

V. Country Implementation Experiences

1. Introduction

A number of developed countries have implemented accrual budgeting and accounting (see Table 2, page 12). This part reviews implementation approaches and experiences. It begins by identifying general implementation tasks then examines the implementation approach taken by New Zealand (NZ), which was chosen because it was the first OECD country to fully implement accrual budgeting and accounting in government—a substantial collection of materials on its experiences have been compiled in the ensuing period.⁶² The experiences of four other developed countries are also considered in order to identify implementation approaches and lessons (see Appendix 4).

2. General Implementation Tasks

A variety of strategies, sequences and timeframes may apply to adopting accrual accounting. Nevertheless, the following preparatory activities will generally be required, once a decision has been taken to adopt accrual accounting:

- Reviewing existing systems, arrangements and capacity;
- Developing an implementation strategy and project plan;
- Developing a communication/education strategy;
- Developing a training/capacity enhancement strategy and plan;
- Establishing project teams;
- Agreeing to accounting policies and reporting formats;
- Identifying accounting information system requirements;
- Clarifying external and internal audit roles; and
- Designing quality assurance processes.

⁶² Although Iceland implemented accrual budgeting and accounting at around the same time as NZ, little has been written on its experiences. Moreover, it should be recognized that governments using the Soviet accounting system introduced accrual accounting concepts many decades before NZ.

Implementation activities will generally include

- Developing charts of account and detailed accounting policies and instructions;
- Delivering communication and training programs;
- Establishing opening balance sheets (identifying and valuing assets and liabilities);
- Implementing changes to information systems, where necessary;
- Auditing opening balance sheets; and
- Implementing changed internal control and audit arrangements.

3. The New Zealand Experience

In the mid-1980s, NZ began a decade-long process of rigorous reforms including exchange rate liberalization, labor-market deregulation, privatization and public sector management reform. As part of the public sector reforms, government budgeting and reporting moved from the cash to the accrual basis over about a 6-year period (see Table 6).

Table 6. Implementing Accrual Budgeting
and Accounting in New Zealand

1987	Departments begin preparations for accrual accounting
1989	Public Finance Act passed Departments begin move to accrual accounting (first five go live) (July)
1990	All departments except three on accrual accounting (June) Final departments go live (December)
1991	First half-year whole-of-government financial statements (December)
1992	First annual whole-of-government financial statements (June) First half-year consolidated whole-of-government financial statements (December)
1993	First annual consolidated whole-of-government financial statements (June)
1994	First consolidated accrual budget (June) First monthly consolidated whole-of-government financial statements (October)
2002	First fully line-by-line consolidated whole-of-government financial statements

Source: Updated from Warren, Ken. 2000. The Impact of GAAP on Fiscal Decision Making: A Review of Ten Years Experience with accrual and output-based budgets

in New Zealand. Paper prepared for the Australasian Treasury Officers Conference, October. Modifications and additions have been made.⁶³

Objectives and Effectiveness

The initial objective of the NZ public sector reforms was to enhance technical efficiency and improve accountability (see, for instance, the Public Finance Act 1989, State-Owned Enterprises Act 1986, and the State Sector Act 1988). This emphasis was later extended to achieving aggregate fiscal discipline. Figure 3 reveals a marked improvement in NZ fiscal aggregates, some of which was due to the introduction of accrual-based budgeting and reporting (but the precise impacts cannot be quantified). The overall reforms are credited with improving fiscal control, efficiency, asset management and public sector culture (see Figure 3).

