

New development: Towards a grand convergence? International proposals for aligning government budgets, accounts and finance statistics

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Government responses to recent financial crises have imposed heavy burdens on the public finances of many countries, and exposed weak links between fiscal information sources: budgets, accounts and finance statistics. In order to better understand the causes and effects of financial crises—as well as to predict them early and manage them effectively—the International Monetary Fund (IMF) recently proposed a standard for fiscal forecasting. Viewing this alignment proposal as the culmination—a ‘grand convergence’—of earlier attempts at linking and improving these three fields, the authors describe and assess the IMF initiative, and discuss its likely impact.

Keywords: Fiscal transparency; government accounts; government budgets; government finance statistics; IMF alignment proposal.

Modern governments require three fiscal information systems:

- Budgeting.
- Accounting.
- Statistics.

These systems tend to be maintained by separate government offices, staffed by professionals trained in different disciplines, and guided by separate standards at national and international levels. While much progress had been made to improve the quality of these reporting systems, recent financial crises, mainly in the USA and Europe, exposed their fault lines. In order to better understand the causes and effects of these crises in terms of the underlying fiscal condition, the International Monetary Fund (IMF) recently called for common standards for retrospective and prospective public fiscal reporting in the context of revitalizing fiscal transparency monitoring and enforcement. The IMF’s proposal was made in an August 2012 paper: *Fiscal Transparency, Accountability, and Risk* (the ‘FTAR paper’) prepared by the IMF’s Fiscal Affairs Department in collaboration with the Statistics Department, and released in

November 2012 (IMF, 2012a).

What makes this IMF proposal new—and even bold—is that budgets, accounts and statistics would be aligned or harmonized. The implementation of the proposal would be tantamount to a grand convergence of the main fiscal information systems. Like all syntheses, this one will be hard to agree and achieve.

We describe the IMF’s alignment proposal as the culmination of past and current efforts to improve government budgets, accounts and statistics, which have proceeded separately and in pairs, as depicted schematically in figure 1. The areas of overlap in figure 1 do not necessarily correspond to the extent of alignment, harmony or convergence. We will explore the subtle differences among these terms in a future paper. In this paper, ‘accounting’ includes financial measurement and retrospective financial reporting; ‘financial statements’ correspond to accounts. ‘Budgeting’ includes fiscal forecasting and resource allocation. ‘Statistics’ refers to government finance statistics and includes statistical reporting.

After describing the key elements of the IMF proposal in the context of other reform measures, we offer our assessment and make some conjectures about its impacts in terms of likelihood of successful implementation around

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the world.

Separate developments in recent decades

Due to their unique disciplinary foundation, professional and sponsoring organizations (**define these?**), budgeting (B), accounting (A) and statistics (S) have developed separately (see figure 1).

The ideas of performance and sustainability have driven government budget reform in recent decades. Instead of viewing the budget only as a means of financial control, performance budgets incorporate output and outcome measures to provide incentives to produce results. The planning horizon is lengthened in medium-term fiscal frameworks and long-term fiscal sustainability to take into account the future cost of contingent liabilities and policy commitments.

With the advent of International Public Sector Accounting Standards (IPSASs), government accounting standards have become internationalized, emphasizing external accountability with consolidated financial reports on the accrual basis. However, the traditional budgetary accounting remains strong (Heiling and Chan, 2012), and the suitability of this kind of new accounting for government is not universally accepted. Responses to Eurostat's December 2012 public consultation on the suitability of IPSASs for EU member states (see <http://epp.eurostat.ec.europa.eu>) were very divided with an almost even split between respondents believing IPSASs suitable; not suitable and only partly suitable for Europe.

Since 2001, the IMF's *Government Finance Statistics Manual* (GFSM) has adopted the accrual basis. A new edition of the manual, while keeping this fundamental principle, will require two additional statements: a statement of total changes in net worth, and a statement of explicit contingent liabilities and implicit obligations for social security benefits (IMF, 2012b).

However, given their common monetary measurement and functions in support of fiscal policy, management and evaluation, the past decade has also seen efforts to relate these fiscal functions to each other.

Partial convergence in the past decade

By 'partial convergence', we mean incomplete and partly successful efforts to bring budgeting, accounting and finance statistics in line with each other. These are denoted by the double overlaps—A and B, A and S, B and S—in figure 1.

