



SOUTH ASIAN FEDERATION OF ACCOUNTANTS (SAFA)

**A STUDY**  
**ON**  
**ACCRUAL-BASED ACCOUNTING**  
**FOR**  
**GOVERNMENTS & PUBLIC SECTOR ENTITIES**  
**IN**  
**SAARC COUNTRIES**

SEPTEMBER 2006

## **Brief Introduction of SAFA**

South Asian Federation of Accountants (SAFA), an apex body of SAARC, was established on August 22, 1984. The broad objective of SAFA is the development of a coordinated accountancy profession in the SAARC Region. In furtherance of this objective, SAFA coordinates and evolves technical, ethical and educational guidelines, works towards international recognition of qualifications of accounting bodies of the region and encourages development of national accounting bodies.

### **Member Bodies**

Institute of Chartered Accountants of Bangladesh  
Institute of Cost and Management Accountants of Bangladesh  
Institute of Chartered Accountants of India  
Institute of Cost and Works Accountants of India  
Institute of Chartered Accountants of Nepal  
Institute of Chartered Accountants of Pakistan  
Institute of Cost and Management Accountants of Pakistan  
Institute of Chartered Accountants of Sri Lanka

### **Office Bearers of SAFA**

Mr. Sunil Goyal	President
Mr. Indrajith Fernando	Vice President
Mr. Muhammad Nurul Hassan	Advisor
Dr. Ashok Haldia	Permanent Secretary

### **SAFA Working Group on Accrual-Based Accounting for SAARC Governments & Public Sector Entities (PSEs)**

Mr. Muhammad Rafi	(ICMAP)	Chairman
Mr. Satipati Moitra	(ICMAB)	Member
Mr. C. R. Mamtaz uddin Ahmed	(ICMAB)	Member
Mr. Anwaruddin Chowdhury	(ICAB)	Member
Mr. C.R. Mazumdar	(ICAB)	Member
Mr. Jayant Gokhale	(ICAI)	Member
Mr. Manoj Fadnis	(ICAI)	Member
Mr. D L S Sreshti	(ICWAI)	Member
Mr. Narayan Bajaj	(ICAN)	Member
Mr. Pushpa Lal Shresta	(ICAN)	Member
Mr. Masood Muzzaffar	(ICAP)	Member
Mr. Sujeewa Rajapakse	(ICASL)	Member
Mr. H. M. Henna Jake Bardana	(ICASL)	Member

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**A STUDY ON  
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IN SAARC COUNTRIES**

**Background**

In the 54<sup>th</sup> South Asian Federation of Accountants (SAFA) Assembly meeting held at Katmandu-Nepal, Mr. N.D.Gupta, the then IFAC Council Member, apprised the participants about the role of IFAC for the development of Accounting Profession and the initiatives taken by IFAC in the Public Sector Accounting. He also informed that IFAC Public Sector Committee (now IFAC International Public Sector Accounting Standards Board – IPSASB) was issuing International Public Sector Accounting Standards (IPSASs) for the Governments and Public Sector Entities (100% owned government organizations that are not government business enterprises and are not operating as joint stock companies or corporations) with a view to harmonizing the government financial reporting all over the world. He said that countries like New Zealand and Australia had already adopted the IPSASs and implemented accrual-based accounting system for the governments while many other developed countries were also in the process of implementing the Accrual-Based Accounting System (ABAS) for the governments & PSEs and adopting the IPSASs for Public Sector Accounting. All member bodies of SAFA emphasized the need for implementation of ABAS by the SAARC governments and adoption of IPSASs in due course of time and decided to constitute a Working Group on Accrual-Based Accounting System for SAARC Governments and PSEs. Accordingly, a Working Group headed by Mr. Muhammad Rafi of ICMAP (a past member of IFAC-PSC and currently member of Consultative Group of IPSASB) and comprising representatives of all SAFA member bodies was constituted by the SAFA Assembly. The Terms of Reference (TORs) for the Working Group are as under:

- 1.1) To conduct study on "*The introduction of Accrual-Based Accounting System in the Governments/ Public Sectors of SAARC Countries*"; and,
- 1.2) To look into the ways and means by which the SAFA may help the governments and public sector Entities (PSEs) of SAARC countries in adoption/ implementation of Accrual-Based Accounting System in line with guidelines prescribed in the International Public Sector Accounting Standards (IPSASs).

