PUBLIC SECTOR ACCOUNTING REFORM

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Abstract

The public sector accounting as the ex post recording and reporting of financial operations of government represents the fundamental management process in public sector entities. Even before, but especially in time of financial and economic crisis, countries are facing a challenge to improve the information served by public accounting for the state budgeting purpose; most often by reforming accounting principle from cash flow into accrual. The financial and economic crisis revealed that accounting based on accrual principle provides more transparent budgeting. Accrual accounting is an accounting methodology under which transactions are recognized as the underlying economic events occur, regardless of the timing of the related cash receipts and payments while the cash flow accounting recognizes the revenues and expenditures when cash is received and paid respectively. The accounting on accrual principle obtains more transparent and complete review of the business activities and property of the users of public funds then cash principle does. The paper analyses the three accounting models (on the examples of Slovenia, Croatia and Serbia) and principles of state budgeting in order to assess the connection between stages of accrual principle implementation and budgeting. It identifies that regardless of the stage of accruals implementation in the national accounting legislation, the planning and execution of the state budgets (the budget accounting) is still on the cash principle.

Key words*: Public sector accounting, budget accounting, accrual principle, cash principle, accounting reforms.*

1 Introduction

The public sector accounting can be described as a system which gathers, records, classifies and summarizes 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). It represents the accounting systems of public sector entities organizations. The public sector entities are entities that implement public policy through the provision of primarily nonmarket services and the redistribution of income and wealth, with both activities supported mainly by compulsory levies on other sectors. The public sector consists of governments and all publicly controlled or publicly funded agencies, enterprises, and other entities that deliver public programs, goods, or services. The concept of public sector is broader than simply that of core government and may overlap with the not-for-profit or private sectors. For the purposes of this guidance, the public sector consists of an expanding ring of organizations, with core government at the centre, followed by agencies and public enterprises. Around this centre, there is a zone consisting of publicly funded contractors and publicly owned businesses, which may be, but for the most part are not, part of the public sector (The Institute of Internal Auditors, 2011). The public sector (the general government sector) has to be managed like any other sector or organization. The accounting (system) has the information function and its task is to provide information for the decision-making. The public sector accounting systems present the monitoring and research in monetary units expressed events and activities of direct and indirect budgetary users regardless of their national or municipal character. The accounting systems of direct and indirect budgetary users carry out transactions, perform computing, collect relevant data, identify and archive book-keeping notes, perform the controlling, prepare mandatory accounting statements, control the fulfilment of claims and financial obligations. Thus the main goal of public sector accounting is to obtain transparent and complete review of the business activities and property of the users of public funds. The financial part of the management is based on some important data and information that are provided in accounting sector (function). In the traditional approach of delivering public service, the primary role of accounting is to record expenditure in the detail, required for budgetary purpose and compare it with that budget. The Treasury of the Ministry of Finance then summarises the information and presents a report to the Council of Ministers and the Parliament. Generally though, that information is not of primary interest, while it is based upon historic costs and therefore represents a little current managerial relevance. Fundamentally, the objective of the accounting information in traditional administrative approach countries is to provide information for economic planning and control (Hepworth, 2003). More precisely, the accounting (system) should provide information for planning and execution of the budget.

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The global economic crisis has underscored the importance of accountable and transparent use of public funds, in particular in light of deteriorating fiscal position and rising public debts. There is now a growing consensus that good information on government activities matters. It can help policy makers better navigate their reform agenda. Public and financial institutions require it too, amid increased concerns over sustainability of public accounts. And businesses need it for their strategy planning. Overall, public sector accounting and budgeting systems can either strengthen or weaken the trust which underpins relations in a society. If ever it is now clear that it is the time to unconditionally establish requirements for greater transparency and accountability in public finance. The financial and economic crisis revealed that accounting based on accrual principle provides more transparent budgeting. The public accounting trend leans towards the transition from cash flow principle to accrual principle. The accounting systems based on cash flow principle, register transactions and business events in the moment the money is received or the payment settled, registering incomes and expenditures. The accounting systems based on accrual principle on the other hand register transactions and business events in the moment the economic value is created, transformed, exchanged, transferred or expanded and the moment all economic flows are registered. The income and expenditures statements based on accrual principle facilitate only yearly budget monitoring and may subsequently cause financial instability while they are not providing data for the management of tangible fixed asset (Jones and Pendlebury, 2000; Duhovnik, 2011).

Accrual accounting is an accounting methodology under which transactions are recognized as the underlying economic events occur, regardless of the timing of the related cash receipts and payments. Following this methodology, revenues are recognized when income is earned, and expenses are recognized when liabilities are incurred or resources consumed. This contrasts with the cash-accounting basis under which revenues and expenditures are recognized when cash is received and paid respectively. Accrual accounting in the context of the public sector would generally imply the recording of transactions on an accrual basis, and the preparation of accrual-based financial statements for the government as a whole (Khan and Mayers, 2009; Tudor and Mutiu, 2006). Many developed countries have gone through gradual or radical change of public sector accounting where traditional cash flow public accounting has been changed with accrual based public accounting. There are also many developing and transitional countries that have accelerate public sector reform by introducing accrual or some kind of modified accrual or cash accounting.