Accounting has gained influence on the

budget, but only in a few countries. Instead of passively obeying budget laws and concepts, accounting has begun to be more independent, hoping to add value to information in the budget. Heiling and Chan (2012) identify five stages in the evolution of this relationship:

- 1 Budgeting is not influenced by *ex post* accounting information.
- 2 Accounting provides information on budget execution.
- 3 Financial reporting uses the budgetary basis to measure and communicate actual performance relative to budgetary targets.
- 4 Accounting criticizes but does not seek to change budget concepts and methods.
- 5 Agreeing with the long-term perspective of accounting, the budget also adopts the accrual basis. In most countries, budgeting remains more powerful than accounting.

Stage 3 is now endorsed by international standards. Stage 4 is common among advanced English-speaking countries. In our view, Australia, New Zealand and the UK have achieved Stage 5.*

The decision to adoption of the accrual basis for the 2001 GFSM was a giant step that brought the GFS and accounting standards closer together. In 2003, an inter-institution task force was formed to harmonize IPSASs and statistical reporting. Based in part on the deliberations, IPSAS 22 was issued in 2006 to provide disclosure requirements for presenting information about the general government sector (GGS), a GFS concept, in consolidated financial statements. In early 2013, the International Public Sector Accounting Standards Board (IPSASB) began inviting public comments on a consultation paper which recommends that governments use integrated financial information systems to efficiently produce financial statements and statistical reports (IPSASB, 2012).

The use of the accrual basis and GGS coverage make it difficult to align government budgets with the GFS. The same situation has happened to the alignment between budgeting and accounting: accrual budgeting is realized only at Stage 5. However, state-of-the-art fiscal forecasting, necessary for sound budgeting,

*In the absence of a standard definition of accrual budgeting, it is difficult to be definitive about the extent to which it is practised. The US Government looked to Australia, Iceland, The Netherlands New Zealand and the UK for relevant experience (GAO, 2000).

has already adopted the long-term perspective and accepted the necessity of anticipating the cost of funding liabilities and policy commitments. Most countries, nevertheless, continue to express their annual budgets in terms of cash and/or legal obligations. The exceptions, to our knowledge, are very few and include Australia and the UK, which have made significant advances in aligning budgetary and statistical reporting. Australia decided in 1991 to adopt the GFS-based uniform presentation framework (UPF) for its budgets. Initially, the UPF was adopted on a cash-basis, and in 1997, all federal state and territory jurisdictions, though not local governments, agreed to adopt the accrual UPF for their 2002–03 budgets. While these budgets are accrual-based, they also contain cash-based information in accordance with GFS requirements.

In the UK, there has been a long-standing close relationship between budgets and statistics (see, for example, Jones, 2000). By the time the first *Economic and Fiscal Strategy Report* was published in June 1998, the European System of Accounts (ESA) 95 was endorsed as the basis for measuring the UK public finances (Treasury, 1998).

In 2007, the UK Treasury set up its ‘Clear line of sight’ project to align national accounts based on ESA 95, budgets, estimates and accounts, in response to concerns that differing fiscal reporting systems made it too complex for users to understand, manage and scrutinize public spending (Treasury, 2010). Accountability was seen as impaired when a quarter of the government spending was not voted on by parliament based on the estimates figures. The project therefore aimed to have ‘a comprehensible and coherent system of planning, authorizing and reporting of government expenditure’ in place (House of Commons, Liaison Committee 2008, paragraph 40). Consequently, UK budgets have largely aligned with ESA 95, with some remaining differences (see Treasury, 2012).

In summary, Australia and the UK have demonstrated that it is possible to achieve a high degree of convergence between budgets, accounts and finance statistics. Globally, the most progress has been between accounts and statistics, as a result of the acceptance of accrual measurement and reporting on a consolidated level. The long-term perspective and broad coverage underlying the GFS and IPSASs are commonly practised in fiscal forecasting, but rarely in annual budgeting. Even so, the IMF has initiated a global advancement toward the

full alignment of standards for all three systems of fiscal information.

Towards grand convergence

We use the term ‘grand convergence’ in this paper to describe a situation in which standards for budgets, accounts *and* finance statistics are consistent, denoted by the triple overlap area in figure 1. Building on previous convergence efforts, the IMF’s FTAR paper (IMF, 2012a) renewed the IMF’s call for improvement of fiscal transparency, which the IMF regards as ‘a critical element of effective fiscal policy-making and risk management’ (IMF, 2012c). The alignment is seen as a precondition for fiscal transparency, and stronger institutions at national, regional and international levels are necessary monitoring compliance.

Despite progress in the past decade, the FTAR paper found considerable shortcomings in governments’ compliance with fiscal reporting standards, the standards themselves, and the monitoring of governments’ compliance with those standards. The FTAR paper therefore proposed strengthening fiscal transparency by:

- Improvements in fiscal reporting standards.
- Enhanced international monitoring of country compliance with those standards.
- A concerted effort to promote implementation of those standards.