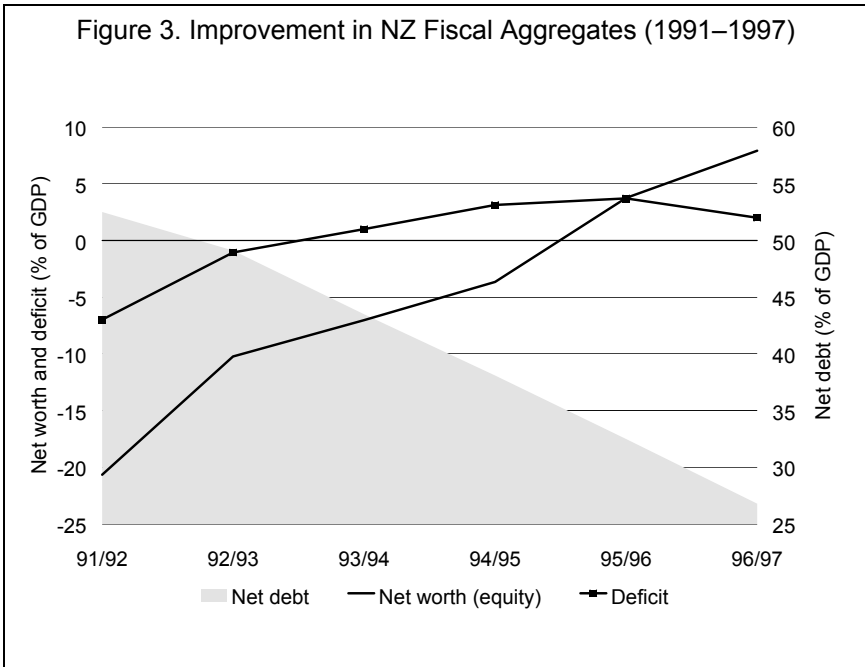
First, a 1997 study contended that the relative slackness of the NZ system, with respect to aggregate fiscal discipline, declined from 74% in 1984 to 6% in 1994.⁶⁴ The authors opined that “prior to the reforms, most public financial statements and budgetary documents were not available to the general public for scrutiny and, even if they were made available, they could not be easily understood even by accountants and financial experts in the private sector. Consequently, government performance was largely non-transparent. The [adoption of accrual accounting] changed this dramatically.” (p. 432).

⁶³ The coauthor of this report was the Coordinator of Aggregate Fiscal Forecasting and Monitoring at the NZ Treasury when the Government moved its aggregate budgets and reports from the cash to the accrual basis. In this role, he was responsible for coordinating, preparing and analyzing the Government’s forecasts, budgets and financial reports (cash based, accrual based, SNA and GFS). He was also responsible for implementing and maintaining the Government’s financial information system. During the early part of the reform process, when accrual accounting was introduced at the organizational level, he was involved in audits of public sector departments and state-owned enterprises, while at the Audit Office.

⁶⁴ Campos, J. E., & Pradhan, S. 1997. Evaluating public expenditure management systems: An experimental methodology with an application to the Australia and New Zealand reforms. *Journal of Policy Analysis and Management*, 16(3), 423-445.

“...for the first time, it was possible to apply these accounting concepts and disciplines to the budget process and fiscal management. The Government’s determination to apply sustained fiscal discipline was hugely aided by the availability of such sophisticated and effective accounting tools. The Budget of 1991 yielded a huge fiscal dividend extracted from the application of these modern tools. The credibility of our fiscal policy framework was further boosted by the requirement that all this accounting and budgeting had to be conducted in compliance with generally accepted accounting practice. Maintenance and enforcement of those accounting standards is entrusted to a private entity independent of the Government. In this way a government, were it to be so tempted, is denied the ability to engage in self-serving interpretations.”

— Former NZ Finance Minister, Ruth Richardson⁶⁵



Source: New Zealand Treasury.

⁶⁵ Richardson, Ruth. Opening and Balancing the Books: The New Zealand Experience in IFAC. 1996. *Perspectives on Accrual Accounting*. Occasional Paper 3. New York: Public Sector Committee. p. 9.

By using independently-determined accounting rules (GAAP) for its fiscal forecasts and results, the Government was able to demonstrate its commitment to transparent budgeting. Any government faces difficulty in demonstrating commitment to prudent fiscal management when it sets the rules on how it accounts for its results. The independence of the GAAP standard-setting process from government allowed this difficulty to be addressed. The presentation and format of the financial statements was also familiar to those with a general knowledge of accounting. As a result, debates on fiscal results shifted to matters of economic substance rather than on the appropriate accounting form.⁶⁶

Second, evidence on the impact of the reforms, in terms of decision making and efficiency, comes from a number of sources. For instance, a 1996 study provided evidence of efficiency gains, measured in terms of the unit cost of outputs.⁶⁷

Third, anecdotal evidence indicates that in the past decade, the public sector culture has shifted to that of a managerial culture with a service orientation.⁶⁸ This was supported by professionalization of the government accounting and auditing cadre.