The paper’s objective is to analyse different public sector accounting systems (on the examples of Slovenia, Croatia and Serbia) focusing on the connection between stage of accrual principle implementation and budget accounting. The assessment should point out the benefits and disadvantages of the certain system regarding budgeting system. The methodology used for obtaining the objectives base on comparative review of the literature and in-depth interview with experts and researchers from other countries.

2 Reforming accounting principles (systems) for budgeting

In the second half of the last century radical changes took place in the management tools, information technology, ways of decision-making, performance measurements, accounting procedures, accounting systems, etc. These changes were more transparent in the private sector in comparison with the public sector. In many parts of the public sector, especially central government, countries are still using accounting procedures and standards that have been used for more than a century ago.

2.1 Literature and regulation review

In the last 20 years we have witnessed a radical wave of organizational, managerial and accounting reform in the public sector of many countries and jurisdictions. The public sector accounting reform is the part of the general public sector management reform recognized as the concept of New Public Management (NPM). The public sector has been subjected to transformations in order to enhance the efficiency and accountability of public service delivery. This idea of striving for a rational economics defines business point of view in government necessitated the abandonment of the traditional cash accounting system and the introduction of accrual accounting systems that had been transferred from the profit sector (Barton, 2004; Broadbent and Guthrie, 1992; Burkitt and Whyman, 1994). NPM has its background in the reforms that were carried out in United Kingdom during the Thatcher era and were seen as highly political and ideological at that time. Over the years, the ideological element of the reforms has been de-emphasised and the idea has become a trend. The public sector accounting reform presents the idea of transferring the accounting from cash flow to accrual principles. Government accounting reform is a shift from a cash flow and cash balances concept to a total-economic resources concept. Namely, it is an extension of measurement focus to encompass the total economic resources of governmental entities instead of only concentrating on the cash resources. Accrual accounting provides more comprehensive information (assets, liabilities, revenues, expenses, net assets and changes therein) about governmental entities and whether these entities are operating economically and efficiently. According to Lüder (1992) a more informative accounting system performs two functions: it supplies comprehensive and reliable information on public finance and provides a basis for improved financial control of government activities (Ouda, 2003).

Industrialised countries, followed by developing and transitional countries, have had a desire to accelerate public sector reform by adopting the most advanced innovations. Accrual based financial reporting has been significant among the accounting technologies that have dominated public sector management reforms. An extensive international study (Lüder and Jones, 2003) focusing explicitly on governmental accounting reforms in several European countries and European Commission, pointed out that the accounting reforms consist of introducing accrual accounting in governmental organizations. Additionally, the international comparative study from 2000 (Brusca and Candor, 2002) has concluded that it in Anglo-Saxon countries the accrual accounting principle predominates, while Continental European countries were are still in the process of converting to accrual accounting, by adopting modified cash and modified accrual systems instead of complete or full accrual systems (Vašiček et al., 2008).

IFAC-PSC (International Federation of Accountants– Public Sector Committee[2]) identifies four different bases of accounting: cash, modified cash, modified accrual and full accrual. Cash and accrual represent two end points on a spectrum of possible accounting and budgeting bases. The cash end of the spectrum has traditionally been applied by OECD member countries for their public sector activities. A modified cash accounting system recognizes transactions and other events on a cash basis during the year, but it also takes into account the unpaid accounts and/or receivables at year's end. In fact, the books are held open for around a month after year end while a modified accrual accounting system recognizes transactions and other events on an accrual basis, but certain classes of assets or liabilities are not recognized. A typical example is the expensing of all non-financial assets at the time of purchase (Christiaens and Reyniers, 2009)

In recent years there has been a major trend towards the accruals end of the spectrum in member countries. About half of member countries have adopted accruals to one degree or another (OECD, 2003). But cash accounting is still used for reporting purpose in many countries. This phenomenon is a clear indication that cash accounting serves some purposes that are not adequately covered by accrual accounting.

The review of the international literature on government accounting reform reveals that the various scientific research contributions are categorized mainly within the three types:

- descriptive studies of the governmental accounting reforms (Coy et al., 1994) and (Christians, 2000);
- empirical studies of the implementation of the accounting reforms (Christians, 1999; Jones and Pendlebury, 2004);
- theories explaining why governments choose to adopt accrual accounting (Lüder et al., 1992).

