

The budget that is approved by Parliament is not available for input to GFMS until very late in December of each year. After it has been approved, then the break down to budget level can take until late January. So the first weeks of January we prepare warrants and improvise with estimated budgets so entities can pay necessary recipients without having to wait until the complete allocation is done for allotment 1 as well as allotment 2.

This could be done for every month of the year and it is either estimates of monthly expenditures or 1/12th of allotment one for each month. What we do in practice is approve and send warrants to the budget entities in the first week of each month and these become that month's allotment 2. The system can then show how the actual budget 2 amount and the initial budget amounts based on the parliamentary approved budget compares. Of course the system does not allow for expenditures in excess of allotment 1 and we must disallow expenditures that exceed cash available.

The following slide is a visual display of financial flows. All Budget entities are at the bottom. Some of them have responsibility to report to Ministries—an example would be that of a school reporting to the Ministry of Education. Although located in a province, its reporting responsibility is not to the province (although that is where receipts and disbursements are processed) but to the Ministry—identified here as Ministry or other fund consolidating to Central. Others report to the provinces—these are identified as budget entities reporting through the regional or UB City fund and consolidated as local. Then these two consolidations are united into one statement for the government of Mongolia. As a result of this type of coding and the chart of accounts structure, not only is a consolidated statement for the government of Mongolia possible, but managers using user codes and security can extract information in budget entities at every level.

The fund group identifies the primary government agency—ministries, organizations, provinces, and others. These nine digits identify the budget entities. Object group identifies line items. We use project groups to identify specific project and we don't yet use object groups.

We actually use two types of vouchers—expense vouchers and journal vouchers. Both follow the same procedures for entry into the system. The treas-

uries get a request for expenditure directly from the budget entity and they complete the expense voucher which is entered into the GFMIS at the Treasury. This requires system checks and supervisor approval before reviewed by Central Treasury both for propriety and cash availability and before being sent to the BOM.

The Latin term for “Buyer Beware” is an appropriate caution to any government interested in acquiring a new GFMIS. Number one is appropriate communications speed and dependability. No system can work with the communications disconnected and no one wants a system that can’t work at reasonable speeds. We experienced significant difficulties with connectivity and speed—more than any other problem. Many of the staff believed that a new system would make their jobs easier. We didn’t even realize that was their expectation. A new complex system will do many more things than old systems could do—and that means more staff that understands complexity and more staff to do the more things that a system will require. The new system does not eliminate corruption. There are effective controls to decrease errors by well meaning employees. A new system can make it more difficult for those intending to use it improperly and it provides additional audit trails for investigators. But corruption does not exist in the system; it exists in the intent of a few individuals. Training early, training just in time and training during practical application; never too much and never quite enough training. We now have a fully integrated financial system that gives us the means to provide accountability, manage risks and improve transparency and the results will emerge if we use it to its fullest.

Thank you for kind attention.

# USING VESTED ASSETS FOR THE RECONSTRUCTION OF IRAQ

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## ABSTRACT

This paper summarizes an important initiative for the post-war stabilization and economic recovery of Iraq: The rapid movement of \$1.7 billion in U.S. currency to Iraq to pay over 3 million Iraqi workers, ex-soldiers, and pensioners. These payments (which eventually supported more than a third of Iraq's population) derived from Iraq government vested assets in the U.S. and were essential to facilitating post-war economic recovery. The initiative involved complex administrative, accounting, institutional, and logistics problems and required close cooperation between Treasury, DOD, OMB, DOJ, State, and the Federal Reserve. It represents an interagency federal financial management policy that actually "worked."

## INTRODUCTION

At the initiation of hostilities with Iraq in March 2003, President Bush issued Executive Order 13290 on March 20, 2003, which stated that all blocked funds held in the U.S. in accounts in the name of the Government of Iraq, the Central Bank of Iraq, Rafidain Bank, Rasheed Bank, or the State Organization for Marketing Oil are hereby confiscated and all right, title, and interest to such funds vested in the Department of the Treasury. The Order further stated that the vested property be used to assist the Iraqi people and to assist in the reconstruction of Iraq, and authorized the Secretary of the Treasury to perform the functions necessary to implement the Order.

Accordingly, the Secretary requested that the Federal Reserve Bank of New York (FRBNY), as fiscal agent of the United States:

- Establish a new account on its books in the name of the "U.S. Treasury Special Purpose Account."
- Receive vested assets into the Account from financial institutions in accordance with directive licenses issued by Treasury's Office of Foreign Assets Control (OFAC)
- Hold and manage the vested assets in the Account in the same manner as the Treasury General Account until FRBNY received further instructions from Treasury.

Beginning in March 2003, \$1.7 billion in vested Iraqi assets was transferred to the U.S. Treasury Special Purpose Account at FRBNY and, over a period of seven months, these assets were withdrawn as U.S. currency and shipped to Iraq. An additional \$192 million of vested Iraqi assets was transferred to the Development Fund for Iraq (DFI).<sup>1</sup> These transactions required the resolution of many complex legal, financial, accounting, procedural, and logistical issues.

## **I. VESTING IRAQI ASSETS HELD IN THE U.S.**

Iraqi government assets in the U.S. were blocked at the time of the 1990-91 Gulf war by Presidential EO.<sup>2</sup> Following the Presidential Order of March 20, 2003:

- The Secretary of the Treasury delegated to OFAC the authority to perform acts incident to the accomplishment of the vestings.
- OFAC issued a Directive License under the Iraqi Sanctions Regulation which authorized FRBNY to transfer funds in the relevant accounts to an account at FRBNY.
- The Secretary sent letters to the executives of the financial institutions in which vested Iraqi assets were held to notify them.

The vesting proceeded smoothly, and by early April \$1.67 billion of vested Iraqi assets had been transferred and were reported as a budgetary receipt. The transfers out of the U.S. Treasury Special Purpose Account were transfers of authority, and DOD made the ultimate expenditures—except for the transfers to the DFI.

## **II. DETERMINING USE OF THE VESTED ASSETS**

In early April 2003, the National Security Council (NSC) determined that one of the most important objectives following the cessation of hostilities in Iraq was to resume basic government operations and assure the provision of important public services. This decision was informed by Treasury planning that began in the Fall of 2002, and successful implementation of the plan required a credible and secure system for paying emergency workers, civil servants, and pensioners. Because of a lack of certainty about how the existing payments systems worked in Iraq, and whether they would be usable immediately after hostilities, and out of a desire to avoid payments in Saddam dinars, the Administration devised a contingency plan to temporarily make payments in cash in U.S. dollars. The payments would help resuscitate the Iraqi economy, which in turn would support the Coalition's broader political goals in postwar Iraq.

It was decided to use vested Iraqi assets to fund these payments. The objective was to make emergency cash payments as soon as possible to Iraqi civil servants, military and other essential personnel, and for humanitarian and reconstruction purposes to get the basic economic and social infrastructure of the country functioning quickly after the end of the conflict.

NSC established a process to approve decisions on the uses and amounts of the vested assets. The first steps of the process involved a request from Office of Reconstruction and Humanitarian Relief (ORHA),<sup>3</sup> sent through the Policy Office of the Office of the Secretary of Defense to the NSC's Executive Steering Group (ESG). The ESG approved the plan and Treasury transferred spending authority to DOD.

### III. ESTABLISHING THE ADMINISTRATIVE AND LOGISTICAL PROCEDURES

The legal, accounting, administrative, and logistical challenges were formidable. While the policy had been decided upon, the specifics had to be worked out in a series of meetings between senior staff from Treasury, DOD, OMB, GAO, and State in late March and early April. One of the most contentious issues involved an accounting question: When to record the expenditure. The Army first proposed recording each individual payment, but that would have required a certified U.S. military disbursing officer (DO) to witness each case, and there were nowhere near enough such officers in Iraq. Instead, agencies agreed that the correct Government accounting treatment was that the money should be recorded as outlaid (spent) by the U.S. Government only when it was transferred to an Iraqi official with an approved list of payment recipients. Separate reporting and accounting would trace the ultimate disbursements.<sup>4</sup> Specifically, it was decided to:

- Use vested assets to temporarily make payments in dollars to Iraqi civil servants in essential industries and to pensioners.<sup>5</sup>
- Ensure that these emergency payments were made as soon as possible—starting no later than the week of April 14.
- Ensure that the assets were properly safeguarded, documented, and accounted for.
- Working through ORHA/CPA, establish and implement a mechanism to distribute U.S. dollars in emergency payments and, subsequently, wages/pensions to verified civil servants and pensioners.

With the policy decision made and the major objectives identified:

- The Secretary of the Treasury designated the Secretary of Defense with the spending authority to use, document, and account for the first portion of the vested Iraqi assets.
- The Secretary of Defense delegated this authority to the Director of ORHA and designated the Secretary of the Army the responsibility for receiving, safeguarding, documenting, and transporting the vested assets. The first portion, \$20 million, was to be transferred immediately to fund emergency payments.

The spending authority of vested assets was institutionalized:

- NSC Deputies confirmed DOD/ORHA as the Program Agency to execute spending authority and be held accountable.
- Treasury transferred spending authority to DOD or OMB, and ORHA was designated as the program entity, in installments, at the NSC approved level.
- The authority to spend the vested assets was vested in DOD.
- DOD/DFAS/Treasury/OMB established the necessary budget and accounting structure to account for the spending authority of ORHA/CPA.

#### The Cash Flow Sequence

The following cash flow sequence was initiated:

- Commercial banks transferred the vested Iraqi funds to the new Treasury Special Purpose Account at FRBNY.

- The new Treasury Special Purpose Account at FRBNY received the deposit, and Treasury's Office of the Fiscal Assistant Secretary (OFAS) was accountable for the funds.
- OFAS reported collection of the funds as a budgetary receipt.
- As required, OFAS directed FRBNY to withdraw specified amounts of cash from the account and transport them. OFAS was accountable for the cash at this point.
- The Army took possession of the cash from FRBNY's private carrier at the designated Air Force base. An Army DO was identified as accountable for the cash during transport to Iraq—accountability had transferred.
- The cash was transported by DOD to Iraq. The funds were shipped via Air Force MILAIR (in pallets), and at least two Army personnel safeguarded the funds for each flight.
- Initially, an Army CFLCC Finance Command Military DO assumed possession of the cash in Kuwait and accounted for the physical cash. Subsequently, this occurred in Iraq.
- The CFLCC Finance Command DO financial reports reflected the increase in cash liability.
- OHRA (and then CPA) was authorized to expend the cash. The cash could not be disbursed without a certification from an authorized program certifying officer, and the certifications confirmed that there were sufficient funds available to be disbursed.
- The OHRA/CPA certifying officer certified the disbursement of cash, and the Army DO disbursed cash. The OHRA/CPA certifying officer certified the account destination (e.g. a bank custody account in the Rafidain Bank).
- The Army DO reduced his accountability for the cash disbursed and, as an accounting service for OHRA/CPA, reported the total amount of the disbursement against ORHA's appropriation account—as a budgetary outlay on budget of OHRA/CPA.
- CFLCC Finance Command provided security in Kuwait and provided secure vault storage and transportation of the cash to forward distribution points in Iraq.
- The cash was delivered to the bank for deposit in a joint custody account of OHRA/Government of Iraq (GOI) for distribution based on the authorization to the bank from the OHRA and GOI.
- The cash was distributed by the bank to Iraqis, with oversight from OHRA and GOI and security provided by the military.

## **Budgetary Authority**

The corresponding budgetary authority proceeded as follows:

- An appropriation warrant was issued to the OHRA/CPA appropriation account.
- OHRA/CPA determined the amount of cash required for program activities and designed a payment distribution system.
- An OHRA/CPA certifying officer certified to the Army DO an amount of cash to be disbursed to a payee (e.g., to an OHRA account at a bank branch).
- The Army DO disbursed in accordance with the certification from the OHRA certifying officer.

- ORHA OHRA/CPA and GOI directed the bank as to who should be paid.
- OHRA/CPA maintained account records of how distributions were made and reduced balances of spending authority on OHRA/CPA books.
- Iraqis provided for receipt of funds and payment against a list of workers and pensioners, and the signed pay lists were returned to the CPA observer.

## IV. INDIVIDUAL CASH SHIPMENTS

### *Administrative Requirements*

Administratively, prior to each cash shipment, two major actions were taken.

First, the Treasury Secretary issued a memorandum designating the Secretary of Defense to perform the functions of determining the appropriate uses of, consistent with Executive Order 13290, and making payments from, the property or proceeds of any property vested in the Treasury Department in a specified aggregate amount. Seven such designation memoranda were issued between April 10, 2003 and July 14, 2003. On August 1, 2003, the Secretary authorized the Treasury Fiscal Assistant Secretary (FAS) to transfer the balance of funds remaining in the U.S. Treasury Special Purpose Account. Second, the FAS sent a letter by fax to the Senior Vice President of FRBNY authorizing and directing the conversion of a specified sum of the total amount held in the U.S. Treasury Special Purpose Account into U.S. currency for shipment to Iraq.

For the flights, DOD officials considered several military airfields before settling on the designated air base, because crews there have experience dealing with special security situations. Physical custody of the cash was transferred at the base from the armored carrier drivers to Army DOs, who accompanied the shipments to Baghdad. There, the funds were disbursed in smaller amounts and paid to three million teachers, oilfield crews, dockworkers, guards, other Iraqi government employees, and, eventually pensioners. OHRA/CPA worked with the Iraq Ministry of Finance to compile the lists from which the payments were made. Regular salary payments began the week of May 19, when 1.4 million Iraqi civil servants collected their first salaries in two months. Eventually, payments were being made on a regular basis to 1.4 million Iraqi civil servants and 1.8 million pensioners.<sup>6</sup>

### *The Cash Shipments Sequence*

The cash shipments generally went smoothly, according to the following sequence of events:

- ORHA/CPA prepared a written request to use the vested assets for presentation to the ESG and for interagency coordination with final approval by the NSC.
- About a week prior to a cash shipment, OHRA/CPA notified Treasury of the amount of cash required and when it was required.
- Treasury notified DOD, the FRB, and FRBNY and established a date for the shipment that was consistent with OHRA/CPA needs.
- Treasury and FRBNY decided on the exact amount of cash to be shipped, which was determined by the amount of cash required, the desired denominations, and the capacity of the cash bricks.<sup>7</sup>
- FRBNY notified the private armored carrier of the shipment requirements and the date.
- Treasury notified DOD of the shipment date, and DOD ensured that the MILAIR flight was scheduled.

- Early in the morning of the shipment date the private carrier arrived at FRBNY's Operations Center and loaded the cash in armored carriers.
- At the designated Air Force Base, the seals on the armored carriers were broken, the cash was counted and accounted for, and turned over by the private carrier to the Army DO. The process was witnessed by Treasury representatives, and special security was provided by the military.<sup>8</sup>
- The cash was transferred from the truck pallets to pallets configured to fit on the MILAIR plane.
- The cash was loaded onto the military aircraft and, accompanied by two Army DOs, was flown to Iraq.

The air shipment logistics were:

- The first several shipments were flown to Kuwait, and the cash was subsequently shipped by military convoy to the part of Iraq that had been secured by Coalition forces.
- After the Coalition forces had secured Baghdad, the shipments were made directly to Baghdad.
- For security reasons, the shipments were timed to arrive in Baghdad at mid-morning, so that the off-loading and shipments to Baghdad banks could be conducted during daylight hours.
- No shipments were timed to arrive in Baghdad on a Friday, since this is the Muslim Sabbath and the banks in Iraq are closed.
- The MILAIR flights were not dedicated solely to the vested assets cash; they also carried other cargo.

Between April 11, 2003 and October 17, 2003 nine cash shipments totaling \$1.708 billion of vested assets were made to Iraq. The cash weighed a total of 237.3 tons and occupied 9,363 cubic feet of space. Transportation of the cash from FRBNY to the designated USAFB required 316 pallets, 13 armored tractor-trailer trucks, and 11 armored trucks. The cash included all denominations - ones, fives, tens, twenties, fifties, and hundreds, but later shipments were largely in the higher denominations.

## **V. TRANSFERS FROM THE VESTED ASSETS ACCOUNT**

In addition to the cash shipments of vested assets, two transfers of vested assets were made in May and July, 2003:

- On May 28, \$16.2 million in Iraqi vested assets was transferred from the U.S. Treasury Special Purpose Account to the Treasury General Account at FRBNY. The funds were used by DOD to procure communications equipment for the Iraqi police force.
- On July 15, \$192.4 million was deposited into the U.S. Treasury Special Purpose Account and immediately transferred to the DFI account at FRBNY. These funds represented the final installment owed from a loan made to the UN from blocked GOI assets.

Administratively, these transfers were handled in a manner similar to the cash shipments.

## VI. VESTED ASSETS LITIGATION

From July through October 2003, shipments of vested assets cash were hindered and delayed by two lawsuits in which plaintiffs attempted to attach the funds in the U.S. Treasury Special Purpose Account:

- *Acree v. Republic of Iraq*. In this lawsuit, filed in the U.S. District Court for the District of Columbia, the plaintiffs were U.S. service members who were mistreated as POWs during the 1990-91 Gulf War and their family members. Judgments against the Republic of Iraq, Saddam Hussein, and the Iraqi Intelligence Service were obtained July 7, 2003 in the amount of \$653 million in compensatory damages and \$306 million in punitive damages.
- *Smith v. Islamic Emirate of Afghanistan*. In this lawsuit, filed in the U.S. District Court for the Southern District of New York, the plaintiffs were the estates of victims of the 9-11-01 terrorist attacks. Judgment against the defendant Republic of Iraq was obtained May 7, 2003, in the amount of \$63.5 million in compensatory damages.

Ordinarily, plaintiffs would attach the assets of their judgment debtor (in this case, Iraq) to satisfy their judgments. However, the President had already confiscated and vested Iraqi Government assets in the United States several weeks before the judgment in Smith, and several months before judgment in Acree. Plaintiffs in both cases thus tried to attach the U.S. Treasury Special Purpose Account, which was established at FRBNY to hold the liquid assets that the President had confiscated and vested in the Treasury Department. Two U.S. Courts of Appeals (in the District of Columbia Circuit and the Second Circuit) eventually denied the claims and stated that the plaintiffs could not attach a U.S. Treasury account to satisfy their judgments against Iraq. Nevertheless, these lawsuits were significant both because of the uncertainty and delay they caused the shipment of vested assets cash to Iraq between July and October 2003, and for considerations that went into the decision to establish a separate account at FRBNY for assets vested under the 8-28-03 Presidential EO (discussed below).<sup>9</sup>

These legal actions generated a series of temporary restraining orders (TROs) that repeatedly delayed the cash shipments, and in several cases caused the cancellation and rescheduling of the shipments. In several instances, the TROs were issued while the cash was actually being transported, either between New York and Washington, or between Washington and Iraq.

## VII. THE SECOND VESTING ORDER AND A NEW DFI ACCOUNT

### A New Executive Order

The President issued EO 13315 on August 28, 2003, providing for the confiscation, vesting, and transfer via the U.S. Treasury Special Purpose Account to the DFI assets of former senior Iraqi officials and their families. This EO was necessary because EO 13290 issued on March 20 vested only the blocked funds held in the U.S. in accounts in the name of the Government of Iraq and its entities. The amount of assets subject to vesting under the second EO was much smaller than those under the first EO—less than \$50 million. EO13315 specified that the assets vested under it be transferred to the DFI.

### Vesting and a New DFI Account

On November 18, FRBNY established a new, separate DFI account into which the assets vested under the August 28 EO would be deposited, and this new account helped protect the other DFI funds from risk of attachment. Treasury

then worked with FRBNY to establish the appropriate administrative and accounting procedures so that as soon as the assets were vested, they could be immediately transferred from the U.S. Treasury Special Purpose Account to the separate DFI account.

### VIII. SUMMARY AND CONCLUSIONS

The U.S. Government had to devise a strategy for paying Iraqi workers and pensioners after the fall of Saddam Hussein, and beginning in late 2002 Treasury began developing such a strategy. The strategy was eventually approved in an interagency process after extensive debate, and it recommended making temporary payments in U.S. dollars. This was not dollarizing the economy, because the strategy continued use of local currencies—such as the Saddam dinar in the center and south and the Swiss dinar<sup>10</sup> in the north—and their eventual replacement by a new national currency. It was felt that temporarily using U.S. dollars would create stability and would help prevent a collapse of the dinar.

Keeping workers on the payroll with stable purchasing power was essential to prevent severe hardship and economic collapse. However, many complex issues had to be addressed and resolved expeditiously; including:

- How many workers were there and how much should they be paid?
- What currency should be used to make the payments?
- Where would the funds come from?
- What were the responsibilities of the agencies involved, e.g., Treasury, OMB, FRB, FRBNY, DOD, NSC, State, and DOJ?
- How would the funds be transported to Iraq and disbursed?
- Would the payments system be in good enough condition after the conflict to actually make payments?
- How could hyperinflation and a sharp depreciation of the currency be avoided?

After debate at the highest levels of government, it was decided to use Iraqi regime assets that were blocked at U.S. commercial banks in 1990 during the Gulf War, and these assets had to be confiscated and vested for the use of the Iraqi people. There was \$1.7 billion that could be vested in the U.S. and it was estimated that this amount would likely be sufficient to last until a new currency could be issued in Iraq, and a vesting strategy was developed and approved by interagency legal experts. The President confiscated Iraqi assets located in the U.S. and vested them in Treasury. The Treasury Secretary then directed all vested Iraqi assets to be transferred to a new U.S. Treasury Special Purpose Account at FRBNY.

To make the strategy for paying Iraqi workers and pensioners operational, many tactical issues and contingencies had to be considered. For example, the plan required that the military in Iraq issue public statements worked out with DOD and Treasury that the dinar would continue to be accepted as a means of payment after the fall of the Saddam regime. The plan also required that the first Treasury financial advisers into Baghdad assess the payments system's capability for making dollar payments.

Another operational issue concerned the shipment of U.S. currency to Iraq, and a plan for making the payments to workers and pensioners on the ground had to be developed. It was determined that sufficient U.S. currency in the right denominations was in storage in FRBNY's Operations Center, and that it

was feasible to ship the currency by armored carriers to the designated Air Force Base, load it on military aircraft, fly it to in Kuwait, and then transport it to Iraq—eventually, cash was shipped directly to Baghdad. Nearly 240 tons of U.S. currency were involved because of the need for small denominations of one-dollar and five-dollar bills, and the military shipped the currency through-out Iraq.

Treasury financial advisors in Iraq developed lists of eligible workers and pensioners, and the U.S. currency was distributed to Iraqis who then made the payments. In some cases, the currency was paid at state owned enterprises or government ministries; in other cases, recipients came to local banks to receive payments.

This payments strategy along with all its tactical details was conducted successfully. Even as major combat operations were winding down, a mechanism for the shipment of cash and distribution of emergency payments was established and began to function. Accordingly, ORHA/CPA and the military were able to make monthly emergency payments to dock workers, rail workers, power plant workers, and others essential to restoring basic services. This soon transitioned to regular civil service salary and pension payments to more than three million Iraqis.

Despite tremendous administrative and logistical challenges, the system of payments worked well. Treasury's financial advisors in Baghdad considered this to be a major force for stability in the country, as well as a significant spur to economic growth. A total of \$1.7 billion of the vested assets was shipped to Iraq where it was used principally to support salary and pension payments, and DOD's logistical support was crucial in this enormous undertaking. By the Fall of 2003, over three million Iraqis were regularly receiving payments—including dependents, this comprised essential financial support of more than a third of the population.

Throughout this period there was no collapse of the currency, no hyperinflation, and no serious glitch in the payments process itself. This success was due in large part to pre-conflict planning and to adjustments that were made as the U.S. government implemented the plan and learned from experience. Specifically, from the beginning Treasury's goals were to:

- Use vested assets to make emergency payments to Iraqi civil servants in essential industries
  - Ensure that these payments were made as soon as possible
  - Ensure that the assets were properly safeguarded, documented, and accounted for
  - Temporarily make emergency payments in dollars
  - Determine dollar payment amounts equivalent to pre-hostility civil servant compensation and pension payments
  - Initiate regular salary payments to civil servants and payments to pensioners, and discontinue emergency payments
  - Eventually transfer payments systems and administration to Iraqis
- These goals were achieved, and the shipment of cash to Iraq required:

- Establishing the mechanism for the transfer of funds
- Developing the appropriate accounting and accountability procedures
- Coordinating among staff at FMS, OMB, DOD, State, FRB, FRBNY, Treasury OGC, NSC, and DOJ

- Overseeing the shipments out of the designated AFB
- Securing the cash in Iraq
- Making the payments to Iraqis
- A variety of other related tasks

This program was a success:

- Despite the formidable obstacles involved, the first emergency shipment of cash was delivered and was being disbursed to Iraqis barely three weeks after the conflict had started and while hostilities were still underway.
- Nine cash shipments totaling \$1.7 billion were been made from the U.S. to Iraq between April 11 and October 17, 2003.
- A mechanism was established with DOD, DFAS, and OMB for budgeting, accounting, and safeguarding the cash.
- Over three million pensioners, civil servants, and workers crucial to the functioning of essential public services received emergency and salary payments, and these payments were eventually being made on a routine, monthly basis. Payments were also made to ex-soldiers and for reconstruction purposes.
- No fraud or theft occurred.
- Appropriate public affairs campaigns were instituted

The vesting of Iraq assets, converting these into cash, shipping the cash to Iraq, and disbursing payments to millions of workers, ex-soldiers, and pensioners was an extremely complex, difficult, challenging task. It required extraordinary cooperation and coordination between many different federal agencies in the U.S. and in Iraq. At a time when federal agencies are accused of not talking to each other and of failing to work with each other, and bureaucratic red tape is blamed for making it impossible to get anything done, this initiative stands out as a stellar example of a critically important interagency federal financial management policy that actually “worked.”