## **Importance of Financial Reporting System for the Governments and Public Sector Entities (PSEs)**

2. Presence of an efficient and transparent Financial Reporting System has become extremely important for the governments specially in view of increasing awareness for use of public funds by governments. Realizing the importance of Financial Reporting System, governments of developing countries have started implementing Accrual-Based Accounting System and International Public Sector Accounting Standards (IPSASs). An efficient Financial Reporting System whose salient features are described below can be very helpful for SAARC Countries in enhancing the credibility of financial information, public trust and attracting foreign investment:

- Adequate financial reporting system is essential to introduce accountability in the use of public funds.
- Timeliness of financial information is important for good decision-making.
- Efficient financial management & control system is very important to meet the challenges of the new century.
- Transparency in decision-making, good governance, comparability of financial reporting with other countries of the world and reliability of financial information will motivate foreign investors to make investment in the SAARC countries.
- A financial reporting system based on international standards is very helpful in raising capital from the international markets.
- Tax payers need to know as to where the government has used the tax receipts and the financial reporting provides answer.
- Creditors/ international donor agencies are interested to know whether the government will be able to honor its commitments when fall due. A reliable system would facilitate speedy flow of grants and aids from such agencies.
- Rating agencies need to have timely and reliable information on the financial position to assess government's credit worthiness. Such a rating is very vital in raising finances from international donor agencies, capital markets and investors.
- There is increasing recognition around the world that good governance in the public sector is the key for social and economic development which in turns brings prosperity for the nations.

## **Cash-Basis Accounting System Vs Accrual-Based Accounting System with reference to Governments**

3. Due to ease of compilation of information, Cash-Basis of Accounting was used by governments across the world. Some benefits of cash-basis of accounting are:
  - Government budgets & appropriations are cash based. Monitoring of receipts and spending are easier.
  - Cash based financial reports are budget compliant.
  - Principles underlying the cash basis are easy to understand and easy to explain.
  - Compilation of cash-based information is easier.
  - Operating costs are lower.
  - No need to exercise any judgment in determining the amount of cash flows for the period.
  
4. Cash-Basis of Accounting System, however, has following limitations/shortcomings:
  - Information on assets and liabilities is not available.
  - Impact of consumption of stock of net assets held by government is not known.
  - Cash accounting focuses solely on the cash flows of the current period.
  - Accountability of government for use of its resources becomes difficult.
  - Reporting of receipts and payments in great detail may lead to problems in understanding the information.
  - There is no system of reporting of contingent liabilities which may have significant impact on future revenues.
  - Matching of costs and benefits is not possible.
  
5. Corporate Sectors, investors and society have been the ultimate beneficiaries of the developments taken place in Accounting Profession especially International Accounting and Financial Reporting Standards during last three decades. Time has come that governments should also reap the benefits of

Accrual-Based Accounting Systems, modern public sector financial reporting and standard accounting practices for the prosperity of general public.

6. Major benefits of adoption of Accrual-Based Accounting System and International Public Sector Accounting Standards (IPSASs) are summarized as under:

- The quality of Government Financial Reporting can be improved manifold.
- Comparable financial information is available.
- Harmonization of Financial Reporting within the Government entities.
- Reliability of financial information increases
- Performance evaluation becomes easier.
- Compliance Reporting is possible with reference to principles and standards.
- Accountability is ensured.
- Efficient and standardize Financial Reporting system results into better Decision-Making.
- Information on assets and liabilities are readily available.
- Matching Costs are recorded against the revenues.