Fourth, the adoption of accrual accounting was the “unqualified success story” of the reform process. In a survey of the broad range of public sector management reforms, a “scorecard” was produced—accrual reforms received the highest grade among government managers.⁶⁹

NZ public sector arrangements have been criticized for excessive emphasis on contracting (e.g., the use of performance agreements between ministers and department heads)⁷⁰ and an explicit emphasis on efficiency over equity (e.g., there was a significant reduction in public

⁶⁶ Warren, Ken. 2000. *The Impact of GAAP on Fiscal Decision Making: A Review of Ten Years Experience with accrual and output-based budgets in New Zealand*. Paper prepared for the Australasian Treasury Officers Conference. October.

⁶⁷ Brumby, J., Edmonds, P., & Honeyfield, K. 1996. *Effects of public sector financial management reform in New Zealand*. Paper presented at the Australasian Evaluation Society Conference, Wellington, New Zealand, 30 August.

⁶⁸ Schick, A. 1996. *The Spirit of Reform: Managing the New Zealand State Sector in a Time of Change*, Wellington, New Zealand: State Services Commission.

⁶⁹ Stace, D. & Norman, R. 1995. *Re-invented Government: The New Zealand Experience*. Centre for Corporate Change, Australian Graduate School of Management, University of New South Wales, CCC Paper No. 050.

⁷⁰ Boston, J. (ed.). 1995. *The State Under Contract*. Wellington, New Zealand: Bridget Williams Books.

sector employment).⁷¹ Indeed, some commentators have warned developing countries about adopting aspects of the NZ public model—particularly devolving authority to managers.⁷² Nevertheless, NZ's experience has influenced other countries such as Canada⁷³ and the US:

“When President Clinton and I began what we call Reinventing Government ... we borrowed a great deal from other nations—such as the establishment of government-wide financial standards—personally recommended to me by New Zealand's Treasury Secretary, Graham Scott.”
— Former US Vice President Albert Gore⁷⁴

Implementation Approach

NZ—in common with other countries such as Australia and the US—made government organizations responsible for implementing accrual budgeting and accounting. The Treasury (Finance Ministry) coordinated an education and communication campaign involving booklets, a video, journal, magazine and newspaper articles and many conferences, seminars and presentations. A central Financial Management Assurance function within Treasury provided a strategic internal audit role, and a consultancy service to departments during migration. Minimal training was provided to departments.⁷⁵

Departments individually received approval to move onto the new system. The enabling legislation—the Public Finance Act 1989—provided strong incentives for them to meet implementation benchmarks. It gave departments 2 years to develop their own accrual-based

⁷¹ Kelsey, J. 1995. *The New Zealand Experiment: A World Model for Structural Adjustment?* Auckland University Press/Bridget Williams Books.

⁷² Schick, A. 1998. Why Most Developing Countries Should Not Try New Zealand's Reforms. *World Bank Research Observer* (February).

⁷³ See for instance:

- Schwartz, H. M. 1997. Reinvention and retrenchment: Lessons from the application of the New Zealand model to Alberta, Canada, *Journal of Policy Analysis and Management*, 16(3), 405-421.
- Canadian Office of the Auditor General. 1995. *Toward Better Governance: Public Service Reform in New Zealand (1984-1994) and its Relevance to Canada*. Ottawa, Canada: Minister of Supply and Services.

⁷⁴ Gore, Albert. 1999. Remarks delivered at the Opening Session of the International REGO Conference. 14 January.

⁷⁵ IFAC Public Sector Committee. 1994. *Implementing Accrual Accounting in Government: The New Zealand Experience*. Occasional Paper 1. October. New York.

systems, but this was achieved by most in a year and by all within 18 months.⁷⁶

Specific NZ Implementation Issues and Lessons

This section describes selected NZ implementation issues and lessons.⁷⁷

Personnel skills and numbers. Few government finance functions grew in terms of personnel numbers. There was however a significant upgrading in financial expertise as compliance officers were replaced with professional staff capable of negotiating budgets and marketing financial information. The Treasury was able to make reductions in staff responsible for routine accounting functions, from 6 regional offices, employing about 50 personnel, to 6 staff.