## End Notes

1. The DFI was established by UN Security Council Resolution 1483 on May 21, 2003. It was managed by the CPA, in consultation with the Iraqi Governing Council, the Iraqi Minister of Finance, and the Governor of the Central Bank of Iraq. The DFI was held on the books of the Central Bank of Iraq and the corpus of the DFI was held in the account at FRBNY for the Central Bank of Iraq.

2. The amount of blocked Iraqi assets in the U.S., reported to OFAC in a census conducted in early 1991, was \$1,261 million. In March 2003 \$1,916 million was vested under EO 13290, \$120 million was paid out to claimants, and another \$61 million in various property remained blocked.

3. OHRA was redesignated as the Coalition Provisional Authority (CPA) in June 2003. The CPA ceased to exist when power was transferred to the government of Iraq in June 2004.

4. Some early salary payments were made in local currency. That was a key decision because it implied to Iraq that the Coalition was supportive of the local currency, and it was important that the local currency not lose its value. However, this was not an option for the later payments, because the required dinars were not available.

5. This included emergency payments in Coalition controlled areas and emergency payments nationwide, as necessary, with declaration of a permissive environment.

6. Initially, to facilitate exchanging the U.S. dollars for dinars, small bills were sent—primarily ones, fives, tens, and twenties. But after the exchange system proved capable of absorbing larger denominations, these were used instead. The first shipments also used a combination of old and new currency. However, the old bills were packed in canvas bags, which were more difficult to stack than the shrink-wrapped bricks of new currency. Thus, subsequently only new bills were sent.

7. For example, an OHRA/CPA requirement of \$100 million in cash may have required an actual shipment of \$100,008,000 to fit the desired denominations into the cash bricks.

8. Senior staff from Treasury, FRB, OMB, and DOJ often attended the cash deliveries to witness the cash arrival and transfer to the military aircraft.

9. With respect to both lawsuits, Treasury/DOJ followed a two-pronged approach. On the one hand, the Government fought vigorously to have the courts' decisions overturned so that the U.S. Treasury Special Purpose Account was not attached and the cash shipments to Iraq could continue. However, the Government followed a relatively conservative approach to actually shipping the cash while the matter was in litigation—even though shipping the cash was legally defensible. This more conservative option gave the courts ample time to consider the pending motions and to carefully review the submissions. The conservative option was considered by DOJ/Treasury staff to be optimal, because it was felt that the more time the Court of Appeals had to consider these issues, the more likely it was to deny even interim relief. This was the strategy followed, even though, in several instances, it required temporarily postponing scheduled cash shipments to Baghdad.

10. These are dinars that circulated in the Kurdish region, and they were originally printed in Switzerland.



# Practical and Conceptual Transition Problems of Accrual Accounting in the Public Sector

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## Introduction

Hughes and Minovski (2004) have laid out a plan for implementation of the international public sector accounting standards in developing countries and economies in transition. This plan has identified six steps for implementing the accrual IPSASs (see Hughes and Minovski, 2004). However, the transition to accrual accounting in the public sector encounters several major problems. Some of these problems are likely common for both developed and developing countries and some others are more confined to the developing countries. The latter emanates as a corollary of prevalence of a certain political, bureaucratic and socioeconomic environment in the developing countries (these problems have been called additional transition problems). The last issue of *Public Fund Digest* has dealt with the additional transition problems (Ouda, 2005). Accordingly, this article identifies the common practical and conceptual transition problems to accrual accounting in the public sector of both developed and developing countries and deals with the nature of these problems and means of handling them. Bear in mind that the main focus here is to shed light on these problems more than to present ready-made solutions for them. As the best way to tackle them will depend on many factors such as the prevailing circumstances in each country, degree of development, management and political systems and accounting and budgeting systems used.

## 1- Practical transition problems

### - Legal problems

Some of the practical problems that preclude the transition to accrual accounting in the public sector are legal in origin (United Nations, 1984). For example, most of Government Accounts and Budget Acts do not actually use the word accrual. Namely, these Acts do not clearly require the government accounts to be maintained on an accrual basis. Then, there is a lack of legal pressure, which is essential to push the governing bodies to think about its implementation or to take the required actions for that implementation. For instance, the Dutch Government Accounts Act of 1976 (including the latest adjustment of April 12, 2001(seventh adjustment) and January 17, 2002 (eighth adjustment)), with the exception of the agencies, has stated that central government accounts should be maintained on a commitment-cash basis. Another example, the Egyptian Government Accounting Act NR 27 of 1981, with the exception of investment budget, has stated that the government accounts both local and central should be maintained on a cash basis. Consequently, the absence of legal pressure can be considered as an obstacle of the transition to accrual accounting.

In addition, the inflexibility of the legal system plays an essential role in creating implementation barriers. Professor Lüder made this point clear in the Comparative Study 1989. He stated that in the countries with Roman-Germanic traditions, such as Germany and France, public sector accounting principles and procedures are laid down in details by law. On the other hand, in the countries belonging to the English traditions such as the United Kingdom, United States and Canada, there are only general legal prescriptions for the keeping of public sector accounts (Lüder, 1989). Then the legal system of countries that belong to the Roman-Germanic traditions (civil law) is less flexible than in countries with the English legal traditions (common law). As a result of its built-in inflexibility, the legal system of civil law countries offers greater impediment to changes to the public sector accounting system than the legal system of common law (Lüder, 1992). Generally speaking, the legal systems of developing countries can not distinctly be classified as a common law or civil law. The laws of many developing countries embody elements of different legal systems. In other words, the laws in these countries are a mix of different legal systems such as France Napoleonic Code, Common English Law, Civil Law, etc. This is due to the fact that the legal systems of most of the developing countries are heavily influenced by former colonial powers whose culture may be overwhelming. Consequently, when explaining the legal systems of many African and Asian countries, it may be more efficient to look at the colonial history rather than at other possible causes. Thus, this legal mixture may offer extra impediments for the transition to accrual accounting. It is also worthwhile to mention that the nature of the standards setters plays a significant role in making the legal system flexible or inflexible. The practice has demonstrated that if the public sector accounting standards had been set by professional body or by the government together with the professional body, this would have resulted in flexibility of the legal system. This is the case of New Zealand, UK and Australia. For instance, the New Zealand Society of Accountants has played an essential role in developing the public sector accounting standards. In this regard, Pallot (2001) stated that the existence of a single professional body, with a single body of knowledge and a single set of accounting standards applied to all sectors, facilitated the movement to accrual accounting. On the other hand, if the public sector accounting standards had only been set by the government, this would have resulted in inflexibility of the legal system, for example, the case of France and Germany. Basically, the design of the legislation is a key element of the transition to accrual accounting in the public sector since the laws and regulations describe the nature, scope, technical standards and procedures of the accounting system to be implemented. The New Zealand experience has revealed that the legislation, which was passed in early July 1989, has required departments to develop accrual accounting systems. It gave departments two years to move from their existing situation to the new full accrual basis (Ball, 2000). Thus, setting a deadline in legislation for the introduction of accrual accounting in the New Zealand public sector had a tactical advantage in that each department felt, or was made to feel, that it had to successfully implement resource accounting on time to avoid holding up the collective project (Pallot, 2001). In addition, legislation to regulate detailed administrative processes should be avoided. It is important that the accounting legislation be fairly general and flexible in nature, and it should provide the discretion to be used by those entities entrusted with making an interpretation and assessment of the financial data. (United Nations, 1984). This in turn will remove the incentives to undertake changes slowly.

**- Cost of designing and installing a new accounting system (including the technical problems)**

The implementation and operating of an accrual accounting system usually requires some changes that entail additional processing costs. In the majority of cases, these costs have been used as an argument by governmental entities in an effort to oppose its implementation. In fact, the transition to accrual accounting in the public sector will require that the old systems should be developed or changed in order to be valid for the new changes. In this context, there is a need to develop the hardware and software systems. This will include the purchase of new computer systems. The new computer systems will not operate without a sophisticated software package. Of course, this will result in an increase of technical costs. Even though the costs of the development of the hardware and software systems can be considered as a transition problem, the development process in itself forms a technical problem since the development of hardware and software systems is not an easy task in particular for the developing countries. These countries are not only suffering from the lack of financial means but also from the lack of technical skills. In this context, the developing countries need both financial and technical support from the international institutions in order to be able to adopt accrual accounting in their public sector. In fact, the cost of adoption of accrual accounting is not confined to the technical costs but also encompasses the cost of development of the accounting procedures and of series of new accounts and supplementary accounts or records to serve specific purposes. Moreover, the development of the hardware, software and accounting procedures will make the development of financial skills inevitable and this may result in an increase of personnel costs. Thus, the adoption of accrual accounting in the governmental entities entails a complete reform of accounting practices, careful planning, and the issuance of appropriate instructions, as well as attention to be paid to the qualified accounting personnel and relevant training programs, which, in turn, will increase the total implementation costs. However, the adoption costs can be minimized by making use of similar software packages used by the private sector (with some modification). And also by making use of the accounting policies used by other similar entities such as the local governmental entities. In addition, learning from the earlier reformer countries like New Zealand will push down the adoption costs of accrual accounting.

**- Lack of qualified government accounting personnel**

As in the governments of all countries, well-trained and motivated accounting personnel is a basic requirement for ensuring effective use of resources. Effective financial management requires not only a sound policy/legal/regulatory framework and good systems, but also qualified human resources. However, one of the most common problems that encounter both developed and developing countries is the lack of qualified accounting personnel, especially in the government accounting field. In reality, this is a natural consequence of accounting education systems that are followed by different countries. For instance, the accounting education system of some countries is confined to teaching the accounting (whether in the private or public sector) at a basic level (at bookkeeping level) and keeping the advanced studies in accounting only for the high studies such as Master degree. This is the case of most of the developing countries (e.g. Egypt). Traditionally, in many developing countries the great volume of government accounting effort has been in the bookkeeping area. At the universities, government accounting subjects have been introduced into undergraduate accounting courses, generally as final-year one semester selected topics. These selected topics are designed to give students an appreciation of

how the different objectives of government have resulted in an accounting system different from that in the private sector. In fact, these subjects are confined to the bookkeeping area and they do not emphasize the current developments and issues in government accounting e.g. the question of annual reporting standards for governmental entities and modernizing the government accounting system. On the other hand, sustainable development of accrual accounting in the public sector calls for specific accounting skills and cannot effectively be pursued with the help of the accounting personnel that is merely literate at basic level. IFAC (2000) stated that the actual costs of adoption of a particular basis will depend on the existing capacity of personnel in terms of experience and training, and the reliability and completeness of existing systems. Additionally, the adoption costs will be influenced by the nature of the accounting system. If the accounting system is intended to collect information for both internal and external reporting then it will need to be more extensive. In addition, in many developing countries the auditing and accounting services are under-staffed, under-skilled, under-regarded and under-paid. In other countries, the accounting education system is merely focused on the commercial accounting system and not on the government accounting system. This means that there is qualified and sophisticated accounting personnel but they hardly know anything about the government accounting system. This is the case of Germany, the Netherlands and Sweden. Therefore, the education systems that are followed by most of the countries have resulted in an increase of the scarcity of personnel with advanced knowledge in the government accounting field. Consequently, one can infer that the accounting education and qualification systems play an essential role in creating the problem of the lack of qualified accounting personnel in the public sector. Even though the lack of accounting skills found its roots in the low educational levels, it appears to be due more to the lack of suitable training and poor supervision than low educational levels (<http://www.un.org.pk/rgp/pubsec-countries.htm>). Essentially, the successful transition to accrual accounting can not take place, whether in part or in full, without appropriately trained accounting personnel. Accordingly, the lack of qualified accounting personnel can likely be overcome by:

- allowing for the flow of private sector talent and experience to the public sector, namely, recruitment of new staff who has already had experience with the use of accrual accounting;
- designing an appropriate and adequate training program for the old staff. Actually, the training programs need to focus on more than accounting skills; namely, it is not sufficient for the personnel to master the technical aspects of accrual accounting and information management, but they must understand the reasons and the background of its implementation, as well as the rules, the policies and the new norms of the government (IFAC, 2001);
- use of consultants to assist in designing and implementation of accrual accounting;
- reconsidering the accounting education and qualification systems in order to avoid the repetition of this problem in the future; and
- designing an exchange program between the government and private sector that allows for the public sector accounting personnel to share experiences and knowledge.

**- Lack of Generally Accepted Government Accounting Standards**

Unlike the private sector, the public sector entities follow widely diverse financial reporting practices, and in many countries, there are no authoritative standards for the public sector. In some countries where standards do exist, the

body of standards may be either at an early stage of development or limited in application to specific types of entities in the public sector (IFAC May, 2000). This conclusion of IFAC can be sustained through inducing the practice, where it has been noticed that the public sector throughout the world is using a variety of accounting methods, ranging from cash, modified cash, modified accrual to full accrual accounting. Countries that are using or moving rapidly towards full accrual accounting in the central government include New Zealand, United Kingdom, Australia, and Canada. The countries that are moving towards modified accrual accounting in the central government include the Netherlands and the United States. Most of the rest of the world would be between cash and modified cash, including most Continental European countries, Asian countries, African and South American countries. The pure cash basis is probably not really used by any one (Morphett, 1998). The widely diverse financial reporting policies and practices have usually been developed in an ad hoc manner around the need for short-run budgetary control and the need to assess the impact of the cash deficit on the economy (Bradbury, 1998).

On the contrary, the private sector entities throughout the world are using the commercial accounting system and there exist the International Accounting Standards (IASS); namely, the accounting policies which include the specific principles, bases, conventions, rules and practices that are developed for business enterprises. Therefore, it is harder to find in the private sector entities the same diversity that exists in the public sector entities.

However, the existence of widely diverse financial reporting practices in the public sector entities is due to the use of different legal systems and the absence of Generally Accepted Government Accounting Standards. As a consequence of the absence of Generally Accepted Government Accounting Standards, there are many outstanding accrual accounting issues (e.g. reporting entity, infrastructure assets, etc.) which make the matter difficult for many countries to adopt accrual accounting in their public sector. Another consequence of the absence of these standards is that the information needs of users of general-purpose financial reports and the significance of full and transparent disclosure about financial position and financial performance are rarely addressed (Bradbury, 1998). In reality, the influence of the absence of these standards is significant for the developing countries that are not able to set the required accounting policies that should be adopted in their public sector. Usually, they do use the International Accounting Standards as their national standards. Yet, the developing countries feel that they are excluded from the creation of international standards and they are often expected to comply with standards that go beyond their technical and financial capacity. But in the countries most responsible for their production, the national requirements in each country continued to dominate (Jones, 2000). Therefore, the prescribing of accounting standards, principles and practices (accounting policies) that are consistent with the public sector context is an essential step for the successful transition to accrual accounting in the public sector. This is because accrual accounting is more judgmental than cash accounting and requires a more sophisticated regulatory framework. Furthermore, the early focus on accounting policies is significant as they can have an impact on the requirements of information systems, training strategies and communications strategies (IFAC, 2001). Therefore, the lack of well-prescribed accounting standards, principles and practices, which take into consideration the requirements of other related systems and strategies, will be considered as implementation barriers of accrual accounting. So the problem of the absence of Generally Accepted Government Accounting Standards can be overcome by:

- the use of experience of the countries which have already developed accounting standards for their public sector. These countries include New Zealand, UK, Australia, Canada and USA.
  - the use of International Public Sector Accounting Standards (IPSASs) developed by IFAC.
  - the use of Generally Accepted Accounting Practices (GAAP) adapted where appropriate to take account of the public sector context.
- Resistance to change and the absence of the right incentive system**

A common hurdle that faces the transition to accrual accounting in the public sector is the resistance to change. First of all, we would like to ask: are people against change? In general, we can say that people are not against the change. Basically, this depends heavily on the influence of that change on people's position, since people can positively or negatively be affected by the change. Logically, people who are positively affected by the change will support it. On the other hand, people who are negatively affected by the change will continue to oppose it. However, it is common for resistance to change to come from officials who are comfortable with the old system. Therefore, they are entrenching the status quo to strengthen their positions and power. Often, they are able to do this because they have been in their position for decades. In other words, the lack of dissatisfaction regarding the old or current system is seen as a problem. People who are entirely complacent about the status quo will not devote their time and attention to the accounting changes and related issues. In fact, during the transition process, dissatisfaction is an important driving force, even a motivator. Accordingly, when governing body, administrators and accountants are not satisfied with the current traditional government accounting and budgeting system, this will generate the required incentives and motivations for the change or the transition to an improved accounting and budgeting system. Also, it is expected that the resistance to change will come from the lazy people who do not like to be burdened with the additional work that is involved in the change process. It will also come from the people who try to avoid displacement and suffer the consequences of lost employment and income. Apparently, these are some of the patterns of the people who are against the change. In addition to the resistance to change, the lack of the right incentive system is also considered to be an implementation barrier. The departmental heads, chief executives and financial managers will oppose the transition to accrual accounting when such transition is not in their interest. Therefore, it is important that they see that they will obtain some benefits in order to underpin the transition to accrual accounting. So the question is: how do governments handle the unwelcome changes?

Firstly, governments should put in key positions the people who are reform minded and would like to see the system successfully implemented. This can take place by transferring the key bureaucratic directors and directors, and appointing new ones.

Secondly, creating a case of dissatisfaction about the current situation (about the cash accounting and traditional budget) can assist in getting the people to change their behavior towards the transition process.

Thirdly, holding workshops, seminars, and classes and promulgation of articles and booklets explaining the benefits that can be obtained from the transition to accrual accounting in the public sector.

Fourthly, setting an appropriate incentive system that makes the officials to be motivated to the change process and to change their habits and attitudes that

often do not shift as rapidly as the systems themselves. So constant reinforcement of the needs to change—and of the rewards from change—is necessary.

#### **- Absence of external pressure**

In connection with the aforementioned problems, there is another problem related to the demands by the governing, legislative and oversight bodies for data from the annual closing as supporting material in budgetary process. Namely, so long as there is no external pressure on the governmental entities to provide information from accrual based final accounts, interest in working on implementation of accrual accounting principles will remain low (United Nations, 1984). Basically, the governing, legislative and oversight bodies are focusing on the information that is currently provided in accordance with the applicable laws and regulations which specify the types and timing of financial information that they are entitled to receive.

In connection with the laws and regulations that are applied in countries that are using the traditional government accounting the governmental entities are required to provide information on:

- whether resources were obtained and used in accordance with the legally adopted budgets;
- whether resources were obtained and utilized in accordance with legal and contractual requirements; and
- about how the governmental entities finance their activities and met their cash requirements (IFAC, 1991).

Accordingly, they are not requested to provide more information, for instance, on total assets, total liabilities, revenues, expenses, and net worth. Therefore, they do not see any reason or motivation to adopt another accounting system, especially when they are not required to do that. Hence, resistance to the transition to accrual accounting is expected to continue from the governmental entities. Thus, the absence of the external pressure (from governing, legislative and oversight bodies) could in part account for the governmental entities lack of enthusiasm to pursue the implementation of accrual accounting. The absence of external pressure is due to the fact that the governing, legislative and oversight bodies are not able to identify the information that should be provided to them; hence, they can not assess the importance of the information that has not previously been provided. Therefore, it is vital to demonstrate for these bodies what additional information can be derived from accounting data on an accrual basis compared with cash basis accounting data. For instance, the information on whether the governmental entities have managed their assets and liabilities efficiently and effectively is more important than only cash information. Furthermore, with increasingly scarcity of resources to work with, both the governmental entities and the previously mentioned bodies need a basis for operations that will enable them to analyze costs and effects more accurately than before, and to assess in which areas resources should be increased or decreased, relative to the present situation. So the external influence/pressure, coupled with demands for relevant information, should help to promote in the governmental entities a greater awareness of the advantages of accounting on an accrual basis (United Nations, 1984).

#### **- Bureaucratic management culture**

In comparison with the earlier discussed problems, the change of the bureaucratic management culture is considered to be the most difficult one. Because the change of bureaucratic management beliefs, attitudes, rituals and symbols is not an easy task and can take a long time. Basically, achieving a fundamental

culture change can be a lengthy and complex process. Therefore, the change of management culture should be addressed as early as possible, namely, as part of the transition process. In fact, it is difficult to change the bureaucratic management culture that is based on risk-avoiding behavior which is focused on adherence to procedures. Namely, it rewards compliance and creates incentives to avoid risk; having little freedom and less accountability; it is also associated with long organizational hierarchies and limited delegations and with time insensitive. This system is called traditional bureaucratic model of management (or public administration system) (Keeling, 1972). Scott (1996) has argued that while such a system is incompatible with a quest for improved performance, it has long been an extraordinarily successful and durable model of public administration. Public administrators around the world seek greater freedom but they are less anxious to seek greater accountability. Accordingly, it is difficult to change the culture of the public administrators to accept greater accountability and maximum delegations, to be associated with short hierarchies and time-sensitive and risk-accepting behavior and to focus on results not procedures. Of course, the change of the bureaucratic management culture is still very difficult because the public administrators have been practicing this kind of culture for decades and it became one of their traditions and beliefs. In this context, there is a definite psychological resistance to any attempt to change their culture. On the other hand, under the traditional bureaucratic model of the management, the public administrators are not accustomed to use the improved financial information. Consistent with the traditional bureaucratic model philosophy, the improved financial information is not required. Therefore, in view of the public administrators, improving the financial information, as a consequence of the transition to accrual accounting in the public sector, is meaningless. Then, the public administrators will be unwilling to accept the advantages of accounting on accrual basis. Therefore, in order for the governmental entities to be able to adopt accrual accounting, there should be a change from a reliance on input-oriented, risk-adverse, control-oriented behavior patterns of bureaucratic management to more flexible, responsible, result-oriented behavior. This is a change of management culture which is often described as the managerialism or new public management (Hood, 1995). Scott (1996) argues that if a country has already made a commitment to a results-based management system that explicitly specifies the objectives of a government entity, the adoption of the accrual accounting system and the application of modern cost accounting principles will improve a government's ability to assess the costs of achieving those objectives. On the other hand, the expense of installing modern management accounting systems is hard to justify in an environment where performance objectives are not properly specified. In fact, the problem of the change of the bureaucratic management culture can to some extent be overcome by:

- allowing for the flow of the private sector management talents to the public sector;
  - introducing a new system of appointing and remunerating senior public servants; and
  - motivating the public administrators to give up the old way of bureaucratic thinking and to be committed towards the new improvements.
- Lack of internal consistency (organizational characteristics)**

The lack of internal consistency during the implementation of accrual in the public sector entities is one of the most important practical problems that most of the writers have agreed and emphasized on (see for example, Lüder 1992, Ball 2000, Scott 96 and Mir, Gaffkin and Lodh, 1999). Some of them have called

it an organizational implementation barrier (Lüder, 1992). Others have frankly called it an internal consistency problem (Ball, 2000). However, if the public sector entities have been requested to implement an accrual accounting system without an internal consistency framework between each other, this may result in a doubtfully successful implementation of accrual accounting. This is because the lack of internal consistency may result in development of different accounting procedures and practices; and may give rise for treating the arising problem differently and apart. For example, the definition of policy analysis varied across departments, which caused confusion when politicians interrogated the system as to total expenditure on the policy analysis category (Scott, 1996). In addition, this will result in delaying the implementation process itself. Prof. Lüder (1992) has argued that the decentralization of responsibility for changes of accounting practices in the government seems to be an important organizational implementation barrier. In a government with several organizational units exercising responsibility for the development of accounting procedures, there exists the risk that strongly diversified—and nonuniform—accounting systems will develop. Furthermore, those organizational units may have different ideas of what and how to change and thus get into conflict with each other (Lüder, 1992). So, in the absence of the internal consistency, one can infer that when each department and agency is responsible for the development of its accounting practices, this will hinder the development of a harmonized/consistent government accounting system within the governmental entities. Therefore, it is essential that the implementation of accrual accounting within the governmental entities should be undertaken by adoption of a consistent approach across the whole government. Ball (2000) has also demonstrated the significance of internal consistency, as he stated that internal consistency can, perhaps more than anything else, explain the successful implementation of such a radically new system of public financial management. In New Zealand, the chief executives and ministers understood their respective roles in the system and there was a clear framework for resolving detailed implementation problems as they arose. This kept participants in the reform process from being side-tracked by inconsistent decisions or policy resolutions. Perhaps the main reason underlying the successful internal consistency in New Zealand is that New Zealand has had a special situation. New Zealand has suffered from an economic crisis (almost bankrupt). This has created a feeling of responsibility for all the government members that they have to do something to pass this crisis. Accordingly, this induced the government to undertake a program of economic reforms and all government members (chief executives and Ministers) understood their respective role in this program and they supported it. However, in order to assure the desired internal consistency, the Ministry of Finance and the associated accounting institutions should develop the accounting rules, procedures and practices that have to be followed by the whole of governmental entities during the implementation process and coordinate the development of uniform definitions. On the other hand, this is not to say that the Ministry of Finance should direct the detailed accounting practices of individual departments, instead it should coordinate the development and implementation processes. Moreover, there should be training programs to promote the understanding and use of these rules and procedures. Actually, giving the need for internal consistency throughout the whole of governmental entities, such training programs are necessary. Especially, if the government encompasses different governmental entities such as departments, agencies and local entities.

