PUBLIC SECTOR ACCOUNTING SYSTEM REFORM
IN LITHUANIA

Abstract

The harmonisation of public sector accounting standards within the EU is long overdue. At the same time, harmonised accrual accounting rules are only a necessary requirement to achieve improved financial management within the member states as improving efficiency and effectiveness of financial management is largely dependent on the context in which reforms are implemented.

This paper focuses on the reform of budgetary accounting of Lithuania, a country new to the euro zone. Lithuania’s success in driving the transformation of public finance management holds many lessons for developing countries.

Keywords: public sector accounting, accrual accounting, financial management, Lithuania.

1. Introduction

One of the most crucial aspects of New Public Management (NPM) was the wave of reforms in financial information systems. These changes are an essential element to improve the management and decision-making of government institutions, which is also called New Public Financial Management (NPFM) (Guthrie 1999). The cornerstone of reforming financial information systems is the introduction of accrual accounting in the public sector, at the expense of traditional cameralistic/cash accounting systems (Lapsley 1999).
The governments of EU countries have been adopting and implementing accrual accounting systems. Over the past decade the International Public Sector Accounting Standards Board (IPSASB), formerly the Public Sector Committee (PSC) of the International Federation of Accountants (IFAC), has been developing a set of International Public Sector Accounting Standards (IPSAS), which are intended to streamline and support these reforms.

This paper focuses on the reform of budgetary accounting of Lithuania, a country that has recently entered the euro zone. The country’s success in transforming public finance management holds many lessons for developing countries. The study used two test methods: analysis of the literature on the subject, and analysis of normative acts.

2. The Suitability of IPSAS for the Member States

The sovereign debt crisis has underlined the need for governments to clearly demonstrate their financial stability and the need for rigorous and transparent reporting of fiscal data.

Transparency, accountability and comparability of private business accounts have been bolstered by the adoption at the EU level of harmonised accounting standards. The implementation of EU harmonised public sector accounting standards would similarly bolster the quality, transparency, comparability and accountability of public entities in the EU (Berit 2013).

However, recent experiences have shown that the quality of upstream data sources (the accounts of public entities) for these statistics has to be strengthened. This need is at the core of the so-called “6 Pack” of legislation, and in particular Council Directive 2011/85/EU (the Budgetary Frameworks Directive). In this context, EU harmonised public sector accounting standards undertaken at the micro level would also bolster the quality of the macro fiscal reporting under the Excessive Deficit Procedure (Towards Implementing… 2013).

The Budgetary Frameworks Directive sets out the rules on Member State budgetary frameworks necessary to ensure compliance with the Treaty obligation to avoid excessive government deficits. It requested the Commission to assess the suitability of the International Public Sector Accounting Standards (IPSAS) for Member States. The European Commission has forwarded its assessment to the Council and European Parliament, based on information received through consultations with Commission services, international organisations, experts from Member States and other interested parties. It concludes that, even if IPSAS cannot, as it currently stands, be implemented in EU Member States, the IPSAS standards represent an indisputable reference for potential development of Euro-
European Public Sector Accounting Standards (EPSAS), based on a strong EU governance system.

Council Directive 2011/85/EU recognises the crucial role in EU budgetary surveillance of complete and reliable fiscal data, comparable across Member States. It therefore sets out the rules on Member State budgetary frameworks that are necessary to ensure compliance with the obligation, under Article 126 of the Treaty on the Functioning of the European Union (TFEU), to avoid excessive government deficits. On the one hand, fiscal discipline plays an essential role in safeguarding the Economic and Monetary Union, but on the other, financial stability is based on trust (Towards Implementing... 2013).

Article 3 of Directive 2011/85/EU requires Member States to 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. It thereby acknowledges the essential incoherence between public sector accounts, which only record cash flows, and the fact that EU budgetary surveillance is based on ESA 95 accruals data. This means that cash data have to be converted into accruals through approximations and adjustments involving macro-based estimates. Moreover, where accruals accounts do not exist at the micro level, financial transactions and balance sheets have to be derived from a variety of different sources, leading to a “statistical discrepancy” between the deficit compiled via non-financial accounts and that compiled via financial accounts (Towards Implementing... 2013).

