

# IV. DMC Government Accounting

## 1. Introduction

This part reviews the accounting arrangements of nine DMC governments. All have either (i) announced an intention to move to accrual accounting; (ii) begun implementation activities; or (iii) already adopted modified accrual accounting.

Historical accounting practices influence country accounting arrangements and trends. Based on the Table 4 model categorization, the DMCs are classified into two groups: (i) DMCs using standards-based accounting models; and (ii) DMCs with Soviet accounting backgrounds.<sup>44</sup>

Table 4. Economies Classified by Accounting Models

Accounting System	Accounting Model	Features	Economies
Standards Based Accounting	British Commonwealth	<ul style="list-style-type: none"> <li>• Commercially driven</li> <li>• Overriding rule is that financial statements show a “fair” picture</li> <li>• Accounting practices reflect, and develop with, business practices</li> <li>• Professional regulation dominates</li> </ul>	Australia, Bahamas, Ireland, Fiji Islands, India, Jamaica, Kenya, Malaysia, Netherlands, New Zealand, Pakistan, Papua New Guinea, Zimbabwe, Singapore, South Africa, Sri Lanka, Trinidad & Tobago, United Kingdom
	United States	<ul style="list-style-type: none"> <li>• Same as British Commonwealth model except that professional regulation coexists with government regulation</li> </ul>	Canada, Indonesia, Japan, Marshall Islands, Mexico, Panama, Philippines, United States

<sup>44</sup> Although this classification is for private sector accounting models, it is broadly consistent with government accounting classifications. See, for instance, OECD. 2002. Models of Public Budgeting and Accounting Reform. *OECD Journal on Budgeting*. Vol 2(1). December. pp. 5-6.

Accounting System	Accounting Model	Features	Economies
Uniform Accounting Plans	Soviet Union	<ul style="list-style-type: none"> <li>• Government driven</li> <li>• Dominated by statistics and taxation requirements</li> <li>• Accounting practices are statute-based</li> <li>• Accountancy profession not required</li> </ul>	Azerbaijan, People's Republic of China, Mongolia, Russia, Uzbekistan
	Continental European	<ul style="list-style-type: none"> <li>• Government driven</li> <li>• Dominated by taxation requirements</li> <li>• Accounting practices are statute-based</li> </ul>	Belgium, Cambodia, France, Germany, Italy, Spain, Sweden, Switzerland, Viet Nam, Venezuela
	Latin American "Castilian model"	<ul style="list-style-type: none"> <li>• Very similar to continental European model</li> </ul>	Argentina, Bolivia, Chile, Colombia, Ethiopia, Paraguay, Peru, Uruguay

Source: Modified from Nobes, Christopher and Robert Parker. 1995. *Comparative International Accounting*: Fourth Edition: Prentice Hall. p. 67.

## 2. Standards-Based Accounting Countries

Economies with standards-based accounting backgrounds tend to use cash accounting in government, generally reflecting colonial influences. This section describes government accounting in the Fiji Islands, Indonesia, Marshall Islands, Philippines and Sri Lanka.

### Fiji Islands

The financial statements of private sector organizations, government commercial companies and commercial statutory authorities are prepared using the accrual accounting basis. The financial statements of core ministries and departments are prepared using a cash accounting basis in accordance with the *Finance Instructions and Regulations*. However, the Government has purchased a sophisticated accrual-based computer system and has signaled a medium-term intention to move to the accrual accounting basis.<sup>45</sup>

<sup>45</sup> ADB. 2002. *Diagnostic Study of Accounting and Auditing Practices in the Fiji Islands*. Manila. p. 80.