### **Public Sector Accounting in the Developed Countries**

7. Governments and Public Sector Entities (PSEs) of the developed part of the world which were once using Cash-Basis of Accounting are now rapidly moving towards Accrual-Based Accounting System. Some of these countries have not only implemented the full Accrual-Based Accounting but have also adopted International Public Sector Accounting Standards (IPSASs) for compilation of government accounts and financial reporting. Status of implementation of Accrual-Based Accounting and adoption of IPSASs by the Governments is as under:

- Australia (State, Federal and Local Governments)
- Canada (State, Federal and Local Governments)
- Finland (Government agencies and whole of Government)

- France (Local Governments)
- Germany (Some Government Organizations)
- Ireland (Pilot Project For Selected Government Departments)
- Italy (Local Governments)
- Malaysia (Local Governments)
- Netherlands (Government agencies and Local Governments)
- New Zealand (National and Local Governments)
- Sweden (Central Government agencies and Local Governments)
- Switzerland (Local Governments)
- Tanzania (Local Governments)
- United Kingdom (Local Governments)
- USA (Federal Government)

### **IFAC-International Public Sector Accounting Board (IPSASB)**

8. Role of IFAC for improvement in financial reporting in the public sector all over the world is commendable. IFAC has constituted International Public Sector Accounting Standards Board (IPSASB) to harmonize and standardize government financial reporting standards. The main objective of IPSASB is “to develop programs aimed at improving public sector financial management & accountability including developing accounting standards and promoting their acceptance”. IPSASs, Studies and Guidelines issued by IPSASB are extremely beneficial for an efficient and transparent Financial Reporting System.

### **International Public Sector Accounting Standards (IPSASs)**

9. IPSASB has so far issued the following IPSASs, studies and guidelines for the governments and public sector Entities:

#### **IPSASs**

<b><i>No.</i></b>	<b><i>Title/ Subject</i></b>
1	Presentation of Financial Statements
2	Cash Flow Statements

<b>No.</b>	<b>Title/ Subject</b>
3	Net Surplus or Deficit for the Period, Fundamental Errors and Changes in Accounting Policies
4	The Effects of Changes in Foreign Exchange Rates
5	Borrowing Costs
6	Consolidated Financial Statements and Accounting for Controlled Entities
7	Accounting for Investments in Associates
8	Financial Reporting of Interests in Joint Ventures
9	Revenue from Exchange Transactions
10	Financial Reporting in Hyperinflationary Economies
11	Construction Contracts
12	Inventories
13	Leases
14	Events after the Reporting Date
15	Financial Instruments: Disclosure and Presentation
16	Investment Property
17	Property, Plant and Equipment
18	Segment Reporting
19	Provisions, Contingent Liabilities & Contingent Assets
20	Related Party Disclosures
21	Impairment of Non-Cash Generating Assets
Cash	Financial Reporting under the Cash Basis of Accounting

**Studies and Guidelines**

IFAC IPSASB Study 13 – Governance in The Public Sector

IFAC IPSASB Study 14 – Transition to Accrual Based Accounting :  
Guidance for Governments and Government  
Owned Entities

Financial Reporting By Government Business Entities.

Applicability of International Standards on Auditing to Audits of Financial Statements of Government Business Entities.

## **Position in SAARC Countries**

10. The awareness on the benefits of Accrual-Based Accounting System and efficient Public Sector Final Reporting System is increasing day by day in the governments of SAARC countries which are still using cash basis of accounting for reporting purposes. Like other developing countries, SAARC countries are also marching towards Accrual-Based Accounting System. Some countries have chalked out plans for introduction of Modified Accrual Accounting while the others are slowly moving from cash-basis to accrual-basis of accounting. A comparative position of introduction/ implementation of Accrual-Based Accounting System in Governments, Local Bodies and PSEs of SAARC countries is summarized in the following paragraphs:

### **10.1) Bangladesh**

- Government, Local Bodies and PSEs are using Cash-Basis of Accounting with the exception of two city governments/local bodies and some PSEs which are using Accrual-Based Accounting System.
- Government is planning to move on to Accrual-Based Accounting System in future but IPSASs not being followed.
- There is a general awareness about IPSASs and work of IFAC on Public Sector Accounting in the government.
- Cash-Basis IPSAS is not being followed where the accounts are maintained on Cash-Based Accounting System.

