

A CROATIAN PERSPECTIVE ON IPSAS BASED ACCOUNTING AND FINANCIAL REPORTING MODEL IN PUBLIC SECTOR

DAVOR VAŠIČEK, PHD, FACULTY OF ECONOMICS, UNIVERSITY OF RIJEKA
dvasicek@efri.hr

GORANA ROJE, MSC, STATE ASSET MANAGEMENT OFFICE
gorana.roje@duudi.hr

VESNA VAŠIČEK, PHD, FACULTY OF ECONOMICS AND BUSINESS, UNIVERSITY OF ZAGREB
vvasicek@efzg.hr

Background (1)

- **Croatian Science Foundation project 8509 Accounting and financial reporting reform as a means for strengthening the development of efficient public sector financial management in Croatia**
- Project duration: 4 years (2014-2018); Principal investigator + 9 team members (researchers)
- Research areas:
 - PSA harmonization and its further development; Croatian PSA terminology creation
 - Government asset management system upgrading
 - Internal reporting (PS cost and management accounting implementation)
- CSF and Project overall goals:
 - Fostering internationally competitive research groups
 - Fostering interinstitutional cooperation (academic and non academic institutions, PS units/authorities)
 - Dissemination

Background (2)

- **PSA harmonization and its further development; Croatian PSA terminology creation – research objectives:**
 - exploring the adequacy of existing modified accrual basis model appliance and budgetary users' financial statements qualitative characteristics comparison to the accruals appliance in chosen segments of the Croatian public sector;
 - to explore the appropriateness of existing modified accrual accounting and financial reporting system in certain Croatian public sector sub-sectors,
 - examining the level of Croatian budgetary accounting compliance with IPSAS on the path of international comparative studies on PSA harmonization that would foster the creation of Croatian PSA terminology
 - interpretation on application of a selected number of IPSAS in Croatian PSA content
 - PSFM and PSA international trends' and practical guidenlines adoption possibilities' analysis.

The scope (1)

... to reflect:

- **the need for adjustments of Croatian public sector (governmental) accounting and reporting system so that it complies with the compulsory and recommended EU regulations** (e.g. Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States sets that Member States shall have in place public accounting systems comprehensively and consistently covering all subsectors of general government and containing the information needed to generate accrual data),
- **the fact that Croatian budgetary regulatory framework implies future changes on the path of European and worldwide public sector accounting and financial reporting reforms** (e.g. Croatian Budget Law recommends and normatively enables the International public sector accounting standards (IPSAS) implementation),
- **the ongoing Croatian public sector accounting development processes** and specific features and perspectives of Croatian governmental accounting and budgetary system reform in the light of international public sector accounting harmonisation processes

The scope (2)

- **perspectives for further development of Croatian government accounting and financial reporting system:**
 - an overview of recent publication referring to harmonization of budgetary accounting in the Republic of Croatia with the International Public Sector Accounting Standards;
 - reflecting on the implementation level of selected accounting solutions defined by IPSASs in Croatian public sector and the conformity of reporting in Croatian budgetary system with international accounting and statistics standards;
 - the overview and elaboration of existing modified accrual financial reporting model constraints and eligible tendencies and challenges towards a possible IPSASs appliance
 - systematization of financial, legal and technical constraints associated with full accruals model and IPSAS introduction.

Background – Croatian perspective (1)

- ✓ existing government accounting/financial reporting system has been based on modified accruals,
 - ✓ national public sector accounting standards have not been developed,
 - ✓ IPSASs appliance has not been mandatory, but the implementation of certain accounting solutions defined by IPSASs has been recommended by Law.
- The research topic is mainly driven by:
- (i) the fact that Croatian budgetary regulatory framework implies future changes on the path of European and worldwide public sector accounting and financial reporting reforms :
- State Budget Act - Budget accounting principles - Article 98:
- “(1) Budget accounting shall be based on the generally accepted accounting principles of: accuracy, authenticity, reliability and individual presentation of business events, and on the International Accounting Standards for the public sector.
- (2) Budget accounting shall be kept according to the principle of double entry bookkeeping and to the distribution of accounts in the chart of accounts.”

Background – Croatian perspective (2)

(ii) the urgent need for adjustments of Croatian public sector (governmental) accounting and reporting system so that it complies with the compulsory and recommended EU regulations - Council Directive 2011/85/EU:

- ✓ the general government sector in Croatia has conformed to GFS standards, EU countries follow the ESA standards regarding the general government sector components/aggregates.