### - Lack of political commitment

No doubt that the international experience with respect to the transition to accrual accounting in the public sector has proved that the political commitment is an essential factor in creating a climate fit for the adoption of accrual accounting. Furthermore, this experience has revealed that the public sector reform, including the accounting reform, was a product of a marriage between the political and bureaucratic interests. For instance, the UK Financial Management Initiative and American and Canadian practice of increasing ministerial authority and accountability inspired greater ministerial decision making in budgetary management. The financial management and budgetary reforms were in the interest of both politicians and bureaucracy. Thus, it blended with minister's desire for a system to put them in strategic control of their departments. In addition, it blended with the desire of bureaucracy to unshackle itself from the administrative rigidities (Xavier, 1998). In addition, the existence of the political commitment can assist to a great extent in diminishing the resistance to change. Ball (2000) argued that the political commitment for the reforms created a climate in which chief executives saw little advantage in seeking to delay or impede the reforms, and instead worked towards their successful implementation. Therefore, we see that the lack of the political commitment will make the implementation of accrual accounting in the public sector almost impossible, in particular in the countries where non-democratic political systems dominate. So the existence of the mutual interests of both politicians and bureaucracy will make the adoption of accrual accounting a reality. Assume that there are no mutual interests between both of them, then the question is: is it possible to adopt accrual accounting in the public sector? Especially, when the government is not inclined to be open with its public by limiting the amount of the information it reveals about its own performance. In general, the absence of the mutual interest of both politicians and bureaucracy will of course make the transition to accrual accounting more difficult. But on the other hand, there are two external pressure factors that can affect the transition process in spite of the absence of those mutual interests. These two factors are:

- 1- The impact of the international organizations such as the International Monetary Fund (IMF) and the World Bank. Such organizations can have major impact on making the accounting reform possible. Agencies, such as the International Monetary Fund and World Bank can act directly as change agents (Husain, 1993). Structural Adjustment Policies promoted by IMF act as a direct stimulus to social, economic and political change and innovation in many countries (Godfrey et al, 1999). This is the case of the developing countries and transitional economies. In developing and transitional economies a more direct impact can be observed where international organizations require particular accounting reforms to be effected as a sine qua non of assistance being funded (Godfrey et al, 1999).
- 2- The impact of public through what Lüder called as "Market for votes". Where the political competition in tendency causes an endeavor and readiness to achieve a more informative system of governmental accounting given the interest of users (public) in additional or improved information (Lüder, 1992). This is the situation of United States.

So the aforementioned factors can offset/overcome, to some extent, the absence of the mutual interests by creating the required political support under the pressure of the international organizations and market for votes.

### **- Lack of communication about the change process**

The lack of communication about the accounting change process can result in delaying or impeding the transition to accrual accounting in the public sector. Laughlin (1991) in his skeletal models of organizational change points out that during the organizational transformation a schizoid organization is clearly possible. The schizoid situation often takes place at the initial stage of the change. The communication about the change process can help to overcome the schizoid situation or to make it not to persist long. New South Wales (NSW) experience concerning the public sector reform process has given a clear example on the vital role that the communication about the change process can play. The communication on the transformation process has assisted the NSW agency of Department of Public Works and Services (DPWS) in its attempt of adopting several new management and financial practices. Mir et al (1999) stated that staff in the DPWS was given adequate training in the change process and education on the implication of various changes implemented in the DPWS. During the critical time of its transition phase, especially at the initial stage, all staff were provided with regular Communications Bulletins which advised of the implementation progress, and the designated agents answered staff questions on a regular basis. Also Mir et al (1999) mentioned that the communication process was (and still is) particularly important in introducing the commercial accounting and new management systems. During the four-year period (1988-1992) in which the package of financial reform was introduced, a comprehensive program of training was conducted for both the users and preparers of accounts (Mir et al. – <http://panopticon.csustan.edu/cpa99/html/mir.html>).

Thus, the communication on the transition to accrual accounting in the governmental entities is fundamental since it provides the staff with a well-articulated transition framework and provides answer to several questions during the critical time. The significance of the communication about the change process seems to be vital particularly in the initial stage. There is a proverb which states that “one has to learn to walk before one can climb mountains”. Therefore, it should be clear, from the outset, for the staff participating in the transition to accrual accounting to know:

- what kind of changes they are required to achieve;
- what the implications of these changes are;
- what the related changes are, etc.

Basically, they should be well posted in, and have a full and comprehensive program about the change process. The importance of communication in the change process is also emphasized and documented in many other studies (e.g. Laughlin 1991b; Tanzer, 1993; Dixon and Kouzmin, 1994 and Lucio et al., 1997).

### **- Lack of information technology capability**

In the absence of information technology capability, it will be difficult to assemble the information required and provide the information necessary for efficient management of operations (Hepworth, 2001). In addition, it results in that accounting system relies on a slower and more cumbersome paper-based system. This in turn can hamper the main aim of the transition to accrual accounting which is timely providing improved information that can assist in decision making process. In reality, there is no striking difference between the developed and developing countries with respect to the significance of the information technology capability for successful transition to accrual accounting in the public sector. As Luder and Jones (2003) argued that the introduction of accrual accounting is unthinkable without availability of an appropriate and affordable standard software. This is not only valid for the developed countries

but also for the developing countries. However, the difference may be found in the starting point. Unlike the developed countries, the accounting work is still being done manually in the developing countries. In this regard, the developing countries will almost start from scratch, namely, they have to build entire software and hardware systems. In fact, this will require huge amounts, which in most of cases are beyond the capacity of the developing countries. Taking into consideration that the developing countries are suffering from the lack of both financial means and technical skills, building of the information technology capability may require both financial and technical support from the international organizations.

#### **- Shortage of financial resources**

Finally, the financial resources are badly needed to overcome most of the previously stated practical transition problems and to help in achieving the requirements of the accounting changes. In fact, the practical transition problems such as cost of designing and installing a new accounting system; lack of qualified accountants; and resistance to change, etc. require sufficient financial means to be overcome. In the absence of the financial resources, these problems will remain unsolved, which in turn will preclude the implementation of accrual accounting. However, the developed and developing countries are not sharing the lack of financial resources problem to the same degree. While the lack of financial resources does not seem to be as a big problem for the developed countries which have sufficient financial means that enable them to meet the requirements of the implementation process, it appears to be as a crisis for the developing countries which usually attribute their failure of getting accrual accounting adopted in the public sector to the lack of financial resources. Although not necessary to the same degree, all developing countries share constraints in financial resources and all these countries face the problem of the insufficiency of financial resources relative to the enormity of the tasks to be accomplished. Increasingly, the lack of financial resources has undermined the ability of developing countries to revamp their public sector. Many of these countries simply do not have the financial means to meet their domestic and international obligations without adequate financial and technical support from the international community. Consequently, overcoming of the lack of financial resources may require international aid.

## **2- Conceptual transition problems**

In addition to the practical barriers, the conceptual barriers also offer greater impediment to the transition to accrual accounting in the public sector entities. The conceptual transition barriers are concerned with the principles that underlie the system of accrual accounting. These principles are basically directed towards the business enterprises. Accordingly, there is a firm belief within the governmental entities that these principles are more valid and applicable to the business enterprises than the governmental entities. This, in turn, make the governmental entities oppose or disregard most of the attempts that have been made to adopt accrual accounting in the public sector. Some of the conceptual problems, which can be considered as an obstacle or impediment for transition to accrual accounting in the public sector, are as follows:

- Identification and valuation of the existing physical assets, for example:
  - infrastructure assets;
  - military assets;

- heritage assets;
- community assets; and
- natural resources.
- Identification of governmental reporting entity and its boundaries;
  - Pension liabilities;
  - Sovereign revenues (e.g. tax revenues);
  - Provisions;
  - Capital charging;
- Ambiguity around some of the accrual accounting principles and postulation which have given rise to a heavy debate about how can they be applied to the public sector, such as:
  - matching principle;
  - realization principle; and
  - going concern.
- Increasing of inflation rates that can create difficulties regarding valuation of governmental assets and liabilities; and
- Lack of profit motive.

In connection with the implementation plan of Hughes and Minovski (2004), on the accrual IPSASs (where most of these barriers have been tackled) and the Paper of FEE published in the last issue of Public Fund Digest, this section will only deal with both lack of profit motive and the increasing of inflation rates which can create difficulties regarding valuation of governmental assets and liabilities as follows:

- Lack of profit motive

Governmental entities exist in a legal environment. Their abilities to collect and spend money on behalf of citizens are derived from legislative authorization (Wescott, S. and Chang, S. 1992). Usually, the governing body prepares its financial plan or budget. After this budget is approved by the legislative body, the governing body is responsible for execution of the budget. In addition, the prices of goods and services produced by the governmental entities often are set by policy rather than by forces of supply and demand. Therefore, the revenues resulting from the sale of goods and services by governmental entities do not necessarily reveal the demand of users for these goods and services. In addition, costs cannot be compared to earned revenues to determine whether the operating costs of the governmental entities are at an acceptable level (Ingram et al, 1991). On the contrary, business enterprises must operate in a market environment and accounting reports for these enterprises focus on the profitability and acquired resources of these entities. Whether the resources are being managed efficiently and effectively can, in part, be assessed by the owners by examining the earnings performance of the business (Ingram et al, 1991). Therefore, the use of accrual accounting in these entities is essential. However, there is a striking difference between the governmental entities and the business enterprises since the profit motive is not inherent in the governmental entities operations as a consequence of the lack of the market forces, and their operating procedures and policies are heavily influenced by legal and political constraints and issues. Thus, unlike business enterprises accounting and reporting,

demonstration of compliance with laws and regulations and /or political agendas is a major objective of governmental accounting and reporting. Consequently, it is logical for the governmental entities to derive that the accounting system, which is used by the business enterprises, will not be suitable for them. Namely, the lack of profit motive in governmental entities has been often given as a reason why accrual accounting is unnecessary. Accordingly, there are no sustainable reasons or motivations, from the governmental entities point of view, even to think about its implementation in these entities. Therefore, one can infer that the lack of profit motivation was/is one of the reasons for not adopting of the accrual accounting system in the public sector entities.

However, the opposite is probably more true. The need to minimize costs where the profit motivation does not exist actually makes the accrual basis more necessary and valuable (United Nations, 1984). The minimizing of the costs is not the only reason that makes the use of accrual accounting in the governmental entities necessary but also the other benefits that can be obtained from the adoption of accrual accounting such as: (Ouda, 2003)

- improving the financial reporting by the government;
- presentation of a full picture of the financial position of the government;
- providing information on the total costs of the government's programs and activities;
- better assets and liabilities management by the government; and
- providing reliable measures for the fiscal policy, etc.

All these benefits make the transition to accrual accounting in the public sector more necessary than the profit motivation. In addition, in the absence of the profit motive, the governmental entities need badly an accounting system that can assist in:

- controlling resources and costs and providing accountability in the lack of market forces;
- revealing whether the government actions were in the interest of both current and future taxpayers or not; and
- whether the net worth is improved or deteriorated.

Accordingly, these reasons are also more important than the profit motivation to make the adoption of accrual accounting in the public sector more necessary.

#### **- Severe inflation experienced by most developing countries as well as developed countries**

Valuation of assets and liabilities is fundamental to the viability of accrual accounting in government (Heald and Georgiou, 1995). The transition to accrual accounting in the public sector will raise other issues. For instance, will the governmental assets be valued according to historical cost or current cost? Taking into consideration the distinctive nature of the governmental assets: is the current cost accounting (CCA) relevant to the public sector entities? In the majority of cases, these raised issues have been used as an argument by public sector entities in an effort to oppose the adoption of accrual accounting. However, the historical cost accounting convention has traditionally been used as basis for preparing accounts because of its underlying simplicity and certainty, derived from original bookkeeping records. But in a period where the prices rise, the historical cost accounting suffers from a number of drawbacks. Aiken (1979)

argues that it is widely accepted that in a period of inflation, historical cost accounts conceal the true position of a business because they:

- overstate profits by charging against revenues an inadequate measure of the true cost of assets sold or used up;
- understate capital employed, by stating assets at historical rather than current costs;
- overstate return on capital employed, by compounding the distortion of the last two cases; and
- distort the information on which decisions are made about the allocations of resources, pricing policy, cost control, distributions and gearing.

Also, the fall in the value of money during a period of inflation has serious implications for accounting. Unless the effects of these implications are taken into consideration, the reported data will be based upon monetary units with different purchasing powers, depending on the value of money at the date of each relevant transaction. By allocating and matching data measured in different purchasing power terms, the accounts fail to report on the real profitability of an entity since inflationary gains and losses which do not reflect real changes in values or resources are not excluded (United Nations, 1984). As a consequence of the drawbacks of the historical cost, the current cost accounting (CCA) was developed to overcome these drawbacks. Herein, the objective is to reflect the current costs of the items in the balance sheet and profit and loss account rather than their original historical or acquisition cost as used in historical cost accounting. The basic objective of the current cost accounts is to provide more useful information than that available from historical cost accounts alone for the guidance of the management of the business, the shareholders and others on such matters as: (Aiken, 1979)

- financial viability of the business;
- return on investment;
- pricing policy, cost control and distribution decisions; and
- gearing.

Thus, CCA is a cost-based accounting system that aims at reflecting the price changes regarding of the items in the balance sheet and profit and loss account rather than their acquisition cost. The assessment of current cost is made by reference to specific price changes rather than to general measure of price changes (Wells, 1981). Physical assets like stock and fixed assets are included in the current cost balance sheet at their value to the business at the balance sheet date, normally net current replacement cost, and monetary items are included at the same amount as in the historical cost accounts. Capital employed is thus stated at current prices and can be compared for different companies within a group or for different groups in an industry. In the current cost profit and loss account, fixed assets used up, or stocks sold, are charged against revenue at current costs at the date of consumption (Wells, 1981). Accordingly, there has been considerable discussion of the relevance, logical validity and operational complexity of CCA as a system of accounting for business firms. The question, however, is: to what extent is the CCA relevant to the public sector entities?

The basis of accounting and reporting methods of many public sector entities, particularly government departments, is the necessity to account for the funds provided to them, either from treasury or as result of their taxing powers. These entities are subject to a strict notion of stewardship. Their accounts are designed to answer the simple questions. How much money did you collect?

What did you do with the money? In addition, if a department is given certain allocations of funds, it will be expressed as a number of dollars – then current money unit. Within certain guidelines, it will be free to spend those money units and obtain what it requires at the going rate of exchange of money units for goods and services. The department must account clearly for money units received and money units spent. Furthermore, they are not required to calculate the amount of any income or loss, nor are they expected to measure in financial terms, any resources at their command at the end of a period. They do not engage in trading and have no concept of an “Operating Capability” which must be maintained out of revenues (Wells, 1981). This means that the basis of accountability in governmental departments is the number of dollar received and spent. Hence, it is inappropriate to manipulate statements of receipts and payments to take account of changes in the purchasing power of the dollars. This also means, taking into account that the changes in purchasing power will destroy the direct nature of the statements used to discharge the stewardship of the departmental officers. Based on the above-stated discussion, one can conclude that CCA is irrelevant for the governments as a whole and should be used only by the government organizations where market forces and efficiency largely determine results. In addition, Aiken (1979) argued that CCA seems to have doubtful validity where market forces do not determine prices. In addition, the effects of inflation are fully accounted for through the capital maintenance and price adjustments on individual assets. But the underlying concepts of profit and capital maintenance clearly envisage a particular kind of entity in which the primary purpose of the accounting process is to determine a profit which can be distributed without eroding the entity’s capital. However, the public sector entities do not distribute profits and have no capital as it is known in the private sector. Consequently, the notion of Capital Maintenance is not appropriate to be applied on the public sector entities. This also gives rise to conclude that CCA is irrelevant for the public sector entities. However, the question of CCA’s likely impact on the government accounting system it self has not yet been explored in any detail. Generally, there may be a place for CCA in government accounting, especially in the countries which have high inflation rates such as the case of most of the developing countries, but its application must be very carefully controlled. Furthermore, it has previously been demonstrated that the nature and the objective of the government are different from the nature and the objective of the business firms. Accordingly, the CCA can also play here a different role than the one it played in the business firms. Heald and Georgiou (1995) have argued that whilst it is entirely legitimate for an elected government to restructure and downsize the public sector, only transparent government accounting system will show the reductions in the public sector net worth resulting from asset sales at less than fair value. Therefore, the public sector entities should adopt the accounting system which can reflect the fair value of the governmental assets in order to avoid the eroding of the net worth resulting from disposing and selling of the governmental assets at less than their fair value. Furthermore, such an accounting system will also affect the intergenerational equity. Then, the implementation of accrual accounting in combination with the CCA can play a vital role in the public sector not through the notion of the Capital Maintenance but rather through the maintenance of the net worth of the public sector entities by reflecting the current value of the governmental assets. Therefore, the CCA can find its place in the public sector through (what we might call) the notion of Net Worth Maintenance. In addition to the notion of net worth maintenance, the implementation of accrual accounting in combination with the CCA can also maintain the intergenerational equity at its current

value. Thus, the notions of Net Worth Maintenance and the Intergenerational Equity Maintenance can give rise to the use of CCA in the public sector entities. In addition, the current cost accounting will find its place in the public sector entities when these entities produce goods and services competitive to the similar goods and services produced by the private sector. In other words, if direct competitors in the private sector adopt CCA as the basis for financial reporting then government entities so placed would reasonably follow suit (Aiken, 1979). Currently, the New Zealand government is using the current cost accounting in the central government. It is stated in the Crown Accounting Policies for External Financial Reporting-Treasury, that the measurement base to be applied is historical cost, adjusted for revaluations of items of property, plant and equipment (where appropriate), commercial forests and marketable securities held for trading purposes. Furthermore, Pallot (2001) stated that financial statements at all levels in the New Zealand are described as being on a modified cost basis, although effectively they are close to being on a current cost basis (including infrastructure and heritage assets are revalued at least every three years). The New Zealand government has therefore moved further towards current value accounting than most organizations in the private sector in New Zealand. This practically means that CCA has already found its place in the public sector in the framework of government accounting reform.

## Conclusion

While the potential returns from the transition to accrual accounting are substantial, so too are the consequences of the transition failure. Accordingly, this article has raised several of the practical and conceptual transition problems which all deserve to be profoundly studied and researched before the actual transition to accrual accounting in the public sector of the developed and developing countries starts. In addition, it has attempted to deal with the nature of these problems and the means of handling them. However, the main focus was to shed light on these problems more than to present ready-made solutions for them. The best way of tackling both practical and conceptual transition problems will depend on many factors such as the prevailing circumstances in each country, degree of development, management and political systems and accounting and budgeting systems used.

Yet, the international experience has revealed that most of these problems are to a great extent common for both of the developed and developing countries. In reality, this is due to the fact that government accounting neither in the developed countries nor in the developing countries has received the studies it warrants, as the government accounting field was a vastly neglected area in the accounting field in most of the developed and developing countries. In spite of the fact that the last two decades have seen an increasing interest in the study of government accounting and budgeting, there remains considerable scope for further work.

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# Accrual Accounting For National Governments

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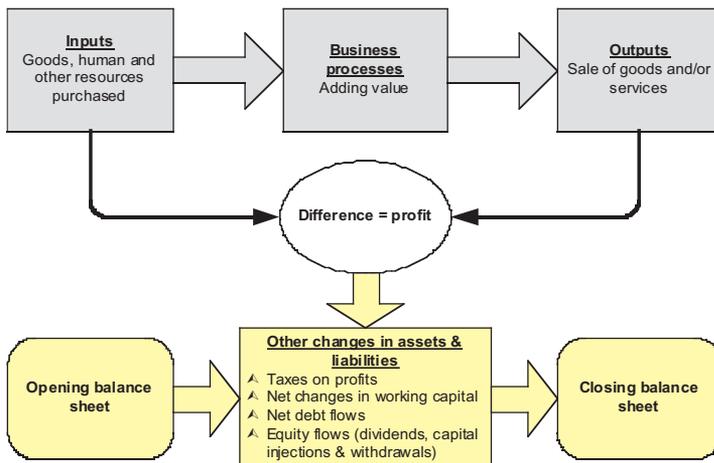
Accrual has for centuries been the basis of the private sector accounting model, yet the public sector has until recently almost universally followed a cash-based model. Furthermore, for business activities accounting has achieved a significance that it does not have in the public sector. This paper asks why these two accounting models have deviated and whether this is linked to the greater significance of the accounting model in the private sector? What has now changed to make accrual the preferred option for the public sector? Is a move to an accrual basis appropriate for some or all governments? And finally, where should such accrual accounting feature in government priorities?

To answer these questions, the place to start must be the successful private sector accounting model.

Why the accrual accounting concept has been so successful for commercial entities

The reason for the dominance of the accounting model in the private sector is that the accrual accounting model provides a universal input-output model as illustrated in Exhibit 1 below.

## Exhibit 1: Accounting as a universal input-output model for commercial entities



This model works for all business entities, whatever the nature of their economic activities, and provides information in common monetary units on:

- Dividend capacity
- Taxable capacity
- Value (if value is the present value of future cash flows, profits provide a surrogate measure of future cash generating capacity)
- Solvency, by providing information on the relative size and relationship of assets, liabilities and cash flows
- Performance, as indicated by profitability and measures based on profit, e.g. price/earnings ratios.

This universal applicability and usefulness are the reasons for the dominance of the accounting model in business, as illustrated.

Why the accounting model works differently for governments

The accounting model as applied to governments cannot be an input output model—inputs are specified in money, but outputs are service delivery, e.g. health care, education, defence – the outputs are not “sales”. Furthermore most of the information needs of commercial entities – dividend capacity, taxable capacity and value – are not relevant to the government entity.

However, the concepts of solvency and performance are equally relevant to government and commercial entities. Solvency in the form of perceived sovereign debt risk affects borrowing capacity and cost; performance is one of the criteria by which elected governments are judged. The use of the accounting model to provide information on these areas is further considered below.

On the other hand, governments have financial management needs not relevant to commercial entities:

- Fiscal management—the need to manage the financial flows, the government borrowing requirement and the levels of taxation so as to support broader national economic objectives. The financial management of the government entity is a part of the broader fiscal management of the national economic entity.
- Budget management—the budget has a more significant role in government, in that it legally embodies government decisions on the raising of revenues and spending of public monies. The financial management model must also manage budget execution.
- Transparency and accountability—the fiduciary responsibility of public servants to account for public money and to ensure it is spent in compliance with legal and regulatory requirements for the purpose intended. The government accounting model and reports should make such accountability transparent.

Thus government financial management and the role of the accounting model are significantly different in the public as compared to the private sector. For these reasons, until recently the accrual concepts of the private sector have not been seen as relevant to the financial management needs of governments.

Firstly, the lack of any concept of profit has taken away one of the reasons for accrual accounting—there has been no need to match the timing because there is no concept of profit in the public sector.

Secondly, because the government entity is not clearly defined (and see further below on different definitions of the government entity) there has been little development of, or perceived need for government balance sheets.

Finally, because (i) government accounting is not an input-output mode and (ii) there is no concept of government profit, accounting has not been used by governments as a tool for managing performance.

