

Transition to Accrual Accounting

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TECHNICAL NOTES AND MANUALS

Transition To Accrual Accounting

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This technical note addresses the following main questions:

- What is accrual accounting?
- What are the reasons for moving from cash to accrual accounting?
- What are the differences between accrual accounting and accrual budgeting?
- What are the main steps to be taken in moving from cash to accrual accounting?
- What are the preconditions for introducing accrual accounting?
- How should a move to accrual accounting be sequenced and managed in relation to the government's overall agenda for public management reform?

I. Introduction

In 2001, the Fund adopted the *Government Finance Statistics Manual of 2001 (GFSM 2001)* as the new framework for collection and dissemination of government finance statistics. *GFSM 2001* is based on the accrual accounting concept, in contrast with the previous cash accounting based framework (*GFSM 1986*). In November 2005, the IMF Executive Board reaffirmed its commitment to *GFSM 2001* and agreed, in principle, that Fund staff should move in a phased way to present fiscal data using the *GFSM 2001* framework in staff reports. The Board also concluded that the migration strategy should recognize a three-phase approach: **presentation** involving reclassification of existing data into *GFSM 2001* format (short term), **reporting** of fiscal statistics (flows and stocks) using the *GFSM 2001* framework (medium term); and full **implementation** of accrual reporting and the associated underlying systems (long term).

* An earlier version of this note was previously issued as part of a series of technical notes on the IMF's Public Financial Management Blog (<http://blog-pfm.imf.org>).

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Although only a few countries have, so far, successfully implemented a full accrual accounting framework, other countries, ranging from transition economies in Europe to developing countries in the Middle East, are considering such a move and are increasingly expressing an interest in receiving technical advice on various aspects of undertaking such a major reform (see Box 1).

Box 1. Accounting Basis for Annual Financial Statements

	Full Cash Basis	Combination of Cash and Accrual basis	Full Accrual Basis ¹
Australia			X
Austria	X		
Belgium	X		
Cambodia		X	
Canada			X
Colombia			X
Czech Republic	X		
Finland		X	
France			X
Germany	X		
Greece	X		
Hungary	X		
Iceland		X	
Indonesia		X	
Ireland		X	
Israel		X	
Jordan		X	
Kenya	X		
Mexico		X	
Morocco	X		
Netherlands	X		
New Zealand			X
Norway	X		
Slovak Republic	X		
Slovenia	X		
Suriname	X		
Sweden		X	
Turkey	X		
United Kingdom			X
United States			X

Source: Data selected from OECD/World Bank Budget Practices and Procedures Database, updated by current information where available.

¹ “Full accrual basis” means financial statements are prepared on the basis of accrual-based national or international accounting standards, also sometimes referred to as generally accepted accounting principles (GAAP).

The main purpose of this note is to assist technical advisors with the provision of advice to developing countries on the design, planning, and implementation of an accrual-based accounting regime. The guidelines address a number of issues associated with the implementation of accrual-based accounting, and are intended to provide broad guidance on the preconditions necessary for the successful transition to accrual accounting, the appropriate sequencing of the reform steps, and the milestones that could serve as yardsticks for the measurement of progress.

These guidelines are intended to apply primarily to general government departments and agencies within national, provincial/state, and local jurisdictions. It is assumed that state-owned enterprises engaged in commercial activities are already budgeting, accounting, and reporting on full accrual basis.

II. What Is Accrual Accounting?

Accrual accounting is an accounting methodology under which transactions are recognized as the underlying economic events occur, regardless of the timing of the related cash receipts and payments. Following this methodology, revenues are recognized when income is earned, and expenses are recognized when liabilities are incurred or resources consumed. This contrasts with the cash-accounting basis under which revenues and expenditures are recognized when cash is received and paid respectively.

Accrual accounting in the context of the public sector would generally imply the recording of transactions on an accrual basis, and the preparation of accrual-based financial statements for the government as a whole (see Box 2).¹ In addition, individual ministries may also be required to prepare audited financial statements on an annual basis, and unaudited reports more frequently. Some advanced countries have also implemented accrual budgeting.² Unless otherwise indicated, the discussion in this paper is intended to apply to accrual accounting, including financial reporting, but not accrual budgeting.

III. Rationale for Moving to Accrual Accounting

At the macrofiscal level, the importance of accrual accounting for macroeconomic policy arises from the fact that it measures assets and liabilities that are relevant to the overall stance of fiscal policy and fiscal sustainability, but which are not measured by cash accounting. In particular, whereas cash accounting measures only conventional debt, accrual accounting measures other quasi-debt liabilities such as accounts payable for the receipt of goods and services, and employee liabilities (e.g., for civil service pensions) (see Box 3).

