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New development: The development of standardized charts of accounts in public sector accounting

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IMPACT

Charts of Accounts (CoAs) in the public sector are important to control accounting records. They support the preparation of accurate and reliable financial statements and consolidated reporting. Standardized CoAs at the national level are desirable but specificities of different public sector areas must be considered, as well as harmonization with budget and Government Finance Statistics (GFS) classifications. Having broad international guidance for each country to develop its own CoA, while fostering public sector financial reporting harmonization, would allow for improved comparability of fiscal effects during difficult periods, such as the Covid 19 pandemic.

ABSTRACT

This article addresses the development of standardized Charts of Accounts (CoAs) in public sector accounting and reporting. In particular, it focuses on matters concerning the role CoAs have, or should have, at a national level, their main technicalities and the expected impact of using them as a bookkeeping instrument on the accuracy of accounting records and, ultimately, on the reliability and usability of the financial information for different purposes. Empirical evidence is provided from a survey to representatives of accounting international and national (Belgium, Brazil, Estonia and Portugal) standard-setters and preparers.

KEYWORDS

Accounts codes; accounting records; budget classifications; comparability; consolidated reporting; GFS classifications; harmonization; information reliability

Introduction

In recent decades, countries around the world have embarked on public sector accounting and financial management reforms. This movement embraces a global trend to introduce accrual accounting (some countries adopting the IPSASs), closing the gap with business accounting, while at the same time striving for increasing global harmonization of financial reporting in the public sector (Brusca & Martínez, 2015; IFAC/CIPFA, 2021; Polzer et al., 2022).

As an integral part of harmonizing public sector accounting practices and reporting, Charts of Accounts (CoAs) are vital enablers. For example, the European Commission released an EPSAS issue paper exploring national approaches to the harmonization of CoAs (EUROSTAT, 2017). The issue paper examined the opportunities and challenges with regards to the harmonization of CoAs in at least three EU member states. EUROSTAT argued that a CoA at the national level (i.e. across levels of government) would underpin harmonized accounting rules and language, and that a standardized CoA might improve the accuracy of accounting records, increasing comparability, overall reliability, and the quality of financial reporting. It would also facilitate the consolidation process and consolidated financial statements. Global financial institutions, like the IMF (2011), have also examined the role of CoAs. They suggest that CoAs have a 'symbiotic relationship' with the structure of the budget, in particular the budget classification. As such, a mistake in designing a CoA could have a long-lasting impact on the ability of the public financial management

(PFM) system to provide appropriate financial information for key decisions.

IPSASs do not provide guidance for a CoA. However, some countries with public sector accounting systems converging with IPSASs (for example Belgium, Brazil, Estonia, Greece and Portugal) have developed national standardized CoAs (EUROSTAT, 2017).

Recent global crises, for example the Covid 19 pandemic, have impacted governments with major fiscal consequences. A re-focused emphasis is urgently needed on the importance of having reliable, transparent and comparable accounting and financial reporting, including through the appropriate structuring of public sector accounting systems.

Whether a CoA would, in fact, facilitate all this requires further discussion. This article aims to contribute to this debate by examining the development of nationally standardized CoAs in public sector accounting and reporting.

The development of charts of accounts in public sector accounting

In general terms, CoAs are organized lists of account titles and corresponding numerical coding structures, which are used to record such financial data as revenues and expenses, as well as to describe the assets and liabilities making up the ledger system. They are important 'for classifying, recording and reporting information on financial plans, transactions and events in a systematic and consistent way', and their scope and content should be defined and maintained 'to support the needs of various users/stakeholders' (IMF, 2011, p. 3).

According to Moura et al. (2012), a CoA should be structured through accounts that express the financial items in both a qualitative way (by the nature of the elements that compose the item, such as money, and property) and a quantitative way (expressing the components in value). Furthermore, it must comprise:

- The title of all necessary accounts and their arrangement in a system;
- The enunciation of the functions assigned to each of the accounts that make up the chart, also known as the 'accounts manual'; and
- The establishment of the routine of the records, developed by the management.

The role of CoAs in the process of working toward the harmonization of public sector accounting has not been examined in the literature despite the European Commission in 2013 stating, with regards to the adoption of IPSASs/EPASAs:

... the development of a new chart of accounts is a key step in the adoption of accruals accounting. A well-planned chart of accounts can assist in the efficient generation of financial information for a variety of purposes (European Commission, 2013a).

The CoA is considered to be the foundation for accounting information systems within public sector entities and governments. It is also seen as a tool to improve comparability, allowing for better consistency of accounting and financial reporting practices. Moura et al. (2012) explain that the preparation of a CoA in the public sector has the following main objectives: control, standardization of accounting records and consolidation of accounts, as well as disclosure of the entity's equity and its variations. Aiming at producing standardized reports, the CoA enables the generation of information that effectively contributes to decision-making, namely by public managers, and to accountability, allowing the general public to monitor the management of public entities.