The empirical studies generally reveal that, due to the different factors, the design and implementation of governmental accounting reforms appear to be less successful and are diverging in an uncontrolled way. Some reforms have had unintended effects, either because of a misuse of the information or because insufficient attention was paid to the application of the reform. First, in some cases, the availability of output information has exposed bad performance of organizations. Rather than using the information to improve future performance, it then quickly becomes a superfluous information flow that is not properly used in decision-making or monitoring the organization. Secondly, reforms are often badly designed, so that they do not deliver on their promises. Schemes for measuring outputs do not always pay attention to their practical application (Christiaens and Rommel, 2008).

The internationally accepted professional frameworks for public sector accounting, which are the base for the financial reports, are the International Public Accounting Standards (IPSAS) and Manual of Government Finance Statistics. International Public Sector Accounting Standards Board organized by the International Federation of Accountants issues standards, which are published in the IFAC Handbook of International Public Sector Accounting. IPSASs govern the recognition, measurement, presentation and disclosure requirements in relation to transactions and events in general purpose financial statements. The standards (International Public Sector Accounting Standards Board – IPSASB, 2007, pp. 5-8):

[2] Has been renamed into International Public SectorAccountingStandards Board (IPSASB) in 2004. The members are: Australia, Argentina, Germany, France (Chair), UK, Israel, Japan, Canada, Malaysia, Mexico, New Zealand, Netherlands, Norway, South Africa, USA.

- support the process of preparing professionally – grounded financial statements in public law entities;
- ensure the application of best practice and use of the most efficient methods in various fields;
- encourage the harmonization of national standards by improving the quality of financial statements all over the glove and reducing the risk on non-information of financial statements;
- satisfy users' needs for reliable information through the financial statements;
- Ensure the consistency and comparability of accounting information in different legal systems.

The International Public Sector Accounting Standards Board has issued accounting standards for both cash-based and accrual-based accounting. The IPSAS, which are used for accrual-based accounting, are based on the IFRS (International Financial Reporting Standards) and IAS (International Accounting Standards) and retain their accounting procedures as well as the original IAS text where needed, while they at the same time further develop areas which the IAS do not cover. International Public Sector Accounting Standards (IPSAS) are independently developed standards and as such are considered as generally accepted best practice and accounting solutions for the public sector all over the globe, as they introduce the strictest possible standards of transparency and clarity in operations of public sector organizations (Mladenović, 2011).

The internationally accepted expert's framework for implementation of accounting systems in public sector has done a certain progress because of:

- requirement for complete and reliable information;
- requirement for transparent business;
- requirements for expediently use of taxpayer s money;
- requirements for decent and professional basis for statistical analyses (IPSASB, 2007).

The second mentioned accounting framework for government finance in EU is Manual on Government Finance Statistic. The Manual on Government Finance Statistic from 2001 describes a specialized macroeconomic statistical system (the GFS system) designed to support fiscal analysis. The manual provides the economic and accounting principles to be used in compiling the statistics and guidelines for the presentation of fiscal statistics within an analytic framework that includes appropriate balancing items. It does not treat systematically the practical aspect for compiling the statistics. The primary purpose of the GFS Manual is to provide a comprehensive framework suitable for analysing and evaluating fiscal policy, especially the performance of the general government sector and the broader public sector of any county. The process of introducing IPSAS is closely related to the existing reporting system based on the ESA95 statistic methodology. IPSAS emphasize the relation between ESA95 and the standards. Namely, IPSAS gives great emphasis to the disclosure of data relating to the state sector, as this improves the quality of statements prepared on this basis. When IPSAS use the term "the state sector", this is referred to a statistical term defined in all significant statistical methodologies. The ESA95 methodology is based on the accrual-based accounting system, thus establishing another link with IPSAS. The fundamental book for national accounts is ESA95 which is in force over the EU through a Council and Parliament Regulation, directly implemented in the Member States without any translation into their national legislation. National accounts (ESA95) and IPSAS are different "worlds" but actually are not so far from each other.

2.2 Cash versus accrual accounting

As mentioned in introduction part, there are two basic accounting methods used to determine when and how to report income and expenses in the books: cash method and accrual method. These methods differ only in the timing of when transactions, including sales and purchases are counted to accounts. Under the cash method, income is not counted until cash is actually received, and expenses are not counted until actually paid. Under the cash basis, revenues and expenses are recognized when payment is made or received. The cash method sets the rule of financial result for the period as the differential between received and paid money and provides the users with the information about money resource received in a certain period, about the spending purpose of it and money balance on the date of reporting. It does not provide the complete information about the asset and liabilities of the public sector entities while there are no balance sheets accept the cash balance. The expenditures can be stopped by suspending the payment of outstanding invoices while the big part of the liabilities is not recorded in the statements (Müller-Marques Berger, 2009; Jones and Pendlebury, 2000). As already mentioned, there is a noticeable reforming trend of accounting systems from cash to accrual system which aim is to increase the value of information for the decision makers and the general public as well. Many countries, like Great Britain, New Zealand, Australia and Canada, have already reformed their public sector accounting according to this trend. The accounting system for public sector influences the financial reports of legal entities of public law and consequently influences the state budget (Roje, 2006).