¹*GFSM 2001* suggests that statistics for the public sector rather than the general government sector are more suited for fiscal analysis.

²The relationship between accrual accounting and accrual budgeting is discussed below.

Box 2. Consolidated Financial Reporting on an Accrual Basis

Selected International Experience

- The U.S. government produces audited consolidated financial statements for mainly the budget entities. It excludes entities such as Army Force Exchange Service, Board of Governors of the Federal Reserve System, and USA Education Inc. (Sallie Mae).
- The U.K. government is currently working on a project to produce consolidated financial statements of the central government.
- The Australian government produces audited financial statements for the federal government as a whole, including analysis of the key aggregates related to: general government entities, public nonfinancial corporations, and public financial corporations that are controlled by the federal government.
- The New Zealand government produces audited financial statements for the government as a whole.

Accrual accounting provides a broader measure of the burden of government financial commitments than does cash accounting.

In addition, the so-called “golden rule,” which has been adopted in some countries, may arguably be best articulated in accrual accounting terms. The golden rule prohibits borrowing to meet any of the costs of current service provisions by government. If it is accepted that the accrual concept of “expenses” is the best accounting measure of the costs of current service provision, it follows that the golden rule requires that the budget be balanced in accrual terms over the business cycle. Expressed differently, this involves an interpretation of the golden rule as permitting only the financing of **net**, and not gross, investment by borrowing (i.e., it requires that depreciation, as one of the costs of current service provision, should be met from revenue rather than borrowing).

An accrual accounting framework is essential to systematically determine the full costs of a government’s activities. Full cost information (including noncash costs such as depreciation, and accrued civil service pensions) is essential for assessing the efficiency of government services and thus is a key element of any public sector performance management framework. More specifically, information about the full costs of government services can be crucial when considering alternative service delivery options including outsourcing and cost recovery, as well as for the purposes of international benchmarking (e.g., comparing the costs of health or education services). In some circumstances, specialized management costing systems may be utilized to determine program and product costs; however, such systems would also utilize the accrual-based data from the main accounting system.

Since accrual accounting requires the preparation of government balance sheets, and this involves the identification, measurement, and periodic reporting of government assets and liabilities, it requires

Box 3. Why Adopt Accrual Accounting?

The case of the “costless” civil service pay increase

A political party in country X promised certain civil service salary increases as part of its election pledges. On winning office, the government found that the promised pay rise would increase the budget deficit to a financially unsustainable level. So the government rescinded the promised pay rise and instead introduced a generous increase in pension entitlements. As the pension increases did not have an immediate cash impact, the budget deficit of the current year, calculated under the cash accounting basis, was unaffected and the additional future pension liabilities were hidden from public scrutiny.

Under a full accrual accounting framework, the increased pension costs would be reflected in the budget bottom line in the year in which the costs were incurred, irrespective of the fact that no cash would be paid for sometime in the future.

The case of the “amazingly inexpensive” police vans

The police force in country Y acquired a fleet of vehicles the purchase price of which were to be paid in three annual installments. The cash budget showed only one third of the total cost in the first year's budget. The full cost of the vehicles were not transparent and the budget deficit did not reflect the cost of the government's purchasing decisions.

Under an accrual accounting framework, the full liability for the vehicles purchased would be reflected in the accounts.

governments to adopt a more systematic approach for identifying, keeping track of, and valuing all assets and liabilities. These activities can encourage the development of systems (such as asset registers) and procedures for planning and management of assets and liabilities. Thus the introduction of accrual accounting, particularly when accompanied by related reform initiatives to improve public sector performance, can promote a general improvement in the management of assets, as well as a heightened awareness of the cost of holding and deploying assets. In a similar fashion, the requirement to identify, measure, and report government liabilities, and the resulting enhanced transparency, can foster better financial planning to ensure that the government is able to meet its liabilities as they fall due.

More generally, it is argued that accrual accounting may help generate behavioral changes on the part of budget decision makers and managers. For example, the accrual-based additional information they receive may prompt legislators to ask ministers and bureaucrats questions that they otherwise would not have asked. Such questions may concern, for example, the status and role of fiscal policy, or the use of public resources, including capital assets, or the government's policy on long-term liabilities such as pensions. In this way, an accrual accounting system may facilitate changes in the attitudes and behavior of ministers and civil servants, and hence to changes in government policy, that benefit the citizens. Whether accrual accounting in practice

produces a significant change in the behavior of managers and other agents—and whether this is for the benefit of the citizens—is, of course, an empirical matter that remains to be tested.

