

AN OVERVIEW OF ACCRUAL ACCOUNTING REFORMS IN NEPAL

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1. The Nepalese Public Sector Accounting Context

Public financial management (PFM) cycle incorporates major four areas - budgeting, accounting, reporting and auditing. Accounting plays a central role in connecting the remaining three areas and achieving the goal of PFM in terms of enhancing transparency and accountability. In the last three decades, particularly with the rise of ‘New Public Management’, changes in public sector accounting have drawn an increasing attention across countries (Van Helden et al., 2021; Kuruppu et al., 2021; Polzer et al., 2021). Nepal is certainly not an exception. Indeed, the scope of the public sector varies across countries, but the Nepalese public sector is made up of embedding

the general government and public corporations. The general government includes governments at all three tiers - federal, provincial and local, whereas public corporations include both financial and non-financial corporations, the majority of which are state-owned enterprises.

The cash basis of accounting has been in operation in Nepal since the 1960s. However, over the years, some noticeable changes have been undertaken to improve the accounting practice and promote accountability. For instance, the application of Information Technology has been significantly increased across public entities both in the recording and reporting of transactions. An accounting manual and charts of accounts have

been developed following the Government Finance Statistics Manual (GFSM) 2014, and Nepal Public Sector Accounting Standard which corresponds the Cash Basis International Public Sector Accounting Standard (IPSAS) have been enforced for reporting across central level agencies. In addition, advanced software applications such as the treasury single accounts (TSA) and the Electronic Fund Transfers (EFT) have been put in force. These reforms introduced in Nepal reflect ongoing trends in international public sector accounting (Polzer et al., 2021; Kuruppu et al., 2021). Some of the notable Public Financial Management (PFM) reforms introduced in Nepal in the last few years, include, among others;

- Enactment of the Federal Financial Procedure and Fiscal Accountability Act, 2076 (Rules also enacted),
- Development and implementation of revised accounting forms and formats,
- Implementation of the Line Ministry Budget Information System (LMBIS), the TSA and the Risk Management Information System (RMIS) at the federal and provincial levels,
- Expenditure (appropriation accounts) accounting through the CGAS from 2020,
- Development and amendment (second) of the Charts of Accounts (COA), 2074,
- Introduction and implementation of SuTRA for budgeting and accounting of local governments,
- Introduction of the Debt Operation and Management Software (DOMS) for debt recording and accounting,
- Implementation of the Integrated Internal Control Framework,
- Implementation and further revision (ongoing) of Nepal Public Sector Accounting Standard,
- Development of a manual for Public Assets Management,
- Further study on the Integrated Financial Management Information System (IFMIS) (on progress), and
- Professional accounting training and courses to selected accounting cadres.

Despite these advancements, the integration of these reforms and application of new technologies in practice has remained relatively poor, and this has continually raised concerns about transparency and accountability. In particular, changes to the accounting systems

through the adoption of accruals have continually proved to be a challenging issue. The aim of this paper is to discuss some of the benefits of accrual accounting and underlying challenges in its implementation. Next, the paper discusses how the Government of Nepal should approach to accrual accounting and engender its propagated benefits, i.e., the effective use of resources and improved accountability.

2. Cash Basis Accounting in Nepal

The existing cash-basis accounting system of Government of Nepal was institutionalized during the 1960s. In an article published in the Accounting Historians Journal, Adhikari and Mellemvik (2009) provide all details relating to the introduction of cash accounting and its dissemination across public entities. Donnalley (1967, p. 2) states that the introduction of cash accounting was a four-year joint project launched by the USAID and the Government of Nepal. Based on the report submitted by Donnalley to the Government of Nepal, the following activities were undertaken during the project period (see Adhikari and Mellemvik, 2009, p. 126; Donnalley, 1967, p. 2);

- Implemented the new accounting system (cash accounting) in twelve out of the fourteen zones of Nepal,
- Offered training to 4565 accountants and officers through in-service training classes,
- Facilitated the dispatch of accounting supplies and equipment to government officers in twelve zones,
- Published and distributed the manual of expenditure accounting, the handbook of property accounting and guidelines for purchase procedures, and
- Made available the first English-Nepali financial dictionary