The accrual principle has been adopted from International Financial Reporting Standards (IFRS). The accounting based on accrual principle enables transparent business monitoring, included claims and liabilities which is not possible using cash flow principle accounting. However public sector accounting reform has raised different questions regarding its cost and related risks. The Association of Charted Certified Accountants and IMF have also expressed their doubts considering the necessity and rationality of accrual based accounting. The expert bodies namely require different set of standards for public sector financial reporting as opposed to the private sector, while doubts are especially present in the field of unselective convergence of public accounting towards the accounting used in private sector, which is based on accrual principle. The public sector accounting purpose is to supply the budgetary accounting. But there is distinction between those in (Matheson, 2003):

- the budget is a future oriented financial plan for allocating resources among alternative uses, both within the government and between governments, and the government and the rest of the economy;
- financial reporting retrospectively describes the results of the entity's financial transactions and events in terms of its financial position and performance.

Accrual accounting requires organizations to maintain complete records of assets and liabilities. It facilitates better management of assets, including better maintenance, more appropriate replacement policies, identification and disposal of surplus assets, and better management of risk such as loss due to theft or damage, the identification of assets in the delivery of services, and encourages managements to consider alternative ways of managing costs and delivering services (International Federation of Accountants, 2003). Accrual accounting provides a broader measure of overall fiscal stance than cash accounting. It, therefore, allows for a better judgement of the sustainability of fiscal policy. For example, in addition to traditional debt, it also includes quasi-debt liabilities (e.g. future obligation to pay civil service pension), depreciation, environmental liabilities, accounts payable, accrued interest, asset valuation changes, etc. Accrual reporting also enhances the quality of decision-making through improved balance and accuracy of macro-economic forecast and monitoring of the composition of fiscal accounts. Because it provides a longer term perspective for fiscal policy implications, and is more consistent with conventional accounting used in the private sector, credit agencies and financial markets also support it. Overall, accrual framework enhances confidence and transparency, and contributes to faster economic growth, although it can also give rise to false interpretation and manipulation of results (Tudor and Mutiu, 2006).

Undoubtedly, cash accounting principle has a lot of constrains which in some points are so obvious posing the enormous doubt about the justification of the principle usage. The strict use of cash method does not require the statement of property and obligations that does not refer to cash flow. The property purchasing causes the expenditure which is completely deducted in the period of calculation. The consequence of such event registration is the lack of property in financial statements. On the other hand, there are the obligations that must be registered in the moment of maturity or in the moment they cause the expenditure. The consistent cash flow accounting decreases the accounting information quality while book-keeping follows the events causing expenditures only. In the certain period a part of business events stay unregistered in that period although it does not mean they will not influence the result in net period. The accounting on the cash principle does not provide the observation of property and obligation changes (Vašiček and Vašiček, 2000). Besides mentioned, the cash based accounting brings important advantage that can be seen as far as the financial plans are concerned. After enactment, those financial plans of public sector entities become the state budget. The resulting rights from the budget (of financial plans) base on cash and are recorded on the cash basis. The control of the receipts and expenditures in cash accounting is much easier that the control of the revenues and expenses in accrual accounting. The financial statements based on cash principle that implement information on receipts and expenditures have the same accounting principle; the cash principle which is the reason for easier coordination (Mladenović, 2011).

The accrual accounting under the requirements of the Standard 2 -IPSAS impose the entities (organizations) to prepare and present financial statements under the cash flow principle as well. Such a cash flow based financial statement should be an integral part of its financial statements for each period for which financial statements are presented (IPSASB, 2007). The reporting on an accrual basis:

- shows how a government financed its activities and met its cash requirements;
- allows users to evaluate a governments on-going ability to finance its activities and to meet its liabilities and commitments;

- shows the financial position of a government and changes in financial position;
- provides a government with the opportunity to demonstrate successful management of its resources;
- is useful in evaluating a government performance in terms of its service costs, efficiency and accomplishments.

Partly as a result of the global economic crisis, public sector finances are under more scrutiny than ever before. Whilst many countries prepare their accounts on a cash accounting basis, there is a growing trend for public sector organizations to move to an accruals basis for accounting. Approximately half of the OECD countries have made the modification in the public sector accounting as far as principle of event registration is concerned. Only few have adapted the accrual principle in budgetary process. Long-term, the accrual principle influence the budget while the revenues are registered in the moment the service is completed and not in the moment cash flow is registered. Also, the expenditures are registered in the moment the costs realise regardless of the cash flow. The obligations in balance sheet are registered as the costs of current period on the other side regardless there are no dedicated funds (Zafreda, 2010).