It is sometimes argued that the benefits outlined above are unlikely to be fully achieved unless the accrual reforms encompass not just accrual accounting, but also accrual budgeting. This issue is discussed below.

IV. Issues Associated with the Transition to Accruals

Formulating accounting policies

Cash accounting is concerned mainly with the recording of cash receipts and payments, and is relatively simple to operate. This simplicity, however, comes at a cost—cash accounting fails to provide essential information about noncash transactions and stocks of assets and liabilities. Accrual accounting, as discussed above, is a more comprehensive accounting system requiring the recording of flows and stocks within an integrated framework. The recognition and measurement or valuation of complex transactions, and assets and liabilities (e.g., finance leases, private-public partnerships (PPP), financial instruments, and intangible assets) often require the exercise of judgment and technical skill with attendant risks of errors and misstatements.³ It is partly to reduce such risks that national and international accounting standards are necessary. Accounting standards provide guidance on acceptable accounting treatment of specific items and define the minimum requirements that general purpose financial statements need to satisfy. One of the most important issues that governments need to address when contemplating a move to accrual accounting is the selection and application of appropriate accounting policies consistent with relevant accounting standards. Where existing standards do not deal with a particular issue, judgment has to be exercised to select accounting policies that would help generate relevant and reliable financial information.

Gaps in current International Accounting Standards

The International Public Sector Accounting Standards Board (IPSASB), a part of the International Federation of Accountants (IFAC), is responsible for issuing International Public Sector Accounting Standards (IPSAS). Currently there are some twenty IPSASs applicable to accrual-based accounting, and one IPSAS applicable to cash-based accounting. Subjects so far covered by IPSASs include presentation of financial statements, the effects of changes in foreign exchange rates, financial instruments, contingent liabilities, and segment reporting. IPSASs are designed to facilitate the generation of government financial reports of high quality that are internationally comparable.

³The initial valuation and periodic depreciation of heritage assets, for example, can be difficult and contentious, and may require sustained effort over a period of years. A pragmatic approach may be necessary to ensure that the efforts are commensurate with the expected fiscal policy and management benefits.

There are still some gaps in the international public sector accounting standards governing the accrual-based recognition and measurement of financial transactions, events, and balances. Significant existing gaps include non-exchange revenue (e.g., taxes and transfers) recognition, accounting for social policies of government, heritage assets, and PPPs. Consultative documents have been issued by the IPSASB in respect of possible standards on the first three of these issues, and work is starting on the preparation of an exposure draft on accounting for PPPs. Governments would need to formulate their own interim standards or guidelines in these areas until the relevant international standards are finalized.

The requirements of the IPSAS are broadly comparable to those of *GFSM 2001*. While there are still some differences, work is currently underway to harmonize these standards.

Cash information in an accrual framework

Moving to an accrual basis of accounting does not mean the abandonment of cash accounting. On the contrary, cash management is an integral element of an accrual-based financial management framework. IPSAS and *GFSM 2001* both require the production of a full statement of cash flows that separately identify cash receipts and payments associated with operating, investing, and financing activities. Modern accrual-based systems have functionalities to support cash-based accounting and reporting. The key design question to be addressed is: what level of information on cash receipts, payments, and cash holdings is required? For high-level treasury (cash management) purposes, cash information at the macrolevel may be sufficient. The task of configuring modern systems to provide such macro-cash accounting and reporting data is relatively simple. However, if the government wishes to retain the capacity to track and evaluate entities, programs, functions, products, or cost elements on a detailed cash-transaction basis, this is still achievable but the attendant system configuration and ongoing maintenance tasks will be more complex.

Alignment of accrual accounting and budgeting

As indicated above, it is sometimes argued that accounting and budgeting regimes should be closely aligned so that there is a clear and transparent basis for comparing, in financial terms, the government's planned and actual financial outcomes (see Box 4).

Some commentators have argued, for example, that without a change in the budgeting regime, a simple move to accrual accounting would fail to trigger the necessary change in culture and incentives and, therefore, would be of limited benefit.⁴ However, governments may decide to adopt accrual accounting as a first step before embarking on the more complex task of introducing accrual budgeting (see Box 5). This may give rise to a temporary incongruity between ex ante and ex post information (e.g., financial statements would include accrual-based expenses while

⁴For example, in some countries a capital charge has been introduced as part of an accrual-budgeting system to provide incentives to agencies to minimize the cost of owning and holding assets, in order to release resources for other more productive uses. However, there are differences of opinion on the effectiveness of such measures.