By using a CoA, financial data can be uniformly sorted and aggregated into operating classifications, such as product lines, cost centres, operational functions, or other categories specific to a particular organization. Therefore, some literature highlights the use of uniform CoAs as a foundation for cost accounting, allowing, in areas like public health activities, information on cost and benefits, uses and outcomes accruing from public health system subsidies, to be used for planning and analytic aims (Honoré et al., 2015). Moreover, such literature also underlines how the lack of uniformity in CoAs makes it difficult to compare systems and programmes (Cartwright, 2008).

In turn, the IMF (2011) has explicitly stated that 'it is possibly the most critical element, or lynchpin, of a well-functioning PFM system' (p. 1). Therefore, the IMF sees the CoA as crucial for effective budget management, including tracking and reporting on budget execution.

Governments and public sector entities have been using uniform CoA for budgeting purposes for many years, often taking as reference budget classifications from international organizations (for example, the IMF). Besides budgetary reporting, governments also prepare their National

Accounts following standardized accounts classification for financial statistics, based on systems of national accounts adopted internationally, such as the United Nations' System of National Accounts (SNA) or the European Union's European System of Accounts (ESA). The extension of PFM systems to include accrual-based financial accounting and reporting requires CoAs for financial accounting to be harmonized, at the least, at a national level.

Uniformity at the country level would allow standardization of processes and the comparison of financial statements, facilitating the production of consolidated accounts. However, one of the main challenges in that respect is that the task of aggregation or consolidation of accounts in a comprehensive manner is rarely attempted in most countries' public sector accounting. On the other hand, several countries prepare aggregated and consolidated budgets and budgetary reporting, with variations and some considering different levels of government. The efficiency of this process would be improved with standardized budget classifications. Furthermore, countries consolidate accounts for statistical purposes, where well-designed CoAs support compilation of Government Finance Statistics (GFS), because the discussion on uniformity has particularly focused on this type of consolidation.

However, at the national level, an important unresolved issue is reconciliation between accounting, budgeting and statistics accounts (European Commission, 2013b). Several countries resort to bridge tables in order to reconcile. This need for reconciliation calls for uniformity in CoAs to track the transactions between budgeting and accounting, and ultimately with statistical reporting, and in so doing, supporting the understanding of the relationships between these reporting systems (Dabbicco & Mattei, 2021). Accordingly, the development of sufficiently detailed CoAs from a preparer's perspective is a key aspect in linking accounting and budgeting systems. This link may be supported by CoAs in collating elements of expenditures, tracking specific transactions and analysis of costs at all levels, and also for specific sectors (Caruana & Dabbicco, 2022).

Other important challenges in the adoption/adaptation of COAs in the public sector are usually time and the complexity of the process (involving many, often diverse, entities), and the break in temporal series from the changeover process. Harmonization itself depends heavily on the time spent on correct classification and mapping of accounts/elements, which can be difficult with a large number of them and a large number of entities.

All in all, the literature indicates that attention has been paid to issues with and the development of CoAs, focusing on their structure, technical aspects and purposes. However, the perspectives of those mainly involved in their development, namely accounting standard-setters and preparers of financial reports, must be considered to explore how CoAs could further develop on a sound basis. While international standard-setters only consider offering general guidance (EUROSTAT, 2017), national accounting standard-setters and preparers may need to reflect on the development of a uniform CoA in each country (European Commission, 2013b).

Developing standardized charts of accounts in the public sector—empirical findings

In order to gather empirical evidence on the role of standardized CoAs in public sector accounting, a survey was carried out in 2019. The survey was sent to potential developers of CoAs: international (IPSASB), European (Eurostat for EPSAS), and national standard-setters and some preparers of financial reports at the national government level in four countries. The selected countries were Belgium, Brazil, Estonia and Portugal, which, due to their national accounting practices and traditions, have developed nationally harmonized CoAs (applied throughout the whole of public sector), while adapting their public sector accounting systems to IPSASs. Most countries develop a level of detail in the classification/coding of accounts up to five digits at least.

The survey comprised 11 main questions, operationalized using the LimeSurvey tool and a link sent via email. The target included 15 respondents, and 10 of them responded.