3 Assessment of different public sector accounting systems – experiences of other countries (Slovenia, Croatia and Serbia)

There are some countries that have started with the public sector accounting reform in 90s or even 80s. Throughout the 1980s Canadian governments significantly changed their financial reporting practice, moving from cash to accrual accounting and from separate accounting reporting to consolidated financial statements. In part, those changes were spurred by the work of the Public Sector Accounting and Auditing Board (PSASB) of the Canadian Institute of Charted Accountants. But the profession could not force governments to adopt its recommendations. Acceptance and adoption of IPSASB as recommended financial reporting practice has only been achieved with the concurrence of governments and the encouragement of legislative auditors who conceived governments that cash basis of accounting failed to provide them with complete and accurate information for decision making and accountability. Even though the accounting standards recommended by the profession in Canada should be adopted voluntarily, virtually all governments in Canada have changed their accounting practice and moved further along the spectrum to accrual accounting, at least in their financial statements (International Federation of Accountants – IFAC, 1996). New Zealand's implementation of the new financial management system is generally regarded as a success. At the start of the implementation there was general dissatisfaction with the status quo. Sustained political and senior management commitment encouraged most public sector managements to welcome the change. An emphasis on communications and a careful ordering of the process ensured that risk was well managed. Apprehensions about cost, accounting policy issues and concerns that the results would be misinterpreted, failed to materialize to any material extent (International Federation of Accountants – IFAC, 1994). Later date researches report that Canada and New Zealand as well as United Kingdom and Australia have already accepted accruals use in both, financial reporting and in the budgeting. Countries have different experiences in conducting public sector accounting reforms while the area is very complex and contains many factors that could potentially affect the reform course and the results of the reforms themselves (Vašiček et al., 2008). Besides before mentioned countries, the accrual accounting has been implemented in Romania, France and United Kingdom. According to strategic planes such reform are planning to realize also Austria, Macedonia and Slovenia.

Similar to the conclusions in the international comparative study by Brusca and Candor (2002), but additionally having taken into account transition countries as well, study by Roje (2007) concluded that it is especially in Anglo-Saxon countries where the accrual criterion predominates in public sector accounting, while Continental European countries are still in the process of converting to accrual accounting for both reporting and budgeting. Typically, the latter countries (Continental European countries and more precisely transition countries) have so far adopted modified cash or modified accrual systems instead of complete or full accrual systems. According to Roje (2007), the data concerning countries in transition (for example Poland, Slovakia, Check Republic, Romania, Croatia), pointed out several discrepancies among the set of countries as far the process of adopting more complex accounting basis was concerned. This drew to the conclusion that the transformation stage towards adopting accruals in governmental accounting and reporting in a chosen set of transitions countries was characterized by accounting basis inconsistency.

The accounting and reporting is the area in which serious weaknesses are still found in most Central and Eastern European countries. In many of the countries, the budget classification system does not yet conform to international standards. Typically, the accounting standards are not consistent with international practice. In several cases, the countries are unable to produce national accounts confirming to ESA95. In most cases, the external auditors do not provide an option on the government accounts that confirms to international standards. In some countries, there are serious delays in reporting on budget implementation. One country has not published budget reports for the last two years (Richard, 2002). Some countries use a cash base approach, others have moved, in part or completely, to accrual because of the benefits it brings. But this move also entails risk and preparatory actions that need to be carefully planned and well understood, especially if the institutional setting is weak and capacities for proper implementation are missing.

3.1. Slovenia – cash principle

The national framework for the public sector accounting and preparation of financial statements for public sector entities are Public Finance Act (in Slovenian: Zakon o javnih financah) and Accounting Act (in Slovenian: Zakon o računovodstvu) as well as their implementing regulations. Public Finance Act is the legal basis for budgetary and financial planning and execution while Accounting Act enacts the book-keeping (recording) of the transactions caused by budget execution. "The provisions of the Accounting Act shall apply to bookkeeping and preparing annual reports for the 4 main entities; state, municipal budgets, indirect and direct budget users, the Medical Insurance Institute of Slovenia and Institute for Pension and Disability of Slovenia."(Article 89 of the Public Finance Act). Annual report comprises the balance sheet, the income statements, the notes to the Financial Statements, and business report (article 21 of the Accounting Act). The financial statements of the four public finance treasuries in Slovenia are prepared on the principle of cash flow. The financial plans of the state, the municipal and both insurance funds (ZPIZ and ZZZS) prepare, accept and implement according to the principle of cash flow. The Accounting Act on the other hand prescribes accounting for the indirect budgetary users based on the principle of cash flow and the accrual principle as well. In Slovenia direct and indirect budgetary users keep the books and prepare the financial statements according to the cash flow principle, while the indirect budgetary users do both according to the cash but also accrual principle. The duality is used from the enforcement of The Accounting Act, while the double book-keeping causes a lot of additional work, the confusion of the accounting information receivers, the lack of transparency and finally a lot of reporting problems.