Box 4. What Are the Differences Between Accrual Accounting and Accrual Budgeting?

Accrual accounting is concerned with recording and ex post reporting of transactions in accordance with the accrual concept. Technically, a government can implement accrual accounting without making any changes to its existing cash budgeting framework, including arrangements for funding ministries and agencies. Under such circumstances, in addition to the accrual-based financial statements, budgetary accounts on a cash basis will also have to be prepared.

Accrual budgeting, on the other hand, involves ex ante planning on an accrual basis. This means that accrual budgets incorporate, in addition to cash flows, all projected noncash transactions and stocks of assets and liabilities. For example, accrual budgets include, as budgeted expenses, noncash items such as depreciation and civil service pension entitlements. This enables accrual budgets to provide information to the parliament and other stakeholders of not just the cash costs, but of the full resource implications of the planned government activities. The parliamentary appropriations may also be calculated on an accrual basis to pay for the full costs of government operations regardless of the year in which the cash may be spent. This can give rise to complex accounting and cash management issues that have to be addressed before accrual budgets can be successfully implemented.

Revenues can also be budgeted on an accrual basis provided they can be reliably forecast and measured. The impact of these projected transactions on the stock of assets and liabilities have also to be estimated and reflected in a budgeted balance sheet.

the budget would continue to be based on cash expenditure). On the positive side, however, the accumulation of accrual accounting experience and availability of accrual-based historical data during this period is likely to contribute to a smoother eventual transition to accrual budgeting.

Where there are timing differences in the introduction of accrual accounting and budgeting, there will be a need to maintain the capacity to generate suitable cash-based reports in the interim, as discussed above.

Accrual-based budgets seek to show the estimated full resource, rather than just the cash, implications of the planned government activities. Thus budgeted financial statements show the accrual-based budgeted revenues and expenses, budgeted cash receipts and payments, and the estimated impact of the planned activities on the assets and liabilities of the government. Budgeting on a multiple forward-year basis requires the construction of rolling, continuous budgeted financial statements across the forward years. In tandem with this, governments may also decide to introduce accrual-based appropriations to align spending authorization with budgets and actuals, although government have adopted different approaches in this area, reflecting, among other things, the constitutional and legal requirements of individual jurisdictions.

Box 5. Alignment of Accrual Accounting and Budgeting

Selected International Experience

- The United States produces accrual-based financial reports, but has not announced any plans to adopt accrual budgeting.
- The United Kingdom implemented accrual accounting and reporting in executive agencies and subsequently adopted accrual accounting and budgeting for the central government.
- France has adopted accrual accounting, but has not yet announced an intention to adopt accrual budgeting.
- Australia introduced annual accrual reporting, and a few years later adopted accrual budgeting.
- New Zealand introduced accrual reporting and budgeting simultaneously.

Budget classification and the chart of accounts

A budget classification sets out the manner in which the budgeted revenues, expenditures, and financing items would be categorized and presented in the budget. Under a cash budgeting system, the budget classification would not include stocks of assets or liabilities.

A chart of accounts (COA) is a logical coding framework that forms the basis of recording accounting transactions and balances (flows and stocks) in the general ledger, the principal accounting record of an entity.

In a well-designed system, the COA should incorporate the budget classification. This means that in addition to all the accounts specified in the budget classification, the COA will include other accounts required for accounting and reporting purposes. For example, a COA will have accounts for assets and liabilities that would not normally be included in a cash-based budget classification. In addition, a COA would normally also include information about particular revenues and expenses at a more detailed level than required for the budget classification.

If a government moves to accrual accounting and accrual budgeting simultaneously, then the COA and the budget classification can be expected to be unified, at the appropriate level of aggregation. However, if the government decides to adopt an accrual accounting regime, while continuing with cash budgets, there will be significant differences between the two classification systems. The COA, in these circumstances, must maintain the capacity to generate both accrual-and-cash based reports. In addition, in these circumstances, the accrual system must provide necessary functionality to prevent breaches of legal expenditure limits, which may be based on cash or commitment concepts.

