

### ***3rd – Fiscal sustainability in the modern State -Perspective***

#### **Transparency, accountability and changing the basis of accounting**

Nowadays, the public sector is being put under high pressure to increase the amount and the quality of its output, while disposing with fewer resources and being confronted with demands to further increase its transparency and accountability. Transparency and accountability add to the development of a stable environment and to the improvement of the management of public funds. Transparency of public finance aims at efficient and comprehensive accountability of public sector employees and therefore provides for better management of public funds. The key information is referred to governmental operations, since they enable the assessment of the appropriateness of the use of public funds. Many financial crises that occurred in the nineties of the past century have opened up several issues related to the designing and managing of the fiscal policy and to the need of reducing the vulnerability of states. The two basic questions arising are, whether transparency of public finance can foresee and avoid crises, and whether the inclusion of the concepts of transparency and accountability into the legal bases and administrative procedures can contribute to better management of public finance. The answers to the above two questions depend on the institutions which are included in the process and have important responsibilities therein. The founding of institutions, which will provide for transparency and accountability is only the first step; another important condition is that the institutions operate effectively. The key question is whether transparency and accountability are in line with the objectives for which they were set up. It can easily happen that despite the established processes the public remains insufficiently informed and obtains limited information, because details are concealed or can be accessed only by a limited number of public employees. Even though the mechanisms of transparency and accountability exist, the institutions are not effective enough. Therefore, in order to develop healthy public finance and efficient management, it is not enough to introduce the concepts of transparency and accountability, and to provide the legal basis to implement them. It is also not enough to be submitted to the demands of transparency and accountability, for it is necessary to design mechanisms that shall efficiently operate and follow the objectives of the concepts. The Supreme Audit Institutions (SAI) have an important role, since they assess whether the concepts were implemented, point out differences between the practical solutions and their theoretical basis; between the activities formally approved and the activities implemented by the public sector entities themselves. The SAIs need to be able to understand and follow all the reforms of the

public sector and, if possible, stimulate their implementation. Therefore, some important changes have to be undertaken also by the SAIs. In its study<sup>1</sup>, the FEE (Federation des Experts Comptables Europeens) has presented a number of changes that must be implemented by the external auditors, regarding reforms of the public sector:

- The change from the cash to the accruals basis in budgeting, accounting and financial reporting means that auditors not only have to understand new frameworks but also have to be in a position to evaluate the many value judgements which are fundamental to accruals accounting. Furthermore, they are often called upon to give advice to their clients on such matters of judgement at an early stage;
- Increasingly, auditors are also examining matters of economy, efficiency and effectiveness. In other words, they are perceived as being able to “study areas of service delivery and publish studies which promote the best ideas and methods of achieving best value whilst, at the same time, identifying savings and resources which can result”;
- Another important role for the external auditor is in the area of performance measurement in the public sector where they are often involved in the assessment of the systems used to collect and present the data;
- Governance processes are also a key aspect of new public management (NPM) - inspired reforms, and external auditors are called to express their view about it. In so doing they will often rely on the work of internal audit as mentioned above. As is the case for internal audit, examination of governance issues will generally include looking at risk management issues;
- Reporting to the audit committee is important to the external auditor in an NPM environment;
- In undertaking their work, external auditors cannot neglect the issues relating to their client’s strategic plans and the ways in which those plans are implemented. These issues acquire a new significance under NPM because they form the backdrop for the organisation’s operations and the auditor cannot make assessments of the public sector organisation’s efficiency and effectiveness without knowledge of them;
- Accountability takes on a new importance under NPM and auditors need to consider this when assessing an organisation’s financial reporting regime;

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<sup>1</sup> The New Public Management, A perspective for finance practitioners, December 2006

- Traditionally, external auditors expressed opinions on financial statements. Recently, there have been calls to involve external auditors to provide assurance on the internal controls of an organisation. Another aspect of NPM is that public sector organisations should look for innovative approaches to the delivery of public services. It has been said that it is “important that auditors recognise the danger of being perceived as discouraging well managed risk taking, and ensure that their work lives up to the spirit of statements made on attitudes to innovation”.

One of the key issues that need to be tackled is the transition from the cash basis of accounting towards the accrual basis of accounting. It is the issue of improving the informative value of financial statements regarding transparency and accountability of the public sector. Many countries have already concluded this transition, in others it is in progress. Yet, some countries still discuss the advantages and disadvantages of the two systems.

In Slovenia, there is currently still a discussion on the transition from cash based accounting towards accrual based accounting. The question is not whether to introduce the accrual system, as we have already reached an agreement on that, but it remains to be decided how to carry out the transition and how long the period of transition from the cash basis to accrual basis should be.

In Slovenia, most of the public sector entities (about 2/3 of them) already prepare their financial statements on the basis of the accrual accounting system. Among them there are agencies and public utilities. But the cash accounting system is still being used for the State budget and for municipal budgets, as well as for the Pension and Health Insurance Funds and other public funds.