The Slovenian public accounting system is the modified version of accounting system based on the cash-flow principle. Researching the public sector accounting legislation reveals that the public entities in Slovenia do prepare their financial reports on the cash flow basis but are simultaneously obliged to prepare it on accrual principle in some cases. As the reforming process of public sector (known as Public Sector Management) in general and the public sector accounting is going on for a couple of decades, Slovenia has started to reconsider the possibility of modifying the accounting principles. In the last years all the international professional analyses have exposed the accrual principle on the top of the public sector accounting profession because of the positive effects of this approach, among those the need and requirement for complete information for users of financial reports in advance (Zafreda, 2010).

Slovenia is considering two approaches to accrual accounting transition; the immediate adoption of accrual-based accounting or gradual transition (adoption). The gradual transition should be understood in the manner that in the first phase, all public finance funds continue to use cash-based accounting for preparing their books of account and for recording income and other receipts as well as expenses and other outflows, while all direct and other indirect budget users both at the state and local level begin applying accrual-based accounting methods.

3.2. Croatia – modified accrual principle

The legislative framework regarding governmental accounting is determined by The Budget act (in Croatian: Zakon o proračunu) and supplemental set of regulations. The regulations (decrees, instructions, and policies) define and analyse certain parts of The Budget Act more precisely and thus enable faster and easier qualitative adoption of regulated solutions. According to the mentioned regulations all general government entities (central and local government and their component entities, i.e., departments, boards, agencies, commissions, etc.) are obligated by the law to apply governmental accounting and financial reporting model.

The fact that all entities within general government are obligated to this model, assures the complete accounting and reporting on general government activities. Croatia has regulated the uniform chart of accounts and consistent appliance of rules for recording cash transactions and economic events, with the aim to assure standardised information base for conducting additional data analysis when needed. As far the information on budget (budget planning and budget execution) and accounting and financial reporting is concerned, the appliance of organisational, economic, functional, location and programme classifications of the budget is obligatory.

From 2002 Croatia has established the new governmental accounting system based on accrual accounting principle and finally left behind a cash flow system. This system is a kind of moderated or adjusted accrual principle system in which national public sector accounting standards have not been developed. This is mainly due to the fact that accounting framework in Croatia has been set up as a law-based system. Despite the non-existence of national public sector accounting standards, the appliance of IPSASs has not been enacted as obligatory, though the implementation of certain accounting solutions defined by IPSASs has been recommended by the aforementioned Croatian regulations. Consequently, the majority of existing procedures/solutions applied in Croatian public sector accounting practise have complied with those recommended in IPSASs. The requirements concerning further adjustments of Croatian Governmental accounting information system development towards the international trends are, therefore, viewed through the accruals introduction and consequently through the encouragement for fully complying with IPSASs that would enhance better understanding of Croatian public expenditures accounts at the international level (Roje, 2012).

3.3. Serbia - IPSAS on cash flow base

The legislative framework regarding governmental accounting is determined by The Budget System Act (in Serbian: Zakon o budžetskom sistemu) and by Regulation for budget accounting (in Serbian: Uredba o budžetskom računovodstvu). Regulation for budget accounting specifies the accounting system and Treasury General Ledger defined in article 62. of The Budget System Act. The budgetary accounting includes the conditions and methodology of accounting but also preparation, presentation, submission and publication of financial statements. This regulation applies to the state budget, the budgets of territorial autonomy and local governments, as well as their direct and indirect budget beneficiaries, the Health Insurance, Republic Pension and Disability Insurance Fund and Republic Fund responsible for the employment as well as the beneficiaries of the Health insurance Fund.

The budgetary accounting is conceived on the cash flow basis what means that the transactions and other events are recognized when cash is received or payment. The financial statements should be prepared according to IPSAS – for a cash basis and contain information about the source of the funds collected during a specific period and the purpose for which the funds were used in the cash balance at the reporting date. Budget beneficiaries and mandatory social insurance may keep accounting records for internal reporting purposes on the accrual basis as well, as long as the financial statements are prepared on a cash basis because of the consolidated reporting.

Starting from 2010 the regulation application of international public sector accounting standards referring to Article 75 of the Budget System Law entered into force. It defined that the IPSAS shall apply to keeping books of account and preparation, presentation, submission and disclosure of financial statements of the direct and indirect beneficiaries of budget funds, beneficiaries of compulsory social insurance organizations' funds, the Republic of Serbia budget funds and the budget funds of autonomous regions and local self-government units.

3.4. Comparison

The selection of countries for the comparison has not been random. All three belong to the group of ex-Yugoslavia Republics and arise from the common public sector accounting and budgeting system. After the deconsolidation in 90s they have gone their own development path of their political, legal, economic and social system. The development of their own public finance and all the flanking elements was more or less full of potholes events. The cross section of situation regarding public sector accounting shows that each of them has chosen different accounting method as far as cash – accrual principle is concerned. Slovenia enforces the cash flow principle based on national accounting rules, Croatia has modified accrual accounting principle and Serbia has adopted cash flow principle based on IPSAS.