On the other hand the requirements of fiscal management, debt management and rule compliance have all been served perfectly adequately by a cash based accounting model, and hence that has until very recently continued to be the model used by most of governments.

What has changed to require accrual accounting for governments?

Five key requirements require the application of the accrual basis to government financial management:

1. The requirement to manage public sector performance requires the ability to compare resources consumed (measured through the accrual accounting model) with physical output performance targets.
2. Secondly, accrual measures of costs are required to be able to compare alternative methods of production (including out-sourcing), control costs and inform resource allocation decisions.
3. Accrual measures of cost are required as a basis for setting user fees where cost recovery is a government objective.
4. The need for a government balance sheet to evaluate the level of sovereign risk and hence government borrowing capacity.
5. The need to identify and measure government liabilities, including inter-generational liabilities (e.g. pensions).

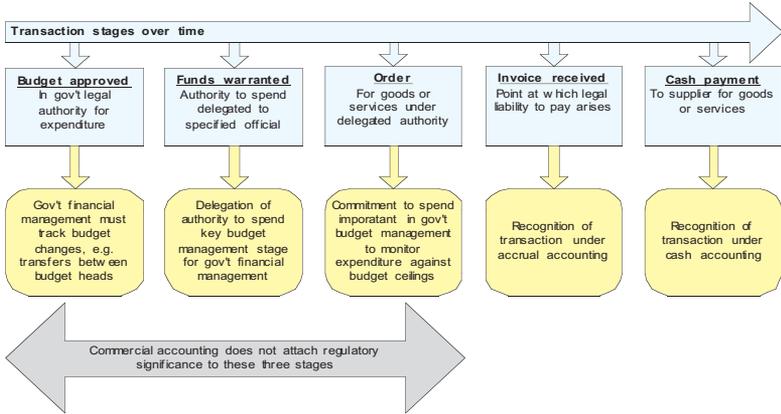
For all of these reasons simple cash accounting cannot any longer adequately meet the needs of the governments. However, there are significant problems and issues in applying accrual accounting to governments as summarised below.

Firstly, since government cash inflows and outflows are not directly related, there can be no concept of profit, and hence the accounting model can never be a comprehensive input-output model for government. It must be combined with non-financial output indicators.

Secondly, there is no single definition of the entity of government. For example, the IMF GFS defines the scope of government, and hence the entity of government, quite narrowly to include only the central, state and local government sectors, excluding all government business enterprises and financial institutions. On the other hand the IFAC Public Sector Committee Study 8 "The government financial reporting entity" argues that "governments should be responsible for the resources that they control, and accordingly the boundaries of the government financial reporting entity should be widely drawn to encompass all the resources the government controls..." This is a much broader definition than the IMF/UN definition, but also argues for sub-entities for reporting purposes. Attempts are being made to reconcile these two different views, but the reality is that there is no single definition of the entity of government - different entity boundaries are appropriate for different purposes.

Thirdly, the problem of recognition of transactions is compounded for government by multiple transaction stages. These are most acute for expenditures, as illustrated in Exhibit 2 below.

## Exhibit 2: Comparison of expenditure stages



Thus a government accounting system needs to recognise more stages, and there are more options as to when a transaction is recognised. Indeed, traditional government accounting has recognised the “commitment” as well as the cash stage. This flows from the legal significance of the budget to authorise expenditure, and the need to recognise authorisation stages in order to manage budget execution.

A move to accrual principles does not remove the need to track all government transactions stages, since such information is useful both to predict cash flows, to ensure compliance with budgetary ceilings and to manage debt. The conclusion is that the timing transaction recognition is not clear cut, and there is a case for recognising more transaction stages in government financial management. The International Public Sector Accounting Standards have not so far addressed the issue of recognising multiple transaction stages. Yet in practice the ability to recognise and manage such multiple stages, especially on expenditure, is a key factor in evaluating accounting packages for government.

However, despite these issues and problems, it is clear that cash based accounting can no longer adequately meet the needs of governments, and there is a need to move towards an accrual basis for government budget and accounting.

Practical problems of moving from cash to accrual accounting.

However, even if the merits of accrual accounting are accepted, the move from cash-based to accrual accounting is not an easy or cost free transition. Other publications set out the steps for transition<sup>1</sup>, but some of the key requirements include:

- Designing a new conceptual framework for accrual based financial management
- Adoption of accounting and reporting standards and detailed decisions on rules to be applied
- Revision of financial management legislation, rules and regulations
- New IT systems and business processes

- Identification and valuation of assets and liabilities
- Training of staff and users
- Management of the transition and cut-off from one system to the other

For New Zealand the cost of transition from cash to accrual has been estimated at US\$99 million<sup>2</sup>. In the UK no cost estimates are available, but the process started in 1997 and is expected to be completed in 2006. It is noteworthy that despite international awareness of the benefits of accrual accounting for governments very few have fully completed such a transition. The costs and complexity are daunting.

## **Issues that accrual accounting fails to address**

Accrual accounting does not address all of the issues of public financial management, and even if accrual accounting is adopted there is likely to be a continuing requirement for cash information for some purposes.

Accrual accounting does not in itself address the issue of fiscal risk, i.e. the contingent liabilities of government. An example would be guarantees of government on loans made to state owned enterprises. Such contingent liabilities do not form part of accrual financial statements, though they should be included in notes. However, accrual accounting does include actual liabilities even though these may not be known with certainty, e.g. future pension costs of government employees.

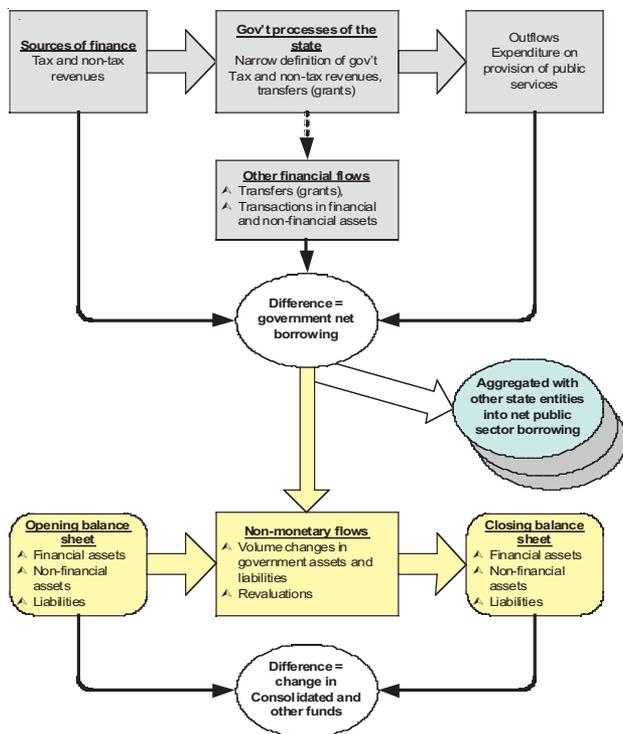
Even with a move to accrual accounting, there remains a need for cash flow information. This is particularly for government fiscal management, and the need to manage government revenues and borrowings. Therefore a government accrual accounting system would need to be established in such a way that it can still generate information on cash flows. This is particularly true with budgets, and the importance of the borrowing requirement. For this reason some countries have adopted accrual accounting, but still prepare the budget on a cash basis.

There is also an argument that even if accrual accounting is adopted, there is a case for a cash based budget, since this is the legal authority to raise taxes and borrow money, all defined in cash terms. However, these problems can be overcome by presenting both cash and accrual information as is the pattern for financial statements.

## **A conceptual model for government financial management**

The accounting model for governments is clearly different to commercial entities, and is implicit in the new IMF GFS. The government (national and sub-national) receives an inflow of funds from various sources, which are then spent for public purposes. It therefore has opening and closing balance sheets valuing assets and liabilities. This model is summarised in Exhibit 3 below.

## Exhibit 3: A conceptual model for government financial management



It is considered that this model, whilst less elegant than the commercial entity model, does provide a working conceptual framework for the application of accrual concepts to government financial management. Whilst financial inflows and outflows are not directly linked, they are nevertheless under the control of government, and therefore the borrowing requirement is a real and important measure. Furthermore, the information in this model can be aggregated across government to provide whole of government financial information.

## Conclusions

There can be no doubt that an accrual approach to government financial management both offers significant benefits and is the only basis to meet perceived information requirements. However, accounting can never be as complete a solution for governments as it is for commercial entities, for all of the reasons indicated above. There will always be a need to track transactions, especially expenditures, at other stages in the financial cycle for different purposes, to provide cash measures for fiscal and debt management, and for other non-financial performance measures to compensate for the lack of output prices.

The question is whether the benefits of accrual accounting justify the effort and costs involved in a move. The New Zealand<sup>3</sup> study concluded that the return on investment in accrual accounting was 7 percent. Of course the

assumptions underlying such estimates can always be questioned, and New Zealand is a relatively small and rich country, with a resource of a strong accounting profession to support such a transition. Nevertheless this analysis does indicate that there are measurable benefits from adopting accrual principles.

So the question is under what circumstances it is appropriate for a country to move from cash to accrual basis for accounting and budgeting. The following guidelines are suggested:

- For rich countries, or for those where a fundamental reform of their government accounting is anyway required, then a move to accrual accounting will yield substantial benefits. However, the limitations of accrual as applied to governments must also be recognised; transactions must be tracked from budget to cash; and non-financial performance indicators must be integrated with financial information to measure value for money.
- For countries with more limited resources the move to accrual may be an inappropriate use of scarce resources, or it may even be infeasible. Such countries should consider whether a move to modified accrual might be more feasible, especially with the introduction of new financial management systems, and yield many of the benefits of full accrual. The Highly Indebted Poor Country Assessments indicate that poor countries should first get their cash accounting systems working properly.

In summary, accrual accounting must be the preferred basis for government financial management. But the case for the accrual basis is not so overwhelming as to make it an automatic recommendation for every country. Benefits of moving to the accrual basis must be evaluated against cost and feasibility on a country by country basis to make a decision appropriate for a specific country situation and point in time

## End Notes

1. IFAC PSC Study 14 "Transition to the Accrual Basis of Accounting" 2002.
2. Scott, Graham, Ian Ball and Tony Dale (Summer 1997) New Zealand's Public Sector Management Reform: Implications for the United States. *Journal of Policy Analysis and Management* 16.3: 357-381.
3. Information from Scott, Graham, Ian Ball and Tony Dale, op cit above.



# DEVELOPING A CHART OF ACCOUNTS TO MEET IPSAS AND GFS REQUIREMENTS FOR FINANCIAL REPORTING BY GOVERNMENTAL ENTITIES

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## INTRODUCTION

There has been considerable confusion in the accounting for government operations by many countries as they implement the International Public Sector Accounting Standards (IPSAS)<sup>1</sup> and the Government Finance Statistics Manual (GFSM)<sup>2</sup>. The confusion evolves around whether the coding in the GFSM is an accounting system that should be strictly adhered to or is only a statistical reporting system. IMF clearly identifies that the GFSM is not an accounting system as follows: "Although the GFS system is described in standard accounting terms, it is important to remember that it is a statistical reporting system that might differ in important ways from the underlying financial accounting system from which most of the GFS statistics will be derived."<sup>3</sup>

Yet, despite this assertion, many advisers continue to insist that it is an accounting system. This creates extensive difficulty when trying to implement an accounting system under the International Public Sector Accounting Standards (IPSAS). The difficulty occurs since otherwise well meaning individuals attempt to use the coding structure in the GFSM for the Chart of Accounts in the accounting system. In an attempt to clarify this issue, this article presents some typical accounting entries and illustrates how to prepare financial statements that meet both the IPSAS and GFSM expectations.

## GENERALLY ACCEPTED ACCOUNTING PRINCIPLES FOR GOVERNMENTAL ENTITIES<sup>4</sup>

Most countries throughout the world are on the cash basis of accounting and many are considering the transition to an accrual basis of accounting. This transition period can be long and may involve implementing a sophisticated, automated accounting system. A conceptual framework for the accrual basis of accounting in the public sector has not yet been developed by the IPSAS Board. In the absence of a conceptual framework, a modified accrual accounting system using a fund structure for the transitional period could be beneficial. Although the IPSAS Board has not suggested the use of a fund structure, such a structure with accounting principles broken out by source of funds similar to the following are often adopted:

1. A governmental accounting system must make it possible to (a) present fairly and with full disclosure the funds and activities of the government in conformity with generally accepted accounting principles, and (b) determine and demonstrate compliance with finance-related legal and contractual provisions.
2. Governmental accounting systems should be organized and operated on a fund basis. A fund is defined as a fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual equities or balances, which are segregated for the purpose of carrying on certain objectives in accordance with special regulations, restrictions, or limitations. Fund financial statements should be used to report detailed information about the primary government.
3. The following fund types should be used to the extent that they have activities meeting the criteria for using those fund types:
  - a. *Governmental Funds*—General Fund (to account for all financial resources in support of government operations except those required to be accounted for in another fund), Special Revenue Funds (to account for the proceeds of specific revenue sources that are legally restricted to use for specific purposes), Capital Project Funds (to account for financial resources to be used for the acquisition or construction of major capital facilities (other than those financed by proprietary and trust funds), and Debt Service Funds (to account for the accumulation of resources for, and the payment of, general long-term debt principal and interest).
  - b. *Proprietary Funds*—Government Business Enterprise Funds (to account for operations that are financed and operated in a manner similar to private business enterprises).
  - c. *Fiduciary Funds*—Trust and Agency Funds that are used to account for assets held by a governmental unit in a trustee capacity or as an agent for others.
4. Only the minimum number of funds consistent with legal and operating requirements should be established.
5. A clear distinction should be made between general capital assets of governmental funds and capital assets of proprietary and fiduciary funds to insure proper accounting. General capital assets include land, buildings, improvements other than buildings, and equipment used by activities accounted for by the fund types classified as governmental funds.
6. Capital assets should initially be reported at historical cost.
7. Capital assets of proprietary and fiduciary funds should be depreciated over their estimated useful lives.
8. A clear distinction should be made between general long-term liabilities of governmental funds and long-term liabilities of proprietary and fiduciary funds to ensure proper accounting.
9. In the transitional period, financial statements for governmental funds should be presented using the current financial resources measurement focus and the partial accrual basis of accounting. That is, revenues should be recognized in the accounting period in which they become available and measurable while expenditures should be recognized in the accounting period in which the fund liability is incurred (except for unmatured interest on general long-term liabilities which should be recognized when due). Financial state-

- ments for proprietary and fiduciary funds should be presented using the economic resources measurement focus and the accrual basis of accounting where revenue and expenses are recognized in the period where an exchange takes place. In the long-term, financial statements of all funds should use the economic resources measurement focus and the accrual basis of accounting.
10. The accounting system should provide the basis for appropriate budgetary control of the governmental funds as well as an annual statement reflecting a comparison between the approved budget and actual revenue received/expenditures made.
  11. Transfers should be classified separately from revenues and expenditures or expenses in the basic financial statements in order to assist in the consolidation process. Revenues should be identified by source and expenditures/expenses should be identified by function and economic classifications.
  12. A common terminology and classification should be used consistently throughout the budget, the accounts, and the financial reports of each fund.
  13. In the long-term, a whole-of-government financial report should be prepared and published as desired by the international oversight bodies.

## **SELECTED ACCOUNTING ENTRIES FOR AN AUTOMATED DOUBLE-ENTRY PARTIAL ACCRUAL ACCOUNTING SYSTEM**

In an automated system, the coding structure is an important design feature—one that affects the ease of operation and the ability to prepare useful financial reports. Most coding structures provide for the multiple classification categories recommended by the international oversight bodies. All segments of the coding structure are used for expenditure transactions, but not all segments are needed for revenue and some balance sheet transactions. Segments not needed to record a transaction are left blank. Sufficient edit checks are built into the automated systems to insure that all the data necessary for a transaction are accurately recorded. In addition, high-level supervisors are given limited override authority if a change is needed in the recording of a transaction. The menu-driven program used by the system makes it relatively simple to move around within the account classification structure. Further, the system should permit the periodic preparation of desired financial statements for external reporting. In addition, information can be aggregated within any given segment to provide a wide variety of custom financial reports for internal management purposes.

Automated accounting systems typically use separate files or ledgers for accounting and budgetary reporting. Actual revenues and expenditures are posted to the general ledger and budget amounts are posted to the budget ledger. The same account numbers and titles used in the budget ledger are used in the general ledger to permit budgetary comparison reporting. The system should provide a separate encumbrance ledger to record encumbered amounts and monitor budgetary compliance. Selecting the type of transaction from a menu on the computer screen determines into which ledger (or ledgers) a particular transaction is posted. All such systems must provide transaction detail reports and other documentation of entries and postings in order to provide an adequate audit trail.

This section explains some of the basic accounting entries used in an automated double-entry partial accrual accounting system to recognize financial

resources. The use of different ledgers is transparent to the user of an automated accounting system so the entries reflected in this section might be confusing to some. The same accounting entries for recording and revising the budget would apply to a double-entry cash accounting system as well as the full accrual accounting system. However, only those accounting transactions during the fiscal year dealing with cash would apply to a cash accounting system. For a full accrual accounting system, all resources would be recognized as desired in the IPSASs in order to identify the total assets owned and the total liabilities owed. The entries may be modified in the automated system to adhere to the specific system design requirements of a particular vendor for their database.

**A. RECORDING AND REVISING THE BUDGET IN THE GENERAL FUND:**

	<u>General Ledger</u>		<u>Subsidiary Ledger</u>	
	<u>DR</u>	<u>CR</u>	<u>DR</u>	<u>CR</u>
1. Estimated Revenues	X			
Estimated Other Financing Sources	X			
Fund Balance		X		
<i>Estimated Revenues Ledger:</i>				
Taxes				X
Social Contributions				X
Grants				X
All Others				X

To record the amount of estimated revenue and transfers in by other organizations (by source) to the level of detail desired in the budget. (Note—Revisions during the fiscal year to Estimated Revenues or Other Financing Sources are made by adjusting the above amounts by the amounts desired.)

2. Fund Balance	X			
Appropriations		X		
Estimated Other Financing Uses		X		
<i>Appropriations Ledger:</i>				
Compensation of Employees				X
Interest				X
Use of Goods and Services				X
Consumption of Fixed Capital				X
Subsidies				X
Grants				X
Social Benefit				X
All Others				X

To record the amount of anticipated expenditures (by economic classification) and transfers out to other organizations to the level of detail desired in the budget. (Note—Revisions during the fiscal year to Appropriations or Estimated Other Financing Uses are made by adjusting the above amounts by the amounts desired.)

**B. RECORDING ROUTINE TRANSACTIONS IN THE GENERAL FUND:**

	<u>General Ledger</u>		<u>Subsidiary Ledger</u>	
	<u>DR</u>	<u>CR</u>	<u>DR</u>	<u>CR</u>
1. Accounts Receivable (or Cash) X				
Revenues	X			
		X		
<i>Revenues Ledger:</i>				
Taxes				X
Social Contributions				X
Grants				X
All Others				X

**To record the daily receipt of cash or to recognize accounts receivable.**

2. Encumbrances	X			
Reserve for Encumbrances		X		
<i>Encumbrances Ledger:</i>				
Use of Goods and Services			X	

**To enhance budgetary control by reserving funds upon the issuance of a purchase order or contract.**

3a. Reserve for Encumbrances	X			
Encumbrances		X		
<i>Encumbrances Ledger:</i>				
Use of Goods and Services			X	
3b. Expenditures	X			
Accounts Payable (or Cash)		X		
<i>Expenditures Ledger:</i>				
Use of Goods and Services			X	

**Upon receipt of the items ordered, this double entry reverses the original entry encumbering the funds and recognizes the expenditure for supplies and the liability incurred. If fixed assets were acquired, the following entry would be used in lieu of the one identified above.**

3b. Expenditures	X			
Accounts Payable (or Cash)		X		
<i>Expenditures Ledger:</i>				
Use of Goods and Services			X	
<i>General Fixed Assets Account Group:</i>				
Fixed Asset			X	

**To recognize the expenditure for fixed assets and the liability incurred. In addition, the initial cost of the fixed asset is recorded in an account group reflecting all fixed assets owned (by name and location).**

	<u>General Ledger</u>		<u>Subsidiary Ledger</u>	
	<u>DR</u>	<u>CR</u>	<u>DR</u>	<u>CR</u>
4a. Expenditures	X			
Accounts Payable (or Cash)		X		
Due to Social Security Fund		X		

*Expenditures Ledger:*

Compensation of Employees			X	
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*Social Security Fund:*

4b. Due from General Fund	X			
Social Contributions		X		

**To record the compensation (includes amount withheld and the matching portion from the General Fund for Social Security) of government employees.**

5a. Due to Social Security Fund	X			
Cash		X		

*Social Security Fund:*

5b. Cash			X	
Due from General Fund				X

**To record the transfer of cash from the General Fund to the Social Security Fund for contributions by government employees and the matching portion from Government Operations.**

6. Property Taxes Receivable	X			
Estimated Uncollectible Current Taxes		X		
Tax Revenues		X		

*Revenues Ledger:*

Property Taxes			X	
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**To record the property tax levy.**

7. Cash	X			
Property Taxes Receivable		X		

**To record the collection of current taxes.**

8. Revenues	X			
Estimated Revenues		X		
Estimated Other Financing Sources		X		
Fund Balance		X		

**To close the budgetary and actual revenue accounts into Fund Balance. (This entry assumes that more revenues were received than anticipated.)**

	<u>General Ledger</u>		<u>Subsidiary Ledger</u>	
	<u>DR</u>	<u>CR</u>	<u>DR</u>	<u>CR</u>
9. Appropriations	X			
Estimated Other Financing Uses	X			
Encumbrances		X		
Expenditures		X		
Fund Balance		X		

**To close the budgetary and actual expenditure accounts into Fund Balance. (This entry assumes that the amount expended and encumbered is less than the amount budgeted.)**

**C. RECORDING TRANSACTIONS IN THE SPECIAL REVENUE FUNDS:**

	<u>General Ledger</u>	
	<u>DR</u>	<u>CR</u>
<i>Special Revenue Fund:</i>		
1. Grant Receivable	X	
Deferred Revenue		X

**To recognize the promise of a grant upon meeting conditions of the grant.**

<i>General Fund:</i>		
2a. Due from Special Revenue Fund	X	
Accounts Payable (or Cash)		X
<i>Special Revenue Fund:</i>		
2b. Expenditures	X	
Due to General Fund		X

**To recognize receivables in the General Fund for expenditures made on behalf of the Special Revenue Fund against the authorized grant to meet the conditions of the grant.**

<i>Special Revenue Fund:</i>		
3a. Cash	X	
Grants Receivable		X
3b. Deferred Revenue	X	
Revenue from Grants		X
3c. Due to General Fund	X	
Cash		X
<i>General Fund:</i>		
3d. Cash	X	
Due from Special Revenue Fund		X

**To recognize receipt of cash for the grant in the Special Revenue Fund upon meeting the conditions of the grant and the transfer of funds to the General Fund for expenditures incurred to meet the conditions of the grant.**

**Another example is given below for another Special Revenue Fund (the Social Security Fund).**

	<u>General Ledger</u>	
	<u>DR</u>	<u>CR</u>
<i>Social Security Fund:</i>		
1a. Due from the General Fund	X	
Social Contributions		X
<i>General Fund:</i>		
1b. Expenditures	X	
Due to the Social Security Fund		X

**To record the funds due to the Social Security Fund by the General Fund for social contributions.**

General Ledger

DR      CR

*Social Security Fund:*

2a. Cash	X	
Due from the General Fund		X

*General Fund:*

2b. Due to the Social Security Fund	X	
Cash		X

**To record the payment of the liability incurred in entry 1 above.**

*Social Security Fund:*

3. Social Benefits	X	
Cash		X

**To record payment of social benefits to those eligible.**

*Social Security Fund:*

4. Social Contributions	X	
Social Benefits		X
Fund Balance		X

**To close the nominal accounts. (This entry assumes that more was contributed to the Social Security Fund than was expended in support of social benefits.)**

**D. RECORDING TRANSACTIONS IN THE CAPITAL PROJECTS FUND:**

General Ledger

DR      CR

*Capital Projects Fund:*

1a. Cash	X	
Transfer-in from General Fund		X
Transfer-in from Government Business Enterprises		X

*General Fund:*

1b. Transfer-out to Capital Project Fund	X	
Cash		X

*Economic Enterprise Funds:*

General Ledger

DR      CR

1c. Transfer-out to Capital Project Fund	X	
Cash		X

**To record the receipt of cash from the General Fund and the Government Business Enterprises Funds into the Capital Projects Fund.**

*Capital Projects Fund:*

2a. Cash	X	
Proceeds from Bonds (or others)		X

*General Long-Term Debt Account Group:*

2b. Bonds (or other borrowings) Payable		X
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**To record long-term borrowings from others.**

*Capital Projects Fund:*

3. Encumbrances	X	
Reserve for Encumbrances		X

**To record the contract issued for the major construction project.**

*Capital Projects Fund:*

4a. Reserve for Encumbrances	X	
Encumbrances		X
4b. Construction Work in Progress	X	
Contract Payable (or Cash)		X

**To recognize the liability (or payment) of the contract.**

*Capital Projects Fund:*

5a. Transfer in from General Fund	X	
Transfer in from Government Business Enterprises	X	
Proceeds from Bonds (or others)	X	
Construction Work in Progress		X
Cash		X

*General Fund:*

5b. Cash	X	
Transfer-out to Capital Projects Fund		X

*General Fixed Assets Account Group:*

5c. Building	X	
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**To close the Capital Projects Fund and transfer remaining cash to the General Fund. Also, to record the initial cost of the Building in the General Fixed Assets Account Group.**

**E. RECORDING TRANSACTIONS IN THE DEBT SERVICES FUND:**

General Ledger

DR                  CR

*General Fund:*

1a. Transfer-out to the Debt Service Fund	X	
Cash		X

*Government Business Enterprises Funds:*

1b. Transfer-out to the Debt Service Fund	X	
Cash		X

*Debt Services Fund:*

1c. Cash	X	
Transfer-in from the General Fund		X
Transfer-in from the Government Business Enterprises		X

**To recognize the cash being transferred into the Debt Services Fund for repayment of principal and interest on debt.**

*Debt Services Fund:*

2. Expenditures	X	
Cash		X

**To pay principal and interest on debt.**

*Debt Services Fund:*

3. Transfer-in from the General Fund	X
Transfer-in from the Economic Enterprise	X
Expenditures	X

To close the Debt Services Fund (assuming that the exact amount of funds needed for repayment of principal and interest on debt was transferred).

