Time to reform Ireland's public sector accounting

Connolly, C., & Stewart, E. (2021). Time to reform Ireland's public sector accounting. *Accountancy Ireland*, *53*(4), 30-33. https://www.charteredaccountants.ie/docs/default-source/publishing/accountancy-ireland-archive/accountancy-ireland-august-2021.pdf

Published in:
Accountancy Ireland

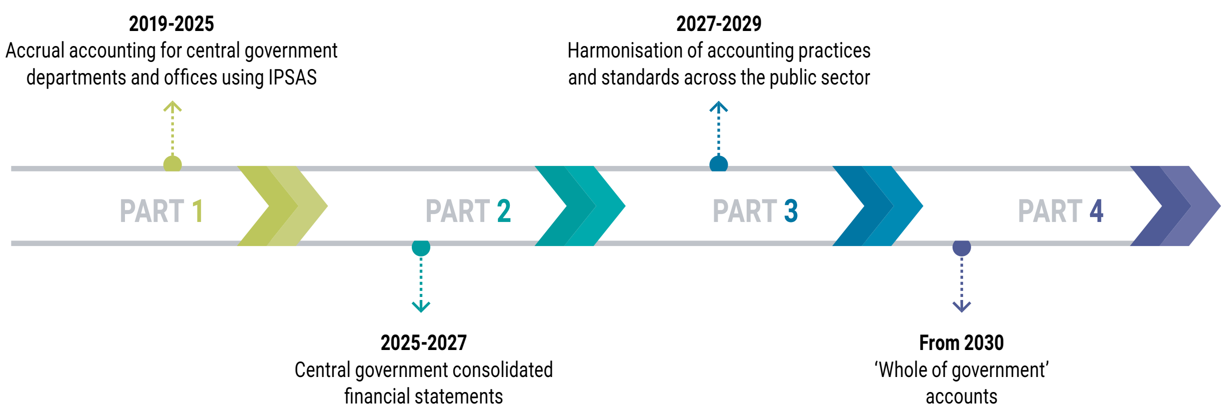
Document Version:
Publisher's PDF, also known as Version of record

Time to reform Ireland's public sector accounting

Prof. Ciaran Connolly FCA and **Dr Elaine Stewart** draw on their recent research for an Institute report to examine the public sector's proposed accruals-based accounting framework, which represents a significant shift for the Irish Government.

Under the current system of Irish central government financial reporting, budget documents and financial reports are typically prepared on a traditional cash-accounting basis, with their institutional coverage mainly limited to central government. However, Ireland is one of the few remaining OECD countries to account and budget in government on a cash basis. While considered robust and reliable, it is argued that cash accounting alone does not enable the planning and asset management that an accruals-based system allows. Motivated by the 2008 global financial crisis and the OECD's 2019 recommendations following its evaluation of Ireland's fiscal reporting, forecasting and budgeting systems, the Irish Government

FIGURE 1: Reform timeline



sought to modernise its public sector accounting practices.

On 27 May 2021, Michael McGrath TD, Minister for Public Expenditure and Reform launched Chartered Accountants Ireland's position paper on plans by the Irish Government to reform public sector accounting in Ireland. Researched by the authors of this article and drawing on the views of key stakeholders in the process, *The Reform of Ireland's Public Sector Accounting* examines the proposed new accruals-based accounting framework, which represents a significant change to the way the Irish Government accounts.

IT IS MY VIEW THAT THE HARD-WON CREDIBILITY WE ENJOY FOR OUR MACRO FRAMEWORK NEEDS TO BE REFLECTED AND DEVELOPED AT THE MORE MICRO LEVEL BY INTRODUCING MODERN ACCOUNTING AND FINANCIAL REPORTING, STEPPING UP OUR LEVELS OF CAPABILITY AND LEVERAGING THE PROFESSIONALISM THAT IS IN PLACE ACROSS THE PUBLIC SERVICE.

Michael McGrath TD, Minister for Public Expenditure and Reform.

Recommendations to modernise public accounting systems are not confined to Ireland. Over the last 25 years, there has been a global shift towards accrual accounting in the public sector. While several governments (e.g. Australia, Switzerland and the UK) have adopted full accrual accounting, others (e.g. Italy, Philippines, South Africa and Spain) use a modified form. Some, such as Germany, have no immediate plans to do either.