The major reasons for developing a standardized CoA in public sector accounting pointed out by all respondents related to:

- *Issues concerning the standardization of accounts and accounting practices.* A common and standardized accounts structure for a whole country was considered by all respondents to be fundamental to allow uniform accounting records and practices, the establishment of accounting routines, and facilitating the development of appropriate IT and controlling systems. However, there was a perceived need for entities to attend to their specificities, reflecting the necessity for special arrangements for some areas of the public sector.
- *Facilitating the accounting records and the preparation of financial statements.* A standardized CoA supports obtaining consistent and comparable data for financial statements. A combination of the needs for a uniform, but tailored, basis for consolidating data in financial statements, and the analytical elaboration of accounts in the CoA, would allow tracking specific transactions for specific groups of public sector entities, and better identifying transactions, including those to be eliminated within consolidated accounts.
- *Facilitating the production of both consolidated accounts and Whole of Government Accounts (WGA).* In general, respondents considered accounts standardization to be ideal. However, in practice there seems to be a major need to develop CoAs by countries, with more detailed standardized codes and procedures of accounts, in order to produce consolidated and WGA. Furthermore, it would be important to consider the relationship with CoAs used by public sector bodies, as well as business enterprises, as these should prepare financial statements for consolidation of data with their controlling entity.
- *Enabling the link to budgets and budgetary control, and compiling GFS (statistical reporting).* These advantages were mentioned by some respondents, as well as *the support CoAs give to cost accounting.* The link to budget classifications was a concern in all countries, mostly where budgets are still cash-based. Depending on the results of the analysis, options to have the same or

different accounts for budgeting and for presenting some transactions or situations (accounting/budgeting) were being considered. The possibility of linking to National Accounts/GFS, and even of aligning with them, were being considered particularly in EU countries using ESA2010, but not in Brazil.

Overall, a standardized CoA was acknowledged by respondents to be an important tool (or accounting technology) to improve accuracy in records and increase the reliability of information, supporting audit assurance, and reducing the cost of preparing financial reports. Understandability and comparability of information (including with the budget) were among other issues generally recognized to be facilitated by a CoA—standardization allows for traceability of transactions and improves information transparency. Respondents admitted that the CoA enables the bookkeeping system to be linked to various other dimensions of classifications in the accounts system—economic classification, functional statistical classification (COFOG) and other statistical classifications; and, more recently, for ‘green budgeting’ (European Commission, 2022). They agreed the CoA also facilitates control and auditing procedures.

Finally, respondents said that, in terms of public sector accounting, the CoA includes accounts specific for public sector transactions and to control off-balance sheet elements. The level of standardization of the CoA vis-à-vis the detail depends on the information needed by the jurisdiction where it is to be applied. Some customization was underlined by respondents from all the countries surveyed, as a requirement for specific cases, but a centralized root structure was highlighted as crucial in order to keep consistency.

Conclusion

Summing up, harmonized CoAs within countries make sense and the development of CoAs at the national level needs to embed specificities of public sector transactions and to link both to financial statement items and to the budget. The link to statistics is important for EU member states, where a common fiscal discipline is monitored using GFS figures. CoAs have a role in control, standardization of accounting records, and consolidation of accounts. Important broader statistical aspects were highlighted by our survey related to the level of detailed consolidation, and the integration of classifications. An important new role is emerging with respect to green budgeting.

However, a CoA standardized at EU level has not been pursued, as it would not allow enough flexibility for country circumstances; rather, the idea is to establish common principles or best practices to be followed by member states when developing their own CoA (European Commission, 2013b).

While the relationship between accounting, budgeting and GFS has been discussed in the literature (Caruana et al., 2019), at international level the discussion on the promotion of general guidance on CoAs, jointly with the statistical community, would be a research avenue to explore.

The current circumstances arising from the pandemic put further pressure towards public sector accounting reforms, notably on the need to consider the options to link budgeting and accounting (and GFS). Accurate financial

reporting on fiscal policies, sustained by a harmonized public sector accounting system, including appropriate CoAs at the national level, is of the utmost importance, in order to better organize accounting and budgeting, allow controlling the future fiscal effects, and better supporting PFM during challenging times.

A debate article by Cohen et al. (2021) highlighted how Covid 19 can be seen as an accelerator for public sector accounting reforms towards harmonized accrual-accounting, namely via IPSAS/EPAS—an opportunity missed in the aftermath of the 2008 financial crisis. Similar economic events and transactions should be recorded by the different countries following the same accounting standards, and according to the same public sector accounting paradigm. Another research need is how standardized CoAs at the national level, following broad principles within the IPSAS/EPAS framework, might improve reporting and accountability concerning the impacts of the pandemic on each country's financial performance and net worth.

Further research may be also necessary on the supporting role of technology, for example in connection to the tools used to consult, extract and organize the information from a database (for example, blockchain), with digitalization supporting and empowering the role of CoAs and of the accounting profession, potentially increasing transparency, strengthening accountability, and improving monitoring with full accessibility of data.

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