The Government's *Finance Instructions* and *Regulations* govern the preparation of cash-based reports, but these instructions are not accounting standards and are not internationally comparable. However, a recent study investigated preferences as to who should set accounting standards for, and monitor their application in, the public sector. Among other things, the study concluded that there is substantial stakeholder support for the introduction of accrual public sector accounting standards within the Fiji Islands.<sup>46</sup>

## Indonesia

The State Financial Accounting Agency is responsible for government accounting arrangements. In the absence of public sector accounting standards, financial report preparation was, until very recently, largely based on a 1925 treasury law and private sector accounting standards, some of which are not suitable for public sector reporting.

Work is currently underway to implement GFS in the central Government. In an effort to provide legislative support for public sector financial management reforms, government submitted three bills to parliament in September 2000 (covering state finances, state treasury, and state audit). The State Finance Law was approved on 6 March 2003 and is awaiting Presidential assent. Among other things, this law: (i) requires preparation of central and local government balance sheets and budget realization reports; and (ii) provides a basis for accounting standard-setting arrangements and procedures.

The Government Accounting Standards Committee prepared a seven-year action plan starting in July 2002. The action plan envisages a transition from cash accounting to accrual accounting, culminating with IPSAS-compliant government accounting standards in 2009. The Committee has already prepared 4 IPSAS-based government financial accounting standards (PSAPs).

## Marshall Islands

The Marshall Islands follows US government accounting practices as promulgated by the Government Accounting Standards Board (GASB). In particular, section 104 of the *Financial Management Act 1990* requires public sector organizations to account in accordance with GASB

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<sup>46</sup> Vatuloka, Eroni and Greg E. Shailer. 2000. Preferences for the Regulation and Monitoring of Fijian Government Accounting. *Asian Accounting Review*. Vol(8). No. 2.

standards. Most government accounting is on a modified accrual basis; however, GASB 34 (*Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*) requires a move towards full accrual accounting.<sup>47</sup>

The effective date of GASB 34 requirements depends on total annual government revenues in the first financial year ending after 15 June 1999—in the year ended 30 September 1999 the Government reported revenues of \$90.4 million.<sup>48</sup> Therefore, government financial statements have to comply with GASB 34 requirements starting with the financial year beginning on 1 October 2002.

Private sector organizations, state-owned enterprises and statutory authorities use the accrual accounting basis and are required to prepare financial statements in accordance with US GAAP.

## Philippines

Fund, obligation and cash-disbursement-ceiling accounting methods are used in government. Taxes are accounted for on the cash basis and the accrual basis is used for other revenues and expenses.<sup>49</sup> Government financial reports and statements, like commercial entities, are prepared based on official accounting records. In the case of government organizations, specific laws and regulations tightly prescribe the format and contents.

The requirement to prepare and submit balance sheets and operating statements was introduced in 1979. Financial statements include (i) current assets, (ii) contingent assets, (iii) fixed assets, (iv) current liabilities, (v) contingent liabilities, (vi) allotted appropriations, (vii) income, (viii) invested surplus, (ix) contingent surplus, (x) national clearing account, (xi) the total surplus, and (xii) assorted notes to the accounts.<sup>50</sup>

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<sup>47</sup> ADB. 2002. *Diagnostic Study of Accounting and Auditing Practices in the Republic of the Marshall Islands*. Manila. pp. 23-24, 64-65.

<sup>48</sup> Government of the Marshall Islands. 2001. *Republic of the Marshall Islands: General Purpose Financial Statements and Independent Auditors' Report for the year ended 30 September 2000*. Majuro. 18 May. p. 5.

<sup>49</sup> Pobre, Hermogenes P. and Araceli Bernal-Magno. 1987. *Government Accounting*. Manila. pp. 19-21, 307-330.

<sup>50</sup> *Ibid.* pp. 14-15.

The Commission on Audit is planning a move to full accrual accounting. To this end, it is considering the appropriateness of IPSAS as the basis for government accounting standards.

