Public Governance Directorate

Financial Reporting in Ireland

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by

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The OECD Review of Financial Reporting in Ireland assesses opportunities and challenges associated with adopting accruals in Ireland for government accounting. Due to issues with the comprehensiveness and legibility of the current financial reports, the Review recommends that going forward, the Irish Government establish accrual financial statements compliant with international standards for its departments and offices and harmonise accounting standards used by entities within the general government sector. The report notes that accrual data would be a "building block" for richer, more reliable fiscal information, which would, in turn, help formulate improved assumptions for fiscal forecasts and be better equipped to identify fiscal risks. Beyond the adoption of accrual accounting, this report proposes that the Irish Government considers modernising its financial reporting framework by preparing integrated reports for departments and offices and consolidated financial statements. Integrated accounts for departments and offices would provide an overview of each department's resources and spending alongside information on their strategy and performance. This would enhance and improve scrutiny and examination of departmental performance by the Committee of Public Accounts and by the Oireachtas Sectoral Committees.

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Foreword

The OECD *Review of Financial Reporting in Ireland* builds on the experience and knowledge acquired by the Budgeting and Public Expenditures Division of the OECD Directorate for Public Governance over past decades through the meetings and workings of its Network of Financial Management and Reporting Officials.

The Review also draws upon the close collaboration between the OECD and the Irish Government, including the participation of Ireland in the OECD Working Party of Senior Budget Officials. This collaboration enriches the assessment and results of the Review of Financial Reporting in Ireland.

The aim of the Review is to assist the Irish Government in assessing opportunities and challenges associated with adopting accruals, the accounting basis used by a large majority of OECD countries, and more generally to provide recommendations for the modernisation of its financial reporting system.

This mission was organised in the broader context of the work underway in the European Union for developing a single set of harmonised accrual-based accounting standards.[1] This mission was organised with funding from the Structural Reform Support Programme (SRSP) and co-ordinated by Mr. Guilhem Blondy of the European Commission's Structural Reform Support Service (SRSS).

To write this report, two missions were conducted in Dublin in September 2018 and January 2019. During the first mission, interviews were held with key stakeholders of the Irish fiscal reporting ecosystem: representatives from the Government, Houses of the *Oireachtas*, Comptroller and Auditor General, Irish Fiscal Advisory Council, and the Central Statistics Office as well as think tanks and representatives of the accounting profession. During the second mission, the preliminary findings of the Review were discussed with representatives from the same institutions. The authors would like to thank the Irish stakeholders for their availability and openness to recommendations.

The missions benefited from the presence of two examiners from the United Kingdom (Mr. Ian Bulmer) and Portugal (Mr. Luis Viana). The authors would like to express their gratitude to them as well as to Mr. Guilhem Blondy for their invaluable inputs during discussions with Irish stakeholders and comments on the draft report.

This report was written by Ms Delphine Moretti, Scherie Nicol, Emeline Denis, all at the Budgeting and Public Expenditures division of the OECD Directorate for Public Governance, and Mr Tim Youngberry, OECD consultant. It reflects comments provided by delegates who attended the 19th Annual OECD Senior Financial Management and Reporting Officials Symposium.

Box 1. Accruals, accrual accounting and accrual budgeting

What does "accruals" mean?

The term "accrual" is associated with two related concepts.

Firstly, the recognition of economic events at the time at which they occur, regardless of when the related cash receipts and payments change hands. Economic events can include the delivery of a taxable service by a private company (for which the government accrues tax revenue), performance of a public service by a government employee (for which the government accrues a salary and perhaps a pension expense), or the loss or theft of a government asset such as a vehicle or equipment (for which a reduction in the asset stock will be recognised). These economic events may generate a corresponding or simultaneous cash flow, but in many cases – such as depreciation, revaluations, or impairment – they do not. This is an important difference between cash and accrual bases.

Secondly, the recognition of all stocks of assets and liabilities in balance sheets. Under accrual accounting, governments recognise all assets and liabilities including financial assets (such as equities), non-financial assets (such as land and buildings), and liabilities other than debt securities and bonds (such as payment arrears and pension obligations). These stocks are usually recorded at their current market value, or some approximation, and regularly revalued to ensure the balance sheet reflects the government's true financial position at a given point in time. Governments that follow pure cash accounting typically account only for their cash holdings on the assets side and, possibly, debt on the liability side of their balance sheets. These are often valued at or the value at which they were initially acquired or issued.

What is accrual accounting?

"Accruals" concepts are used for producing government accounting and statistics - that is the reporting of past activities of government – in a growing number of countries. Accrual accounting and accrual-based statistics are governed by standards, including those set by international standards setters (e.g. International Monetary Fund, or IMF, and Eurostat for statistical standards; International Accounting Standards Board, or IASB, and International Public Sector Accounting Standards Board, or IPSASB, for accounting standards).

What is accrual budgeting?

"Accruals" concepts are also increasingly applied to budgeting - that is firstly the forecasting of the future resources and costs of government activities and secondly the granting of the authorisation for spending of public funds. The principle of accrual budgeting is simple: it consists of forecasting economic events that will be generated by the government policies on an accrual basis and/or controlling the utilisation of those resources against the authorisation granted by Parliament on the same basis.

Accrual budgeting is developing and is not governed by international standards. Governments have therefore adopted different approaches for their accrual budgeting regimes. Some countries forecast assets, liabilities, expenses and revenue on accrual basis in their budget; while others do so only for revenues and expenses forecasted. Some countries using accrual budgeting continue granting authorisations for spending public funds on cash basis.