Training and capacity building. The Treasury did not provide training for departmental financial managers. This was in opposition to strong views that training was necessary to realize the benefits and reduce the risks associated with the new regime. In keeping with the wider reforms, the approach was intended to promote self-reliance among departments. In hindsight, it was the right decision.

Computerized accounting systems. An advantage of accrual accounting systems was that activities—such as commitments or purchase order systems, payroll, fixed assets, creditors and debtors—were integrated into one system. This reduced double processing and reconciliation problems, and resulted in significant time savings.

The central accounting system was modularized into individual accounting systems. This assisted departmental flexibility, by ensuring that accounting systems can keep pace with technology and can continue to meet changing needs, as departmental activities change—one department can take advantage of new system features of particular value to its organization without having to refer to the rest of the bureaucracy.

Several departments initially implemented accounting systems where significant authority (for example to add ledger codes) was given

⁷⁶ *Ibid.*

⁷⁷ This section is directly based on the following paper prepared by Ken Warren of the NZ Treasury: IFAC Public Sector Committee. 1994. *Implementing Accrual Accounting in Government: The New Zealand Experience*. Occasional Paper 1. October. New York.

to regional offices. These were quickly found to be cumbersome and were hurriedly recentralized.

Property (land) valuations. Departments and auditors found it particularly difficult to ensure that all properties were reported. It was necessary to coordinate searches of government valuation records with the Land Transfer Office and individual departments—previous asset records were found to be of little value and significant resources were required to identify all the property holdings and obtain auditable valuations. This work however had a most valuable spin-off in identifying surplus properties that could be sold.

Reliability of information. Assurance over the reliability of the information was derived from three sources. First, departmental chief executives and chief financial officers were required to sign a statement of responsibility with the consolidation schedules that to the best of their knowledge they were a fair reflection of their financial results. Second, the Financial Management Assurance team reviewed the consolidation schedules and draft financial statements with the resulting analysis providing some measure of comfort. Third, the full audit carried out by the Audit Office provided assurance through the opinion attached to the financial statements.

Demand for information. Unless decision makers demand and use accrual information, then the implementation is less likely to succeed. Significant efforts were made to educate ministers, parliamentarians and the media about uses for accrual-based information. This helped create demand.

Costs of implementing accrual accounting. The costs of implementing accrual accounting systems compared with cash systems were relatively trivial. Overly centralized accounting processes—with poorly-integrated subsidiary elements—are cumbersome and expensive compared to private sector practices of centralized cash management and streamlined financial management systems.

Leveraging off private sector accounting. Major gains were achieved by leveraging off private sector accounting. By making use of GAAP the best of private sector off-the-shelf accounting software could be used and the pool of skills and expertise available to the financial management reform was sufficiently widened to cope with the new demands and make benefit from the new opportunities.

Better information doesn't necessarily change results. Accrual information provides a better basis for budgetary decision-making. It also widened the issues that are considered. However, the objectives of the decisions did not change. Furthermore, the improved results—for example reduced debt and unit output prices—were facilitated rather than caused by the accounting system. Indeed, the fiscal improvements achieved by government were primarily due to political will. A less sophisticated system could have achieved a great deal in the presence of that political will, and an even more sophisticated system would achieve very little if the political will to use it were not present.⁷⁸

Only so much can be achieved immediately. Change is resource intensive. In the early years of accrual budgeting, the main pressure on change was in achieving a set of budget documentation that provided the information. Only when this was in place were we in a position to concentrate our resources on streamlining the processes. The automated-checking processes now used to collect and collate financial information were simply not possible until the basic structures were in place (see Box 8).

4. Implementation Issues and Lessons

The implementation experiences reviewed in the preceding sections, together with other country experiences (see Appendix 4),⁷⁹ and a recent OECD paper⁸⁰ provide a basis for identifying general implementation issues and lessons.

⁷⁸ Warren, Ken. 2000. *The Impact of GAAP on Fiscal Decision Making: A Review of Ten Years Experience with accrual and output-based budgets in New Zealand*. Paper prepared for the Australasian Treasury Officers Conference. October.