### **Sri Lanka**

The financial statements of private and public sector organizations that are classified as specified business enterprises are prepared using the accrual accounting basis. The budgets and financial statements of other government bodies are prepared using a cash accounting basis.<sup>51</sup>

The Government is considering introducing accrual budgeting and accounting as part of the ADB-supported Public Expenditure Management Reform Program.<sup>52</sup>

## **3. Soviet Accounting System Countries**

The “Soviet accounting system” catered to the needs of central planning; in particular, the system provided accounting information, including (i) financial information, (ii) tax information, and (iii) statistical information. It emphasized standardization and uniformity so that information could be compared across sectors and industries.

The system did not use market-based accounting concepts such as going concern, consistency and substance over form. Furthermore, provisions for doubtful debts or obsolete inventories were not estimated—doubtful accounts were written off only when they were clearly not collectable. Accounting consisted of adhering to prescribed charts of accounts (Uniform Accounting Systems, UAS) that were designed to meet the requirements of the central planning system. The primary function of accounting was to record the factual data necessary to assess plan accomplishments, rather than to assess an organization’s financial situation.

Public and “private sector” organizations used the system, which employs double-entry bookkeeping and reflects many aspects of accrual accounting.

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<sup>51</sup> Government of Sri Lanka. 1992. *Financial Regulations of the Government of the Democratic Socialist Republic of Sri Lanka*. Department of Government Printing: Colombo.

<sup>52</sup> ADB. 2002. *Diagnostic Study of Accounting and Auditing Practices in Sri Lanka*. Manila. pp. 24, 63-64.

## Azerbaijan

Government activities are generally accounted for on an accrual accounting basis at the organizational level and on a cash basis for consolidated budgeting and reporting—the cash basis was introduced with support from international institutions, particularly the IMF and the World Bank.

Government organizations prepare monthly cash reports and quarterly accrual reports that are submitted to the MOF. In 2001, the MOF began publishing consolidated quarterly reports incorporating revenues, expenditures, expenditure arrears, stock of government and government-guaranteed debts, and new loans contracted or loan guarantees issued. A revised Budget Systems Law has been drafted and is being considered.<sup>53</sup>

## People's Republic of China

With the exception of government organizations, all organizations use double-entry bookkeeping and all transactions are recorded on the accrual basis. Not-for-profit organizations (e.g., schools, kindergartens, hospitals) have recently moved from cash accounting to a modified accrual accounting basis.<sup>54</sup>

Government budget accounting system reform began in 1998. It took account of the PRC's successful enterprise accounting reforms and international public sector accounting practices. Among other things, as a consequence of the initial reforms: (i) the cash accounting basis is required to be used in general budget accounting; (ii) administrative units may use either the cash or accrual basis, depending on their specific circumstances; (iii) double entry bookkeeping has been implemented; (iv) the previous focus on fund sources, applications and balances has been replaced by new accounting elements comprising assets, liabilities, net assets, revenues and expenditures. For example, the Change in Fund Activity Statement became a statement of assets and liabilities, and various statements about financial flows were added.<sup>55</sup>

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<sup>53</sup> ADB. 2002. *Diagnostic Study of Accounting and Auditing Practices in Azerbaijan*. Manila. p. 50.

<sup>54</sup> ADB. 2000. *Financial Management and Governance Issues in the People's Republic of China*. Manila. p. 8.

<sup>55</sup> Jiwei, Lou (First Vice Minister, Ministry of Finance). 2002. Government Budgeting and Accounting Reform in China. *OECD Journal on Budgeting*. Vol 2(1). December. pp. 51–80.

