



A Conceptual Study on Public Sector Accounting System: Benefits and Challenges

Ashoka M. L. and Aswathy P.***

ABSTRACT

The accounting system of public sector differs from private firms. When the public sector is service oriented and give more focus on transparency in financial reporting, private firms are concerned more about profit maximisation and increasing value of firm. Public sector accounting is concerned with recording, analysing, classifying, summarising, communicating and interpreting financial information of government organisations. The present government accounting in India is cash based accounting. The public sector is reforming its accounting system as it is inevitable in providing a fair view of the public finance with full cost disclosure. Since we are bound to maintain credibility and transparency at the global level, it becomes necessary for the nation to adopt the international public sector accounting standards. India is moving towards accrual system of public sector accounting in a phased manner. Only few nations have adopted the International public sector accounting standards (IPSAS), whereas many others have adapted these standards. This paper attempts to study the traditional public sector accounting and benefits and challenges involved in the adoption of the international standards.

Keywords: *Public sector accounting; IPSASB; IPSAS; Harmonization of government Accounting.*

1.0 Introduction

Public sector is that part of a nation's economic activity which is traditionally owned and controlled by government. It means that the public sector is composed of

**Professor, Department of Commerce, University of Mysore, Mysore, Karnataka, India. (Email: ashokml.uom@gmail.com)*

***Corresponding author: Research Scholar, Department of Commerce, University of Mysore, Mysore, Karnataka, India. (Email: aswathy.p@live.com)*

those public organisations which provides utilities and services to the community and which traditionally have been seen as essential to the fabric of our society.

Public sector reform is a dynamic and fast moving process. Globalisation and national factors may take reform initiatives into directions that cannot be foreseen today. So, the public sector reform including management and accounting reforms is becoming a must. Public sector accounting can be seen as the accounting method that is used by non-profit pursuing organisation in the public sector which comprises the central and state governments whose performance cannot be evaluated by the size of their profit. Public sector accounting is that system of accounting which supports the government to record information about their financial affairs so that it helps to shape its monetary and fiscal policies.

The government accounting system worldwide has some common objectives and peculiarities in measuring and recording the receipts, expenditure and their budgetary control. Countries started moving from the traditional cash based system to the modern accrual based system to keep in pace with the non-public sector. Till some international standards were established there was no uniformity in the accounting practices of different nations.

We can see that government accounting reform is a shift from a cash flow and cash balances concept to a total economic resources concept. It is an extension of measurement focus to encompass the total economic resources of government entities instead of only concentrating on the cash resources. Accrual accounting provides more comprehensive information (assets, liabilities, revenues, expenses, net assets and changes therein) regarding government entities and whether these entities are operating economically or not. (Ouda, 2003). The next part of the paper is presented as review of literature, methodology, discussions and conclusions.

2.0 Review of Literature

This section deals with analysing the existing body knowledge and earlier research work to identify the gap for the current study. Ouda (2003) analysed the government accounting reform and opined that a shift is to be made from the cash accounting to the accrual accounting which in turn is a change from less informative accounting system to one which is more informative. Wang *et al.*, (2018) found that most of the South Asian nations have adopted IPSAS though to different extend by taking different approaches and directions and India is still following cash based accounting system.

Jayasinghe *et al.*, (2015) has opined that the rapid development of public sector accounting and auditing in emerging economies present empirical challenges because of the different ways in which public sector reforms are understood and enacted by institutions. Paul (2019) found that the adoption of accrual basis of accounting in a phased manner by government will be helpful to all stakeholders in the nation.

Baker *et al.*, (2018) analysed the reasons for development for public sector accounting standards in Canada and found that the role played by the inter organisation professional network in defining and labelling problems has resulted in the development of standards. PwC (2015) in its survey gave the insight that all governments should produce high quality and transparent financial statements that are credible and internationally recognised using IPSAS or equivalent standards.