Regardless, the use of accruals in the public sector is growing. Of the 165 countries included in the *International Public Sector Financial Accountability Index 2021 Status Report*, published by IFAC and CIPFA, 49 (30%) use accrual accounting, with approximately half of these applying International Public Sector Accounting Standards (IPSAS) either directly or as a reference point. By 2025, it is estimated that 83 (50%) of the 165 countries will operate accrual accounting, with around 73% using IPSAS to some extent. Governments across the globe, including those in Latin America, the Caribbean, the Middle East and Africa, are instigating IPSAS implementation projects. Meanwhile, in Europe, the European Commission is working with member states to develop European Public Sector Accounting Standards, with IPSAS used as the baseline.

Moreover, a small number of countries have implemented consolidated accounts (e.g. Australia, New Zealand and the UK), something that is also included as part of the Irish Government's proposed reforms (see Figure 1 above).

The proposed reforms

While acknowledging that cash accounting provides strong control over departmental expenditure, a number of reports, including the OECD's 2019 report, have advocated significant reform to the current process of financial reporting in Ireland on the basis that:

- cash-based information alone is insufficient for understanding the public sector financial position;
- as audited Appropriation Accounts are required to be published within nine months after the period to which they relate, Ireland is among the slowest of OECD countries in making such reports available; and
- reports from central government, commercial and non-commercial state bodies are not consolidated. This presents difficulties, particularly where reports are prepared for EU bodies such as Eurostat.

FIGURE 2: Summary of stakeholders' views

DRIVING FORCES

- Reforms are being (primarily) driven externally by the OECD and internally by DPER.
- Awareness that other countries have adopted similar approaches, with Ireland being an outlier.
- While Ireland is not a keen adopter per se, it is not anti-reform.
- Limited communication about the reforms until recently.
- Driven centrally with perceived limited input to date from the Finance Officer Network (FON) and the Standing Advisory Group.
- Role of FON growing.

BENEFITS

- Improved information for decision-making aided by faster closing.
- Better understanding of financial health and position.
- Compliance with international best practice.
- Benefits for public representatives.
- Ability to see the 'big picture'.
- Improved understanding of outputs and outcomes.

CHALLENGES

- Ensuring adequate staff resources and filling education and skills gaps.
- Maintaining momentum and retaining top-level support.
- Legislative changes.
- FMSS implementation.
- Retaining cash budgeting could limit impact.
- Tailoring IPSAS to suit the Irish context.

APPROPRIATENESS

- Supportive, but aware of the difficulties.
- Cash is still important.
- Mixed views as to whether and when accrual budgeting should be implemented.

On 15 October 2019, the Irish Government announced a series of reforms to Ireland's public sector accounting which, while retaining core elements of the existing cash-based system, include:

- introducing accrual accounting in central government departments and offices, applying IPSAS as the underlying framework;
- preparing central government consolidated financial statements; and
- harmonising accounting practices and standards across the wider public sector to enable the consolidation of all public sector entities into a 'whole of government' account.

When implemented, it is expected that the reforms will underpin confidence in Ireland's public finances and unlock value from the State's assets while realising the benefits of professional financial management, timelier financial reporting, and a general improvement in economic and fiscal performance.

Large-scale reforms, like those proposed, are rarely introduced in a single stage but are typically rolled out over many years, often in conjunction with new IT systems. The Department of Public Expenditure and Reform (DPER) is leading the reform process and has developed an action plan to introduce the reforms with a phased approach (see Figure 1). This begins with the application of IPSAS as the underlying framework to introduce accrual accounting in central government departments and offices (Part 1, 2019–2025). Next, the intention is to prepare central government consolidated financial statements (Part 2, 2025–2027), followed by the harmonisation of accounting practices and standards across the wider public sector (Part 3, 2027–2029), and finally, the consolidation of all public sector entities into a 'whole of government' account (Part 4, from 2030). The feasibility of this latter part depends on the degree of integration of accounting systems, especially outside central government, where many entities currently use different accounting standards (e.g. FRS 102) and operate separate IT systems.

While factors such as the COVID-19 pandemic and complications in developing the Financial Management Shared Services (FMSS) system have impacted the original timelines, progress has accelerated more recently.

Purpose, approach and stakeholders' views

Drawing on the experience, progress and lessons learned from other countries and governments that have introduced similar reforms, together with the views of representatives from government departments, agencies and advisory organisations/individuals, the Institute's position paper examines the driving forces, benefits, challenges and appropriateness of the reforms. The views expressed by interviewees are summarised in Figure 2.

The consensus was that the reforms have been mainly driven externally by the OECD, as Ireland is one of the few OECD countries that continue to report on a cash basis. Internal motivations included the potential benefits arising from access to better information on public sector assets and liabilities, including pension obligations.