## **F. RECORDING TRANSACTIONS IN THE GOVERNMENT BUSINESS ENTERPRISES FUNDS:**

These transactions would be recorded on the full accrual basis of accounting in the same manner as those transactions recorded in the private sector with the exception of the transfers-in and transfers-out identified earlier.

## **G. POSTINGS OF TRANSACTIONS RELATED TO GFS CODES 3, 4, AND 5**

The primary confusion in the extraction of data for use in the statistical reporting system prescribed by the IMF evolves around the use of the GFS Codes 3, 4, and 5. Code 3 transactions are those that increase or decrease the ending balance in the financial and non-financial assets through purchase, disposal, or consumption of fixed capital, as well as the increase or decrease in the ending balance of liabilities through settlement or incurrence of debt. The Codes 4 and 5 are reserve accounts in the Net Assets/Equity section of the Statement of Financial Position. As such, their ending balances are not closed out at the end of the accounting period but are carried forward from one period to the next.

The following example attempts to clarify the issue:

1. Purchase non-financial asset for 4,000 cash.
2. Receive tax income of 20,000 cash.
3. Pay debt of 3,000 cash.
4. Increase value of non-financial assets by 2,000.
5. Increase debt by 1,000 due to currency conversion.
6. Decrease value of financial assets by 1,500 due to bankruptcy of debtor.
7. Dispose of non-financial assets with a value of 4,500 with 1,000 holding gain and accumulated depreciation of 4,000 resulting in a realized gain of 500.
8. Record expenses of 12,000 with a decrease in financial assets of 10,000, an increase in liabilities of 1,000, and an increase in accumulated depreciation of 1,000.

These transactions are summarized as follows from the accounting system where Account Number 1XX represents financial assets, 2XX represents non-financial assets, 3XX represents liabilities, and 4XX represents net assets/equity:

Summary of General Ledger Transactions							
Account	Account Nr.	Beginning Balance	Debit	Trans. Nr.	Credit	Trans. Nr.	Ending Balance
Financial Assets	1XX	5,000	20,000	2	4,000	1	
					3,000	3	
					1,500	6	
					10,000	8	6,500
Non-Fin. Assets	2XX	15,000	4,000	1	4,500	7	
			2,000	4			16,500
Acc. Depreciation	2XX	-6,000	4,000	7	1,000	8	-3,000
Liability	3XX	-4,000	3,000	3	1,000	5	
					1,000	8	-3,000
Acc. Surplus/(Losses)	4XX	-5,000	12,000	8	20,000	2	
					500	7	-13,500
Holding Gains/(Losses) Non-Financial Assets	4XX	-2,000	1,000	7	2,000	4	-3,000
Other Volume Changes Financial Assets	4XX	-1,750	1,500	6			-250
Holding Gains/(Losses) Liabilities	4XX	-1,250	1,000	5			-250

For reporting in the statistical system prescribed by the GFS Manual, the results would be extracted from the accounting system as follows:

- a. Code 3 transactions for financial assets (where netting of acquisitions against disposals is permitted) would be 1,500 (20,000 total acquisitions, 17,000 total disposals, and 1,500 other volume change credit).
- b. Code 3 transactions for non-financial assets (where separate components are desired) would be 4,500 (4,000 acquisitions, 4,500 deposal, 3,000 net negative consumption of fixed capital, and a net holding gain of 1,000).
- c. Code 3 transactions for liabilities (where netting is permitted) would be 1,000 net settlement.
- d. Code 4 transactions for non-financial assets would be a net holding gain of 1,000 and a net holding loss of 1,000 for liabilities. There were no Code 4 transactions for financial assets.
- e. Code 5 transactions for financial assets would be a net decrease of 1,500. There were no Code 5 transactions for non-financial assets or liabilities.

These transactions would be reflected in the Statement of Financial Position prescribed by the IPSASs as follows:

Statement of Financial Position							
				2002		2001	
Assets							
Financial Assets					6,500		5,000
Non-Financial Assets				16,500		15,000	
Less Acc. Depreciation				<u>3,000</u>	<u>13,500</u>	<u>6,000</u>	<u>9,000</u>
Total Assets					20,000		14,000
Less Liabilities					<u>3,000</u>		<u>4,000</u>
Net Assets/Equity							
Acc. Surplus/(Losses)				13,500		5,000	
Holding Gains/(Losses) Non-Financial Assets				3,000		2,000	
Other Volume Changes Financial Assets				250		1,750	
Holding Gains/(Losses) Liabilities				<u>250</u>		<u>1,250</u>	
Total Net Assets/Equity					<u>17,000</u>		<u>10,000</u>

## FINANCIAL STATEMENTS

IPSAS 1 and 2 recommend that governments prepare whole-of-government financial statements which would consolidate the financial statements from the GBEs with those from the general government sector. The GFSM excludes the financial statements from the GBEs and recommends reporting the financial results for the general government sector only. Both the IPSAS and the GFSM recommend four sets of financial statements but they differ in content and format. However, if the Chart of Accounts is properly coded, the database used to prepare the IPSAS financial statements can also be used to prepare the GFS financial statements since both sets of financial statements are extracted from the same accounting system. The Cash Flow Statement prescribed by IPSAS 2 is preferred (especially the direct method) since it deals strictly with cash transactions whereas the Cash Flow Statement prescribed by the GFSM mixes cash transactions with accrual transactions.

The use of Code 3 transactions confuses the issue as far as an accounting system is concerned. However, this information desired by the IMF can be easily provided by subtracting the beginning balance from the ending balance and taking into consideration the volume changes (Codes 4 and 5) for the specified assets and liabilities. For example, the Code 6 accounts can be used to make direct entries on assets and liabilities. The entry would be to debit the asset and credit Accounts Payable upon purchase of an asset.

The Code 4 and Code 5 accounts are Reserve accounts in the Net Assets section of the General Ledger. If an asset increases in value on revaluation, the asset would be debited and the Reserve account (Code 4) would be credited. In like manner if there are other volume changes that increase the asset value, the asset would be debited and the Other Volume Changes account (Code 5) would

be credited. Subtracting the beginning balances from the ending balances in the Code 6 accounts and considering the entries in the Code 4 and Code 5 accounts (the codes 4, 5, and 6 accounts are all real accounts), the amounts desired for the Code 3 accounts can be derived.

## CONCLUSION

The Chart of Accounts is crucial to the design of any accounting system and it must be flexible enough to maintain fund control and give management sufficient information to oversee the efficient and effective use of all economic resources. The IPSASs provide the procedures necessary to identify which accounting transactions to recognize and how they should be measured. Using these standards as the basis for the Chart of Accounts, an accounting system can be properly designed. In the design of the accounting system, the coding structure provided by the GFSM readily identifies the information that needs to be designed into the accounting system in order to be able to extract the pertinent information for the financial statements desired by the IMF. As soon as the Chart of Accounts is adopted, a test budget can be entered into the system along with some test postings. Then, all standard reports can be checked and further reports that might be needed can be defined.

When these steps are completed, the operations definitions can be finalized and the operations in the system can be implemented. This will permit the operations to be tested at one or more pilot organizations. When these pilots have been successfully tested, the system can be rolled out to all organizations to be included in the system. The key to successful implementation is the full and complete definition of the Chart of Accounts.

## End Notes

1. Cash Basis IPSAS and Handbook of International Public Sector Accounting Standards (2004 Edition) published by the International Federation of Accountants. For those countries that have adopted the IPSASs, the IPSASs are the standards that the Supreme Audit Office uses in each country on which to base their audit opinion relative to the fair presentation of the general purpose financial statements.

2. Government Finance Statistics Manual, 2001 published by the International Monetary Fund. There are no audit requirements for the Supreme Audit Office to express an opinion of the fair presentation of the financial statements extracted from the accounting system.

3. Footnote 6, pg. 5, GFSM 2001.

4. Adapted from Wilson, Kattelus, Hay; *Accounting for Governmental and Nonprofit Entities*, 12th Edition (McGraw-Hill, Irwin, 2001).



# ISSUES IN ACCRUAL BUDGETING

By: JON R. BLÖNDAL<sup>1</sup>

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There would appear to be a growing consensus among OECD member countries concerning the merits of adopting accrual **accounting** in the public sector. Nearly one-third of member countries have adopted full accrual accounting and a number of other member countries have adopted accrual accounting for specific transactions—most frequently for the recording of interest on the public debt and employee pension costs (see Table 1).

There would appear to be less consensus regarding the adoption of accrual **budgeting** (accrual appropriations)<sup>2</sup> where views diverge widely on its desirability. Only three member countries have adopted full accrual budgeting, although several member countries have adopted accruals for specific transactions in the budget—again, most frequently for the recording of interest on the public debt and employee pension costs (see Table 2).

This paper is not designed to advocate a specific stance in regards to the adoption of accrual budgeting. Rather, it is designed to focus attention on some of the key issues involved in accrual budgeting. The adoption of accrual budgeting often offers a wide range of options for implementing many of the key issues, and the paper aims to highlight these.

The paper attempts to isolate the issues relevant to accrual budgeting specifically. For a more general discussion of accruals, see "Accrual Accounting and Budgeting: Key Issues and Recent Developments" (*OECD Journal on Budgeting*, 3:1, 2003).

## Box 1. Accruals and cash

Accruals and cash are often portrayed as opposing end-points on a spectrum of possible bases for accounting and budgeting. The cash basis of accounting and budgeting recognises a transaction when the cash is received or when cash is paid out. The accruals basis recognises a transaction when the activity (decision) generating revenue or consuming resources takes place, regardless of when the associated cash is received or paid.

In fact, cash is an inherent feature of the accruals basis and the two work very much in tandem. Accruals records transactions **both** on an accruals basis, as described above, and on a cash basis. The operating (profit and loss) statement presents the information on an accruals basis and the cash-flow statement presents the information on a cash basis.

This paper begins by discussing the benefits of adopting accrual budgeting as highlighted by its advocates together with a discussion of the issues raised by its detractors. The paper then discusses a series of "technical" issues involved with the adoption of accruals—including the treatment of non-cash items in appropriations, cash management systems, controlling capital assets acquisitions and opening balance sheet values. All of these relate directly or indirectly with the capitalisation and depreciation of assets, which is (one of) the fundamental differences between cash and accruals bases. The paper next discusses

the implications of accrual budgeting for fiscal policy setting and concludes with a discussion of its impact on the role of parliament.

## 1. Benefits of accrual budgeting

The advocates of accrual budgeting point to many specific benefits that accrual budgeting may bring. These can usefully be divided into the following six groups:

- First, accrual budgeting provides **improved cost information to decision makers and improved discipline for budget execution purposes**. Decisions will now be based on the total cost of producing outcomes and outputs, rather than only the immediate cash outlay. (Non-cash items are discussed in section 2 below.) Budget execution must also have regard to costs being deferred and is more constrained from undertaking activity for which the cash impact will affect later reporting periods. This is especially relevant when managers have increased autonomy to act on this improved information.

Detractors note that for most transactions the cash and accrual numbers will be the same, as the timing difference in recording transactions only affects relatively few areas. The budget could incorporate accruals for the specific transactions where it is of significance—employee pensions, interest on the public debt, etc. Other approaches such as commitment budgeting can be employed to ensure budget discipline is maintained in a devolved managerial environment.

Various forms of centralised funds in a cash budgeting environment could serve the same purpose—for example, a special charge for employee pensions, a special charge for office accommodations, etc. Such central funds would be on an accruals basis, so in essence this means introducing accruals to specific parts of the budget. Of course, such mechanisms have their limits and would not be appropriate for some types of transaction.

- Second, accruals will focus attention on **improving the management of capital stock**. It provides better incentives to manage assets and dispose of those no longer needed, and better incentives in planning investments, as this affects depreciation. It also provides new impetus **to manage working capital** (debtors, creditors and stocks).

Detractors note that these are all important areas but can be improved without the adoption of full accrual budgeting.

- Third, accrual budgeting **eliminates biases perceived** to exist with the recording of capital investments as a “lump sum” rather than being capitalised and depreciated over its useful life. Capital spending is said to be neglected in the traditional cash-based budget framework, with the state of infrastructure and other capital assets being unsatisfactory as a result. If an asset has a useful life of—say—25 years, then why should its total acquisition cost be treated as a single item in one year’s budget rather than being capitalised and the costs distributed over its useful life through depreciation?

Detractors note that fiscal discipline may be undermined if it is possible to commit resources in one year with the financial impact (cost) only being recorded over a 25-year period. They note that a different “matching principle” is applicable to the public sector, one that matches the political decision to spend money with the time period when the total cost is recorded in the budget. The fundamental problem of determining depreciation—an integral

part of accrual budgeting—also creates a new opportunity for elected officials to expand government programmes without having to show any costs.

- Fourth, accrual budgeting will **illuminate the long-term sustainability of public finances** by highlighting the long-term consequences of current decisions. This derives from the incorporation of a balance sheet in the accrual budgeting framework that encompasses the government's assets and liabilities.

Detractors note that the government's greatest asset—its power to tax—and its greatest liability—the costs associated with ageing populations—do not meet the recognition criteria for assets and liabilities, respectively. As a result, accrual budgeting does not present a comprehensive picture of the sustainability of public finances.

Detractors of accrual budgeting also note that very long-term budget forecasts (40-75 years) on a cash basis may be a superior alternative for illuminating the sustainability of public finances. This eliminates the problems associated with the recognition criteria outlined above and other technical accounting issues which are detailed in later sections of this report. It also has the virtue of being easier for elected officials and the general population to understand.

- Fifth, the adoption of accrual budgeting is a **catalyst for other management reforms** in the public sector. The introduction of accrual budgeting cannot be seen in isolation: the countries that have adopted accrual budgeting have done so in the context of wider management reforms in the public sector, i.e. reducing input controls, increasing flexibility, focusing on outcomes and outputs. The introduction of accrual budgeting was a key lever for changing behaviours in this context and for fostering "culture change" in government.

Detractors note that the great expectations associated with accrual budgeting, not least in terms of its impact on "culture change", are exaggerated and that relaxing input controls and focusing on outcomes and outputs can be realised without the adoption of accrual budgeting.

- Sixth, proponents claim that accrual budgeting is necessary in order to **ensure symmetry with accrual financial reporting (accounting)**. This of course applies only to countries where accrual accounting has been adopted. It is argued that the two have to be on the same basis in order to enable comparability between the budget and the actual results, making them both easier to understand and assess. This is also fundamental in terms of the government's accountability for implementing the budget as authorised.

Detractors note that this is a "back door" argument for the adoption of accrual budgeting and as such has no merit. It could equally be stated that accrual accounting should be abandoned for the exact same reason. It should also be borne in mind that a number of member countries have explicitly rejected the linkage, whereas others have done so implicitly as evidenced by the greater acceptance of accrual accounting than accrual budgeting.

Furthermore, detractors note that accruals introduces a great deal of technical complexity into budgeting, thus making it less transparent and less understandable. Accruals also offers new opportunities for manipulation that are of a different nature than in cash budgeting (capitalising expenses, use of depreciation, valuations and revaluations, etc.). Opportunities for manipulation exist in cash budgeting as well but they mainly concern timing issues—e. delaying expenses beyond the reporting period, accelerating revenue collection from the next reporting period. Finally, the detractors of accrual budgeting note that its intro-

duction involves significant costs in training and systems upgrades and that the benefits simply are not worth it.

The discussion below focuses on the expenditure side of the budget while Box 2 provides a brief overview of the impact of the accruals treatment of tax revenue.

### **Box 2. Accrual tax revenue**

In a “perfect” accruals framework, tax revenue should be recorded at the time that the economic transactions which result in a subsequent taxation liability take place. It is however very difficult, if not impossible, to know when all such transactions take place.

As a result, revenue is generally recognised as accruing at the time the relevant tax law indicates the existence of a requirement to pay an amount of tax, or when a tax liability assessment is made. In short, revenue is only recognised when the taxpayer incurs an assessment to pay tax.

This generally means that the adoption of accrual budgeting requires only two changes to be made to the current cash estimates of tax revenue:

- First, an adjustment for tax receivables. This adjustment recognises revenue for which an assessment has been made but which has not yet been received, and excludes cash received which has already been accounted for in receivables (because it accrued in a previous reporting period).
- Second, an adjustment for bad and doubtful debts. This adjustment recognises the fact that some accounts receivable are never paid and are eventually written off. At the end of each financial year, tax receivables that are likely to become uncollectible are brought to account and expensed to the year just finishing. This matches the “expenditure” to the period in which it was incurred.

The issue of making provision for bad debts does not arise under cash accounting because the government only recognises receipts as they come in. Thus, the accruals treatment of tax revenue has the potential to improve the management of tax revenues (receivables).

Other possibilities exist as well. Some countries treat tax revenue essentially on a cash basis in an otherwise accruals framework. It is also possible to “time shift” the revenue backwards to the “appropriate” time period in accruals terms.

## **2. Appropriations for non-cash items**

The key difference between the accruals and the cash basis of budgeting is that accruals recognises expenses in the operating (profit and loss) statement when the activity consuming the resources takes place, and not when actual cash exchanges hands. Several accrual expenditures are however non-cash in nature—on an annual basis. These include depreciation, post-employment benefits (pensions, health care), interest payable on government debt, employee leave entitlements (annual leave, long-service leave), revaluations of assets (downward) and liabilities (upward), and payables at year end.

Questions arise about how such non-cash items should be treated under an accrual appropriations framework. In essence, there are two possible approaches that have been developed:

- Cash is appropriated for the full accrual amounts, including non-cash items such as depreciation. Agencies are expected to replenish their current assets

from accumulated depreciation and they have the budget authority to do so (cash-in-hand model).

- Cash is appropriated for only the cash component of full accrual amounts (no-cash-in-hand model).

The **cash-in-hand model** is the more radical of the two. Agencies would receive cash for both the cash required during the year and for the non-cash items—depreciation.<sup>3</sup> Their cash appropriation would therefore reflect the full cost of operating the agency.

The proponents of this model claim that the adoption of accrual budgeting is not simply about changes in how transactions are technically recorded in the budget, but is rather about introducing fundamental changes in how government is managed. The full cost of government is now to become the focus of the operating budget, rather than the immediate cash requirement. This can only be achieved if appropriations reflect these full costs with cash. Otherwise they will not be effectively managed. It was felt that if the no-cash-in-hand model had been adopted, the desired changes in management behaviour would not have materialised, since the actual appropriations received by ministries and agencies would have been essentially the same as with the old cash-basis budgeting framework.

The cash-in-hand model is especially attractive in cases where reforms of the public sector have involved a clear purchaser-provider split, with the purchaser expected to provide “outputs” in exchange for a given “price” reflecting the full costs of the outputs.

The downside of the cash-in-hand model is that control of cash and capital acquisitions (replacements) can become ambiguous. If an agency is given cash to fund depreciation expense, there is a risk that the money may be used for purposes other than replacing capital assets in the future. This applies equally to the officials in an agency, the Ministry of Finance and to elected officials. Clear criteria are required for the use of depreciation expense, i.e. to replace capital assets.

Similarly, parliament may lose control over how capital assets are acquired since it will have funded them through a depreciation expense in previous years. Cash management policies and specific controls over capital acquisitions can serve to alleviate these problems. They are discussed in subsequent sections of this paper.

The **no-cash-in-hand model** would only appropriate cash for the cash requirement of agencies. Non-cash items – such as depreciation – would not receive a cash appropriation. These items would nonetheless be recognised in the budget as approved by parliament. The budget would contain both the amount of the full accrual costs and the cash required. The financial statements of agencies would report the total accrual amount as revenue on their operating statement—in the same manner that all expenses are treated on an accruals basis. The difference between the cash requirement and the total full cost appropriations would be treated as accounts receivable in the balance sheet. This would give formal recognition to these non-cash items.

The proponents of the no-cash-in-hand model see it achieving the benefits of accrual budgeting with very little changes to current cash-based appropriation arrangements. Although appropriations would continue to be on a cash basis, the total amount recorded in the budget would also include the non-cash items. The model avoids any risks associated with spending cash received for non-

cash items on unrelated initiatives and serves to reinforce parliament's control over capital acquisitions.

The detractors of this model note that the very fact that it will not change the current appropriation arrangements means that in effect the old "cash-based" budgeting system is being continued and the desired "culture" shift in managing resources will not take place. There may also not be total faith in agencies ever receiving their accounts receivables as recorded in the balance sheet. This provides a new opportunity to "game" the system.

### 3. Cash management systems

The management of cash is typically centralised in the Ministry of Finance, and this has not changed for member countries that have implemented an accrual budgeting system.

The nature of appropriations is inherently linked to the cash management systems that the government employs, and therefore the interface between cash management and appropriations differs depending on the extent of "decentralisation" of the appropriation system. The decision on which appropriation system is to be employed will be dependent on views as to which system best aids the control of public finances by the legislature and which best reflects the discretion that agencies need to perform and to be responsive.

Appropriations may be designated as being for:

- the cash expenditure made **by** agencies;
- the cash provided **to** agencies;
- the costs incurred for the production of outputs **by** agencies;
- the price paid **to** agencies for the production of outputs.

The first approach and, in some cases, the second approach represent the no-cash-in-hand model as described above. The nature of the appropriation will ensure that the agency is only allotted the cash required for its operations in a given year. The last two approaches, and sometimes the second approach, represent the cash-in-hand model where the cash management system must also manage the transfer of cash to agencies that will not need the cash resources immediately.

One option is to allocate the cash but retain control of the agency banking arrangements so that the cash is still managed in a centralised manner. Another option would be to allocate to agencies only the cash that they need to cover their cash requirements. In effect, the cash management system would be used to transform the cash-in-hand model into the no-cash-in-hand model. The non-cash items would be a notional amount in their bank accounts—i.e. as receivables.

In all the above cases, strong controls are kept on cash and how it is used. Centralised systems can be put into place to control capital acquisitions (replacements). As with the no-cash-in-hand model described above, the problem with this approach is that it may undermine the desired culture change, i.e. there may be no change in management behaviour from the traditional cash-based budgeting systems.

The other extreme would be for agencies to receive cash "in their account" for the full amount of the non-cash component of their appropriation. Agencies would have the responsibility to manage this part of their appropriation. They would be subject to general cash management arrangements such as sweeping

balances in all accounts overnight. More detailed controls could vary. For example, the use of appropriations for non-cash items could be discretionary for each agency only up to a certain amount. All amounts in excess could require the approval of the Ministry of Finance. These issues are further discussed in the next section.

#### 4. Control of capital assets acquisitions

The manner in which control of capital assets acquisitions is exercised is critical to the adoption of accrual budgeting. There are two related issues involved here. The first is a conceptual view on the role of accumulated depreciation in funding new capital assets acquisitions. The second is a practical view on how capital assets acquisitions should be conducted.

The **role of accumulated depreciation** can be characterised as either of the following:

- Accumulated depreciation expense that an agency has acquired gives it a right to capital spending in that amount.
- Accumulated depreciation expense that an agency has acquired DOES NOT give it a right to capital spending in that amount.