At the beginning of the new century, the World Bank started a country financial accountability assessment, as part of improving the PFM system. Of the recommendations incorporated in the assessment report, one was particularly focused on accounting, emphasizing the importance of considering the adoption of international public sector accounting standards and accrual accounting (Adhikari and Mellemvik, 2011). The World Bank in 2006 conducted another study comparing the existing international public sector accounting and auditing standards in Nepal with those of international standards. This was part of a wider South Asian project. In the report, areas were highlighted in which the existing cash

accounting system was incompatible with the Cash Basis International Public Sector Accounting Standard (IPSAS), along with some striking limitations of the existing system in terms of accommodating off budget transactions and direct payments and grants offered by donors (Adhikari and Mellemvik, 2010). A key recommendation provided to the government was to take a step towards the adoption of the Cash Basis International Public Sector Accounting Standard, as part of a longer-term goal to embrace the accrual basis of accounting. Following this recommendation, the Accounting Standards Board started developing Nepal Public Sector Accounting Standard corresponding to the requirements laid down in the Cash Basis IPSAS. All central level agencies have now started preparing their consolidated statements following the Nepal Public Sector Accounting Standard (NPSAS), and currently the NPSAS is undergoing a revision so as to reflect the changes introduced to the Cash Basis IPSAS by the IFAC in 2017.

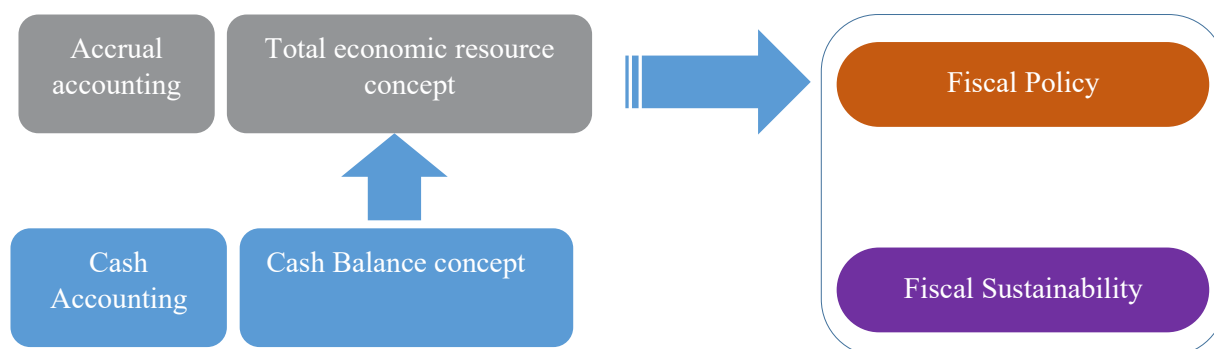
As is the case in other countries (Kuruppu et al., 2021), discussions about the extent to which accrual accounting is important in Nepal and whether the country has the capacity to implement accrual accounting continue to have continued in Nepal. The simplicity of cash accounting has been acknowledged, but whether the cash accounting can meet the information requirement of the government and other users has been an important part of the discussion. In fact, such discussions are not new in the Nepalese context. Nepal is perhaps a country in the developing world, which has been reckoned to be at the forefront in terms of taking initiatives towards accrual accounting. Nepal's journey towards accrual accounting has been explained in detail in the study conducted by Adhikari and Mellemvik in 2011. The study shows that the importance of accrual accounting was initially mentioned in Nepal during the 1980s having experienced challenges in implementing the planning and program budgeting (PPB). One issue raised in favor of accrual accounting was that it would allow the government to identify the full costs of development projects and programs and help demonstrate their performance and results. The same study conducted by Adhikari and Mellemvik (2011) also mentions the accounting reform project set up by the government in the late 1980s. Although the report of this project was not made publicly available, Adhikari and Mellemvik (2011) state that the project team emphasized the importance of introducing some forms of accruals, in particular the simple form of accruals which could recognize government receivables and payables. The project team also developed accounting codes,

classifications and formats to support the simpler forms of accruals, and the plan was to pilot these new accounting measures in some selected development projects. No evidence is available, whether this pilot took place, and any results produced.