Abhishek and Divyashree (2019), analysed public sector accounting at Indian and global level. The study identified that although India has taken efforts to initiate accrual system it is not fully implemented at global standard and hence it calls for commitment from accounting professionals, academicians, researchers to enable India's PSA achieve global standards.

From the analysis of earlier studies, it is clearly found that the status of public sector accounting is still in infancy stage and not much study had taken place so the current study is intended to conceptually analyse the public sector accounting in India and across the globe.

3.0 Objectives

From the analysis of the literature the following objectives have been framed for this study:

- To examine the traditional public sector accounting system.
- To study the benefits and challenges in the implementation of IPSAS.
- To examine the current status of public sector accounting in India.

4.0 Methodology

The present study is conceptual in nature. It is conducted based on secondary data collected through various published sources like journals, research articles, websites, government reports, public sector accounting standards etc.

5.0 Discussion

“Public sector accounting can be defined as a system which gathers, records, classifies and summarises as reports the financial events existing in the public sector and

as required by accountability and financial transparency provides information to information users associated to public institutions.” (Kara, 2012)

The public sector is reforming its accounting system due to many reasons. The first objective is to provide a fair view of public finance which is related to assessing the full cost of government operations. In general, the public management need to be modernised by introducing a performance culture. Besides this the financial crisis in the past and the high level of public debt underlines the importance of harmonised accounting standards so as to provide timely and reliable financial data and enable complete and comparable financial and fiscal reporting.

Accounting is inevitable to all organisations, whether they are profit oriented or not is immaterial. Accounting has always been considered as a key function of any organisation, which plays fundamental role of collecting and recording data related to any economic transaction of the organisation. Here we can trace a difference in relation to the object and the users’ needs that accounting tries to accomplish.

The accounting system of private sector and government sector differ due to the environment of the accounting system. While the primary responsibility of government entities is fiscal accountability, the main goal of organisations in private sector is profit maximisation. The government determines the shape of its monetary and fiscal policies based on the accounting results. The basis of accounting depends upon when the transaction to be recorded is recognised and the rules adopted for measurement and evaluation process. In a broader view two accounting trends can be recognised, a traditional one which is cash based accounting and a modern one which is accrual based accounting. In the middle we can consider at least two variations, the modified cash based system and the modified accrual accounting system. (Rossi, 2016)

Under accrual basis of accounting, the financial effects of events and transactions are recognised in the periods in which they occur, regardless of whether or not cash has been received or paid. This means that revenues are recorded when the right to collect them is generated and the expenditures are recorded at the time goods and services are received, irrespective of when cash is paid. Although the focus of accrual accounting is on all assets, not just cash it contains complete information about cash flows. Under cash accounting the cash receipts and payments are recorded as they occur. It does not take into consideration when it is incurred, it considers only when it is received or paid. When it comes to modified cash accounting cash receipts and disbursements committed in the budget year are recorded and reported until a specified period after year end. In modified accrual accounting accrual accounting is used but certain classes of assets, for example fixed assets, or liabilities are not recognised.

The traditional approach to public accounting focused on ensuring effective control of the use of public fund. It was merely designed as a system for reporting budget execution.

The main features of traditional approach to public sector accounting are:

- Extensive use of single entry book keeping
- Transactions are recorded on cash basis
- Obsessive following of principles of legality and expenditure control.

Along with the problems of shortage of information disclosed by the financial statements and notes to financial statements, there are some chief accounting shortcomings of the traditional public sector system (Garcia, 2014). They are given below.

5.1 Cash based system

In the traditional cash based system transactions were recorded only at the time of receipt or payment of cash. Therefore, managers did not have access to much of the information needed for efficient decision making.

5.2 Investments

In traditional accounting system investments are treated as expense and booked to a single accounting year. The acquisition of fixed assets is also treated as an expense and charged to a single accounting year which leads to distortion as the useful life of the asset is much longer. Depreciation is also not shown in the books of accounts.