The design of the government's COA can have a critical impact on the efficacy of the accrual accounting framework. The COA occupies an important central place because it determines the classification of transactions and balances recorded in the government's general ledger and, therefore, determines the scope and content of financial reports that will be available from the government's central system. The COA must have the capacity to accommodate current data requirements and, to the extent practicable, anticipate future requirements. The COA must also be designed in such a way that it can support diverse reporting requirements of governments (e.g., management reports, budget reports, financial statements subject to audit, and reports in accordance with other applicable requirements (e.g., *GFSM 2001*, the European System of Accounts (ESA) 1995, and System of National Accounts (SNA), without the need for multiple data entry.

In order to meet the diverse requirements, COAs are often designed as a combination of segments (or dimensions) where each segment corresponds to a particular information element. Thus a COA may have separate segments for economic, functional, administrative, and regional classification. In addition, separate segments may also be utilized to capture data about cost centers, programs, projects, outputs and outcomes. Transactions would be recorded, and reports generated, utilizing an appropriate combination of segment codes. In this way, a well-designed COA can facilitate the capture, classification, analysis, and reporting of a large quantity of data.

Opening balance sheet

The systematic identification and valuation of assets and liabilities as at the date from which accrual accounting is to commence is an essential step in the move to accrual accounting. The opening balance sheet has to be supported by adequate information and explanation necessary for audit. This can be a very challenging and time-consuming process. The concept of materiality may be used to make judgments about assets and liabilities that should receive the most attention during this exercise. Similarly, as discussed below, the phasing of the implementation process may also assist in prioritizing this task appropriately.

Central versus Decentralized Financial Processes

An important structural decision to be made in relation to the accounting function is: should the detailed accounting and reporting processes be undertaken by the central finance ministry or the line ministries and agencies? A secondary question is: if responsibility is to be devolved, should line ministries develop and maintain their own financial systems, or should they have online access to one system maintained by the ministry of finance (MoF)? While also relevant in a cash accounting environment, these issues require particular consideration of the additional complexities of an accrual framework.

On the first question, governments need to assess the increased scale and complexities involved in the detailed identification and measurement of accrual transactions and balances, and consider whether there may be benefits in devolving authority for day-to-day accounting and financial

reporting to the line entities, rather than attempting to undertake this function centrally. Advanced countries that have so far adopted accrual accounting have generally taken this approach. However, for developing countries with capacity constraints, this may not be feasible in the short term. There may also be a risk that the central authority (e.g., the MoF) will not receive the necessary reports from the line entities in a timely manner, and that this will, in turn, delay the generation of consolidated reports. Regardless of the option chosen for detailed accounting and reporting, the responsibility for setting consistent accounting policies and guidelines for the government as a whole will usually rest with the MoF or equivalent central agency.

On the secondary question, the development and maintenance of one centralized system, with distributed processing by line ministries, may offer significant economies of scale, and may be particularly suited to developing countries with limited accounting and information technology (IT) skills. This will enable the MoF to access transaction data on a real-time basis, and may also reduce the risk of delay in generation of consolidated reports. Alternatively, if day-to-day accounts processing and financial report preparation are conducted by line entities autonomously on their own separate systems, a practice favored by the more advanced countries, the MoF may need to maintain a specialist consolidation application to automatically collect and consolidate the financial reports of the line entities.

Consolidation issues

Regardless of whether the government adopts a centralized or decentralized model, it is important for the purposes of generating consolidated financial statements for the general government sector or the public sector, that all inter-agency transactions and balances, by sector, are separately identified in the entities' accounts to enable their elimination. While eliminations of flows are required to produce good quality cash-based consolidated reports, an accrual-based framework also requires elimination of stocks (e.g., accounts payable, accounts receivable, debts, and investments). Further, systems and procedures have to be designed to ensure that eliminations of flows and stocks are equal and opposite within an integrated double-entry accounting system.

Special systems and procedures may also be necessary to efficiently and routinely eliminate a large volume of inter-entity transactions between the MoF and line entities, and, more generally, between public sector entities: these transactions may include the provision of appropriation funding to entities, transfers of collected revenues from entities, financing transactions such as equity injections and loans, and payment of "ownership" returns such as dividends and interest to the MoF, etc.

"Controlled" and "administered" items

As discussed above, a key benefit of an accrual accounting framework is that it provides information about the full cost of service delivery by ministries and agencies. However, in order to facilitate the achievement of this objective, it may be necessary to distinguish items that are "controlled" by the reporting ministry/entity (salaries, goods, and services) from items that are only "administered" by it

on behalf of the government (subsidies, grants, social benefits). This is because large transfer items handled by an agency may dwarf its costs of service delivery, and in the absence of such distinctions, it may be difficult for users of financial statements to assess such costs, as distinct from the total budgetary resources the agency may handle on the government's behalf.