### **10.2) India**

- Central and State Governments are currently using Cash-Basis of Accounting but there are plans to introduce Accrual-Based Accounting System in Central and State Governments soon. Pilot projects on implementation of Accrual-Based Accounting System have already been started. Four State Government including Tamil Nadu, Maharashtra, UP and Karnataka are using Accrual-Based Accounting System.
- The Honorable Supreme Court of India, in 2001, opined that the Urban Local Bodies should adopt immediate measures to convert their accounts from cash to accrual basis. The said decision of the apex Court in India has largely contributed to render momentum to the conversion process

and several Urban Local Bodies are now speedily moving towards Modified Accrual System. The accounts of Municipal Corporation of Delhi (MCD) are being maintained on Accrual-Based Accounting since 2003.

- There is a general awareness about IPSASs and work of IFAC on Public Sector Accounting in the government but IPSASs not being followed.
- Government Accounting Standards Advisory Board has already been constituted. A National Accounting Manual based on Accrual Accounting has been approved.
- Institute of Chartered Accountants of India (ICAI) has issued a Technical Guide on Accounting & Financial Reporting by Urban Local Bodies.
- ICAI has also constituted a committee on Government Accounting Standards.

### **10.3) Nepal**

- Government and Local Bodies are using Cash-Basis of Accounting. PSEs are using Accrual-Based Accounting System.
- There is a general awareness about IPSASs and work of IFAC on Public Sector Accounting in the government but IPSASs not being followed.
- Government is planning to move on to Modified Cash-Basis of Accounting System in future. World Bank has agreed to finance the project for introduction of Accrual-Based Accounting System in the Government and Local Bodies.

### **10.4) Pakistan**

- A New Accounting Model (NAM) has been implemented in the Federal & Provincial Governments and is being implemented in the Local/City Governments. The NAM is based on modified Cash System but it is capable of conversion into Accrual-Based Accounting System in future.
- Full Accrual-Based Accounting System is not being followed currently.
- There is a general awareness about IPSASs and work of IFAC on Public Sector Accounting in the government. Comments on Exposure Drafts (EDs) issued by IPSASs are being sent by both ICAP & ICMAP. Cash-Basis IPSAS not being followed where accounts are kept on Cash-Based Accounting.

- ICAP has constituted a committee on Government Accounting Standards while ICMAP has constituted a Public Sector Committee to take care of public sector accounting in the country.

#### **10.5) Sri Lanka**

- Central Government is following Cash-Based IPSAS while Provincial Councils and Local Government Institutions are using Cash-Basis of Accounting.
- PSEs are using Accrual-Based Accounting.
- There is a general awareness about IPSASs and work of IFAC on Public Sector Accounting in the government.
- Government has carried out awareness program on Accrual-Based Accounting System among senior government officials.

11. The study indicates that Governments of SAARC countries are using Cash-Based Accounting System. SAARC countries have yet to implement Accrual-Based Accounting System and adopt IPSASs for the purpose of financial reporting. In many SAARC countries even the Cash-Basis IPSAS is not being followed.