5.3 Inventories

The purchase of inventories is treated as expense and its sale is treated as profit with no associated cost. This practice affects the financial position especially when the value of inventories figures heavily in the balance sheet.

5.4 Provisions

Provisions are not considered in the traditional public accounting system. It is accounted only when the contingent liabilities generate a payment. It will not create a fair image when we do not account for a possible liability.

5.5 Accruals and prepayments

Revenues or expenses related to more than one year like interest earned or other liability are recorded in traditional public sector accounting only when it is received or

paid irrespective of when the revenue or expense were generated which leads to distortion of profit/loss for the year.

When all these shortcomings can be seen in traditional public sector accounting, there is a need to update and modernise to adapt with the universal and more complex environment. This has called for the need for suitable accounting standards.

5.6 Public sector accounting in the global context

The accounting system in use in the public sector organisations varies across countries and type of organisations. Countries that have a level of state government is observed to have a complex accounting arrangement. Accounting practices of various state governments vary greatly from one other, which leads to significant accounting heterogeneity within a given country.

International Public Sector Accounting Standards Board (IPSASB) instituted IPSAS in an effort to improve financial reporting by public sector organisation and for comparability purpose. At the global level, harmonisation of public sector accounting should be realised by adopting IPSAS which is a well-developed set of accounting standards for use by public sector entities.

The adoption of IPSAS is gaining momentum across the world. In 2015, the European Union announced the establishment and adoption EPSAS (European public sector accounting standards) based on IPSAS with adoption dates to be determined by respective countries. Some countries like Australia, Canada, US, France and few others has adopted the full accrual basis of accounting.

Most of the South Asian nations have adopted the IPSAS though to different extents. Nepal, Bangladesh, India and Pakistan have adopted standards aligned with cash based IPSAS. (UNCTAD, 2018) Most of the South Asian countries are geared towards adapting rather than adopt the standard in all material aspects. (Wang *et al.*, 2018)

5.7 Public sector accounting in the Indian context

The Comptroller and Audit General of India (CAG) constituted the Government Accounting Standards Advisory Board (GASAB) with the support of government of India to facilitate reforms in government accounting. It formulates and recommends Indian Government Accounting Standards with a view to improve the standards of government accounting and financial reporting which will enhance quality in decision making and public accountability. Two types of accounting standards are being developed by GASAB for the government to address the issues relating to existing cash system of accounting and its migration to the accrual accounting system in the future. The standards developed to make cash based accounting more popular are called Indian

Government Accounting Standards and those developed for the accrual accounting system in the government are called Indian Government Financial Reporting Standards (IGFRS). The latter is to facilitate pilot studies and the on-going applied research on accrual basis of accounting in Government.

The accounting system prevailing in Government of India and the states is cash based. The preparation of government accounts in India is governed by the government accounting rules 1990 that is framed under Article 150 of the constitution of India.

5.8 IPSAS

The need for globalisation, ease in management of international trade and implementation of joint international development projects require comparable and similar accounting standards. For comparing financial information across companies, organisations and public entities, accounting standards and accounting practices have to be harmonised.

International Public Sector Accounting Standards Board (IPSASB) was established by International Federation of Accountants (IFAC). IFAC is a global organisation dedicated to serving public interest by strengthening the accounting profession and contributing to the development of strong international economies. IPSASB was formerly known as public sector committee. It IPSAS which apply to the accrual basis accounting and cash basis of accounting. Before issuing accrual accounting IPSAS it looks for guidance available from IFRS issued by IASB. If any accounting standards are there it adopts the same. If no standards are available, then IPSASB will issue new accrual accounting IPSAS.

IPSAS are the public sector equivalent of International financial reporting standards (IFRS). The move towards using IPSAS in public sector has the potential to change the practice of accounting and reporting in this sector, just as IFRS have accomplished with listed companies. (ACCA, 2017)

IPSASB has so far issued 32 IPSAS for accrual accounting and it has also issued comprehensive cash basis IPSAS that includes mandatory and encouraged disclosure sections. The intention of instituting IPSAS was to modernise the public sector financial reporting. These standards are issued and revised by the IPSASB and these standards are based on IFRS for application by public sector entities across the world.