Interviewees highlighted potential staffing, training and IT-related challenges associated with reform implementation, acknowledging that while the process has been slow to start, there is evidence that its pace is growing. However, despite this positivity, it was recognised that the timetable had slipped in a similar manner to that for the FMSS, with the successful introduction of the new system being considered integrally linked with the reform of Ireland's public sector accounting (e.g. to facilitate the preparation of IPSAS-based departmental and ultimately 'whole of government' consolidated accounts). Other anticipated challenges included implementing the necessary legislative changes, with some questioning the logic of introducing accruals-based accounting while maintaining a cash-based budgeting system.

While accepting the challenges, the vast majority of interviewees viewed the reforms positively. The consensus was that they could standardise how departments present their financial information, making them more professional and user-friendly. They could also facilitate the closing of accounts in a timelier manner so that the information is more relevant and provides better information for departments' public representatives.

The way forward

Experience indicates that political support and leadership at the highest levels is critical if public sector accounting reforms are to succeed. Furthermore, research suggests that their success (however this is defined) is influenced by the extent to which they are shaped by private sector ideas, with the excessive use of private sector consultants often impacting negatively on the receptiveness to change. Thus, while the public sector is entwined with the private sector through outsourcing and privatisation, it remains distinct in terms of its stakeholders, objectives and outcome measures. Therefore, while the reforms have clear implications for departmental accounting functions, their success depends upon input and support from key stakeholders across the public sector so that they fit 'the Irish public sector context'. Hence, engaging with, for example, departmental managers, statisticians, ministers and public representatives will help to identify the risks, gain political support, and secure buy-in.

Relatedly, good project management and governance arrangements are critical to ensure the timely implementation of the accounting reforms (and FMSS) and that the delivery of government services is not unduly disrupted. This might involve piloting aspects of the reforms in some departments or agencies, including having dry-run or dummy years before the changes 'go live' to help identify needs and potential pitfalls. For example, training and developing the knowledge of preparers and users of the systems and information is essential. Knowledge transfer is also important to avoid 'consultant dependency' while capacity building (e.g. recruitment and training) is critical to project success.

As noted above, DPER has developed a plan to implement the reforms in a phased manner over the next decade. Not unexpectedly, a number of issues will need to be considered further, if not resolved, during this period. For example, Ireland's current constitutional arrangements require the preparation of cash-based Appropriation Accounts. However, there is evidence that 'full' accruals-based accounts can be advantageous, including the better management of assets and a greater awareness of obligations, which can facilitate more accurate planning and effective risk management. In addition, although few countries have adopted full accrual budgeting, with many applying a modified version, continuing to operate cash budgeting in tandem with accruals-based notes to the cash-based Appropriation Accounts may cause confusion and limit the potential benefits of the reforms. Although, evidence from the Northern Ireland experience suggests that accrual budgeting creates its own problems.

THESE REFORMS WILL GREATLY ASSIST US IN DELIVERING A NEW AND MODERN SYSTEM FOR IRELAND. I DON'T UNDERESTIMATE THE SCALE OF THIS TASK – IT IS QUITE A CHALLENGE TO REFORM ACCOUNTING RULES THAT HAVE THEIR ORIGIN IN LEGISLATION – STILL ON OUR STATUTE BOOKS – DATING BACK TO 1866. HOWEVER, *IS FADA AN BÓTHAR NACH BHFUIL AON CHASADH ANN* – IT'S A LONG ROAD THAT HAS NO TURNING, AND AS WE EMBARK ON THIS JOURNEY, WE CAN LOOK BACK ON A SYSTEM THAT HAS SERVED US WELL IN THE PAST BUT NEEDS MODERNISATION NOW.

Michael McGrath TD, Minister for Public Expenditure and Reform.

Conclusion

Ireland's planned public sector accounting reforms are ambitious but appropriate and timely. They represent a significant statement of intent by the Irish Government to modernise the State's public sector accounting practices and must remain a priority. While obstacles and redirections can be expected along the implementation journey, these should be viewed as opportunities to design a system that is fit for purpose and appropriate for the Irish context. For example, while the FMSS system implementation has been delayed, this presents an opportunity to ensure that it will support the preparation of IPSAS-based accounts and assist with the preparation of consolidated accounts, together with the information needed for the EU and Eurostat.

Prof. Ciaran Connolly FCA and Dr Elaine Stewart, Queen's University Belfast, are authors of *The Reform of Ireland's Public Sector Accounting*, published by Chartered Accountants Ireland.