Slovenia has not changed its system in the last 20 years but is intensively considering the transition into accrual principle accounting, maybe even IPSAS implementation. The professional public is considering two approaches to accrual accounting transition; the immediate adoption of accrual-based accounting or gradual transition (adoption). The gradual transition should be understood in the manner that in the first phase, all public finance funds continue to use cash-based accounting for preparing their books of account and for recording income and other receipts as well as expenses and other outflows, while all direct and other indirect budget users both at the state and local level begin applying accrual-based accounting methods. Nevertheless which of those the profession (divided into two opposite sides nowadays) will choose, similar steps have to be taken in order to achieve goal; transition on accrual-based accounting. There are also two possibilities as far as legal settlement is concerned. On one side, current accounting policies used by direct budget users or certain users of the unified chart of account in their bookkeeping and preparing of financial statements can simply be rolled-out to include budgets, public funds and direct budget users, utilising national accounting policies or the entirely of the International Public Sector Accounting Standards can be adopted (Janc, 2011).

Croatia has gone through different stages and has modified accrual accounting principle in public sector. From 2002 Croatia has had its own accounting framework set up as a law-based system and has not had national public sector accounting standards developed, nor has applied accruals in government accounting system, nor has had IPSASs enacted as obligatory (but only recommended by the legislation), has complied certain existing accounting procedures with those recommended in IPSASs. The gradual transition from cash to accruals in the government financial reporting lead Croatia towards the introduction of accruals in governmental financial reporting, the reconciliation and eventual consistency of accounting basis adopted for financial reporting with the accounting basis adopted for the budget, and the reconciliation and presentation of differences between statistics' reports on public expenditures' and the amounts in financial statements (Roje et al., 2012).

Despite the Regulation on application of international public sector accounting standards in Serbia (Official Gazette of the Republic of Serbia No. 54/09) IPSAS have not yet come to use. The professional organizations and consulting firms conduct periodic training of public sector accountants but that seems to be all for now.

Discussing public sector accounting in context of improving the government financial reporting towards the accrual based accounting brings inevitable question. What is the final purpose of the improvement of the informative value of the financial reports of public sector organizations? The state budget or the budgetary accounting, indeed. The budget accounting systems of the majority of European countries, including Slovenia, Croatia and Serbia, are based on cash flow principle. Only Australia, New Zealand, Denmark and United Kingdom use accrual budgeting system (Vašiček et al, 2008). The significant trend towards accruals in financial statements of public sector entities has not resulted in accrual budgeting[3]. Many assume that the focus of good fiscal policy must be primarily on cash fiscal aggregates (OECD, 2009). The others believe that the accrual accounting has often been introduced as an accounting system separate from the budgetary accounting, which remains on a commitment basis and cash or near cash basis. The pragmatic attraction of this is that the wealth of additional data provided in the accrual accounts is just that: additional data. These data do not necessary change the way that a government functions, not least because the budgets still occupy most people attention when concerned with financial matters (Jones, 2007).

There are three possible models of connection between accounting and budgeting in the international context (Brusca and Condor, 2002):

a) the accounting system is limited to the registration of budgetary operations which means that the financial accounting is limited to the budgetary information and only the transactions that affect the budget are registered (i.e. Germany);
b) the budgetary system and the accounting system are connected which means that the connection between accounting and budgetary information is established in such a way that the accounting system allows the monitoring of the budget. Therefore, given that the resources are allocated through the budgetary process, the budget is converted to the primary instrument for accountability (i.e. Italy, Portugal, France, Romania and Spain);
c) the budgetary and the financial accounting systems are two independent systems which means that there is no connection between the budgetary and the accounting information, so that on the one hand accounting statements are produced and contained in the Financial Report, and on the other hand budgetary statements are produced to fulfill legal requirements. The public institutions produce the financial information presenting the same statements as the business entities, without taking into account budgetary obligations (i.e. Australia, Canada, New Zealand, United Kingdom).

[3] The accrual budgeting means that spending ministries are given budgets which are defined in terms of accrual concept and that the budgets sets quantitative limits on the expenceswhich they incur rather than the cash payments they make.