⁷⁹ See, for example:

- IFAC. 2003. *The Modernization of Government Accounting in France: The Current Situation, the Issues and the Outlook*. New York. Public Sector Committee.
- OECD. 1997. Iceland's budget and financial accounting reform. <http://www1.oecd.org/puma/focus/compend/is.htm#Iceland's%20budget%20and%20financial%20accounting%20reform> [accessed on 12 December 2002].

⁸⁰ OECD. 2002. *Accrual Accounting and Budgeting: Key Issues and Recent Developments*. Paris.

Box 8. Process Automation

The New Zealand Government went through a variety of approaches to consolidating and preparing accrual reports and budgets. Several interim steps were taken. This enabled processes to mature and requirements to be better understood:

- Departmental financial statements (cash and accrual) were initially collected by spreadsheets and uploaded into (i) a simple commercial general ledger, for preparation of cash and accrual reports; and (ii) a purpose-built database, for preparation and analysis of budgets. The information was then reentered into spreadsheets for final consolidation. This approach had minimal cost and worked, but presented significant problems:
 - Departmental financial forecasts and reports were often internally inconsistent (e.g., balance sheets did not balance and cash flow statements were inconsistent with other financial statements)
 - The collection spreadsheets were error-prone as was the database. Moreover, the process entailed management of hundreds of computer diskettes; and
 - It took weeks for reports and budgets to be collected, reviewed, amended, consolidated, analyzed and published.
- An integrated financial consolidation system was procured and implemented in 1994 (for a cost of about \$700,000, including implementation support, hardware and software). The system
 - Introduced automated validation tests. These tests (of which there were over 1,000) ensured that clean data was provided to Treasury;
 - Automated data collection and consolidation (information was transmitted via modem);
 - Amalgamated forecast, budget and actual data into one system; and
 - Supported advanced analysis.
- The following benefits were achieved:
 - Accurate data was provided within 10 working days of month-end;
 - Consolidations could then be performed instantly;
 - Significant reductions in personnel numbers were achieved;
 - Other resources were freed from basic accounting and redirected towards analysis; and
 - Consolidated government financial statements could be published within 4 weeks of month-end.
- A final step was taken in 1997-2000, when the system was rebuilt as an Internet-based database.

Quality assurance is important

A quality assurance procedure is desirable and implementation benchmarks should be included in the implementation strategy as an incentive mechanism. This can create a sense of competition among entities.

Communications are essential

The countries that first moved to accruals generally cite the need for more and better communications as the single biggest factor that was underestimated during implementation.⁸¹

Close communication with the supreme audit institution (SAI) is essential. The SAI should reinforce the reform process and assist entities in implementation.

Communicating with politicians—notably parliamentarians—is an ongoing challenge for most countries that have introduced accruals. First, initial support from politicians may decline with successive elections when new politicians are not adequately communicated with. Second, in most countries, a small group of ministers and legislature members have taken the decision to adopt accruals. But, when accrual information starts arriving, it has confused other politicians as very little effort was made to communicate with them. This potentially undermines the legislature's ability to effectively hold the executive to account. The lesson is to have a strong communication strategy when accrual accounting is being introduced and to maintain it over time.

Experience also reveals a communications gap with the media and, by extension, with the public. There can be confusion when accrual budgets and financial statements are first introduced. In particular, the media may have limited understanding of the figures and the underlying concepts. Some countries have successfully combated this risk through media training sessions, and by having experts available in the media “lock-up room” when the budget is introduced.

The number and mix of accounting personnel will change

Suitably-qualified accountants need to be employed and cash-trained government accountants need to be reeducated. Where a country has an absolute shortage of accounting skills, this needs to be considered when implementation strategies and schedules are designed. However, it is

⁸¹ OECD. 2002. *Accrual Accounting and Budgeting: Key Issues and Recent Developments*. Paris.

important not to over-invest in training—some countries have over-estimated the need for training. Consideration should be given as to how surplus accounting staff are to be handled.

Use commercially-available financial management information systems

New financial management information system (FMIS) implementations often accompany the introduction of accruals. A very clear lesson is for governments to opt for commercial software and to adjust internal processes where necessary. Problems occur—and costs rise—when governments build their own systems or make significant modifications to commercial software.

Many FMISs are replaced within a short period of their implementation (almost all departmental FMISs used in NZ were replaced after just 2 years). This reflects poor decisions being made about organizational needs, because managers are unfamiliar with their information needs under accrual accounting. The lesson is not to invest in a complex FMIS, until the organization has familiarized itself with the accrual environment.