### **Constraints in SAARC Countries**

12. The study indicates that there are a number of constraints in the SAARC countries for implementation of accrual-based accounting system and adoption of IPSASs and guidelines issued by IFAC-IPSASB. Major constraints include:
  - 12.1) Large population in SAARC countries and associated problems.
  - 12.2) Relatively smaller number of professional accountants to cater for the accounting needs of the society.
  - 12.3) Lack of accrual accounting knowledge in the government sector.
  - 12.4) Lower computer literacy in the government sector.
  - 12.5) Practical difficulties due to widespread area of implementation in many SAARC countries.
  - 12.6) The government machinery in most of the SAARC countries has perceptibly been complacent with regard to consideration of the issue

of conversion from historical cash-basis of accounting to accrual-based accounting. The grim financial performance of most of the government-run commercial Entities including those, which have taken lead by switching over to accrual basis of accounting, may also be the cause of the lack of appreciation, its suitability and advantages for the governments.

### **Recommendations for SAARC Governments**

13. In view of significance of efficient Government Financial Reporting System and importance of transparency and accountability in the use of public funds, the Working Group suggests that SAFA countries should get the full advantage of IPSASs and IFAC-IPSASB guidelines and studies on government sector accounting and financial reporting. The SAFA countries should pursue a phased-program for conversion of prevailing cash-based accounting system into accrual-based accounting system for the government & PSEs. In this direction, following recommendations are made:

#### **Generally Accepted Accounting Principles**

- 13.1) In most of the SAARC countries, the government sector accounting has been devoid of advancement in terms of continuing existence of rule based accounting framework but as the government mandate becomes increasingly growth-oriented, the realignment of the financial accounting and information systems supporting the developmental role of the government at varied levels has become imperative. As the government accounting systems in the region have historically relied on cash basis of accounting and been supported by the rules and codifications for accounting, there is an evident need for adoption of accounting standards and a set of generally accepted accounting principles.

#### **Time-Bound Action Plan**

- 13.2) Having recognized that the accounting standards shall render strength to the government accounting system, the Working Group strongly recommends that the governments should draw a time-bound plan of action to put into place the established accounting principles. In this context, SAFA member bodies would be pleased to render the requisite

support to the governments to ensure development of an efficient accounting system in timely manner.

### **Conceptual Framework for Implementation of Accrual-Based Accounting System**

13.3) A lack of proper comprehension of the nature and role of accounting standards is perceived to be an influential deterrent in converging towards modern accounting and reporting systems in SAARC countries. As the exercise in respect of the definition of a conceptual framework, formulation of accounting systems and implementation thereof in governmental framework is technical and complex in nature, a body with representation from respective stakeholders and active support ideally respective professional accountancy bodies should be formed by the respective governments.

### **Government Accounting Standard Board**

13.4) A Government Accounting Standards Advisory Board be constituted on the pattern of one already working in India. Representatives from the Departments of Auditor General, Controller/Comptroller General, Ministry of Finance and respective member bodies be appointed on the Board.

### **Creating Awareness on the Advantages of Accrual-Based Accounting System**

13.5) One of the primary functions of most of the governmental and local bodies is the proper utilization of funds received during a period from the budgetary allocation. These bodies, therefore, consider the cash basis of accounting as sufficiently effective tool to exercise control over finances. It is necessary that these bodies be enlightened about the advantages of accrual-based accounting system and effective financial control for smooth and efficient operations.

### **Logical Assessment of Existing Cash-Based Accounting System**

13.6) Information System maintained on cash basis as opposed to accrual based accounting may not be effective enough to highlight the deficiencies and imprudence underlying the transactions undertaken inside the government setups. As such a logical assessment in respect

of the various accounting systems and comprehensive projection of the conversion process with adequate inputs from the professional accounting bodies is needed.

### **Approach to Conversion**

14. The successful illustrations of conversion to accrual-based accounting system in many countries across the globe have empirically favored beginning of the initiative with conversion in city governments or Urban Local Bodies particularly due to lesser restraints in terms of constitutionally mandated adherence to historically established accounting framework, which is required by the other tiers in the government setup.