(iii) previous research – actual accounting and FR model represents a significant step towards transition to full accruals; proven as not broad enough for certain PS subsectors (i.e. healthcare sector)

The development of governmental accounting information system in Croatia

- Croatian national government accounting system:
 - ✓ had historically been influenced by the cameral accounting theory,
 - ✓ its budgetary system has influenced the accounting system,
 - ✓ the governmental accounting information system's structure and contents has been viewed more in function of State's budget goal achievements and less in function of achieving greater management efficiencies and hence better outcomes.
- **1994 to 2001: intense development process of implementing modified accruals as a gradual transition from cash basis to full accruals appliance as the ultimate goal of the governmental accounting reform.**
- **The governmental accounting reform started in 2001; shortly after a modified accrual accounting as a gradual transition from cash to accruals was implemented.**
- The accounting framework in Croatia has been set up as a law – based system: since governmental activities have been financed through the Budget, the legislative framework regarding governmental accounting development determined by the State Budget Act and other additional set of regulations - decrees, instructions, and policies.

Existing governmental accounting information system in Croatia (1)

The distinguished qualitative features of the existing Croatian governmental accounting system:

- all general government entities are obligated by the law to apply governmental accounting and financial reporting model
- unified chart of accounts and consistent appliance of rules for recording cash transactions and economic events are regulated by the law as well
- information on budgeting (budget planning and budget execution) is made available for public; accounting and financial reporting - the appliance of organizational, economic, functional, location and program classifications of the budget is obligatory
- existing accounting information system of a general government - based on modified accrual accounting basis and the historic cost principles regarding balance sheet items, as a gradual transition towards accruals implementation and compliance towards the IPSASs;
- actual amounts and financial statements are prepared on modified accrual accounting basis, budget amounts are still prepared on cash basis - accrual accounting reform comes first and budgeting follows;
- consistent appliance of internationally recognized and comparable analytical framework of financial and statistics reporting (GFS 2001) has resulted in establishing contextual and functional linkage concerning financial and statistics reporting;
- legal obligation to make periodical and annual financial reports; obligation for consolidated semi annual and annual settlements.

Existing governmental accounting information system in Croatia (2)

The most important features of Croatian governmental financial reporting model based on modified accrual accounting basis:

- revenues are generally recognized on cash basis with only certain revenues recorded on accrual basis;
- regular expenditures and liabilities are recognized on accrual basis;
- not all government asset items get recognized and valued; expenditures regarding the fixed assets supply are not capitalized but rather treated as an expense in full when obtained; the State Budget General Ledger fails to incorporate the full data on assets owned by the Republic of Croatia

IPSASs and current Croatian public sector accounting/budgeting practise (1)

- although IPSASs are not obligatory enacted in Croatia, certain Croatian public sector financial reporting procedures comply with those recommended by IPSASs
- financial reports that are prepared in Croatian budgetary system are identical to the set of the financial reports recommended by IPSAS 1.
- the accounting basis adopted for the budget differs from the basis adopted for the financial statements but budget (s) are publicly available
- according to IPSAS 24 actual amounts should follow the same accounting basis as for the reporting on budget amounts, so that the comparison of these amounts can be made on the same basis of accounting as adopted for the budget - such a comparison cannot be conducted in Croatia unless reports on actual amounts are reclassified regarding the accounting basis used.

IPSASs and current Croatian public sector accounting practise (2)

IPSAS 6 and IPSAS 22:

- the requirements for reconciliation and presentation of differences between statistics' reports on public expenditures' and the amounts in financial statements are deemed necessary,
- the existing procedures currently applied/accepted in Croatian public sector accounting practise, and information required for preparation and presentation of consolidated financial statements and requirements for governments that disclose information about the general government sector, comply with those recommended by the IPSASs - Croatian financial/accounting and statistics reports assure the sufficient amount of relevant information disclosure regarding general government sector. Existing differences are due to:
 - (a) distinctions regarding the general government sector coverage,
 - (b) the fact that Croatian governmental financial and statistics information systems are founded on GFS 2001, and
 - (c) the fact that not all public enterprises are included in the consolidated financial reports of the State.

The conformity of reporting in Croatian budgetary system with international accounting and statistics standards (1)

- Entities/units which are obligated to apply budgetary accounting in Croatia are determined by the GFS boundaries for the Croatian accounting system is set up in a way that the consolidated financial reports of the general government ensure the data needed for preparing the GFS reports:
 - economic classification according to which the items in the Chart of accounts are defined, is based on the classification enacted by the GFS;
 - analytical framework of financial reporting in Croatian budgetary system conforms to GFS model;
 - the coverage of the general government sector in Croatia conforms to GFS standards/boundaries.
 - The differences that arise are due to the fact that modified accounting basis is applied on a mandatory basis in Croatian budgetary system, while GFS is accrual based.

The conformity of reporting in Croatian budgetary system with international accounting and statistics standards (2)

Croatia's entry in the EU:

- Chapter 2, Article 3 of the Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States which regards accounting and statistics: “As concerns national systems of public accounting, Member States shall have in place public accounting systems comprehensively and consistently covering all sub-sectors of general government and containing the information needed to generate accrual data with a view to preparing data based on the ESA 95 standard“
- Ministry of Finance has been obliged to form fiscal statistics in accordance to international methodologies – IMF public finance statistics (GFS 2001) and the European statistics methodology - ESA 95.
- The Ministry has taken steps towards modifying data requirements in accordance to the ESA methodology - changes of the Chart of accounts for budgets and budgetary users with the appropriate elaboration of data and changes in the process of budget execution as the step forward in accruals adoption and appliance as required by ESA methodology.