The lack of coherence between primary public-sector accounts and ESA 95 accruals data is also acknowledged in the Commission communication of 15 April 2011 to the European Parliament and the Council: Towards Robust Quality Management for European Statistics. This communication draws attention to the high dependence of the quality of European-level statistical information on the appropriateness of the entire production process. Eurostat therefore promotes a system of harmonised accruals-based accounting standards, consistent with the ESA, for all entities of the government sector. IPSAS is currently the only internationally recognised set of public-sector accounting standards. It is founded on the international financial reporting standards (IFRS) widely applied by the private sector and at this point consists of a set of 32 accruals accounting standards, plus one cash-based standard. It is in this light that Article 16(3) of Directive 2011/85/EU requires an assessment of the suitability of IPSAS for the Member States (Christiaens & Reyniers 2009).

As noted above, IPSAS is currently the only internationally recognised set of public sector accounting standards. It stems from the idea that modern public sector management, in line with the principles of economy, effectiveness and efficiency, depends on management information systems that provide timely,
accurate and reliable information on the financial and economic position and performance of a government, as would be the case with any other type of economic entity.

However, despite recognition of the high value of IPSAS, no Member State has implemented it in full.

Taking into account the views that Member State authorities and others put forward in the public consultation, the overall conclusion is twofold. On the one hand, it seems clear that IPSAS cannot easily be implemented in EU Member States as it stands currently. On the other, the IPSAS standards represent an indisputable reference for potential EU harmonised public sector accounts. The following concerns will need to be addressed (International Public Sector… 2015):

– currently, the IPSAS standards do not describe sufficiently precisely the accounting practices to be followed, taking into account that some of them offer the possibility of choosing between alternative accounting treatments, which would limit harmonisation in practice;

– at its current state of development, the suite of standards is not complete in terms of coverage or its practical applicability to some important types of government flows, such as taxes and social benefits, and does not take sufficient account of the specific needs, characteristics and interests of public-sector reporting. A major issue is the capacity of IPSAS to resolve the problem of consolidating accounts on the basis of the definition used for general government, which is now a core concept of fiscal monitoring in the EU;

– at present, IPSAS can also be regarded as insufficiently stable, since it is expected that some standards will need to be updated once work is completed on the current project of completing the IPSAS conceptual framework; and

– at present, the governance of IPSAS suffers from insufficient participation from EU public-sector accounting authorities. Any reform should ensure that the independence of the standard-setting process is strengthened, while public-sector-specific needs are effectively addressed. In addition, the IPSAS Board currently seems to have insufficient resources to ensure that it can meet, with the necessary speed and flexibility, the demand for new standards and guidance on emerging issues in the evolving fiscal climate, particularly in the wake of the crisis.

On the other hand, most stakeholders agree that IPSAS would be suitable as a reference framework for the future development of a set of European Public Sector Accounting Standards, referred to below as “EPSAS” (International Public Sector… 2015).

EPSAS would give the EU the capacity to develop its own standards to meet its own requirements with the requisite rapidity. It would offer a set of harmonised accruals-based public-sector accounting standards, adapted to the specific requirements of EU Member States, that could be implemented in practice. The EU-wide implementation of EPSAS would dramatically reduce the com-
plexity of methods and compilation processes used to transform these data onto a quasi-harmonised basis and minimise risk as regards the reliability of the data notified by Member States and published by Eurostat. It can be envisaged that the first step would be to establish EU governance for this project with the objective of clarifying the conceptual framework and the aim of instituting common EU public sector accounting. EPSAS could initially be based on the adoption of a set of key IPSAS principles. EPSAS could also use IPSAS standards that were commonly agreed by Member States. EPSAS should, however, not regard IPSAS as a constraint for the development of its own standards. However, it should be noted that drawing up a set of harmonised European Public Sector Accounting Standards would not in itself guarantee timely and high quality public accounting data. Additional conditions would have to be met, including (Towards Implementing… 2013):

- strong political support and joint ownership of the project,
- public administrations capable of running a more complex accounting system in each individual public entity,
- integrated IT systems for budget, payment, contract management, double-entry book-keeping, invoice management and statistical reporting,
- timely reporting (e.g. monthly) of all economic events in the integrated accounting system of the public entities,
- availability of resources, human and modern IT, and
- effective internal control and external financial audit of public accounting.