Financial information becomes useful only when it is presented in a comparable, verifiable and understandable version.

The IPSAS regulates the financial accounting process of government sectors excluding profit making entities. The motivation of applying these standards in the public sector is their ability to provide a more transparent and accurate financial

overview of firms with the implication being a radical change in practice of financial reporting and easy comparability. (Rossi, 2016)

The public financial management can be improved by adopting International public sector accounting standards IPSAS for financial reporting. (PwC, 2013)

IPSAS has become an international reference for the development of public sector accounting systems worldwide. The objective of IPSAS is to serve the public interest by developing high quality accounting standards and also other publications for use by the public sector entities around the world for the preparation of general purpose financial reports.

It is indicated through various studies that government accounting arrangements are extremely heterogeneous. The presence of various levels of government like central, state and local have its implications in the adoption of IPSAS.

IPSAS is the only globally accepted accrual based public sector financial reporting standards. It provides for the disclosure of all assets, liabilities and contingent liabilities.

IPSAS develops two sets of accounting standards, accrual accounting IPSAS and cash accounting IPSAS.

IPSAS the equivalent of IFRS that govern financial accounting in private business entities are steadily gaining implementation momentum in past few years.

5.9 Benefits of IPSAS adoption

By adopting IPSAS the countries can avail many benefits, few of which are given below (ACCA, 2017)

- IPSAS adoption provide better clarity on the financial position of the public sector entities across the world. It is necessary in promoting transparency and curtailing corruption and fraud. It helps the authorities in making efficient decisions as both financial position and its implication is known.
- Increased standardisation supports to avail more efficient audits and helps mitigate the risk of significant material misstatement. Standardisation of the accounting and reporting process provides more opportunity for better analysis of data and decision making.
- IPSAS plays a major role in the professionalization of the accounting and finance function across the public sector.
- IPSAS adoption provides broader social and economic advantages. It helps in attracting inward investment into the public sector especially the emerging economies. When the financial statements are prepared in accordance with the

IPSAS standard it brings confidence to investors. Better international comparability among public sector entities is possible.

- IPSAS adoption supports the policy makers in explaining and generating support for their plans for the government.

5.10 Challenges in adopting IPSAS

While implementing IPSAS some practical challenges may arise with regard to regulatory context, institutional arrangements, technical accounting and some financial reporting issues from the broader development of the profession.

- Legal changes along with new regulations and governance practices are required which may be complex and time consuming and vary from one country to other. Countries that have a level of state government is observed to have the most complex accounting system. Hence planned changes will have to be implemented.
- Another aspect is the institutional arrangements. In any country before adoption of IPSAS it is important to assess the complexity of the accounting institutional arrangements. The levels of government may have an effect on the level of complexity of institutional arrangements.
- IPSAS adopting countries face some key technical problems that relate to the implementation of international standards, transition from cash accounting to full accrual accounting.
- In addition to the technical challenges there are overall challenges pertaining to ensuring timeliness of reporting and quality of data that supports the accrual financial reporting.

6.0 Conclusion

The main aim of the government is to render essential services to its citizens and it does not seek profit from this. Public sector accounting can be used to measure revenue and expenses of government and it can be also used for budgeting, planning and forecasting. Cash based government accounting does not provide users with complete and comprehensive information needed for decision making. But the accrual system can overcome to a great extent the shortcomings of cash system. Now economies have become more interdependent and global, so it is high time to move to the accrual system of accounting which will help government to measure assets and liabilities more objectively. The Indian government is still following the cash basis of accounting with some accrual disclosures made in the financial statements.

6.1 Limitation and scope for further research

The main limitation of this study is its conceptual nature. Future researches can be undertaken in an empirical manner by using primary data.

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