V. Preconditions for a Move to Accrual Accounting

Given the technical and conceptual difficulties in the adoption of an accrual-based system, the following preconditions are considered to be critical to the success of a planned transition to accrual accounting.

An acceptable cash accounting based system

A sound accounting system that can generate reliable cash-based data is an essential basis from which to start the move to an accrual framework. Countries that do not have such a reliable cash-based system should first concentrate on improving the existing systems and processes, before considering any move to accrual accounting. It is suggested that countries should be assessed to be in this category if they exhibit a combination of some or all of the following weaknesses: an inadequate budget classification, no COA or double-entry based general ledger system, and inadequate fiscal reporting, including large unexplained differences between revenue and expenditure on the one hand, and financing data on the other.

Political ownership

It is critical that the planned introduction of accrual accounting is supported at the highest levels of the executive. To be effective, this support must be prominent and unambiguous. The executive should be seen to be transparently championing and supporting the philosophy of change, the reasons for change, the objectives of change, and the timetable for change.

The support of the legislature is also essential, not only to ensure passage of any new financial management legislation, but also to endorse and utilize the changed financial reporting and evaluation regime that will follow.

Technical capacity

International experience suggests that a lack of adequate technical resources can be a major impediment to successful implementation of accrual accounting. It is essential that a government considering a move to accrual accounting has either a core of officials with required technical (accounting, IT, etc.) skills, or the capacity to recruit such people for its key positions. Outside consultants may be used to supplement in-house resources to develop the framework and the associated systems and procedures. However, in order to ensure that the reforms are sustainable, consultants should be used mainly for capacity-building purposes and to assist officials with specific technical implementation issues (e.g., IT systems).

Although not essential, the following institutional and professional arrangements would greatly facilitate a move to an accrual accounting framework:⁵ a well-established and regulated national professional accounting body; a well functioning supreme audit institution; effective parliamentary public accounts committees; a national valuation office (or private sector valuation experts) to assist with valuation of assets; and an actuarial institution to assist with valuation of employee and social policy liabilities.

Systems

Although, in theory, cash or accrual accounting can be implemented with either a manual or an electronic system, in practice, it would be inadvisable for a government to attempt to implement full accrual accounting without the aid of a modern government financial management information system (GFMIS) with proven functionality in areas such as general ledger, accounts payable, purchases, assets management, etc. Implementation of such a system would be a major project, which would normally be a subset of the accrual accounting project.

VI. Sequencing of Reform Steps

The sequencing of implementation should take into account the context of the overall reform agenda of the government. International experience suggests that a move to accrual accounting is usually a supportive rather than a leading component of a set of broader public sector reforms. As discussed above, some governments have implemented accrual accounting first, and then moved on to accrual budgeting. Accrual budgeting, in turn, has been associated with an increased focus on performance of the public sector and associated reforms such as performance budgeting, cost recovery, and outsourcing.

This section provides broad guidance on the appropriate sequencing for a full implementation of accrual accounting, including periodic financial reporting by line entities and at the whole of government levels in accordance with relevant accounting standards. The implementation issues associated with a move to accrual budgeting are outside the scope of this paper and are not covered in this section.

Implementation timeframe and sequencing

International experience suggests that implementation timetables vary and are difficult to compare given the differences in scope and sequencing of the reforms. Thus, the United States implemented accrual reporting by agencies and consolidated reporting for the entities included in the federal government's budget. The United Kingdom initially implemented accrual accounting and reporting at executive agencies on a pilot basis, followed by a move to accrual accounting and budgeting, a more complex and time-consuming undertaking. The government intends to produce "whole of government" financial statements (i.e., public sector—central government) in

⁵Indeed, some of these would be desirable even in a well functioning cash accounting system.

the future. Australia initially implemented annual accrual-based departmental financial reporting, and undertook the preparation of “whole of government” (public sector—central government) financial statements as a separate project. The whole of government financial statements for a central government represent the consolidation of the financial statements of the entities including public nonfinancial and financial corporations that are controlled by the central government.