For all Member States, but in particular those that currently use only cash accounting, the implementation of EPSAS accruals accounting would be a major reform. Some of the issues that would arise include (Towards Implementing… 2013):

- conceptual and technical accounting issues,
- staff and consultant expertise, training skills,
- communicating with and educating managers and decision-makers,
- liaison with, and training of, auditors,
- adjustment or modernisation of IT systems, and
- adapting the existing national regulatory frameworks.

If the principle of EPSAS were adopted, the Commission could envisage providing assistance in some of these areas, for instance by playing a role in organising the sharing of training and expertise, assisting Member State governments on conceptual and technical matters, or coordinating and sharing the planning of Member States’ public accounting reforms.

If a Member State had significant and evident gaps, weaknesses and inconsistencies in its public financial management information systems, it would be appropriate to consider these in plans to implement EPSAS and this would have to be reflected in the implementation timetable.
The establishment of the EPSAS governance structure would be guided by, but not follow exactly, the model used by the Commission in establishing the governance of IFRS in the EU context, because of the specificity of the public sector and the focus on intra-EU comparability. It should seek to use, where possible, the experience and expertise of national public-sector accounting governance structures in the Member States.

Nevertheless, EPSAS would need to establish and maintain close links to the IPSAS Board in order to inform its agenda and decision-making and because EPSAS standards may need to differ in some cases from IPSAS standards. It would be important not to create unnecessary divergence between EPSAS and IPSAS, and between EPSAS and IFRS, given that government-controlled entities may already be required to report on an IFRS basis or according to national commercial accounting standards.

EPSAS should also be developed with a view to minimising differences with the ESA, in order to give the perspective, ultimately, of complete integrated systems applicable at micro and macro levels.

3. Public Sector Accounting and Financial Reporting System Reform in Lithuania

In 2005, Lithuania began its Accounting and Financial Reporting System Reform (hereinafter – accounting reform) in the public sector including budgetary bodies, State social insurance funds, other reserve funds, tax funds, controlled healthcare public bodies, State and municipalities as separate legal entities. The aim of the accounting reform was to transition the public sector to accruals-based accounting starting in 2010 (Bikienė 2011).

The implementation of the accounting reform required the drawing up of new public sector accounting and financial reporting standards, model accounting manuals, plans of accounts, consolidation manual, recommendations for individual groups of public sector entities; harmonisation of legislation with the intended requirements of accounting standards; the analysis of information systems and software used for the management of accounting in the public sector; as well as the formulation of alternative optimisation solutions for IT systems and software in the public sector.

During the implementation of the accounting reform as well as during the enforcement of the Law on Public Sector Reporting, 26 standards on public sector accounting and financial reporting were drawn up. Provisions of some of the standards were supplemented and/or specified taking into consideration remarks and recommendations of public sector entities, which had started applying new standards in 2009, shortcomings found in the submitted financial accounts, ques-
tions presented by public sector entities, as well as non-conformities identified during the development and introduction of the design of the information system for consolidation of financial accounts in public sector entities (Bikienė 2011).

A new accounting information system for the management of the State treasury accounting was introduced; and State treasury processes concerning the financial management and accounting were described and optimised. An information system for the consolidation of public sector accounting and accounts is currently being introduced.

All of these developments are a huge challenge and responsibility both for internal audit and external audit, as well as for public auditors. Proceedings of the reform (Muckutė 2013):

1) I stage (2005–2008) – The Concept Paper of the Reform was approved in 2005. Related legal acts, NPSAS, instructions prepared:
   - Public Sector Accountability Law (2007),
   - 26 NPSAS based on IPSAS,
   - unified chart of accounts,
   - accounting manuals,
   - feasibility study of IT systems preparation,
   - training;

2) II stage (2009–2015) – standardisation and consolidation:
   - standardised accounting IT system in 150 public sector entities (2009–2011),
   - centralised accounting IT system for public sector consolidation (2009–2011),
   - help desk in the Ministry of Finance (since November 2010),
   - additional training, consultations, seminars for public sector accountants,
   - The First State Consolidated Financial Statements for 2010 – on 1 October 2011,
   - The First National Set of Financial Statements (State, municipalities, Social Funds) for 2012 – supposed on 30 June 2013.