The adoption of the accrual basis for general budget accounting is now being considered. In particular, accounting principles used in enterprise accounting systems may be gradually introduced. To this end, clear requirements are needed for fixed asset depreciation, overseas investment, income tax and other issues related to their economic activities.<sup>56</sup>

For national accounts purposes (SNA 1993), a national balance sheet has been prepared annually since 1997, but is incomplete and has not yet been published. The biggest issue is valuing non-financial assets.<sup>57</sup>

## Mongolia

State-owned enterprises and the central bank are required to prepare IAS-compliant financial statements. Government organizations use modified accrual accounting (revenues are rarely accrued due to budget financing arrangements). Aggregate government reporting is on a cash basis.<sup>58</sup>

Government organizations prepare and submit two major financial statements to the MOF on a quarterly and annual basis: balance sheets and associated notes, and budget performance reports. The contents and formats of these financial statements do not meet IAS or IPSAS requirements. Moreover, non-financial assets (e.g., inventories and physical assets) and some expenses (e.g., utilities) of government organizations are commonly reflected in the financial statements of other entities (e.g., the inventories, physical assets, and utility expenses of the MOF are reported in the financial statements of "Building No. 5"). This issue of entity-definition limits the ability of financial statements to reflect entities' position and performance.<sup>59</sup>

## Uzbekistan

Uzbekistan uses sector-neutral accounting. That is, with few exceptions, accounting standards, regulations and procedures apply equally to public sector organizations and to private sector organizations. Budget organizations account and report in accordance with the *Accounting Law*

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<sup>56</sup> *Ibid.*

<sup>57</sup> Lihua, Dong (National Bureau of Statistics). 2001. *The Status of Implementation of the 1993 SNA in China*. Paper presented at the concluding workshop on ADB TA No. 5874-REG: Rebasing and Linking of NAS. 13-16 February. p. 3.

<sup>58</sup> ADB. 2000. *Financial Management and Governance Issues in Mongolia*. Manila. p. 47.

<sup>59</sup> Public Sector Performance (NZ) Ltd. April 1999. *Final Report on TA No. 2931-MON: Program Preparation for Governance Reforms: Status Assessment of Pilot Agencies*. Vol III(3). p. 16.

1996, national accounting standards (NAS), Accounting Instructions for Budget Organizations and operational classifications of revenues and expenditures of the State Budget. NAS are being made IAS-compliant.<sup>60</sup>

The *Accounting Law 1996*—which applies to private and public sector organizations—states that the basic accounting principles are the maintenance of accounting records on the basis of the double-entry system; going concern; monetary measurement of transactions, assets and liabilities; reliability; accrual measurement; prudence (conservatism); substance over form; comparability; neutrality; matching principle; and historic cost.<sup>61</sup>

## 4. Conclusion

This part revealed a general trend among ADB DMCs toward accrual accounting. It also illustrated that there are significant differences between individual countries (see Table 5).

Table 5. Selected ADB DMCs: Direction of Government Accounting

DMC	Current Basis	General Direction
Fiji Islands	Modified cash	Accrual
Indonesia	Modified cash	Accrual
Marshall Islands	Modified cash	Accrual
Philippines	Modified accrual	Accrual
Sri Lanka	Modified cash	Accrual
Azerbaijan	Accrual	Accrual
China, People's Republic of	Modified accrual	Accrual
Mongolia	Modified accrual	Accrual
Uzbekistan	Accrual	Accrual

The review identifies the comparatively advanced accounting methods of economies that formerly used the Soviet accounting system. Nevertheless, the descriptions in this part should be treated carefully for the following reasons that are discussed later in this report:

<sup>60</sup> ADB. 2000. *Financial Management and Governance Issues in Uzbekistan*. Manila. p. 22.

<sup>61</sup> *Ibid.*

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- Accounting capacity was not considered. For instance, the Marshall Islands is required to introduce accrual accounting, but has no professionally-qualified accountants.
  - Government accounting arrangements must be considered in a wider public management context. There may be higher priorities than adopting accrual accounting. For instance, Indonesia is working to reestablish basic accountability following decentralization of government functions.
  - Implementation effectiveness was not considered—there are significant differences between regulatory requirements and actual practice. For instance, although Mongolian government accounting appears reasonably advanced, there are significant basic issues (e.g., misleading asset valuations).
  - Institutional and environmental rigidities were ignored. For instance, in attempting to improve government accounting arrangements, the Philippines will have to overcome significant resistance from groups with vested interests.