As a broad guideline, it is suggested that a developed country or a transitional country with good access to resources may target an overall timeframe of three to five years for full implementation of accrual accounting. A developing country with resource constraints may target an overall timeframe of ten years to achieve full implementation, although it may be possible to complete the implementation in selected areas within a shorter timeframe. Much of this time would be devoted to ensuring that the essential preconditions for moving to accrual—reforms of budget classification, cash accounting, and fiscal reporting, etc. as described above—are implemented. These steps themselves are likely to be complex and time-consuming in many countries that have basic systems, low capacity, and poor incentives for reform. Regardless of the timeframe, governments should adopt a staged approach to the implementation, in accordance with a clearly articulated migration plan. As discussed below, the implementation can be staged by business areas (commitment management, cash management, etc.), by groups of entities belonging to a particular sector (e.g., health), or by size of public sector entities.

Implementation staging by business areas

Given the complexities involved in identification and valuation of nonfinancial assets, it may be expedient to initially focus the implementation effort on financial assets and liabilities, and continue to account for nonfinancial assets on a cash basis. Even within financial assets and liabilities, it may be possible to phase the implementation so that items such as accounts payable, accounts receivable, and debts are incorporated into the framework first, while the more complex issues such as valuation of liabilities arising from certain PPP arrangements or nonmarketable equity investments, are addressed at a subsequent stage.

Adopting a carefully staged approach could facilitate the implementation of accrual accounting in the selected areas within a shorter timeframe than the overall timetables for a full implementation suggested above. For example, many governments already maintain memorandum (i.e., outside the official accounts) records of accounts payable and receivable, and debts. For these countries, it would not be unduly onerous to incorporate these items within a formal accrual accounting framework. The remaining financial assets and liabilities could then be identified and valued, and this should also not present insurmountable difficulties for many countries. In this way, the government could produce a “financial” balance sheet in a relatively short timeframe. The task of identifying and valuing nonfinancial assets could be completed over a longer period. More detailed illustrative guidance on staging of implementation by business areas is set out in the Appendix to this paper.

Implementation staging by sector or size, and pilot studies

Developing countries may consider a graduated implementation across public sector entities. It is possible to design different paths for different types of entities. Thus, state-owned enterprises (SOE), if operating on a cash basis, may be targeted for the first phase of a move to accrual accounting, to be followed by general government entities. Thus, the government may initially produce consolidated reports for various subsectors, then progress to complete whole of government reports at a final stage. In developing countries with limited access to skilled resources, this approach may also facilitate the development of a core of implementation expertise at a small number of sites, which can then be used to assist with the implementation at the remaining sites.

It is also possible to design different implementation paths by the size or materiality of the entities. It may be useful to defer the transition of very small entities that may lack resources and expertise and which might constitute only, say, 1 percent or 2 percent of the consolidated government budget, and concentrate the implementation effort on the larger entities. Where capacity is low, it may be sensible to conduct pilot studies in key representative agencies, to build up experience for wider implementation. As part of this strategy, a “train the trainer” approach may be adopted to facilitate progressive implementation across the government.

VII. Conclusion

It has been argued in this note that, in principle, the introduction of an accrual accounting system would be beneficial to all countries at both the macro and the micro levels. All countries would benefit from: a more comprehensive measure of fiscal sustainability that accrual accounting can provide; information about the full resource implications, and not just the cash expenditure, of government programs; and the enhanced transparency, and the resulting focus on better management of assets and liabilities. However, some of the benefits are more likely to be realized if accounting and budgeting are both performed on an accrual basis.

That said, for many countries the capacity to implement an accrual-based accounting system is severely constrained by a lack of resources, particularly accounting and IT skills and a modern GFMIS. For these countries, the full implementation of accrual-based systems, therefore, should be viewed as a long-term objective.

This should not prevent governments from initiating the implementation process and taking the first steps toward accrual accounting. Governments can commence the process by progressively identifying and measuring financial assets and liabilities, thus constructing an opening financial balance sheet. This could form the basis of an initial accrual accounting system, while work continues on the more difficult task of identifying and valuing nonfinancial assets.

There are some other clear lessons from the international experience that can guide countries along the transition path: implementation of a full accrual accounting system should not be attempted until the government's existing cash-based systems are soundly based; and implementation of accrual budgeting is more complex and generally should not be attempted until accrual accounting systems have been firmly established.

International experience also suggests that the implementation of accrual accounting is major reform that requires strong political support, has to be sustained over a period of several years, and involves a significant investment of human and financial resources. It is important that governments are aware of these implications before embarking on such a major change to their public financial management framework.