We focus here on the improvement of public fiscal reporting by means of common standards for budgets, accounts, and finance statistics—‘accountability documents’ in the FTAR paper. Specifically, the FTAR paper called for:

- More complete coverage of public sector institutions.
- More comprehensive reporting of direct and contingent assets and liabilities.
- Recognition of a broader range of transactions and other economic flows.
- More frequent and timely fiscal reporting.
- More rigorous approach to fiscal forecasting and risk analysis.
- Presenting forecast and actual fiscal data on a consistent basis.

To achieve a more complete coverage of public sector institutions, the FTAR paper urged all fiscal reports to capture the activities of public entities outside the general government. These included public non-financial corporations and public financial corporations, including central

banks, as they can have significant fiscal implications for the GGS. Governments were also urged to provide a more comprehensive picture of overall sovereign net worth by reporting of direct and contingent assets and liabilities. During the global financial crisis, countries have expanded and diversified their government assets and liabilities, especially in advanced economies. Even so, relatively few governments can fully account for their overall financial position. The current methods of reporting contingent liabilities need change because governments are tempted to class their liabilities as just on the unlikely side of 'probable'.

The FTAR paper also called for the recognition of a broader range of transactions and other economic flows, to prevent governments from designing specific transactions that might artificially reduce their publicly reported deficits or debt. The IMF is currently developing practical guidance on the sequencing of the adoption and implementation of accrual-based reporting standards. The FTAR paper also urged governments to consider publishing reports on a monthly rather than quarterly basis.

Significantly, the FTAR paper called for a new standard for fiscal forecasting and risk disclosure which helps to improve the quality and consistency of prospective fiscal reporting. With the IPSAS and GFS in place, there are international standards for retrospective fiscal reporting. In contrast, there are currently no

internationally accepted standards for the content and presentation of the budget and related documents. As a consequence, the methodology, construction, and time horizon of fiscal forecasts and budgets vary greatly across countries. As a start, the FTAR paper proposed guidelines for the standard on fiscal forecasting and related risk disclosure and analysis (see figure 2).

The IMF is urging international standard-setting bodies to work together to harmonize ('align') reporting standards for budgets, statistics, and accounts. There are many technical issues for them to resolve. For example, should the standard for fiscal forecasting cover both cash and accrual budget forecasts, including forecast balance sheets? Should the new statements on contingent liabilities and social security obligations be included in budgets and accounts?

The IMF has called for greater co-ordination of national, regional and international institutions to strengthen the monitoring of fiscal transparency and to provide incentives for improvement. Capacity building of national institutions is seen as most critical. On its part, the IMF has invited public comments on how it can best revise its fiscal transparency manual and codes, and change the way it evaluates the observance of fiscal transparency standards and codes.

Assessment and conjectures about impacts

The B-A-S alignment proposal

An international standard on fiscal forecasting, with the requirement for disclosure and analysis of fiscal risk, is an innovative contribution in the IMF's comprehensive proposal for reinvigorating fiscal transparency efforts. Such a standard for prospective fiscal reporting would require much intellectual rigor and institutional backing in its implementation. The FTAR paper provided a preliminary outline and some basic elements. Much remains to be done.

The IMF's proposal to align the reporting standards for budgets, accounts and statistics represents the 'holy grail' of harmonizing international standards and integrating fiscal information systems. The IMF seeks to extend the reach of international standards to the GGS and eventually the whole public sector. The FTAR paper seems to optimistically view as manageable the obstacles in implementation and divisions among professions and organizations. The paper directs attention to the most difficult area of direct and contingent assets and liabilities. It focuses attention to the gaps and inconsistencies that exposes the

Figure 2. An international standard for fiscal forecasting.

A new standard for fiscal forecasting could help improve the quality of consistency of prospective fiscal reporting. The standard would require fiscal forecasts to:

- Cover a minimum time horizon and set of institutions.
- State the economic, demographic, and other assumptions.
- Separately identify the impact of new policy measures and...all announced government policies.
- Provide a breakdown of [revenues and expenditures].
- Provide a reconciliation of material changes since the last fiscal forecast.
- Analyse the distributional impact of government policies on households.
- Regularly include long-term fiscal forecasts based on a plausible range of forecast assumptions.

The standard would also require disclosure and analysis of fiscal risks through:

- Provision of fiscal scenarios on the basis of various macroeconomic assumption.
- A statement of discrete fiscal risks.
- An account of how these risks have been taken into consideration in setting the overall fiscal stance.