The first approach is based on the fact that agencies with accumulated depreciation should be allowed to spend that money on new capital acquisitions. This approach recognises that control over that capital expenditure passed to the agency when the legislature approved the depreciation expense in each previous year. This approach would be in line with the “culture change” argument and the need to empower agencies to manage their total expenditure.

A critique of this approach is that it may not result in optimal capital decisions since the accumulated depreciation on past assets may not be a guide to the desired allocation of future capital expenditure, i.e. this approach assumes that capital decisions made in the past would continue to be appropriate in the future. Under this approach, many parliamentarians also feel that they have lost control over capital acquisitions since their only involvement was to approve the depreciation expense on existing assets. Also this approach may be acceptable for minor assets, but will become increasingly risky as the expenditure relates to larger and longer lived assets.

The second approach is that accumulated depreciation gives no right to capital expenditure. Agencies would receive appropriations for non-cash items such as depreciation per the no-cash-in-hand model as described in a previous section above, but would not have any right to use it. This approach recognises that a whole-of-government review of capital requirements is more likely to result in optimal capital decisions than a system which is based on historic capital expenditure patterns. This approach also gives an overall view of assets in terms of their condition and whether their value is being maintained. It also reinforces the role of parliament in approving all expenditures, including specific capital expenditures.

The critique of this approach is that it does not empower managers and would not in effect reflect any changes from the present manner of capital acquisitions.

The second issue—**how capital assets acquisitions should be conducted**—is directly related to the above. If agencies have already received parliamentary authority for capital expenditure in the form of accumulated depreciation, then they can use that money in accordance with guidelines and the approval of the

Ministry of Finance. If agencies have no such authority, they will need to seek parliamentary approval for all capital acquisitions in the form of a capital budget.

It should be recognised, however, that new capital acquisitions will often consist of using both accumulated depreciation and new funding. In general, this can either be achieved by a system of internal loans or by separate capital appropriations (equity injections) to the respective agency.

Under the former approach, the Ministry of Finance would lend to the relevant agency sufficient money to cover the cost of new capital acquisitions in excess of accumulated depreciation. This would then be repaid by the agency from future appropriations. Such a facility is most suitable for smaller capital acquisitions. Limits to this regime and effective parliamentary supervision would need to be put in place.

In other cases, it may be decided that that the level of capitalisation of an agency needs to be increased and a separate capital appropriations (equity injection) be made to the agency. This could take place in the context of a capital budget. The importance of the level of capitalisation of agencies is discussed in the next section.

### **Box 3. Role of accumulated depreciation expense**

When it comes to financing new initiatives, the funds that an agency may have in accumulated depreciation can be considered a pool of fungible funds. The agency itself, the Ministry of Finance, and/or parliament may view that the mission of an agency has changed and that the funds should be used for other activities than new capital acquisitions. This raises questions about whether restrictions should be placed on the use of such funds, for example that they can only be used for new capital acquisitions.

## **5. Opening balance sheet values**

A key challenge in accrual budgeting is to ensure that the opening balance sheet is as accurate as possible since the balance sheet provides the base information for the calculation of depreciation – and in turn future capital acquisitions (replacements).

### **Box 4. Registering and valuing assets**

The most basic issue, yet often the most time-consuming and difficult one, associated with the adoption of accruals is to identify and value the assets that the government owns. Governments have traditionally not kept accurate and up-to-date registers of assets, a fact noted by supporters of accruals as a good example of the advantages of adopting accruals.

Valuing assets poses special problems in the public sector as well.

First, the government owns categories of assets that are uniquely public sector in nature—military assets and heritage assets such as museums and monuments being prime examples—that can be very difficult to value. The usefulness of such valuation may be quite questionable as well.

Second, accruals offers the choice of valuing assets according to either historical cost or fair value (usually market value, but in the absence of reliable market values, replacement cost is usually used as a proxy). Both are accepted valuation methodologies under GAAP (generally accepted accounting principles). Historical cost gives the

advantage that the numbers used are certain in the sense that they are based on a verifiable acquisition price of each asset and do not fluctuate. The disadvantage is that the reported amounts generally bear little relevance to the current value of the asset. Furthermore, the original acquisition price in the public sector is often unknown or at nil or nominal amounts. Market value gives the advantage that the reported amounts are in line with their current value. The disadvantages lie in the fact that professional judgments must be made in assessing their values and that their values can fluctuate sharply between reporting periods. Regardless of which method is adopted, it is of primary importance that that method be applied consistently.

At the time of the switch to accrual budgeting, a decision needs to be made whether the level of assets in a given agency is too low, too high, or appropriate for it to carry out its activities on a sustainable basis. It should not simply be assumed that agencies have the correct level of assets; this needs to be analysed and optimised.

Agencies may of course make proposals for an increased level of assets in future years, but the underlying assumption will generally be that agencies started out with the capital necessary to ensure sustainability of their activities. Capital injections to purchase additional assets will of course become part of the annual budget formulation process in an accruals environment, but such requests should be limited to responses to new demands and needs rather than rectifying past “mistakes”.

Conversely, where there may be concerns that agencies are “asset-rich”, it will be difficult to reduce the level of assets once the switch to accrual budgeting has been implemented because these excess assets represent a source of funding for the agency in the form of depreciation. Member countries that have adopted accrual budgeting have generally introduced a system of “capital charging” as well to align the goals of individual agencies with the whole-of-government perspective. Box 5 highlights a capital charging regime.

### **Box 5. Capital charging**

A capital charge is levied on an agency and is designed to be a substitute for interest costs and a return on capital. At a minimum, the charge should cover the government’s cost of borrowing. This is the bottom line cost of government. However, the activities conducted by governments are not without risk, and it is possible to argue that some form of risk premium in addition to the government’s borrowing cost is also appropriate.

A capital charge usually consists of a rate levied on an asset base. The rate will vary depending upon the way in which it is calculated and the countries in which it is operating, but will normally be in the region of 5-15%. The asset base upon which the charge is levied could be: total assets, fixed assets, total assets less current liabilities, or total assets less all liabilities.

One of the main incentives associated with a capital charge regime is that agencies may retain savings that they make by reducing the amount of the charge. The impact of this incentive will depend upon the extent to which agencies actually realise the benefits of such savings. In some OECD member countries, the system of legislative appropriations may mean that any additional spending has to be formally approved. Administrative mechanisms may need to be developed to address this issue and to reduce the transaction costs associated with the operation of the incentive.

Another issue which needs to be considered is whether the charge will be fully funded in its first year of application. If it is fully funded, then agencies’ financial positions do not immediately alter. However, there is an incentive to reduce asset holdings because

that will reduce the capital charge in subsequent periods.

For a more comprehensive discussion of capital charging, see “Modern Financial Management Practices” (*OECD Journal on Budgeting*, 2:2, 2002).

## 6. Fiscal policy setting

To date, fiscal policy setting has been inherently a cash-based concept—measuring the flows between the budget and the economy as a whole. The accrual balance and the cash balance will—by definition—diverge. (It should be noted that some countries apply the national accounts [statistical] basis for this purpose, which incorporates elements of accruals.) Assessment of the impact of the budget on the economy is therefore more likely to be driven from the cash-flow statement than from the operating (profit and loss) statement.

Reconciliation between the cash-flow statement and the operating statement is mainly due to two factors—revaluations and depreciation/capital expenditure. **Revaluations** reflect changes to the value of assets and liabilities. These revaluations do not affect cash measures of the budget balance; they reflect changes in the value of assets and liabilities resulting from non-transactions—such as changes in market values. **Capital expenditure** is not measured on the operating statement of governments; it considers the depreciation (capital use) instead. The adjustment required here is to add capital expenditure and delete depreciation expense.

Both to aid understanding and to assist in assessing the economic impact of the budget, member countries that budget on an accruals basis report the details of these reconciliations. It may be necessary to offer sector-specific details of the adjustments/cash-flows as well.

Increasingly, fiscal policy has regard to issues of sustainability of the government’s policies. The operating statement and the balance sheet provide a richer (although not complete) set of indicators that is regarded by proponents of accrual budgeting as being more useful in these regards.

In particular, a fiscal indicator or target that encapsulates the extent to which assets are being consumed or impaired, and which accounts for growing or reduced provisions in “pay-as-you-go” programmes, is more likely to accurately reflect and influence the sustainability of the government’s policies than targets that do not.

## 7. The role of parliament

Parliament’s “power of the purse” is the primary vehicle for the legislature to hold the executive to account. It is therefore of fundamental constitutional importance that parliament be fully satisfied with—and fully understand—the nature of accrual budgeting. The experience of countries that have adopted accrual budgeting demonstrates that this can be most challenging. In this respect, it needs to be recognised that budgeting is an inherently political act.

Due to its technical nature, accruals can confuse decision makers, reducing its transparency and understandability, and therefore undermine parliament’s role in the budget process. It should be noted that the three OECD member countries that have adopted accruals are all Westminster countries that give pre-eminence to the executive in budgetary matters and a limited role to Parliament.

Irrespectively, accruals requires a great number of professional judgments to be made on a variety of issues. It can be fairly said that accruals opens up many opportunities for “creative” accounting, as was discussed in a previous section. The role and independence of standards-setters is therefore of primary importance, and this is very much acknowledged by proponents of accrual budgeting.

A specific concern of parliament with the adoption of accruals also has to do with the treatment of capital acquisitions/depreciation. In a sense, parliament can be said to have delegated authority over capital acquisitions to the executive through approving depreciation expenses. Parliament will not have specific controls unless a regime (capital budget, for example) is put in place to support them.

## 8. Conclusions

This paper discussed the views of proponents and detractors of accrual budgeting and attempted to throw light on many of the “technical issues” surrounding its implementation. The paper has also surveyed the impact on fiscal policy setting and the role of parliament.

What emerges clearly from the discussion is the wide disparity of views among the budgeting community on the desirability of accrual budgeting. The discussion has also revealed that there is a great variety of models for implementing accrual budgeting, some more radical than others. The three member countries that have implemented full accrual budgeting exemplify the differing models in many ways.

It is also important to note that none of the member countries that adopted accrual budgeting did so in isolation; it was done in the context of far-reaching reforms in other areas of government management. Accrual budgeting was therefore part of a much wider reform agenda and it is difficult to assess the role specifically played by accrual budgeting. The importance of implementing accrual budgeting in terms of achieving “culture change” is, however, emphasised by all the countries that have adopted accrual budgeting.

Whether or not to adopt accrual budgeting will likely be on the agenda of member countries for a long time to come. It is an area that is ripe for more in-depth comparative analysis.

## End Notes

1. Jón R. Blöndal is Deputy Head, Budgeting and Management Division, Public Governance and Territorial Development Directorate, OECD.

2. This paper uses the term “budget” to refer to the law or collection of laws authorising expenditures, and/or the incurrence of obligations to make expenditures, to be financed from taxes or levies. It is recognised that this term does not have a unified meaning across all member countries, especially Westminster countries.

3. The discussion here uses depreciation as the main example for the treatment of non-cash items in general.

*NOTES: Methodology for classification of countries in Table 1 and Table 2*

- Refers to core national governments only and does not consider the use of accruals by local/regional governments or state-owned enterprises/other commercial organisations.
- Countries are classified as “full accruals basis” irrespective of whether heritage and military assets, and non-exchange revenue (taxes), are treated on cash basis.

**Table 1. Use of accrual accounting in OECD member countries**

## Whole-of-government financial statements

	Cash basis	Cash, except certain transactions on accruals basis	Accruals, except for capitalisation and depreciation of assets	Accruals basis
Australia				X
Austria	X			
Belgium	X			
Canada				X
Czech Republic	X			
Denmark		X		
Finland				X
France		X		
Germany	X			
Greece	X			
Hungary	X			
Iceland			X	
Ireland	X			
Italy	X (*)			X (*)
Japan	X			
Korea		X		
Luxembourg	X			
Mexico		X		
Netherlands	X			
New Zealand				X
Norway	X			
Poland		X		
Portugal		X		
Slovak Republic	X			
Spain		X		
Sweden				X
Switzerland	X			
Turkey	X			
United Kingdom				X
United States				X

Source: OECD.

(\*) To be verified.

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- Countries are classified as “full cash basis” irrespective of whether they have an obligations/commitments system in place.
  - Refers to financial reporting and not to statistical reporting (GFS).

**REFERENCES**

Ball, Ian (2002), “Modern Financial Management Practices”, *OECD Journal on Budgeting*, Volume 2, Number 2, p. 49-76.

Blöndal, Jón R. (2003), “Accrual Accounting and Budgeting: Key Issues and Recent Developments”, *OECD Journal on Budgeting*, Volume 3, Number 1, p. 43-59.

**Table 2. Use of accrual budgeting in OECD member countries**  
Accrual appropriations

	Cash basis	Cash, except certain transactions on accruals basis	Accruals, except for capitalisation and depreciation of assets	Accruals basis
Australia				X
Austria	X			
Belgium	X			
Canada		X		
Czech Republic	X			
Denmark		X		
Finland			X	
France	X			
Germany	X			
Greece		X		
Hungary	X			
Iceland			X	
Ireland	X			
Italy	X (*)			X (*)
Japan	X			
Korea		X		
Luxembourg	X			
Mexico		X		
Netherlands	X			
New Zealand				X
Norway	X			
Poland	X			
Portugal		X		
Slovak Republic	X			
Spain	X			
Sweden		X		
Switzerland	X			
Turkey	X			
United Kingdom				X
United States		X		

Source : OECD.

(\*) To be verified.



# LAW ON THE AUDITING OF THE FINANCIAL OPERATIONS OF THE INSTITUTIONS OF BOSNIA AND HERZEGOVINA

Website: [www.revizija.gov.ba/en/audit-law/](http://www.revizija.gov.ba/en/audit-law/)

SLUZBENI GLASNIK - Number 17/99, October 1999

English Certified Translation: Prepared by the World Bank

Endorsed by the Office of the High Representative

## I BASIC PROVISIONS

### Article 1

This Law provides for establishment and method of working of the Office for Auditing of the Financial Operations of Institutions of Bosnia and Herzegovina, appointment of the Auditor General, Deputy Auditor General, Acting Auditor General and Acting Deputy Auditor General, defines authorities, powers and responsibilities of the Auditor General, kinds of auditing and submission of audit reports, establishment and function of the Coordination Committee of the Supreme Audit Institutions and quality assurance of the Audit Office for the Financial Operations of the Institutions of Bosnia and Herzegovina

## General definitions

### Article 2

In this Law, the terms used have the following meaning:

**“Office for Auditing of the Financial Operations of the Institutions of BiH”** means the Supreme Audit Institution for Financial Operations established by article 3 of this law;

**“Auditor-General”** means the person appointed to the post under this Law;

**“Co-ordination Committee”** means the technical committee comprising the Auditors-General of the Supreme Audit Institutions in Bosnia and Herzegovina established by article 29;

**“Institutions”** means all institutions of Bosnia and Herzegovina determined by the constitution and the law, any government agency, or any company in which the government has a share-holding, regardless of the size of that share-holding;

**“House of Parliament”** means each separate chamber of Parliament;

**“Minister”** means the Minister responsible for Finance;

**“Performance audit”** in relation to a person or body, means a review or examination of any aspect of the operation of that person or body;

**“Presidency”** refers to the Presidency of the Presidency of Bosnia and Herzegovina;

**“Pre-audit”** refers to the examination or certification of accounting transactions as part of the accounting system;

**"Responsible Minister"** means the Minister within whose portfolio responsibility for the area under review falls.

**"Authorized Official"** means any official appointed by the Auditor General, in writing, to carry out duties or functions;

**"Premises"** means any building, office, land or site.

## **II OFFICE FOR AUDITING OF THE FINANCIAL OPERATIONS OF THE INSTITUTIONS OF BOSNIA AND HERZEGOVINA**

### **Foundation**

#### Article 3

(1) The Supreme Audit Institution is established under the name of the "Office for Auditing the Financial Operations of the Institutions of Bosnia and Herzegovina" (Hereinafter: Audit Office).

(2) The Audit Office comprises the Auditor General and staff identified under Article 5. of this law.

### **Function**

#### Article 4

Function of the Audit Office is to help the Auditor General in carrying out his task of Auditor General.

### **Staff**

#### Article 5

Staff of the Audit Office shall be appointed in accordance with the Rules of Service agreed between the Auditor General and the Council of Ministers, which must not be less advantageous than the ones provided for government servants of Bosnia and Herzegovina.

## **III AUDITOR GENERAL**

### **Auditor General**

#### Article 6

(1) There shall be an Auditor-General for the Financial Operations of the Institutions of Bosnia and Herzegovina appointed under this Law.

(2) The Auditor-General shall be appointed by the Presidency acting only in accordance with the advice of both Houses of the Parliamentary Assembly of Bosnia and Herzegovina;

(3) The Auditor-General shall be appointed for a fixed, non-renewable period of five years. The Auditor-General should not normally be aged over sixty years old on appointment.

(4) The Auditor-General may resign in writing to the Presidency.

(5) The Presidency may remove the Auditor-General from office only if each House of Parliament passes a motion asking for the removal of the Auditor-General on the grounds of misbehavior or the quality of audit work fails to meet the standards determined in accordance with Article 9 of this Law.

(6) The Auditor-General's salary and allowances shall be prescribed in the Regulations made in accordance with this Law and should not be less than those that would be paid to a national holding the position of Governor of the Central Bank. Such salary and allowances will be a direct charge to the budget.

(7) The appointment of the Auditor-General and any cessation of appointment shall be reported in the Official Gazette of Bosnia and Herzegovina and Official Gazettes of the Entities.

### **Deputy Auditor-General**

#### Article 7

(1) There shall be two Deputies to the Auditor General for the Financial Operations of the Institutions of Bosnia and Herzegovina appointed under this Law.

(2) The Deputies to the Auditor General shall be appointed by the Presidency acting only in accordance with the advice of both Houses of the Parliamentary Assembly of Bosnia and Herzegovina;

(3) The Deputy Auditor General shall be appointed for a fixed, non-renewable period of five years. The Deputy Auditor General should not normally be aged over sixty years old on appointment.

(4) Deputy Auditors-General shall be appointed from the other two constituent peoples nationalities than that from which the Auditor-General has been appointed.

(5) The Deputy Auditor General may resign in writing to the Presidency.

(6) The Presidency may remove the Deputy Auditor General from office only if each House of Parliament passes a motion asking for the removal of the Deputy Auditor General on the grounds of misbehavior or the quality of audit work fails to meet the standards determined in accordance with Article 9 of this Law.

(7) The Deputy Auditor General's salary and allowances shall be prescribed in a separate act, in accordance with this law.

### **Acting Appointment**

#### Article 8

(1) The Presidency shall appoint a Deputy Auditor-General to act as Auditor-General:

(a) if there is a vacancy in the office of Auditor-General; or

(b) during any period when the Auditor-General is absent from duty or is, for any reason, unable to perform the duties of office.

(2) An Acting appointment shall not exceed a period of six months.

(3) A person Acting under this article is entitled to the same remuneration and allowances as apply to the office of Auditor-General.

(4) The appointment of an Acting Auditor-General and any cessation of that appointment shall be reported in the Official Gazette of Bosnia and Herzegovina and Official Gazettes of the Entities.

## **IV MAIN FUNCTIONS AND POWERS OF THE AUDITOR-GENERAL**

### **Duties of the Auditor-General**

#### Article 9

(1) In discharging his duties under this Law, the Auditor-General shall satisfy himself:

(a) that all reasonable precautions have been taken to safeguard the collection and custody of revenues and that the law, instructions and directions relating thereto have been duly observed;

(b) that the disbursement of revenues, including extra budgetary funds, has taken place under the proper authority and for the purposes intended by such authority;

(c) that all reasonable precautions have been taken to safeguard the receipt, custody, issue and proper use of public reserves, and that the instructions relating thereto have been duly observed.

(2) In addition to his duties under paragraph (1) the Auditor-General shall draw to the attention of the Minister and the responsible Minister any apparent lack of economy, efficiency or effectiveness

(a) in the collection and custody of revenues.; and

(b) in the expenditure or utilization of revenues, including extra budgetary funds, or reserves.

### **Duties not to be undertaken**

#### Article 10

(1) The Auditor-General shall not undertake any pre-audit examination or certification of accounting transactions as part of the accounting system where in his opinion this would preclude the proper exercise of his functions under this Law. In case that such refusal occurs, the Auditor General must deliver in writing the reasons for refusal to the requesting institution, within 56 days from the day of their submitting the original request;

(2) The Auditor-General shall not undertake any duties outside those he is required, by or under this Law, to perform if he considers that such duties are incompatible with the responsibilities of his office.

### **Functions under other Laws**

#### Article 11

The Auditor-General's functions include any functions given to the Auditor-General by any other Law.

### **Delegation by the Auditor-General**

#### Article 12

(1) The Auditor-General may, by written instrument, delegate any of the Auditor-General's powers under any Law to any Audit Office employee or contracted staff. The Auditor-General may not delegate his responsibilities in any case.

(2) In exercising powers of functions under the delegation, the employee or contracted staff member must comply with any directions of the Auditor-General.

### **Accounts and Audit**

#### Article 13

(1) The Auditor General carries out annual audit of public accounts, which includes all ministries, offices, courts and bodies of Government, public funds to the extent that the accounts are available, except in the case described under paragraph (6) of this article and reports to the Parliamentary Assembly of Bosnia and Herzegovina.

(2) Where the public accounts of any defined body are not made available within six months after conclusion of the reconciliation period, the Auditor General shall notify the Parliament of Bosnia and Herzegovina of that fact.

(3) The Auditor-General's functions in relation to public accounts include but are not limited to auditing financial statements or reports of:

(a) enterprises, companies, organizations or institutions partially or wholly owned, controlled or funded from the government budget or other funds controlled or guaranteed by Bosnia and Herzegovina;

(b) institutions or activities which receive government funds or funds provided by any external organization, either as a loan or grant, to Bosnia and Herzegovina.

(4) In reporting on the public accounts referred to in paragraphs (1) and (2), the Auditor-General shall report:

(a) whether the accounts have been compiled in accordance with all relevant legislation;

(b) whether the annual accounts present a true and fair view of the operations for the year and of the position at the year end; and

(c) on the economy, efficiency and effectiveness with which the organization has used its resources in discharging its functions.

(5) The Auditor-General shall submit his reports to the Presidency and Parliamentary Assembly of Bosnia and Herzegovina, and he shall also send a copy of each report to the Finance Minister and the responsible Minister concerned.

(6) Until December 31, 2002, the Auditor General shall not have to report on all public accounts defined under paragraph (1); however, he will have to provide to the Parliament of Bosnia and Herzegovina an abstract of all public accounts published, and those audited, taking into account the funds made available to the Auditor General. In determining the time during which the accounts shall be audited, the Auditor General shall set forth the priorities, taking into account the importance of the amounts at issue, and probability of loss for the Government.

## **Performance Audits**

### Article 14

(1) In terms of economy, efficiency and effectiveness the Auditor-General may at any time conduct a review or examination of a particular aspect of the operations of the whole or part of any institution of which the Auditor-General has the right to undertake audits.

(2) As soon as practicable after completing the report on an audit under this article, the Auditor-General shall submit his report to the Presidency who shall cause it to be laid before Parliament; and he shall also send a copy of each report to the Finance Minister and the responsible Minister concerned.

(3) The Auditor-General may give a copy of the report to any other Minister who, in the Auditor-General's opinion, has a special interest in the report.

## **Comments on draft reports**

### Article 15

(1) After preparing a draft performance audit report, the Auditor-General must give a copy of the draft report to the head of the administration of the institution concerned.

(2) If the recipient of the draft report gives written comments to the Auditor-General within 28 days after receiving the draft report, the Auditor-General must consider those comments before preparing a final report and where there is disagreement include those comments in the final report to be laid before Parliament of Bosnia and Herzegovina.

### **Special Audits and Audits by arrangement**

#### Article 16

(1) The Auditor-General may at any time carry out special audits at the request of the Parliament of Bosnia and Herzegovina or at the specific request of a related institution.

(2) The Auditor-General may enter into an arrangement with any person or institution:

(a) to audit financial operations of the person or institution;

(b) to conduct a performance audit of the person or institution;

(c) to provide services to the person or institution that are of a kind normally performed by auditors.

(3) Special audits and audits by an arrangement may provide for the payment of fees to the Auditor-General. The fees are to be received by the Auditor-General on behalf of the government.

(4) The Auditor-General must not perform functions under this article for a purpose that is outside the government's legislative power.

### **Auditing Standards**

#### Article 17

(1) The Auditor-General must implement the audit standards as approved by the Co-ordination Committee and ensure that such standards that are complied with by persons undertaking any audit function under this Law.