Table 1: The accounting and budgetary system in Slovenia, Croatia and Serbia

Criteria	**Slovenia**	**Croatia**	**Serbia**
Enactment date	1999	2002	2010
Public sector accountig system	Adjusted (modified) cash	Adjusted (modified) acrual	IPSAS – cash principle
The advantages of accrual elements in the system	• except undirect budgeraty users all the transactions regord on the cash flow basis; • indirect budgetary users register transactions on cash as well as accrual basis; • procurement of fixed assets causes the expences in the reporting period in which the purchase was made (are not capitalized).	• regular expenditures and liabilities recognized on accrual basis; • revenues generally recognized on cash basis (only certain on accrual basis); • procurement of fixed assets causes the expences in the reporting period in which the purchase was made (are not capitalized).	-
Budget accounting	Cash flow principle	Cash flow principle	Cash flow principle
Budget parts	• The statement of revenues and expenditures • The statement of receivables and investment • The statement of financing	• The statement of revenues and expenditures • The statement of financing • The special budget part which consists of the budgetary users expenditures	• The statement of revenues and expenditures • The stetement of financing

Source: own, 2013

There is much greater acceptance of accruals for financial reporting than for budgeting purposes. This does not appear to be a temporary snapshot as countries migrate to accrual budgeting but rather a firm view among a number of member countries. Two reasons are most often cited for this. First, an accrual budget is believed to risk budget discipline. The political decision to spend money should be matched with when it is reported in the budget. Only cash provides for that. If major capital projects, for example, could be voted on with only the commensurate depreciation expense being reported, there is a fear that this would increase expenditures for such projects. Second, and somewhat contradictory to the first reason, legislatures have often shown resistance to the adoption of accrual budgeting. This resistance is often due to the sheer complexity of accruals. In this context, it is noteworthy that the legislatures in those countries that have adopted accrual budgeting generally have a relatively weak role in the budget process (Blöndal, 2003).

But we should not forget that the cash accounting does not provide the information about the assets value that were used and about the incurred liabilities caused by certain decisions. Consequently, the financial statements and the budget do not provide the information about how current spending influences changes in surplus of assets over liabilities. The cash accounting system focuses only on cash flow of the ongoing year. The same reason can be expressed as far as taking the responsibility of the governance is concerned. The more precise reporting about the receipts and expenditures in cash accounting could cause only reduction in intelligibility. And finally, we should remember that cash principle cannot provide the information about potential liabilities which influence the deficit of the budget in coming years (Mladenović, 2011). Under the cash basis of accounting the revenues will only be recognized in the financial statements in the period in which cash is received. However, the cash receipts do not make distinction between current receipts and capital receipts. So an excess of receipts over payments cannot be called income because receipts might encompass capital receipts. This will result in that the revenues, which are earned in a given fiscal year, are not known. As such it is difficult to evaluate the efficiency of the collection staff, and to discover the losses during the collection process. In addition, under cash basis, receipts and revenues are identical since no difference exists between the time when they are recognized and when they are collected. But under accrual basis, the recognition of revenues is required at the time when they are earned, and the receipts occur when revenues are collected (Ouda, 2003).

4 Conclusion

Since the 1980s there has been a radical wave of organizational, managerial and accounting reforms in public sector in many countries and jurisdictions. The New Public Management concept has played a dominant role in this reform defined business point of view in governments necessitated the abandonment of the traditional cash flow accounting system and the introduction of accrual accounting systems that had been transferred from the profit sector. Transition to accrual accounting and budgeting is an important component of public sector reform, although it does traditionally not top the agenda. Before embarking on the transition, it is vital that the expected results are well understood and roadmap is carefully designed. Accrual framework is not a panacea, and despite the significant efforts and costs involved, it does not provide all information that is often required by the public sector users, or can even lead to distortions if not introduced properly. Experience suggests that it can boost accountability and enhance performance of the public finance management.

The public accounting trend leans towards the transition from cash flow to accrual principle. The income and expenditures statements based on cash flow principle facilitate only yearly budget monitoring and may subsequently cause financial instability while they are not providing data for the management of property and obligations. The cash flow accounting is appropriate in circumstances where the minority of liabilities are long-term. Lately the countries are facing the increasing long-term liabilities such as the liabilities for the social security, the unemployment and the pensions. Nevertheless if the budget revenues and expenditures are recorded according to the principle of cash flow, general government deficit is conceived on the same principle. The accounting based on accrual principle enables transparent business monitoring, including claims and liabilities which is not possible using cash flow principle accounting. Finally, public sector accounting reform is only a part of the public management changes required in last couple of decades. The accounting, cash or accrual based, is only one of many “business” functions in the public sector as the system. That is why, the accountant will have to work closely with top and line management to ensure that they have the financial information that they require to enable them to fulfil their responsibilities effectively.

The financial and economic crisis revealed that besides private, also public sector need high quality financial information from the financial statements. The financial statements should fully disclose information, including the long-term impact of decisions taken and not just their short-term impact on cash flows and should have the clear distinction between market and non-market activities in the public sector, as well as the financial statements and statistical reports. They should be sufficiently detailed to provide insight into past, present, and partly also in the future, which means that it must include financial information on the known future expenditure. The theory has explored and practice of financial and economic crisis confirmed that information supplied by the accrual based accounting provides transparent budgeting. Additionally, such information helps to establish greater trust between the government and its voters. By providing such information, the government will help prove the correctness of their decisions on the public finances and its ability to deal with them; this will create a better foundation for their recovery and to protect the credibility of democratic legitimacy (Duhovnik, 2011).

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