Source: IMF (2012b), p. 28.

vulnerability of the current standards on fiscal transparency. Finally, the proposal offers an expansive vision for ‘fiscal reporting’ by defining it as ‘the production of summary information about the past, present, and future state of the public finances for both internal (management) and external (accountability) uses’ (IMF, 2012a, p. 5)—to prevent, or at least slow, the proliferation of systems that do not communicate effectively with each other.

The FTAR paper properly includes budgeting in the alignment proposal; however, it may have over-estimated the willingness of the national budget authorities to participate in the triple alignment. The FTAR paper is silent on whether alignment would extend from fiscal forecasts to annual budgets as such. Government budgets are subject to the fiscal laws and regulations of a jurisdiction—the prerogatives of politicians and officials, who are or feel accountable to their constituents. Faced with urgent issues of the here and now, these public officials may not have the incentive to even consider accrual-based fiscal reports which pressure them to address fiscal sustainability issues. We are therefore cautious about the prospects of subjecting budget documents to a set of common international reporting standards.

The proposals by the IMF for alignment are largely based on normative arguments as there is very limited practical experience available. The IMF paper (IMF, 2012a, box 7) cites Australia, New Zealand and the UK as countries that have attempted to harmonize all three reporting frameworks; that being the case leads us to ask: why most countries are *not* doing this? Only when their reservations are overcome would it be possible to disseminate this practice on a global basis.

In summary, the IMF’s FTAR paper identifies two key principles—broad coverage and accruals—to align budgets, accounts and finance statistics. We find the goal worthy and the logic persuasive. Others may argue, however, that, despite some common elements, each of these fiscal information systems has its users, concepts and methodology. The FTAR paper will likely provoke debates that will shape its impacts.

Likely impacts

The IMF’s package of reform measures, with the budget-accounts-statistics proposal as a capstone, is likely to produce short-term impacts on the harmonization of international standards and longer-term impact on national practices in the direction of greater convergence.

The IMF, subjecting itself to the impact of the proposals, is already taking several simultaneous steps to ensure the consistency of its own standards or guidance for member states. The IMF is revising the GFSM (IMF, 2012b) and the existing fiscal transparency manual and codes. It is also working on a new improved edition of its guidance on the transition to accrual accounting.

At the international level, the IMF’s alignment proposal would accelerate the harmonization of accounting and statistical guidance, and would stimulate a lively debate on accrual budgeting. The alignment proposal built on separate and joint activities on the GFS and IPSAS. Unfortunately, compared with IPSAS and GFS, accrual budgeting is not a mature practice and lacks a strong conceptual foundation. Furthermore, there does not exist an institutional framework at the international level to further develop international standards on accrual budgeting beyond the standard on fiscal forecasting proposed by the IMF.

The normative arguments in the FTAR paper are persuasive and the IMF has institutional levers for implementing the reforms. As a co-sponsor of the Public Expenditure and Fiscal Accountability (PEFA) network, the IMF’s new thinking and guidance would likely affect the criteria used by PEFA partners to evaluate the practices of countries that receive international financial assistance (PEFA, 2011). Thus the impact of the IMF proposals would be institutionalized, if they are incorporated into the qualitative judgment and quantitative PEFA performance scores.

Consequently, two groups of countries are more likely to be directly impacted by the IMF’s FTAR proposals: developing countries that receive international lending and aid, and developed nations in financial distress. Understandably, international lending institutions wish to hold their debtors accountable, as do public and private donors with respect to recipients of their assistance. Accountability requirements are part and parcel of loan and aid agreements, and are enforced as a matter of contractual obligation. Developed nations in financial crisis, such as some European Union members, could be subject to international FTAR requirements if these requirements were one of the conditions of an external rescue package. IMF’s prestige and mandate to conduct surveillance ensure that its ideas are taken seriously around the world.

The costs and benefits of implementing the IMF’s FTAR proposals would be distributed unevenly in the world; nevertheless, all

countries could benefit from the alignment of fiscal information systems of budgeting, accounting and statistics. Few voices argue against fiscal transparency, fiscal accountability and fiscal sustainability, which have, at least in principle, become international norms of good fiscal conduct. The pace of implementation of these ideals in a particular country would crucially depend on its willingness and ability. Willingness is predicated on political culture and institutions, while ability depends on resources, both human and others. It takes both to translate the FTAR proposals into fruitful actions.

In summary, the benefits of implementing the IMF's alignment proposal accrue to international and national accountability institutions, but the costs of implementation are borne primarily by national governments. We foresee a long period of deliberation, education and debates before the proposals in the FTAR paper are universally adopted.

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