(2) If the Auditor-General becomes aware of any breaches of these standards, the Auditor-General must report on the breaches in a report under Article 18.

### **Extra reports to the Parliamentary Assembly of Bosnia and Herzegovina**

#### Article 18

(1) The Auditor-General may at any time cause a report to be tabled in the Parliament of Bosnia and Herzegovina on any matter.

(2) The Auditor-General must give a copy of the report to the Presidency, the Finance Minister and to any other Minister who, in the Auditor-General's opinion, has a special interest in the report.

### **Extra reports to Ministers**

#### Article 19

(1) The Auditor-General must bring to the attention of the responsible Minister any important matter that comes to the attention of the Auditor-General while:

(a) conducting an audit; or

(b) performing other functions.

For this purpose, "important matter" means any matter that, in the Auditor-General's opinion, is important enough to justify it being brought to the attention of the responsible Minister.

(2) The Auditor-General may at any time give a report to any Minister on any matter.

### **Contracting outsiders to assist with audits**

#### Article 20

The Auditor-General, on behalf of the Government, may engage any person under contract or in a working relationship, to assist in the performance of any Auditor-General function.

### **Annual report of the Audit Office**

#### Article 21

Within three months after 31 December each year, the Auditor-General must:

- (a) prepare a report on the operations of the Audit Office during that year; and
- (b) cause a copy of the report to be tabled in each House of Parliament.

## **V INFORMATION GATHERING POWERS AND SECRECY**

### **Information gathering powers not limited by other laws**

#### Article 22

The operation of articles 24 and 25 is not limited by any other law, except to the extent that the other law expressly excludes the operation of these articles.

### **Purpose for which information gathering powers may be used**

#### Article 23

The powers of articles 24 and 25 may be used for the purpose of, or in connection with, any Auditor-General function, except:

- (a) an audit or other function under article 11;
- (b) preparing a report under article 18 or 19;
- (c) reporting breaches of auditing standards set under article 17.

### **Power of the Auditor-General to obtain information**

#### Article 24

(1) The Auditor-General may, by written notice, direct an institution to do all or any of the following:

- (a) to provide the Auditor-General with any information the Auditor-General requires;
- (b) to attend and give evidence before the Auditor-General or authorized official;
- (c) to produce to the Auditor-General any documents in the custody or under the control of the person.

(2) The Auditor-General may direct that:

- (a) the information or answers to questions be given orally or in writing;
- (b) the information or answers to questions be verified or given by statement or affirmation.

The statement or affirmation is a statement or affirmation that the information or evidence the person will give will be true and may be administered by the Auditor-General or authorized official.

(3) A person described under paragraph 1 of this article must comply with a direction under this article.

(4) The regulations may prescribe scales of expenses to be allowed to persons who are required to attend under this article.

### **Access to premises**

#### Article 25

(1) The Auditor-General or authorized official:

(a) may, at all reasonable times, enter and remain on any premises occupied by the institution;

(b) is entitled to full and free access at all reasonable times to any documents or other property;

(c) may examine, make copies or take extracts from any documents.

(2) An authorized official is not entitled to enter or remain on premises if he fails to produce a written authority on being asked by the occupier to produce proof of his or her authority.

For this purpose, "written authority" means an authority signed by the Auditor-General that states that the official is authorized to exercise such powers.

(3) If an authorized official enters, or proposes to enter, premises under this article, the occupier must provide the official with all reasonable facilities for the effective exercise of powers under this article.

### **False statements**

#### Article 26

A person must not make an oral or written statement to an audit official if the person knows that the statement is false or misleading in a (material particular.) this may be a legal term, however it does seem a little clumsy

### **Confidentiality of information**

#### Article 27

(1) If a person has obtained information in the course of performing an Auditor-General function, the person must not disclose the information except in the course of performing an Auditor-General function or for the purpose of any Law that gives function to the Auditor-General.

(2) Paragraph (1) does not prevent the Auditor-General from disclosing particular information to the competent authority, if the Auditor-General is of the opinion that the disclosure is in the public interest.

### **Sensitive information not to be included in public reports**

#### Article 28

(1) The Auditor-General must not include particular information in a public report if:

(a) the Auditor-General is of the opinion that the information is sensitive information; or

(b) the Chief Legal Officer has issued a certificate to the Auditor-General stating that, in the opinion of the Chief Legal Officer, the information is sensitive information.

(2) If, because of paragraph (1), the Auditor-General decides:

(a) not to prepare a public report; or

(b) to omit particular information from a public report;

The Auditor-General may prepare a report under this paragraph that includes the sensitive information concerned. The Auditor-General must give a copy of each report under this paragraph to the Presidency, Finance Minister and responsible Minister or Ministers (if any).

(3) In this article “public report” means a report which is to be tabled in the Parliamentary Assembly of Bosnia and Herzegovina. “Sensitive information” is any information whose disclosure would be contrary to the public interest for reasons of security, defense, international relations, internal relations or which would prejudice the privileged commercial interests of any person or institution as recognized by law or accepted in normal commercial practice.

## **VI COORDINATING COMMITTEE OF THE SUPREME AUDIT INSTITUTIONS**

### *Article 29*

(1) There shall be established a Co-ordination Committee comprising the Auditor-Generals of the Supreme Audit Institutions of the Republika Srpska and the Federation of Bosnia and Herzegovina and Office for Auditing the Financial Operations of the Institutions of Bosnia and Herzegovina. This committee shall be chaired by the Auditor-General of the Supreme Audit Institution for the Financial Operations of the Institutions of Bosnia and Herzegovina. In the absence of the Auditor-General, the Co-ordinating Committee may be chaired by his authorised representative.

(2) The main functions of the Co-ordination Committee are to:

- (a) establish consistent audit standards;
- (b) ensure consistent audit quality;
- (c) assign audit responsibility for joint activities;
- (d) determine representation on international bodies.

The cost of the Co-ordination Committee and its Secretariat will be shared between the Supreme Audit Institutions on a basis to be determined under Regulations made in accordance with this Law.

## **VII QUALITY ASSURANCE IN THE AUDIT OFFICE**

### **Independent Quality Assurance**

#### *Article 30*

(1) Quality Assurance in the Audit Office shall be controlled by the Parliamentary Committee for Financial and Economic Policy.

### **Duties and responsibilities**

#### *Article 31*

(1) The Parliamentary Committee for Financial and Economic Policy may appoint an independent Quality Reviewer who will review the work of the Auditor-General’s office to establish whether such work is in accordance with the law, approved audit standards and internationally acceptable audit quality. The Quality Reviewer appointed under this article shall be an internationally recognized organization with expertise in the work of Supreme Audit Institutions. In order to carry out his work, the Quality Reviewer may examine files and other papers held by the Auditor-General, interview audit staff,

accompany such staff on an audits, or carry out such other investigation work, as the Reviewer considers necessary.

(2) The Parliamentary Committee for Financial and Economic Policy shall have the same information gathering powers and shall be subject to the same secrecy provisions as are applicable to the Auditor-General under Part V of this Law.

## **Reporting**

### Article 32

The Quality Reviewer shall each year:

(a) Submit to the Parliamentary Committee for Financial and Economic Policy a Quality Review Report on his work for the year containing conclusions and recommendations for action;

(b) In all Reports, except the first, the Quality Reviewer will comment on the extent to which recommendations from earlier Quality Review Reports have been acted upon;

(c) Submit the Report in draft to the Auditor-General, and the Auditor-General may within a period of 14 days make comments on the Report, which the Reviewer should take into account in preparing his final Report;

(d) The Parliamentary Committee submits the final Quality Review Report to the Presidency for submission to each House of the Parliament; and

(e) All quality review reports laid before Parliament in accordance with the provisions of this Law shall be recorded in the Official Gazette and be available for purchase from the Audit Office of Bosnia and Herzegovina at a fee to be decided upon by the Co-ordination Committee of the Supreme Audit Institutions.

## **Confidentiality of Information**

### Article 33

If a person has obtained information in the course of performing a function under this Part, the person must not disclose the information except in the course of performing a function.

## **VIII TRANSITIONAL AND FINAL PROVISIONS**

### **Guaranteed availability of parliamentary appropriations**

#### Article 34

The Finance Minister must issue funds in full for the amounts that the Parliament of Bosnia and Herzegovina appropriates to the Audit Office.

### **Auditor-General may approve expenditure**

#### Article 35

The Auditor-General has authority to approve a proposal to spend money under an appropriation for the Audit Office.

### **Audit Fees**

#### Article 36

(1) A person or institution whose financial statements are audited on its request is liable to pay audit fees for the audit, based upon a scale of fees determined by the Auditor-General with the approval of the Parliamentary Committee responsible for reviewing the Auditor-General's budget.

(2) Fees are payable within 30 days after issue of a payment claim. Payment claims for installments can be issued before the audit is complete.

(3) The Auditor-General, on behalf of the government, may recover unpaid fees as a debt in a court of competent jurisdiction.

(4) In the annual report under article 22, the Auditor-General must include details of the basis on which the Auditor-General determined the audit fees that applied during the financial year concerned.

### **Report Publication**

#### Article 37

All the Auditor-General's reports laid before the Parliament of Bosnia and Herzegovina in accordance with the provisions of this Law shall be recorded in the Official Gazette of Bosnia and Herzegovina and the Official Gazettes of the Entities and be available for purchase from the Bosnia and Herzegovina Audit Office.

### **Freedom from direction or control**

#### Article 38

In the exercise of his functions under this Law, the Auditor-General shall not be subject to the direction or control of any other person or institution.

### **Indemnity**

#### Article 39

(1) The Government must indemnify a person for any liability that the person incurs.

(2) The indemnity does not cover a liability of a person to the extent to which the person is entitled to be indemnified for the liability on the basis of insurance policy or otherwise.

### **Regulations**

#### Article 40

The Council of Ministers of Bosnia and Herzegovina may make bylaws (regulations) prescribing matters:

(a) required or permitted by this Law to be prescribed; or

(b) necessary or convenient to be prescribed for carrying out or giving effect to this Law.

### **Penalties**

#### Article 41

For an offence or violation committed under Articles 24(3), 25(3), 26 and 27(1) of this law the person responsible may be punished with a monetary penalty in the range of KM500 to KM10,000.

### **Failure to Pay Fees and Penalties**

#### Article 42

In case of obstructing a part or whole of fees and penalties prescribed under Article (VIII - Is this correct?) of this law, the Auditor General may pronounce the measure of stopping the work or blocking the bank account of the respective institution.

## **Application of Law**

### Article 43

In case of conflict with obligations prescribed under other law, this law shall prevail.

### Article 44

This Law goes into effect on the eighth day since the day of its publication in the Official Gazette of Bosnia and Herzegovina, and it shall also be published in the Official Gazettes of the Entities.

*A Procurement Law has been drafted for application in Zambia. The draft law was based on a number of Procurement Laws in existence in other countries. It was provided by Ken Torp, an intermittent budget adviser for the US Treasury. His email address is ktorp@earthlink.net*

# ZAMBIA NATIONAL TENDER BOARD ACT

## CAP 394

### PART I

#### Title, Definitions, and Applicability

1. This Act may be cited as the Zambia National Tender Board Act.

2. In this Act, unless the context otherwise requires:

“Board” means the Zambia National Tender Board established by section four (4);

“Chairperson” means the Chairperson of the Board appointed under section five (5);

“company” means a company registered under the Companies Act;

“Director” means the Director of the Board appointed under section \_\_\_\_\_;

“member” means a member of the Board;

“parastatal body” means a statutory corporation or body, or a company in which the Government has a majority or controlling interest, and includes a local authority;

“Secretary” means the person appointed under section \_\_\_\_\_ to be Secretary to the Board and;

“procurement” means the purchase by any agency of the Government of Zambia, or any province, or any parastatal body of any goods, services, or works, irrespective of their source.

3. This Act shall be applicable to the procurement of all goods, services, and works made by all agencies of the Government of Zambia, its provinces, and all parastatal bodies, irrespective of source, with the following exceptions:

- procurements made pursuant to lawfully binding grants, loans, contracts, and international agreements when such grants, loans, contracts, and international agreements specifically require procurements not otherwise consistent with the provisions of this Act and;
- procurements involving national defense or national security which have been exempted from the provisions of this Act after due consideration and careful review by the relevant security/intelligence oversight committee of the Parliament.

## PART II

### Purpose of this Act

4. The purpose of this Act is to simplify, clarify, and modernize the law governing procurement made by the Board; to ensure the fair and equitable treatment of all persons who deal with the Board and the procurement system over which it presides; to provide increased effectiveness and efficiency in the procurement activities of the Board; to foster effective and broad-based competition in the procurement of goods, services, and works; and to promote transparency and integrity in the procurement system of the Government of Zambia.

## PART III

### Establishment and Structure of the Zambian National Tender Board

5. There is hereby established a Zambia National Tender Board which shall be a body corporate with perpetual succession and a common seal, capable of suing and of being sued in its corporate name, and with the power, subject to the provisions of this Act, to do all such acts and things as a body corporate may do by law.

6.(1) The Board shall consist of a Chairperson, appointed by the President of the Republic, who is either the Minister of Works and Supply or the Minister of Commerce and twelve other members of whom the following shall be ex officio members:

- (a) the Secretary of the Cabinet;
- (b) the Commissioner General of the Zambia Revenue Authority;
- (c) the Governor of the Bank of Zambia;
- (d) the Secretary to the Treasury;
- (e) the Minister of Commerce or the Minister of Works and Supply, whichever is not the Chairperson; and
- (f) the Minister of Finance.

(2) The other six (6) members of the Board shall be appointed by the President of the Republic.

(3) Where an ex officio member is for any reasonable cause unable to attend any meeting of the Board, he or she may, in writing, nominate another senior official in his or her organization to attend such meeting and the person so nominated shall be deemed to be a member for the purpose of such meeting.

7. (1) The provisions of this section shall apply to members other than ex officio members.

(2) Subject to the provisions of this section, a member shall hold office for three (3) years.

(3) A retiring member may be reappointed.

(4) Upon the expiry of the period for which a member is appointed, the mem-

ber shall continue to hold office until a successor has been appointed but in no case shall such further period exceed three (3) months.

(5) A member shall cease to hold office:

(a) subject to subsection (4), upon the expiry of the period for which the member was appointed or reappointed;

(b) if the member is adjudged or otherwise declared to be of unsound mind;

(c) if the member is adjudged or otherwise declared to be bankrupt;

(d) if the member is lawfully detained or his freedom of movement is restricted under any law in force in Zambia;

(e) if the member is sentenced to a term of imprisonment exceeding six (6) months;

(f) if he is absent from three (3) consecutive meetings of the Board without reasonable cause;

(g) upon the expiry of not less than one month's notice in writing of the member's intention to resign given by the member to the Chairperson; or

(h) if the member has been adjudged to have resigned from the Board pursuant to the provisions of sections 15 and/or 17 of this Act.

8. A member other than a public officer or an employee of a parastatal body shall be paid such remuneration or allowance as the Board may from time to time determine, subject to the approval of the Minister of Finance.

#### Functions of the Board

9. (1) The function of the Board shall be to establish policy and to promulgate regulations for the procurement of goods, services, and works by the Government and by parastatal bodies. The Board shall also oversee and monitor the implementation of its policies and regulations.

(2) Without prejudice to the generality of subsection (1), the Board may:

(a) promulgate and approve regulations implementing this Act;

(b) advertise locally and abroad for tenders for the procurement of goods, services and works for the Government and parastatal bodies;

(c) establish the procedures relating to the award of contracts behalf of the Government and parastatal bodies;

(d) by regulation provide preferences in the procurement of goods, services, and works to local providers, to small and medium size enterprises, to female-owned enterprises, and to persons and enterprises that are disadvantaged by reason of physical or mental disability;

(e) specify the conditions under which implementing regulations governing the procurement of goods, services, and works may be varied or waived, including the procurement of goods and services from a sole source;

- (f) establish certification, or capacity rating, criteria and requirements for procurement units;
- (g) authorize the establishment of a Central Tender Committee and tender committees for provinces, parastatal bodies, and ministries;
- (h) by regulation, establish financial limits for all public procurements;
- (i) establish regulations and procedures for the use of various procurement vehicles including, but not limited to, purchase orders, running contracts, rate (or fixed price) contracts, and cost reimbursable contracts; and
- (j) establish a Procurement Appeals Board that will provide parties at interest with access to both an internal and an independent external appellate body, each of which will sit in review of, and render decisions on, cases brought before them by aggrieved parties.
- (k) establish regulations that specify contract provisions relating to the assessment of liquidated damages, termination of contract for default, termination of contract for convenience, and acceptable excuses for contract delay or nonperformance.

(3) Without prejudice to the generality of subsection (1), the Board may by resolution delegate its authority to designees or to any Governmental body or parastatal body, or unit of local government.

(4) The retrospective authorization of any contract or commitment is prohibited.

(5) The Board shall approve the procurement provisions under any bilateral or multilateral international agreement and shall participate, in coordination with the Ministry of Foreign Affairs, in all international trade negotiations that relate to public procurement.

(6) Without prejudice to the generality of subsection (1), the Board shall not exercise authority over the award or administration of any particular contract or over any dispute, claim, or litigation pertaining thereto.

(7) The Board shall ensure that procurements, as defined in Part I, section (3) of this Act shall, to the maximum extent feasible, be free, open, and competitive; that they will be publicly announced and awarded; that sealed bid procurements will be awarded to the responsible bidder submitting the lowest responsive bid and; that negotiated contracts, including but not limited to architectural and engineering contracts, will be awarded and negotiated on the basis of demonstrated competence and qualification for the type of services required, at fair and reasonable prices.

#### Central Tender Committee

10. The Board shall establish a Central Tender Committee, in Lusaka, which

shall perform such functions of the Board as are set forth in implementing regulations.

11. The Central Tender Committee shall consist of the following members:

- (a) the Permanent Secretary of the Ministry of Finance who shall be the Chairperson of the Committee;
- (b) the Deputy Secretary of the Cabinet;
- (c) the Permanent Secretary of the Ministry for Works and Supply;
- (d) the Director of the Zambian National Tender Board;
- (e) the Managing Director of the Zambian State Insurance Company Limited;
- (f) the Managing Director of the Zambian Electric Supply Corporation Limited;
- (g) the General Manager of the Bank of Zambia;
- (h) the Company Secretary of the ZCCM; and
- (i) the Secretary of the Zambia National Tender Board.

(2) There shall be a Vice Chairperson who shall be elected by the members of the Central Tender Committee.

12. (1) The functions of the Central Tender Committee shall be to examine and authorize all procurement of goods, works, and services of both the Government and parastatal bodies whose value is above the limits authorized in the implementing regulations of this Act.

(2) Without prejudice to the generality of subsection (1) the functions of the Central Tender Committee shall be to:

- (a) invite and award running contracts on common user goods or services;
- (b) examine and authorize the variation of tender procedures for the tender committees established under the implementing regulations of this Act;
- (c) undertake and regulate registration of suppliers of goods, works, and services.

(3) Except as otherwise provided for in this Act or its implementing regulations, the Central Tender Committee shall determine its own procedures.

(4) The Central Committee shall meet at such times and at such places being not less than once in a month as the Chairperson may determine.

(5) The Central Tender Committee shall cause minutes to be kept of the proceedings of every such meeting and such minutes shall be transmitted to the Board as soon as practicable after the meeting at which they were confirmed. Meeting minutes shall be available at the offices of the Board for public inspection.

(6) The Central Tender Committee may establish sub-committees and may appoint as members of such sub-committees persons who are, or who are not, members of the Central Tender Committee for any specific matter.

(7) The quorum of the Central Tender Committee shall be one half of the members.

(8) The Central Tender Committee shall communicate its decisions,

including any refusal and the grounds for such refusal, to the relevant Chief Executive Officer or the Controlling Officer as appropriate within seven days from the date of the meeting at which such decision was made.

#### Other Tender Committees

13. The Board may, by regulation, establish Provincial Tender Committees, Parastatal Tender Committees, and Ministry Tender Committees and may specify the functions, authority, composition, and financial limits of those committees.

#### Committees of the Board

14. (1) The Board may, for the purpose of carrying out its functions under this Act, establish committees to assist it in its deliberations. Such committees will be advisory in nature and may be dissolved by the Board.

(2) The Board may appoint as members of a committee established under sub-section (1), persons who are, or who are not, members of the Board and such persons shall hold office for such period as the Board may determine

(3) Subject to any specific or general direction of the Board, any committee establish under sub-section (1) may regulate its own procedure.

#### Financial Disclosure

15. Each member of the Board, as a condition of appointment to the Board and as a condition of continuing on the Board, shall submit to the Secretary of the Board a financial disclosure statement. Such statement shall be submitted at the time a member is appointed and updated annually. The statement must disclose the member's, and the member's spouse's, financial interests including ownership of asset shares, ownership whether partial or whole of any business or corporation, any employment whether salaried or not, any membership on a board of directors of any other corporate entity, or any other financial arrangement or investment that might influence, or appear to influence, the member's behavior and actions as a member of the Board. The financial disclosure statement shall be reviewed by the Secretary of the Board who shall report any potential conflicts of interest to the Chairperson of the Board. The financial statement shall be considered a confidential document of the Board and shall be made available only to the Secretary and the Chairperson. Failure to comply with this section of the Act will be deemed a resignation from the Board.

16. All employees of the Zambian National Tender Board are required, as a condition of employment, to submit a financial disclosure statement, as described in Section 14 above, to the Director General of the Board. All employees are required to update the financial disclosure statement annually. The statement will be considered confidential information and will be reviewed only by the Director General or by his sole designee.

## Conflicts of Interest

17. Members of the Board have an affirmative responsibility to excuse themselves from any votes or deliberations of the Board that involve any financial or potential financial interest of that member. Members have an affirmative responsibility to avoid any conflict of interest or any appearance of a conflict of interest. Failure to comply with this section will be deemed a resignation from the Board.

18. (1) If a person is present at a meeting of the Board or any committee of the Board at which any matter is subject of consideration and in which matter such person or such person's spouse is directly or indirectly interested in a private capacity, that person shall, as soon as practicable after the commencement of the meeting, disclose such interest and shall not, unless the Board otherwise directs, take part in any consideration or discussion of, or vote on any question touching upon such matter.

(2) A disclosure of interest made under this section shall be recorded in the minutes of the meeting at which it is made.

## Code of Conduct

19. The Board shall, by implementing regulation, promulgate a code of conduct that will guide the ethical behavior of Board members and all public sector employees who are involved in the procurement of goods, services, and works.

## Prohibition Against Political Influence

20. Exerting political influence, or attempting to exert political influence, upon any person in a capacity to affect a procurement discussion, deliberation, analysis, or vote is expressly prohibited. Political influence includes any form of pressure or suasion brought to bear by any official, elected or appointed, who is in a position to either provide a benefit to, or exact punishment against, any person involved in the Government's procurement process. Evidence of any violation of this prohibition will be transmitted to appropriate legislative or executive authorities for the purpose of initiating disciplinary action.

## Felony to Offer or Accept Emolument or Employment

21. Any person acting as a procurement officer or employee of the Board or of any Tender Committee, or any person who in an official capacity participates in the procurement of goods, works, and services for the Government is guilty of a felony if that person asks, receives, or offers to receive, any emolument, gratuity, kickback, offer of employment, contribution, loan or reward or any promise thereof, either for the person's own use or the use or benefit of any other person or organization from any person interested in such procurement of goods, works, or services.

22. A person who is interested in any way in the sale of any goods, works, or

services to the Government or any of its agencies is guilty of a felony if that person gives or offers to give any emolument, gratuity, contribution, loan or reward, or offer of employment, or any promise thereof to any person acting as a procurement officer or employee, or who in any official capacity participates in the procurement of goods, works, and services for the Government whether it is given for that person's own use or for the use or benefit of any other person or organization.

### Restrictions on Employment of Present and Former Employees

23. It shall be a breach of ethical standards for any employee of any procurement agency covered by this Act who is participating directly or indirectly in the procurement process to become or be, while employed by such procurement agency, the employee of any person contracting with the

procurement agency by whom the employee is employed. Employees found to be in violation of this prohibition will be subject to termination.

24. Any former employee of any procurement agency covered by this Act is prohibited from acting as a principal or an agent in connection with any judicial or other proceeding, application, request for a ruling, or other determination; any contract; any claim; or any charge or controversy, in which the employee participated personally and substantially through decision, approval, disapproval, recommendation, rendering of advice, investigation, or otherwise while an employee, where the procurement agency is a party or has a direct and substantial interest.

25. Any former employee of any procurement agency covered by this Act is prohibited, within one year after cessation of the former employee's official responsibility, from acting as a principal or as an agent for anyone in connection with any judicial or other proceeding, application, request for a ruling, or other determination, or in connection with any contract, claim, charge, or controversy, in matters which were within the former employee's official responsibility where the procurement agency is a party or has a direct or substantial interest.