Source: Moretti and Youngberry (2018)

Executive Summary

The budget process in Ireland has undergone profound reforms during the last quarter of a century, particularly since the 2008 global financial crisis. Together these changes have facilitated fiscal consolidation, introduced medium-term planning, increased transparency, and allowed greater parliamentary and public participation in the budget process. However, by contrast, progress in the area of financial reporting has been limited.

The main purpose of the Irish Government's financial reports is to allow control and scrutiny of the regularity of government cash operations. In keeping with this objective, their format and content is fully aligned with those of the budget documents that they report against, in the sense that they use the same accounting basis (cash), nomenclature (Votes) and accountability boundary (the Exchequer).

Despite having recognised strengths, the Irish financial reporting framework is not fully aligned with the OECD Recommendation on Budgetary Governance, which advises that countries present a comprehensive account of public finances. Compared to other OECD countries, in Ireland, information on government assets and liabilities is very limited; time lags for publishing reports are among the longest in the OECD; and institutional coverage of the accounts is particularly narrow.

Interviews conducted for this review with a variety of stakeholders confirm that improvements to the financial reporting framework are considered necessary. Most stakeholders identify issues regarding the completeness, timeliness and comparability of the accounts prepared by the government that are mostly "technical" in nature. They also express more general concerns regarding the clarity and legibility of the accounts currently prepared at central government level.

Preparing accrual accounting information compliant with international standards; harmonising accounting standards used by entities within the general government sector; and implementing a "faster closing" initiative for Government departments and offices, funds and State bodies are possible solutions to address these concerns, while being cognisant of the need to maintain the core elements of the existing cash basis framework.

The report notes that accrual data would be a "building block" for richer, more reliable fiscal information. Having reliable information on liabilities, provisions and contingent liabilities would help formulate improved assumptions for fiscal forecasts. Implementing accrual accounting enables governments to be more conscious of fiscal risks and better equipped to mitigate them. This in turn can help better planning and risk management for any future fiscal shock.

Further, the quality of fiscal statistics required for reporting under the EU's economic governance framework is linked to the quality of underlying accounting data. To reliably assess how Ireland performs against these fiscal targets defined on an European System of Accounts 2010 (ESA2010) basis, it is crucial to maintain both government accounts and fiscal statistics on an accrual basis.

Beyond the adoption of accrual accounting, this report proposes that the Irish Government considers modernising its financial reporting framework by preparing integrated reports for departments and offices and consolidated financial statements. Integrated accounts for departments and offices would provide an overview of each department's resources and spending alongside information on their strategy and performance. This would enhance and improve scrutiny and examination of departmental performance by the Committee of Public Accounts and by the *Oireachtas* Sectoral Committees.

Consolidated financial statements would provide a complete picture of Ireland's underlying fiscal position, regardless of whether activities are carried out through a Vote, fund or State body. The report also notes that, within consolidated financial statements, certain government activities (e.g. health) could also be presented as "segments", allowing readers of financial statements (or stakeholders) to gain an understanding of spending, and the accumulation of government assets and liabilities by function in totality.

Finally, the report underlines that the ongoing Financial Management Shared Services (FMSS) project and Civil Service Renewal Initiative offer timely opportunities for moving forward the financial reporting framework's modernisation agenda. In particular, the new IT system could readily support the introduction of accrual accounting and delaying decisions on the reform could generate significant opportunity costs. Whilst the FMSS can provide a platform for the introduction of accruals, the management of that project to scope and schedule, including dealing with any project delays, will be critical in the implementation phase of accrual accounting.

To start the financial reporting modernisation, the report advises that the Government agrees on a blueprint for the reform and gets necessary approval from the Houses of the *Oireachtas*. This blueprint should include a roadmap and define milestones. The report proposes a six-year roadmap to be considered by the Government. The roadmap's first phase would aim to bring the information already disclosed in the Appropriation Accounts up to international standards. The second phase would aim at introducing consolidated financial statements and other accrual information required by international standards, across all relevant areas.

Concerning consolidation, the report recommends a sequenced approach – that is the preparation of consolidated financial statements covering all government departments and offices, to be extended to funds and State bodies as soon as the degree of harmonisation and integration of accounting systems across government allows it.

For a successful reform, it will be crucial that the Department of Public Expenditure and Reform fully exercises its oversight and governance mandate on accounting and financial reporting. This should be done by setting up a Government Accounting Directorate within the Department of Public Expenditure and Reform, which would become the permanent unit in the Irish administration responsible for maintaining a uniform set of accounting rules and procedures and overseeing the quality of the finance function.

At all stages of the transition to accruals, the Department of Public Expenditure and Reform should work in close co-operation with all key stakeholders, in particular the Comptroller and Auditor General. To this aim, the new Government Accounting Directorate could be tasked with leading working groups in charge of identifying necessary changes to legislation, setting accounting policies, ensuring these standards and polices meet all user requirements, improving financial controls and delivering training.

Finally, to ensure that accounting standards are developed with the expected level of quality and integrity, this report recommends that the Government Accounting Directorate seeks inputs from all relevant stakeholders (i.e. users, preparers, auditors) for establishing accrual standards that will be applied by general government entities and that an Independent Advisory Body be established to oversee outputs of the working group.