Lithuania has been one of the front-runners in kick-starting the transition to IPSAS, with consolidated financial reports on both state and municipal levels being prepared based on these new accounting standards since 2010. The switch to this new system of financial reporting has been a big challenge and required precise and intensive preparation and coordination (Public Sector in Transition…2014).

Partly, this is because the reforms did not encompass merely a change of accounting principles but also aimed to increase the effectiveness of the accounting function itself. With this in mind, policy-makers at both central and municipal levels began working on the reforms five years before they were implemented. This preparatory phase included pilot programmes by several public sector organisations, as well as the development of regulations, detailed accounting manuals
and instructions for transition. There was also extensive training for public sector accountants and the completion of standardised IT solutions and automated accounting related transactions. Another key initiative was the implementation of a centralised IT solution for national financial statements for more than 4,000 public sector organisations (Public Sector in Transition… 2014).

Given the far-reaching nature of these activities, it is perhaps not surprising that it did not prove to be a painless transformation process. The reforms, which demanded changes in the qualifications of all public sector accountants and initially resulted in greater workload, were treated with a high level of resistance at first. Although strong political support and firm leadership from the Ministry of Finance were crucial in ensuring their successful implementation, there was still a delay of one year from the original launch date. This was primarily due to a lack of preparation by a number of separate public sector organisations.

Now, though, the new system is firmly in place and there have already been two cycles of financial statements based on IPSAS. And to safeguard the reforms in the future, the Ministry of Finance is now focusing on amending and improving standards and other regulations. It is also deploying ongoing support to a call center set up to deal with IPSAS-related enquiries and delivering onsite training and consultations to steadily improve the quality and consistency of financial data.

Implementation of these reforms has been only one step in the transformation of public financial systems, however. In order to maximise the potential advantages of this new system, a country needs to have a consistent vision on public finance reform as a whole, in both the short and long term. Having implemented IPSAS, Lithuania has strengthened the qualification of public sector accountants and moved toward optimising the IT systems used for its government accounting. Although the process is ongoing and the country still faces many challenges, the successful implementation of IPSAS has given the country a crucial head start toward achieving long-term public finance excellence and efficiency.

4. Conclusions

Public finance management has become one of the hottest topics in developing countries and developed economies, especially given the ongoing challenges surrounding fiscal sustainability and the debt crisis. With accountability and transparency increasingly perceived as key elements of sustainable public finance management, international public sector accounting standards (IPSAS) are now viewed as one of the key measures for obtaining transparent, comparable and complete financial information. Lithuania has been one of the front-runners in kick-starting the transition to IPSAS, with consolidated financial reports on both
state and municipal levels being prepared based on these new accounting standards since 2010. The switch to this new system of financial reporting has been a big challenge and required precise and intensive preparation and coordination. Remaining reform challenges are as follows:

- optimisation of accounting and financial reporting function,
- establishment of competence centres,
- encouraging the use of financial statements amongst management of public sector entities,
- analysis of the information in financial statements,
- interrelation to budget execution and statistical reporting,
- long-term fiscal sustainability planning.

Bibliography


Towards Implementing European Public Sector Accounting Standards (2013), Eurostat, May.
Reforma systemu rachunkowości sektora publicznego na Litwie
(Streszczenie)

Unia Europejska od dawna boryka się z problemem harmonizacji standardów rachunkowości w sektorze finansów publicznych krajów członkowskich. W celu poprawy efektywności oraz skuteczności zarządzania finansami publicznymi, zgodnie z wymogami UE, konieczne stało się wykorzystanie zasady memoriałowej do ewidencji operacji rachunkowych dokonywanych w sektorze publicznym.

Celem opracowania jest analiza reformy rachunkowości budżetowej realizowanej w nowym kraju członkowskim strefy euro – na Litwie. Należy zauważyć, że sukces Litwy w zakresie wdrażania standardów rachunkowości budżetowej może być przykładem dla wielu krajów rozwijających się.

Słowa kluczowe: rachunkowość sektora publicznego, zasada memoriałowa, zarządzanie finansami, Litwa.