### **Way Forward**

15. Considering the constraints and challenges in the SAARC countries, the South Asian Federation of Accountants recommends the following action plan for conversion of Cash-Based Accounting System into Accrual-Based Accounting System:
  - 15.1) Constitution of working groups comprising officers from the Departments of Controller General, Auditor General, Ministry of Finance and professionals from accounting bodies on accrual-based accounting.
  - 15.2) Induction of professional accountants in the Federal/Central, Provincial/State, Local/City Governments and PSEs.
  - 15.3) Implementation of dedicated training program at all levels of audit and account services, district levels and subordinated staff. In this context, the professional accounting bodies of SAFA are willing to offer their services to the governments/PSEs.
  - 15.4) Computer training programs should be organized with a view to enhancing the level of computer literacy in governments, local bodies and PSEs.
  - 15.5) Greater collaboration between the Departments of Controller General of Accounts and SAFA member bodies is needed in government/PSEs accounting.
  - 15.6) Creating awareness and determination of time-frame for implementation of accrual-based accounting and adoption of IPSASs in phases.

- 15.7) Customization of International Public Sector Accounting Standards (IPSASs) according to the requirements SAARC countries.
- 15.8) Reconciliation of bank accounts of Federal/Central, Provincial/State, Local/City Governments and PSEs.
- 15.9) Valuation of government assets.
- 15.10) Determination of government liabilities.
- 15.11) Compilation of cash flow statement clearly defining cash flows from operating, investing and financing activities.
- 15.12) Financial assistance from international donor agencies should be sought to pursue a phased program of conversion into accrual-based accounting system.

### **Phased-Program of Introduction of Accrual-Based Accounting System**

16. Conversion of cash accounting system in all tiers of governments in one-go is gigantic task. Therefore this task requires phase-wise completion. In the first phase, an action plan should be prepared for introduction of Accrual-Based Accounting System in the Public Sector Entities and Local Bodies/City Government. With successful implementation of accrual-based accounting system in Local Bodies, the work can then be started at the level of Provinces/States and finally the Accrual-Based Accounting be introduced at the Federal/Central government. An action plan based on following broad guidelines may be drawn for this purpose:
  - 16.1) Announcement of Work Plan and Time-Table for Completion of all tasks.
  - 16.2) Understanding of in-place system.
  - 16.3) Identification of problem areas and constraints.
  - 16.4) Development of Accounting Framework.
  - 16.5) Development of Universal Chart of Accounts
  - 16.6) Selection of Accounting Software package.
  - 16.7) Selection of Pilot Projects for testing of new system.
  - 16.8) Monitoring of testing-phase and removal of bottlenecks.
  - 16.9) Improvements resulting from lessons learned at Pilot Projects.
  - 16.10) Commencement of work in all the areas.

- 16.11) Parallel operations in both the old and new systems till successful implementation of new system.

### **Role of SAFA Member Bodies**

17. The SAFA member bodies are willing to extend professional support and technical assistance to their respective governments for introduction of Accrual-Based Accounting System in all tiers of government including Public Sector Entities. More specifically, the professional accounting bodies, while working with governments in partnership, can assist the governments in the following areas:
- 17.1) The members of professional accounting bodies can work with the Department of Controller General/Comptroller General and Ministry of Finance on the proposed Government Accounting Standards Boards and Working Groups for developing accounting framework.
  - 17.2) The SAFA member bodies can provide services for implementation of Accrual-Based Accounting System in all tiers of governments.
  - 17.3) The professional accounting bodies can develop training programs on Accrual-Based Accounting for the officials of government.
  - 17.4) The professional accounting bodies can design computer/IT training courses for the government officials of government in partnership with respective Federal/Central and Provincial/State governments.
  - 17.5) The SAFA member bodies can draw short-term and long-term plans for human resource capacity building in the areas of accounting, finance and information technology in partnership with respective governments.
  - 17.6) Creating awareness on utility and benefits of Accrual-Based Accounting System among all the tiers of government.

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