Encourage improved information quality and timeliness

There are often problems with the timeliness and accuracy of submissions to the finance ministry. Some countries have achieved significant improvements in information quality and submission dates, by keeping league tables of when the various accounting units submit this information and the number of adjustments that have to be made. This lesson is true both of cash and accrual information.

Have guidance and accounting policies ready early

Countries that have already implemented accrual budgeting and accounting have produced a wide range of guidance and training materials. It is essential to have the specific new accounting policies available early so that line ministries and agencies can prepare for them from the earliest possible moment. The use of task forces on specific issues composed of officials from a range of ministries and agencies serves to get buy-in from them more readily than otherwise.

Commitment accounting provides a good starting point

Many countries, both developing and developed, use a form of commitment accounting. This involves reporting committing resources, even though cash may not have been paid. Commitment accounting—as for instance, used in the Philippines—has many similarities to accrual accounting and can provide a good starting point for introducing accrual-based accounting.

Budgeting and reporting basis should be consistent

The problem with applying accruals only to financial reporting and not to the budget is that accrual information may not be taken seriously. The budget is the key management document in the public sector and accountability is based on implementing the budget as approved by the legislature. If the budget is on cash basis, that is going to be the dominant basis on which politicians and senior civil servants work. Financial reporting on a different basis, risks becoming a purely technical accounting exercise in these cases. To maximize benefits, countries must fully implement accrual budgeting and accounting.

Furthermore, even though budgets and reports may be prepared on the accrual basis, different accounting frameworks may be applied. This causes complexity and confusion. For instance, budgets for the Australian budget sector are prepared on the GFS basis. Financial reports are prepared in accordance with Australian accounting standards. The operating balance measure produced by these two accounting frameworks can differ quite significantly, with non-trivial implications for fiscal policy.⁸²

5. Conclusion

This part reviewed implementation experiences and identified several lessons. Most importantly, there is no first-best implementation approach. Rather, this will depend on country arrangements and circumstances.

Perhaps the overriding lesson is that implementing accruals cannot be seen as a technical accounting exercise. It needs to involve a

⁸² Robinson, Marc. 2001. The Treatment of Revaluations in Accrual-Based Government Accounts. *Journal of Accounting, Accountability and Performance*. Vol 7(2).

“culture change” in government and be linked with wider public management reforms. For accruals to be worthwhile and successful, the new information that accruals brings forth needs to be used to improve decision-making in government. This change will not necessarily happen automatically. It needs to be actively promoted, especially at the level of policy makers and senior officials.⁸³ A recent IMF working paper considers this issue further (see Box 9).

Box 9. Performance Budgeting: Is Accrual Accounting Necessary?

A recent IMF working paper reviews the role of accounting from the perspective of performance budgeting reforms.⁸⁴ The paper argues that, while many OECD countries have moved their accounting systems from a cash to an accrual basis, such a move is perhaps only worthwhile in the context of adopting much wider public sector management reforms. Moreover, while recognizing that accrual accounting does support public management best practices, it argues that many of the objectives of performance-oriented budgeting can be attained by less-than-full accrual accounting, and that unless certain preconditions are met, it is safer for countries to remain with and improve their cash-based accounting systems.

However, the following criticisms might be made of the arguments presented in the paper. First, it overstates the preconditions for moving to an accrual-based system. For instance, it incorrectly assumes that accrual accounting must be introduced together with decentralized accounting and management, thereby weakening basic compliance. Second, the paper disregards evidence regarding the inherent benefits of accrual-based reporting. Third, it strongly advocates supplementing cash-based information with accrual information. While valid as a transitional approach, practical developing and developed country experience reveals that non-integrated ledgers and registers, such as asset registers, quickly become out-of-step with core financial information.

Nevertheless, the paper is consistent with this report in advocating a gradual step-by-step approach to the introduction of accrual accounting.

⁸³ OECD. 2002. *Accrual Accounting and Budgeting: Key Issues and Recent Developments*. Paris.

⁸⁴ Diamond, Jack. 2002. *Performance Budgeting: Is Accrual Accounting Required?* Working Paper WP/02/240. Washington, DC: IMF.