However, apart from these historical events, some initiatives have been undertaken by the Financial Comptroller General Office (FCGO) and the Ministry of Finance (MoF) more recently, which could be important in a transition towards accrual accounting in the longer-term. For instance, in 2017, the 'Charts of Accounts' were revised accommodating the evolving federal context, and the integrated chart of accounts have been issued complying with the IMF's GFSM 2014. The GFSM 2014 recommends governments to develop and disseminate fully integrated flows and stock positions recorded on an accrual basis together with the cash flow data with a view to assessing their liquidity position. In 2020, the Federal Financial Procedure and Fiscal Accountability Act and rules have been enacted, which incorporate some basic elements of accrual accounting. The ongoing IFMIS and the training needs assessment launched by the PEFA Secretariat (TNA study) through the support of the MDTF is also reckoned to be an important step towards accrual accounting. Some of the key achievements made towards adopting accrual accounting in the last few years are as follows:

- The federal Financial Procedure and Fiscal Accountability Act, 2076, has included provisions to adopt and implement accrual accounting. Provincial and local governments have set up similar provisions in their respective Financial Procedure Acts,
- Clause 1.1.1 of the Government Accounting Manual, 2073, mentions that government will migrate to accrual accounting,
- The 56th Annual Report of the Auditor General (point 12.5) includes the recommendation for a transformation of cash to accrual, and the importance of accrual accounting has been outlined also in the 57th and the 58th Annual Reports,
- It is clearly mentioned in the 'Chart of accounts of Nepal, 2074 (Second amendment)' that these are developed with an intention to implement accrual accounting in all three tiers of government.

Some evidence is available showing that some levels of governments have already started practicing simple forms of accrual accounting. For instance, Butwal Sub-



Metropolitan City has been applying accrual accounting since 2002, and the city is considered to be as one of the early adopters. Bharatpur Metropolitan city has also started implementing accrual accounting and the city has clearly indicated in its annual plans and policies about its intension to adopt accrual accounting.

3. Benefits of Accrual Accounting

In accrual accounting, transactions are recognized as the underlying economic events occur, regardless of the timing of the related cash receipts and payments. To what extent accrual accounting serves public interests and promote accountability has continued to trigger academic discussions. Despite this, several benefits of accrual accounting have been highlighted by the IFAC, international organizations such as the World Bank and the IMF and the accounting profession. For instance, a key argument for accruals concerns that it will supply comprehensive and reliable information on public finances and provide a basis for improved financial control of government activities.

In particular, the IPSASB (2010) has commented extensively on the benefits of accrual accounting for public sector entities in its study 14. For instance, in page 12 of the report, it is mentioned that the reporting on an accrual basis of accounting will allow the users to;

- Assess the accountability for all resources the entity controls and the deployment of those resources,
- Assess the financial position, financial performance, and cash flows of the entity, and
- Make decisions about providing resources and doing business with the entity (p. 12).

In addition, the report includes the benefits at a more detailed level, including the way entities financed their activities and met their cash requirements, as well as entities' ongoing ability to finance their activities and settle their liabilities and commitments. Considering these benefits, the adoption of accrual accounting may benefit the Government of Nepal in several areas, including:

- Determining the actual costs of ongoing projects,
- Identifying and valuing government's assets,
- Calculating the cost-of-service delivery and the efficient use of public resources,
- Implementing sound fiscal policies embedding quasi-fiscal activities and entities,
- Undertaking a rational decision on debt management and financing
- Identifying the impacts and contributions of international grants to the economy, and
- Launching a sound forecasting mechanism and improving treasury management

Given the careful adoption of accrual having adequate planning and commitments, accrual information may also help the government executive sustainable financial policies and pursue the principle of intergenerational equity.