26. Any business in which an employee of a procurement agency covered by this Act has a financial interest may not bid, propose, or otherwise participate in any procurement with that agency if the employee either participates personally and substantially through decision, approval, disapproval, recommendation, rendering of advice, investigation, or otherwise, or if such procurement is the subject of the employee's official responsibility where the procurement agency is a party or has a direct and substantial interest.

27. Former employees of any procurement agency covered by this Act are prohibited from selling or attempting to sell goods, services, or works to that procurement agency for a period of one (1) year following the date on which employment with the procurement agency ceased.

### Collusive Practices a Felony

28. (1) Any person, contractor, supplier, consultant or any company or corporation involved in the sale of goods, works, and services to the Government that participates in, or conspires to participate in, any collusive practice, including but not limited to bid rigging, with other such persons, contractors, suppli-

ers, consultants, companies or corporations, for purpose of personal or corporate financial gain, is guilty of a felony.

(2) When for any reason collusion or other anticompetitive practices are suspected among bidders or proposers, a notice of the facts shall be transmitted to the relevant prosecutorial authorities.

### Debarment

29. (1) After reasonable notice to the person or company involved and reasonable opportunity for that person to be heard, the Board, after consultation with appropriate legal authorities, shall have the authority to debar a person or company for cause from consideration for the award of contracts of any kind with the Board. Debarment shall not be for a period exceeding three (3) years.

(2) The Board also has the authority to debar temporarily any person or company if there is probable cause to believe that a person or company has engaged in activity which might lead to debarment. Temporary debarment for probable cause shall not exceed a period of three (3) months unless an indictment has been issued for an offence which would cause debarment under subsection one (1) in which case the temporary debarment shall, after consultation with appropriate legal authorities, remain in effect until after the trial of the person or company under indictment.

(3) The causes of debarment include the following:

(a) conviction of a criminal offence as an incident to obtaining or attempting to obtain a public or private contract or subcontract or in the performance of such contract or subcontract;

(b) conviction for the crime of embezzlement, theft, forgery, bribery, falsification or destruction of records or evidence, receiving stolen property, or any offence indicating a lack of business integrity or business honesty which currently, seriously, and directly affects responsibility as a contractor;

(c) conviction under antitrust statutes;

(d) failure without good cause to perform in accordance with the terms of a contract;

(e) breach of the prohibitions set for in Sections 23, 24, or 25 above; or

(f) any other cause which the Board determines to be so serious and compelling as to affect responsibility as a contractor.

### Tampering With Tender Documents

30. (1) Any person who:

(a) opens any envelope or other container in which a tender is contained, other than in the due and proper execution of that person's duties under this Act and its implementing regulations;

(b) burns, tears, or otherwise destroys or partially burns, tears, or destroys any tender; or

(c) alters or erases or does any other act which falsifies, or

renders incomplete or misleading any tender;  
shall be guilty of an offence and shall be liable, upon conviction, to a fine not exceeding thirty thousand (30,000) penalty units or imprisonment for a term not exceeding three (3) years, or to both.

(2) For the purpose of this Act, “tender” includes documents or things submitted together with a tender and which are relevant to the tender and which are in the possession of the Board, a tender committee, or any other person authorized by the Board.

### Immunity of Board Members

31. No action or other proceedings shall lie or be instituted against any person for or in respect to any act or thing done or omitted to be done in good faith in the lawful exercise or purported exercise of a member’s function under this Act.

### Board Procedures and Meetings

32. (1) The Board shall regulate its own procedure and the validity of any proceedings, act, or decision of the Board shall not be affected by the vacancy in the membership of the Board or by any defect in the appointment of any member or by reason that any person not entitled to do so took part in the proceedings.

(2) For the transaction of its business the Board shall meet at such places and at such times, being not less than once every three (3) months, as the Chairperson may determine.

(3) At any meeting of the Board, the presence of at least seven (7) members currently holding office shall constitute a quorum.

(4) There shall preside at every meeting of the Board the Chairperson or in the absence of the Chairperson such member as the members present may elect for the purpose of that meeting.

(5) A decision of the Board on any question shall be by a majority of the members present and voting and, in the event of an equality of votes, the person presiding as Chairperson at that meeting shall have a casting vote in addition to a deliberative vote.

(6) Notwithstanding the provisions of subsection (5), a decision may be made by the Board on any urgent matter by the circulation of the relevant papers among the members, and by the expression in writing of the views of the majority thereof, provided that any member shall be entitled to require that any decision be deferred until the matter is considered at a meeting of the Board.

(7) The Board may invite any person, whose presence is in its opinion desirable, to attend and to participate in the deliberations of a meeting of the Board but such person shall have no vote.

(8) The Board shall cause minutes to be kept of the proceedings of every meeting of the Board and of every meeting of any committee established by the

Board. Minutes of all such meetings will be open to the public and available for inspection at the offices of the Board.

#### Seal of the Board

33. (1) The seal of the Board shall be such device as may be determined by the Board and be kept by the Secretary.

(2) The Board may use a wafer or rubber stamp in lieu of the seal.

(3) The affixing of the seal of the Board shall be authenticated by the Chairperson and the Secretary, or by the Chairperson and one other person authorized in that behalf by a resolution of the Board.

(4) Any contract or instrument which, if entered into or executed by a person not being a body corporate would not be required to be under seal, may be entered into or executed without seal on behalf of the Board by the Secretary or any person authorized in the behalf by resolution of the Board.

(5) Any document purporting to be a document under the seal of the Board or issued on behalf of the Board shall be received in evidence and shall be deemed to be so executed or issued, as the case may be, without further proof, unless the contrary is proved.

#### Board Proceedings Open to Public

34. All official meetings of the Board shall be announced by prominent posting at the offices of the Board and shall be open to the public with the following exceptions:

(1) the Board may meet in executive session to discuss personnel matters pertaining to employees of the Board and compensation issues relating to the Director;

(2) the Board may meet in executive session to discuss any procurement related data and information that, by its nature, is deemed to be confidential. Such data and information may include, but not be limited to, proprietary data provided by bidders or proposers and data that, if prematurely made public, would undermine the competitive position of a prospective bidder or proposer; and

(3) the provisions of subsections (1) and (2) notwithstanding, all formal actions of the Board and all votes will be taken at meetings that are open to the public.

#### Disclosure of Protected Data and Information Prohibited

35. (1) No person shall publish or disclose to any person, otherwise than in the proper and authorized course of his or her duties, the contents of any document, communication, or information which would tend to vitiate the free, open, and competitive nature of a Government procurement.

(2) Any person who knowingly contravenes the provisions of subsection (1) shall be guilty of an offence and shall be liable upon conviction to a fine not exceeding twelve thousand (12,000) penalty units or to imprisonment for a term

not exceeding three (3) years, or to both.

(3) If any person having information which to his or her knowledge has been published or disclosed in contravention of the provisions of subsection (1) unlawfully publishes or communicates any such information to any other person, he or she shall be guilty of an offence and shall be liable, upon conviction, to a fine not exceeding twelve thousand (12,000) penalty units or to imprisonment for a term not exceeding three (3) years, or to both.

## **PART IV**

### **ADMINISTRATION**

#### Appointment of Director General

36. (1) The President shall appoint, on such terms and conditions as he sees thinks fit, a Director General who shall be the chief executive officer of the Board.

(2). The office of the Director General shall be an office in the public service.

(3). The Director General shall attend all meetings of the Board and shall be entitled to address such meetings, but shall not vote on any matter under discussion, provided that the Board may, for good cause, request the Director General to withdraw from any meeting of the Board.

#### Secretary and Other Staff

37.(1) There shall be a Secretary to the Board who shall be appointed by the Board on such terms and conditions as the Board may determine.

(2) The Secretary shall be responsible for the day-to-day affairs of the Board under the general supervision of the Director General.

(3) The Board may appoint, on such terms and conditions as it may determine, such other staff as it may consider necessary for the performance of the functions of this Act.

#### Inspectorate Unit

38.(1) In order to insure due compliance with the provisions of this Act, the Board shall establish under the general supervision of the Director General an inspectorate unit which shall monitor, in accordance with the rules and regulations made under this Act, all contracts awarded by tender committees, any governmental body, or any parastatal body.

(2) The Board may such inspectors and other staff to the inspectorate unit as may be necessary for the performance of its functions under this Act.

## Powers of Inspectors

39.(1) In the performance of his duties under this Act, any inspector or member of the staff of the inspectorate unit shall have:

- (a) access to all books, records, returns, reports, and other documents relating to the work of any Government Department or parastatal body which is under inspection;
- (b) access at all reasonable times to the premises of any Government Department or parastatal body which is under inspection;
- (c) power to call for any relevant information from persons responsible for the financial administration of any Government Department or parastatal body which is under inspection;

(2). Provided that no inspector or member of the staff of the inspectorate unit shall have access to any books, records, returns, reports, or other documents, or to any premises if:

- (a) such books, records, returns, reports, or other documents or premises belong to any component of the Defense Force or the Zambian Security Intelligence Service; or
- (b) such access is likely to:
  - (i) prejudice the security, defence, or international relations of the Republic of the investigation or detection of offences; or
  - (ii) involve the disclosure of any matters or deliberations of a secret or confidential nature of the Cabinet or of any sub-committee of the Cabinet.

### Failure to Comply with Prescribed Procedures

40.(1) Notwithstanding anything to the contrary contained in any written law, where any expenditure is to be incurred on any procurement of goods or services, it shall be the duty:

- (a) in respect of a head of expenditure, of the controlling officer designated as such for that head of expenditure under section four of the Finance (Control and Management) Act; or
- (b) in respect of a parastatal body, of the chief executive officer of that parastatal body;

to ensure that such procurement of goods, services, or works is in accordance with the procedures prescribed by this Act and its implementing regulations.

(2). Subject to the provisions of subsection (3), every controlling officer or chief executive officer shall be accountable for failing to comply with the provisions of subsection (1).

(3).Where a controlling officer or chief executive officer satisfies that Board that he had, in accordance with the provisions of any rules and regulations made under this Act, delegated his functions under subsection (1) to any other person or committee, then such other person or every member of such committee shall also be accountable for any failure to comply with the provisions of subsection (1).

(4).Where a controlling officer or chief executive officer satisfies the Board that he his, under the provisions of any written law, subject to the control of any other person, board, committee or other body, and that it was such control or direction of such other person, board, committee or other body which caused the failure to comply with the provisions of subsection (1), then such other person or every member of such board, committee, or other body shall also be accountable for such failure to comply with the provisions of subsection (1).

(5).In respect of any failure to comply with the provisions of subsection (1), the Board may take such appropriate corrective or punitive measures as it may consider necessary.

### Surcharge and Appeals

41.(1) Where the Board is satisfied that an employee of the Government or parastatal body has caused financial loss by his recklessness, misconduct, or willful default to follow procedures laid down in this Act or its implementing regulations, the Board shall afford such person a reasonable opportunity to furnish a written explanation as to why he should not be surcharged with the amount of such loss.

(2).After considering any explanation furnished under subsection (1), the Board may surcharge such person with the amount of such loss or any part thereof, and certify in writing to that effect.

(3).Any person aggrieved by a decision of the Board under subsection (2) may, where the amount of the surcharge is in excess of \_\_\_\_\_ kwacha, appeal against such decision to the High Court or to a subordinate court of competent jurisdiction.

(4).The High Court or subordinate court, as the case may be, may, upon determining any appeal lodged under subsection (3):

- (a) confirm, vary or quash the decision of the Board;
- (b) remit the case to the Board with such directions as it thinks fit for giving effect to the decision on appeal;
- (c) make such other order as to costs or otherwise as may seem just.

(5).The Chief Justice may, by statutory instrument, make rules providing for the period within which appeals under this section may be brought and otherwise regulating such appeals.

### Payment and Recovery of Surcharge

42.(1) The amount of every surcharge certified in accordance with subsection (4) shall become due and recoverable from the emoluments or other financial benefits of such employee within thirty days after a copy of the certificate has been furnished to him or, if an appeal with respect to the surcharge has been lodged, within thirty days after the appeal is finally disposed of or abandoned or fails by non-prosecution thereof, as the case may be.

(2).The Board may authorize the payment of a surcharge in installments provided that if default is made in the payment of any installment, the balance of the surcharge outstanding shall thereupon become due and payable in full.

(3).The amount of any surcharge that is not paid shall be recoverable by the Board as a civil debt.

(4).Unless the contrary is proved, in any proceedings for the recovery of the amount of a surcharge, a certificate issued by the Board shall be conclusive evidence of the facts certified therein, and a certificate signed by the Secretary that the sum certified to be due has not been paid to him shall be conclusive evidence of non-payment.

### Resisting or Obstructing an Inspector

43.Any person who assaults, resists, or obstructs any inspector or member of the staff of the inspectorate unit in exercise of his power to call for relevant information under this Act shall be guilty of an offence and shall be liable, upon conviction, to a fine not exceeding five thousand penalty units or to imprisonment for a term not exceeding two years, or to both..

## **PART V**

### **PROCUREMENT APPEALS TRIBUNAL**

44. There is hereby established in the executive branch of the Government of Zambia a Procurement Appeals Tribunal to be composed of a chairperson and six other members. The chairperson and the members of the Tribunal shall be appointed by the Chief Justice of the Republic of Zambia and shall serve on a part-time and as-needed basis.

45. The term of office of the chairperson and each member of the Tribunal shall be four years, except that in making the initial appointments, the Chief Justice shall appoint one member for a term of two years, one member for a term of three years, and the chairperson for a term of four years. Thereafter all appointments shall be for four years or for the balance of any unexpired term, but members may continue to serve beyond their terms until their successors take office. Members may be reappointed for succeeding terms. If there is no chairperson, or if such person is absent or unable to serve, the senior member in length of service shall be the temporary chairperson.

46. The chairperson may adopt operational procedures and issue such orders, not inconsistent with the *Zambian National Tender Board Act*, as may be necessary in the execution of the Tribunal's functions. The chairperson's authority may be delegated to the Tribunal's members.

47. The *Zambian National Tender Board* is authorized to provide for the *Procurement Appeals Tribunal* such services as the chairperson requests, on such basis as may be agreed upon between the *Zambian National Tender Board* and the *Procurement Appeals Tribunal*.

48. The chairperson of the Tribunal shall be a member in good standing of the Bar of the Republic of Zambia and other members shall include representatives of the National Council for Construction, the Chartered Institute of Purchasing and Supplies, the Law Association of Zambia, the office of the Attorney General of Zambia, the Ministry of Finance and National Planning, and the Zambia Association of Chambers of Commerce and Industry.

49. The *Procurement Appeals Tribunal* shall adopt rules of procedure which, to the fullest extent possible, will provide for the expeditious resolution of controversies. The Tribunal may adopt *Small Claims Procedures* for the resolution of controversies involving claims of falling below a threshold to be determined by the Tribunal.

50. Acting by one or more of its members, the *Procurement Appeals Tribunal* shall issue a decision in writing or take other appropriate action on each appeal submitted. A copy of any decision shall be provided to all parties and to the relevant Controlling Officer or Chief Executive Officer.

51. Unless an action has been initiated previously in a court of competent jurisdiction of the Republic of Zambia for essentially the same cause of action, or unless within 15 days after the action is brought before the *Procurement Appeals Tribunal*, written objection is made by either the aggrieved bidder, offeror, or contractor, prospective or actual, or the Director of Public Prosecution, the Tribunal shall have jurisdiction to review and determine *de novo*:

(1) any protest of a solicitation or award of a contract addressed to the Tribunal by an aggrieved actual or prospective bidder or offeror, or contractor; and

(2) any appeal by an aggrieved party from a determination by a Controlling Officer or a Chief Executive Officer, or the designee of either officer which is authorized by the implementing regulations of this Act.

## PART VI

### FINANCIAL AND OTHER PROVISIONS

#### Commitment and Expenditure Control

52. (1) This Act requires that all purchases made by any official or employee of the Government, or a parastatal company, or a unit of local government be made in accordance with the policies and procedures set forth herein and in the implementing regulations of this Act.

(2) Prior to initiating any procurement whatsoever, approving officials must assure that sufficient funds are budgeted and available to fund the estimated cost of such procurement.

(3) Prior to initiating any procurement whatsoever, approving officials must certify that such procurement is necessary and that it is required for a valid public purpose.

(4) No payment of an invoice submitted to any public agency for the payment of goods, works, or services will be paid by the Treasury without a written certification by a person in a proper position of authority that such goods, works, or services have, in fact, been delivered in accordance with any relevant plans, specifications, or contractual requirements.

#### Finances of the Board

53. (1) The funds of the Board shall consist of such moneys as may:

- (a) be appropriated by Parliament for the purposes of the Board;
- (b) vest in or accrue to the Board.

(2) The Board may:

(a) subject to the approval of the Minister of Finance, raise by way of loans or otherwise such moneys as it may require for the performance of its functions;

(b) charge and collect fees on tender and other related documents;

(c) levy fees and other charges for services provided by the Board or by the staff of the Board;

(d) accept grants and donations for the purposes of the Board.

(3) There shall be paid from the funds of the Board:

(a) the salaries, allowances, and loans of the staff of the Board;

(b) such reasonable traveling, transport, and subsistence allowance for members or members of any committee of the Board when engaged on the business of the Board, at such rates as the Board may determine; and

(c) any other expenses incurred by the Board in the performance of its functions.

(4) The Board may invest in such manner as it thinks fit such of its funds as it does not immediately require for the performance of its functions. All income from such investments will be available only for the purposes set forth in subsection three (3).

### Financial Year

54. The financial year of the Board shall be the period of twelve months ending on the 31st December in each year.

### Books of Accounts

55. (1) The Board shall keep proper books of accounts and other records relating to the accounts.

(2) Such books or accounts and other records shall be open for inspection by the Minister of Finance or any person duly authorized by the Minister and to the public upon written request.

56. (1) The accounts of the Board shall be audited annually by an independent external auditor and a detailed report thereon submitted to the Minister of Finance and to the Board. Such report shall be available to the public upon written request.

(2) For the performance of the audit required under subsection one (1), the independent external auditor shall have access at all reasonable times to all accounts, books, records, returns, reports, and other documents relating to the accounts of the Board.

(3) In respect to each financial year, the independent external auditor of the Board shall certify whether or not:

(a) the auditor has received all the explanations and information necessary for the performance of the audit;

(b) the accounts of the Board have been properly kept; and

(c) according to the explanations and other information received, and the books, accounts, records, returns, reports and other documents relating to the Board's accounts produced to him, the accounts of the Board reflect the true and accurate financial position of the Board or of its profit and loss position, including its investments, for the period covered by the auditor's certification.

### Annual Report

57. (1) As soon as is practicable, but not later than six (6) months after the expiry of each financial year, the Board shall submit to the Minister of Finance a report containing a balance sheet showing the assets and liabilities of the Board as at the last day of the financial year, together with all supporting statements and returns duly certified by the independent external auditor of the Board.

(2) The Minister of Finance may at any time request the Board in writ-

ing to submit to him such other reports, returns, or statements, duly certified by the independent external auditor of the Board as the Minister may consider necessary and the Board shall comply with such request.

(3) The Minister of Finance shall, not later than seven (7) days after the first sitting of the National Assembly next after the receipt of the report referred to in subsection one (1) lay it before the National Assembly.

### Regulations

58. (1) The Minister of Finance shall, upon the recommendation of the Board, by statutory instrument, make regulations for the implementation of this Act.

(2) Without prejudice to the generality of subsection one (1), the Minister of Finance may, on the recommendation of the Board, make rules or regulations prescribing any matter which the Board is authorized by this Act to formulate, regulate, or prescribe.

(3) Rules or regulations made under this Act may provide in respect of any contravention thereof that the offender shall be liable to a fine not exceeding twenty-five thousand (25,000) penalty units or to a term of imprisonment not exceeding ten (10) years, or to both.

### Authorization for the Use of Electronic Transmissions

59. The use of electronic media, including acceptance of electronic signatures, is authorized consistent with all applicable statutory and regulatory guidance for use of such media so long as such guidance provides for appropriate security to prevent unauthorized access to the bidding, approval, and award processes and for accurate retrieval or conversion of electronic forms of such information into a medium which permits inspection and copying.

### Additional Legal Provisions

60. If any provision of this Act or any application thereof to any person of circumstance is held invalid, such invalidity shall not affect other provisions or application of this Act which can be given effect without the invalid provision or application, and to this end the provisions of this Act are declared to be severable.

61. The following Acts and all other Acts and parts of Acts inconsistent herewith are hereby repealed:

62. The following Acts and all other Acts and parts of Acts inconsistent herewith are hereby amended:

63. Since this Act is a general Act, no part of it shall be deemed to be impliedly repealed by subsequent legislation if such construction of the subsequent legislation can be reasonably avoided.

64.This Act shall become effective as of \_\_\_\_\_.

Date of this draft: March 1, 2004





# International Consortium on Governmental Financial Management

## Membership Application

Working globally with governments, organizations and individuals, the International Consortium on Governmental Financial Management is dedicated to improving financial management so that governments may better serve their citizens.

1. Enclosed are dues for calendar year \_\_\_\_\_. These dues are in payment for membership as a (please check appropriate category):

- \_\_\_\_ Sustaining Member (\$1,000)
- \_\_\_\_ Organization Member (\$250)
- \_\_\_\_ Organization Member\* (150)
- \_\_\_\_ Individual Member (\$100)
- \_\_\_\_ Individual Member\* (\$50)

2. Organization: \_\_\_\_\_

3. Name and Title (individual member/contact person for sustaining and organization member): \_\_\_\_\_

4. Mailing Address:

Street/Post Box \_\_\_\_\_

City \_\_\_\_\_

Province/State \_\_\_\_\_

Postal/Zip Code and COUNTRY \_\_\_\_\_

5. Telephone: \_\_\_\_\_ Fax: \_\_\_\_\_

6. E-mail/Internet: \_\_\_\_\_

\* A special discount is offered to developing countries, countries with economies in transition and regional groups/organizations in such countries to encourage their participation. This discount is available to **all countries other than** Australia, Canada, China, Egypt, European countries (**except transition economies**) India, Iran, Israel, Japan, Kuwait, Libya, Mexico, New Zealand, Nigeria, Oman, Saudi Arabia, United Arab Emirates, USA, Russia, and Venezuela.

Return **this form** and a check or money order in the appropriate amount to the  
**International Consortium on Governmental Financial Management**

**444 North Capitol Street-Suite 234**

**Washington, DC 20001 USA**

If you have questions, please call the ICGFM at +202.624.5451, or fax +202.624.5473.

Additional information is also available on the website: *www.icgfm.org*.

# ICGFM Officers and Directors

## Members of the Board of Directors

Members for the ICGFM Board of Directors serve a two-year term. Each Sustaining Organization is represented on the Board. The Executive Director solicits nominations to select six Organization Members and six Individual Members to fill remaining Board seats.

### ICGFM Board of Directors as of January 1, 2005

#### **Sustaining Members:**

Association of Chartered Certified Accountants (UK)  
Association of Government Accountants (USA)  
Casals and Associates  
CPA Australia  
FreeBalance  
Graduate School, USDA-Government Audit Training Institute (GATI)  
Grant Thornton  
Inter-American Development Bank – Auditor General  
International Business and Technical Consultants, Inc  
Institute of Internal Auditors  
National Association of State Auditors, Comptrollers and Treasurers (USA)  
Organization of American States – Inspector General  
US Agency for International Development – Inspector General  
US General Accounting Office  
The World Bank – Auditor General

#### **Organization Members**

Cameroon - State Audit Office  
Hungary - State Audit Office  
India - Office of the Comptroller and Auditor General  
International Monetary Fund  
Pakistan - Office of the Auditor General  
VACANT

#### **Individual Members**

Mr. James Bonnell (USA)  
Dr. Jesse Hughes (USA)  
Ms. Blandina Nyoni (Tanzania)  
Ms. Virginia Robinson (USA)  
Mrs. Linda Weeks (USA)  
VACANT

## **ICGFM Officers (Executive Committee)**

ICGFM officers must be members of the Board of Directors. Officers may be re-elected to the same position or a new one. Officers are nominated by the Nominating Committee based on input from the ICGFM members.

### **ICGFM Officers as of January 1, 2005**

President	Linda L. Weeks (Consultant/GATI)
President-elect	Peter Aliferis (AGA)
Past President	Relmond Van Daniker (AGA)
Vice President	Henry Barrett (USAID-IG/MCC)
Vice President	Linda Fealing (OAS-AG)
Vice President	Jesse Hughes (Consultant)
Treasurer	Cornelia Chebinou (NASACT)
Secretary	Dick Willett (Grant Thornton)





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