I. Introduction

Many governments have reformed their public sector arrangements in recent years. They want to concentrate on outcomes—such as immunization, literacy and infant mortality rates—rather than the traditional government focus on inputs (e.g., wages, buildings and motor vehicles). At the same time, they are seeking greater efficiency and better fiscal performance.

Accompanying this reform trend is a move for governments to adopt accrual accounting (just like the private sector)—most members of the Organisation for Economic Co-operation and Development (OECD) have adopted accrual accounting to some extent, and more are planning to do so.[1]

In conducting diagnostic studies of developing member country (DMC) accounting and auditing practices,[2] Asian Development Bank (ADB) assesses, among other things, the extent to which DMC governments use cash or accrual accounting. These studies, and discussions with DMC government officials, reveal that many DMC governments are either moving, or are considering moving, from cash accounting towards accrual accounting (see page 29).

At one extreme, supporters of accrual accounting in government argue that "if it's good enough for the private sector, it's good enough for the public sector." At the other extreme, opponents contend that implementation costs outweigh information benefits—particularly for a DMC government.

Implementing accrual accounting can involve significant direct costs in terms of information technology and training, and indirect costs in terms of institutional disruption. Moreover, costs and benefits will vary between DMCs, reflecting their existing capacity, government arrangements and budgeting methods. Nevertheless, in the general

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1 OECD. 2000. *Focus*. December (18). p. 1.

2 RETA 5877: *Strengthening Financial Management and Governance in Selected DMCs* and RETA 5980: *Diagnostic Study on Accounting and Auditing Practices in Selected DMCs*. These regional technical assistance projects (RETA) involved diagnostic studies of DMC accounting and auditing practices.

absence of policies or practical guidance materials,[3] ADB, together with other agencies, has generally supported DMCs in their efforts to improve government accounting.

This study attempts to critically examine the costs, benefits and suitability of accrual budgeting and accounting for ADB DMCs. Its ultimate objective is to provide the basis for a practical and operationally relevant technical advisory note on public sector accounting reform.

This report is intended to support that objective by (i) describing alternative government accounting arrangements and reviewing evidence supporting their efficacy; (ii) examining factors that support, or impede, accounting reforms; (iii) examining and comparing countries that have successfully implemented accounting reforms with those that have not, and the strategies that enabled impediments to be overcome; and (iv) suggesting criteria for evaluating proposed accounting reforms. This report is strictly advisory. It does not represent guidelines or requirements that must be followed in programs, projects or technical assistances.

[3] In late January 2003, the following paper was released: Diamond, Jack. 2002. *Performance Budgeting: Is Accrual Accounting Required?* Working Paper WP/02/240. Washington, DC: IMF. The guidance provided by the International Federation of Accountants (IFAC)—IFAC. 2002. *Transition to the Accrual Basis of Accounting: Guidance for Governments and Government Entities.* Public Sector Study 14. New York—concentrates on conceptual issues, such as accounting policy selection and asset valuation approaches. It also includes six paragraphs on transitional and developing countries and three paragraphs on information systems.