4. Challenges in Implementing Accrual Accounting

Implementing public sector accounting reforms is challenging. Studies show that for the successful implementation of reforms, political wills and commitments are of paramount important (Kuruppu et al., 2021). Reforms are costly and there is involved an element of risk that both the reform process and enthusiasm may wane along the way. As

experienced in many Western countries (Polzer et al., 2021), implementing accrual accounting is even more challenging as it requires not only advanced technologies and human capital, but also a paradigm shift by shifting a focus on managing resources and engendering results and outcomes. Equally important is to educate users, including the citizens, for the use of accrual information and constantly evaluate the performance of the government and its long-term sustainability. In many Western countries, politicians and other users have been blamed for disregarding accrual information and continue relying on budgetary information both in decision-making and discharging accountability (Van Helden et al., 2021). The importance of promoting public sector accounting education both at schools and university levels is globally acknowledged.

In the context of developing countries, it is generally agreed that the reforms should be introduced incrementally, having assessed the available infrastructure, local practice and education level. For instance, in their recent study of public sector accounting in Sub Sahar Africa, Jayasinghe et al., (2021) have illustrated how the existing local practices, which appear to be much profound that the recommendations made in the Cash Basis IPSAS, are marginalized favoring large scale reforms such as accrual-basis IPSASs. As a result, a number of studies conducted in Africa show that instead of improving governance, economy and accountability, those large-scale reforms have triggered corruption and promoted patronage politics (Polzer et al., 2021). What is important is therefore to strengthen the existing system and pursue incremental changes rather than going for large-scale internationally propagated public sector accounting reforms. Following Schick (1999), few issues which should be settled prior to a transition towards a full form of accruals include:

- Creating environment to demand and support performance prior to introducing performance or outcome budgeting,
- Controlling costs prior to seeking the control of outputs,
- Strengthening the use of cash accounting before complementing and substituting it with accruals,
- Establishing and reinforcing the internal control mechanisms before introducing managerial accountability,

- Operating a reliable accounting system before installing an integrated financial management system,
- Introducing the budget for outputs before focusing on outcomes, and
- Ensuring effective financial auditing before moving to performance auditing.

Given these recommendations, governments in developing countries may need to adopt a rational approach towards reforms, first by refining the operation of the existing cash basis accounting and then only instigating a step towards a simpler form of accrual accounting.

5. Prospects of Accrual Accounting in Nepal

In the context of Nepal, the adoption of a simple form of accrual accounting disclosing at least current fiscal resources and current liabilities could be a rational approach to improving the existing accounting practice and accountability. Many reforms, for instance a Treasury Single Account and the NPSAS, triggered by the Government of Nepal in the last few years offer a good foundation for the introduction of a simple form of accruals. However, any such reforms should be carefully planned through the involvement of wider stakeholders, such as the ICAN, the OAG, the ASB, development partners and other users' groups. Politicians and other users should be made aware of the benefits of having accrual accounting in place, as well as the importance of accrual information in achieving sustainable development of the country.

Study 14 of the IFAC/IPSASB could provide important guidance in this regard. Adhikari and Mellemvik (2011) have in their study clearly outlined the fact that it is unlikely that accrual accounting or any other advanced public financial management reforms would be implemented in Nepal without recognizing the preconditions associated with these reforms and adequately addressing these conditions. Next, without promoting education and training on public sector accounting, it is rather challenging both to implement the reforms and engender the intended results. The government should therefore develop a reliable capacity development strategy, involving the training institutions such as the Public Financial Management Training Center (PFMTC), the Nepal Administrative Staff College (NASC), and the Provincial Center for Good Governance (PCGG). There is also a need for introducing changes in the education curricula by involving the ICAN, the ASB and the

AuSB, and universities, as part of promoting public sector accounting education at different levels. The implementation of the IFMIS system could also help trigger a smooth transition towards a simpler form of accrual accounting. In another study of Nepal's government accounting, Adhikari and Jayasinghe (2017) emphasize the important of revisiting the existing budgetary focus and the role of government accountants prior to implementing reforms. For instance, they argue that reforms would be difficult to execute without changing the emphasis on budget, as well as the agency of government accountants and other users which are constructed on the day-to-day budget practices. This requires a cultural shift prior to implementing reforms. Rather than rushing to reforms, the government is therefore recommended to get engaged with discussions with stakeholders, researchers, accounting practitioners, professionals, and development partners and develop a realistic strategy and timeframe for a transition towards a simpler form of accrual accounting.

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