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ILLUSTRATIVE GUIDANCE ON THE SEQUENCING OF ACCRUAL ACCOUNTING REFORMS

A. Key Implementation Activities

While detailed implementation strategies and sequences may vary to suit the circumstances of each government, the following key implementation steps, in the sequence suggested, should be considered when developing an implementation plan.

- development and dissemination of an overarching philosophy of change, including a clear exposition of the drivers for change and the objectives and deliverables of the reform process;
- undertaking of a detailed scoping study to determine the nature of required change, the structure, speed, context and sequencing of change, the impact on staff and systems, and resources required;
- establishment of implementation steering committee (SC).
- the SC should plan and establish the project governance structures: technical advisors and focus groups, consultative groups, project manager, team leaders and team personnel, project quality assurance and audit.
- establishment of communication and training program;
- adoption of accounting policies consistent with international or national accounting standards;
- drafting and passage of requisite financial legislation;
- selection of a systems solution to meet the accrual accounting requirements, including conceptual design, functional and technical requirements, development of request for proposal (RFP), evaluation of proposals, and selection and contracting of vendor(s) and implementation consultants;
- determination of the sequencing of accrual business areas to be implemented, and for each business area, a full implementation plan (see below); and
- development of an opening balance sheet.

B. Business Area Implementation Staging

The implementation of accrual accounting can be staged across different business areas of governments to address the more pressing requirements first, and also to defer the implementation of the more complex area, e.g., nonfinancial assets until the required technical skills have been built up. A possible staging across business areas is suggested below.

Stage one implementation (Years 1-3)

- General ledger—management of the government's central financial data repository, including COA, ledger structure, and journal structure
- Purchasing—management of the full procurement cycle, including commitment management
- Payments and accounts payable—management of all supplier and grantee payments, including management of accounts payable (arrears)
- Revenue—management of all invoicing and related processes (excluding taxation revenue—this will be managed by the central tax agency)
- Receipts and accounts receivable—management of receipts and receivables functions (excluding taxation revenue—this will be managed by the central tax agency)

<ul style="list-style-type: none"> • Banking management—including management of banking deposits, bank transfers, bank accounts, and bank reconciliation.
<ul style="list-style-type: none"> • Cash management—including management of cash budgeting, cash forecasting, cash accounting, and cash reporting
<ul style="list-style-type: none"> • Fund management—including accounting for and reporting all transactions and balances of trust accounts, extrabudgetary accounts, special accounts, hypothecated funds, etc.
<ul style="list-style-type: none"> • Data collection and consolidation—including automated elimination of intrasector transactions and balances. Note that data collection may not be required if the accounting function is centralized.
<ul style="list-style-type: none"> • Financial reporting—including production of full range of management reports, GAAP financial reports, <i>GFSM 2001</i> reports, SNA reports, ESA reports, etc.
<ul style="list-style-type: none"> • Management of estimates, projections and budgets (if the government has decided that these should be integrated with the accounting functions)
<p>Stage two implementation (Years 3-4)</p>
<ul style="list-style-type: none"> • Investment management (if applicable)
<ul style="list-style-type: none"> • Debt management (if applicable)
<p>Stage three implementation (Years 3-10)</p>
<ul style="list-style-type: none"> • Fixed asset management—including registration, revaluation, depreciation management, maintenance, etc.
<ul style="list-style-type: none"> • Inventory management (if applicable) —including recording, valuation, maintenance, stocktaking etc.
<p>In addition to the above core elements of an accrual accounting system, other system initiatives may be undertaken to improve overall management. Thus management cost accounting systems may be implemented to facilitate more systematic costing of government services, programs, and products. Similarly human resource and payroll management may be improved through implementation of relevant systems. An Executive Information System can also facilitate the extraction and reporting of data in a user-friendly format.</p> <p>For each of the business areas to be implemented, the following implementation steps are suggested:</p>
<ul style="list-style-type: none"> • confirmation of business requirements;
<ul style="list-style-type: none"> • development of full business area design, including detailed system technical design, business process design, data migration plan, and training plan;
<ul style="list-style-type: none"> • configuration and modification of application software, including development of reports and interfaces;
<ul style="list-style-type: none"> • rigorous documentation of the business area policies, procedures and system processes;
<ul style="list-style-type: none"> • planning, design, and delivery of training programs;
<ul style="list-style-type: none"> • identification, valuation, and recording of opening balances of assets, liabilities, and equity elements;
<ul style="list-style-type: none"> • commencement of accrual accounting in a “live” environment; and
<ul style="list-style-type: none"> • post-implementation review after six months.

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