Perspectives for further development of Croatian government accounting and financial reporting system (1)

- The reform has so far resulted in implementing quality solutions that represent a good basis for further adjustment and development of Croatian governmental accounting information system towards more comprehensive accrual based IPSAS appliance.
- Goal: pursue budgetary accounting reform in Croatia, implying accrual accounting basis and International public sector accounting standards (IPSAS) implementation, with the aim to create quality accounting/financial reporting systems and sound financial management.
- Further adjustments and developments of Croatian government accounting system need to be related to:
 - ✓ the country recent accession to EU and the guidelines of the Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States,
 - ✓ applying accruals in public sector accounting and financial reporting practice,
 - ✓ future obligatory IPSAS appliance (Article 98 of the State Budget Act states that Budget accounting is to be based on the International Public Sector Accounting Standards).

Perspectives for further development of Croatian government accounting and financial reporting system (2)

- Even though Croatian State Budget Act gives perspective and broad basis for full implementation of IPSAS, the level of IPSAS implementation is yet to be clearly defined in the set of regulations, since the existing accounting methods are not in full compliance with the requirements of IPSASs for they are based on accruals.
- the necessity of gradualism in introducing accruals into government accounting on national level - segmental approach (local vs. national level, GGS vs. subsectors) in introducing the accruals would prove justifiable, for unified and standardized general government accounting system based on modified accruals does not represent the best accounting solution for all public sector segments.

Further upgrading the existing accounting system

- Clearly defining the consistent application of the appropriate accounting concept in the process of budget planning and budget realization, in relation to the applied accounting concept for assets, liabilities, revenues and expenses recognition of government sector economic units.
- Rethinking the actual unified chart of accounts and financial reports structure, which obliges all economic entities (both on central government and local government level) to report on more than 1 200 items, as it is done on the planning for state budget level.
- Consistent appliance of modified accrual basis results in discrepancies in revenues vs. expenditures (costs) recognition which further results in twisted public spending amounts.
- There is a need to develop and implement managerial and cost accounting methods, and performance indicators calculation use, so to assure higher level of cost and managerial accounting methods development, and external and internal financial reporting convergence.
- There are certain public sector subsystems (i.e. health sector system) where modified accruals are proved not to be sufficiently broad to enable efficient management and reporting for subsystem activities (i.e. accounting information system contains discrepancies and constraints in assuring true and fair view of organization's financial position and performance.)

Financial, legal and technical limitations to potential accounting model change (1)

- In significantly large segment of the general government, spending public resources and revenue-generating is close to the entrepreneurial way of doing business (i.e. healthcare system).
- The structure of state property refers also to the so called public sector specific assets implying certain limitations in accruals adoption (mostly regarding valuation and depreciation). However, at the international level there are techniques and methods of accounting and disclosures that have been developed and successfully implemented in practice.
- The applied information technology that supports the process of accounting for data according to the current government accounting model is considered sufficient to support a new model based on an advanced accounting concept, not implying significant additional IT costs.
- The available technical and human resources in government units - already experienced a greater change – referring to transformation from cash based to modified accruals based accounting/financial reporting system. Thus, further development of the model towards full accruals appliance would not result in greater expanding the scope of work in accounting services.

Financial, legal and technical limitations to potential accounting model change (2)

- Croatian State Budget Act sets, normatively enables and fosters the accruals based IPSAS implementation). This further means that there would be no significant costs referring to severe legal changes, since only amendments to the existing regulatory framework would be deemed necessary.
- In financial terms (i.e. in terms of financing government units) the introduction of a more advanced accounting model does not necessarily imply radical changes in the financing system, since the accounting model based on the accrual basis of accounting supports any possible future system changes, but also supports and objectifies monitoring finances in the current environment.
- In terms of the information quality accrual accounting model fully meets the reporting needs on a comparable basis as well as needs of consolidating general government components.

The importance of IPSAS and other documents' interpretation and translation

- The issuance of the book titled *Harmonizacija proračunskog računovodstva u Republici Hrvatskoj s Međunarodnim računovodstvenim standardima za javni sektor* (in English: *Harmonization of budgetary accounting in the Republic of Croatia with the International Public Sector Accounting Standards*).
- The idea was driven primarily by:
 - the need for a detailed overview of recent international trends in public sector accounting and financial reporting, public sector accounting standards harmonization trends, the work of standard setters, bodies and institutions that have been operating on encouraging the development of accounting standards, producing exposure drafts, recommended practice guidance, consultation papers/studies, etc
 - the need for standardization of the public sector accounting and financial management terminology, when interpreting studies and documents in English to Croatian language.



Many thanks for your intention 😊