In its Strategy for the development of the internal control over the public finance in the Republic of Slovenia for the period 2005 to 2008, the Government of the Republic of Slovenia has defined several objectives. One of them refers to the improvement and updating of accounting by budget users. This strategy foresees that until 2008 the accrual basis of accounting should be introduced overall, together with reporting in line with the methodology ESA 95 and GFS 2001.

The Court of Audit of the Republic of Slovenia believes that the reforms of accounting are necessary, because they are an important basis for the enforcement of the New Public Management in the State. Therefore, when performing audits, in the first place when auditing the state budget, the Court pays special attention to results based budgeting. The Court has assessed that there have already been positive changes in this area; nevertheless further process should be encouraged, considering the lack of appropriate accounting data or information for planning and assessing the outcomes in the public sector as one of the most important setbacks to be overcome.

Taking into account the implemented activities up till now, it is already almost certain that the goal from the Strategy regarding the time-table shall not be fulfilled. Until 2008, Slovenia will not be able to introduce the accrual accounting, as the detailed programme of transition with time-limits has not yet been prepared.

The main problems, hindering the effective and efficient transition to the accrual basis of accounting in our country seem to be:

1. Linking accounting and budget preparation

Accounting and budget preparation on the basis of accrual accounting should be linked. If the budget preparation is not based on the same grounds as the system of accounting, there are more possibilities for weak financial management.

Introducing accrual accounting in the preparation and implementation of the budget usually causes more hesitation than introducing it into the accounting system. The budget is one of the basic documents of the State, which is adopted by the Parliament, and for tax payers as well as for politicians, it is traditionally more important than financial statements. Introducing changes on the budget level demands more time and additional activities connected to informing the public on the advantages of the new system. Furthermore, adequate professional solutions are necessary, due to numerous questions and nation-specific issues (i.e. tax system).

2. Understanding the content of the accounting rules

The management of the public sector entities as well as politicians need to understand and accept the accounting rules. Deviations from the rules that were set should not be allowed, even if the rules are not favoured in certain circumstances. Therefore all proposals need to be studied, and presented to the senior staff, in terms of the advantages and disadvantages of new changes.

When examining the advantages and disadvantages of the proposed solutions, which have been presented, the senior staff can agree with the professional explanations given, but may later in certain circumstances and due to different interests accord its support to inappropriate solutions. Here the role of the SAI is of key importance because it insists that appropriate solutions are implemented consistently.

While planning the introduction of the accrual system, we need to allow enough time for those activities, which enable the senior staff to be informed about the new system and carefully manage the risks of later disagreements.

### 3. Political support

Due to the duration of the reforms, they should be provided full political support. Otherwise it may happen that the change of the political control or in political structure can cause problems in project implementation.

It is appropriate to plan the implementation of the transition within the mandate of a government. Namely, changes in the management usually cause delays or prolong the procedures and sometimes the projects may be even stopped.

### 4. Control of results, not of inputs

Common controls need to be changed in order to enable senior staff to manage the organisation efficiently. This calls for additional training of senior staff or employing heads of departments with managerial skills. Only in such a way can changes in the performance of the internal and external control be achieved.

Altering the ways of thinking is always a lengthy and difficult process. When preparing the renovation of accounting, we should therefore keep in mind that the process should start as

soon as possible, but that it should continue also after the accruals accounting has already been adopted.

#### 5. Additional training of accountants

Accountants must be ready for the implementation of accrual accounting, as they need to understand the changes and their impacts. Only in this way will they be able to assist the management in analysing financial data and in practicing new methods of management. Financial management should be directed towards results based budgeting and efficiency and that is why the co-operation between the management and the accountants is of great importance, regarding the appropriate use of data based on the accrual accounting.

It is relatively easy to plan this task - we only need to pay attention to the adequateness of training in relation to given circumstances. First of all, we must provide some basic information (i.e. from the international standards - IPSAS), and after all the details have been identified by experts, we can present the new system. After the new system has been introduced, we need to ensure a continuous flow of information.

#### 6. Adjusting information technology

Without an appropriate information technology, it is difficult to collect all the data necessary for efficient management. We must be aware of the fact that information systems, which record transactions on the accrual basis, are more complicated and more complex. More controls will need to be built-in than for the cash basis system.

One of the most important decisions is whether to modify the existing applications or to use new ones that are already in the market and are adjusted for use in the private sector.

The introduction of the accrual basis of accounting is a lengthy process that demands numerous resources. It is therefore important that the process is implemented efficiently and effectively. The role of every SAI concerned is to promote this process, to offer appropriate recommendations on the planning, implementation and professional solutions (pay attention to its own independence), to monitor the realization of the projects, and to audit the financial statements afterwards.