Session 2 Notes: Migration Experience from Cash to Accrual Accounting

Case Study – St Helena Government

Background
The St Helena Government (SHG) has been considering the adoption of accrual accounting since 2005, when it was recommended as one element of a Public Financial Management review of SHG by the consulting firm Price Waterhouse Coopers. In March 2010, the Executive Council (ExCo) endorsed a proposal to introduce Accrual Accounting and Output Budgeting from 1 April 2011.

Objectives
The objectives of the Public Financial Management Reform programme were to:

- Align budgets to strategic planning.
- Avoid 'incremental budgeting' with a 3 year budget horizon
- Improve resource allocation.
- Strengthen focus on achievement.
- Tighten up expenditure control.
- Improve management reporting.
- Improve accounting data.
- Raise efficiency of the finance department.

Size and Complexity

SHG is a small unitary government combining elements of central and local government. It has 16 'Directorates' (departments), approximately 900 staff and total budgeted expenditure in 2011-12 of £27.8 million.

Timing
The timetable gave 12 months for migrating from cash to accrual accounting and from input to output budgeting. This timeframe, whilst very short, was considered achievable by the Financial Secretary, given the small size of the jurisdiction, the limited scope of the PFM objectives, the suitability of the existing accounting system to be converted from cash to accrual operation and the adequacy of professional accounting expertise within the Finance Directorate.

Fallback Plan
The short implementation timeframe increased the risk of project slippage. Six project milestones were set in order to assess progress and to decide whether or not the implementation deadline could be met or should be deferred. The six project milestones were:

- June 2010 – Finance Department prepares 3-year budget formats, based on outputs ***[Milestone 1]***
- January 2011 – Finance department converts cash-based budget to accrual format. ***[Milestone 2]***
- June - July 2010 – Strategic Policy Unit (SPU) reviews departmental output definitions and output measures ***[Milestone 3]***
- February 2011 – Departments apply accrual costs to outputs ***[Milestone 4]***

- March 2010 – detailed review of requirements / obstacles to convert to accrual accounting carried out and implementation plan developed. ***[Milestone 5]***
- January – February 2011: Data migration from cash to accrual system ***[Milestone 6]***

Proceed / Defer decision:
- If both Milestones 5 and 6 achieved, continue with accrual-based operation.
- If only Milestone 5 is achieved, implementation will be delayed by 12 months, and revised programme will be developed.
- If neither Milestone 5 or Milestone 6 is achieved, a revised programme will be developed.

System

SHG uses Access Dimensions accounting software. This is a standard commercial accounting package designed for accrual accounting. However, SHG was using Access Dimensions in a cash-accounting mode, with data entry to the system only taking place after payment had been made or revenue had been received. Neither assets nor liabilities were recorded on the system.

This had the advantage for SHG that it would not be necessary to install a new accounting system. The existing system could be retained, but would need to be reconfigured to capture data and operate in an accrual accounting mode. This made substantial cost and time savings since no new system had to be sourced and installed and few new licences were required. SHG system users already had basic familiarity with the software package. However, some new modules were required, including an Asset Register and an Inventory module.

Extensive re-configuration of the system was necessary to prepare for migration to accrual accounting. Although existing nominal codes for categories of revenue and expense were retained, new codes for assets and liabilities were required. Additional nominal codes for revenue and expense categories not previously used (such as gain on sale of assets, or depreciation expense) had to be added. In addition, a new cost centre structure was developed for each Directorate, corresponding to the main services provided within each Directorate. This was to facilitate the attribution of costs to outputs.

The re-configured system was prepared in a separate test environment, to ensure that there was no interference with the existing production system. This provided flexibility so that if the deadline for switchover was missed, the 'old' system could continue to operate.

An unforeseen task emerged in transferring the HR / Payroll data from cash to accrual accounting. The current payroll system had been installed ten years ago, and all of the accumulated data had to be re-computed in order to bring balances up to date.

Data migration

Much of the non-financial data held on the system for 'cash accounting' remained valid under accrual accounting, including supplier records, client/customer records, payroll details. For income and expenditure accounts, opening balances were zero. However, opening asset and liability balances had to be transferred, even though these were not formally included in the cash-based accounts. For example, debtor balances (held on the various government billing systems) had to be imported to the accrual system. Outstanding supplier invoices awaiting payment also had to be imported. However, other balances such as inventory and stores items had to be valued before importing to the opening balances.

Legal Framework

The Constitution provides the overarching financial management legislation, including the rules surrounding appropriation. It was not practical in the short term to modify the Constitution (although changes to support an accrual basis of appropriation and output based budget are now being developed). Subordinate legislation has been introduced to support accrual accounting and output budgeting. A new Public Finance Ordinance has been introduced, together with new Financial Regulations. This legislation has authorised the recognition of expenditure on an accrual basis and for accounts to be prepared in accordance with International Public Sector Accounting Standards (IPSASs). The legislation enables St Helena Government to depart from IPSASs wherever such standards appear inappropriate.

Budget

The SHG budget has been changed from an input focused cash budget to a simplified form of accrual based output budget. The Cost Centre structure in the Chart of Accounts was aligned to the major output or service types provided by each Directorate. Capital expenditure has been separated from operating expenditure. Only operating expenditure is attributed to outputs. Operating expenditure is based on accrual costs, excluding non-cash items such as depreciation expense and unfunded pension costs. A definition in the financial regulations enables the semi-accrual budget to be aligned with the appropriations from the Consolidated Fund.

Training

Training has been separated into three phases:

- Initial accrual principles awareness training – giving general understanding of the differences between cash and accrual accounting
- Specific systems training – giving hands on training to both Finance and Line agency staff on how to process transactions through the new accrual system
- Financial management training – this training is still to be delivered and consists of showing management level staff how to use accrual information to improve their financial control and decision making

Reporting

A hierarchy of reports are produced.

- At whole of government level – Operating Statement and Balance Sheet.

- At Directorate level – Directorate operating statement. Statement of expenditure by output. Detailed output delivery statement.

A budget conformance report is being developed to reconcile the actual operating result (fully accrual) with the budget (partial accrual).

Project Team
The project team comprised:
- Financial Secretary
- Director of Finance
- Head of Accounting Services
- Head of Budget and Financial Policy
- Head of systems and executive support
- Head of IT
- Deputy head of Accounting Services
- User representatives from each Directorate

External Support
External support to the project team was provided by:
- Accounting Systems advisor
- Government financial management advisor

Cost

The project was designed to be undertaken at minimum cost, since SHG is supported with budgetary aid and had no specific aid allocation for accounting reform. Costs incurred to implement the project included:
- Fees for Accounting Systems advisor and financial management advisor
- Additional accounting modules purchased (one off cost)
- Additional user licences (recurrent cost)
- Additional IT bandwidth
- Additional computer servers to handle additional data

Performance Management

Improved performance management with better delivery of services by Directorates was a major objective of the Public Financial Management Reform. To achieve this, SHG reconfigured the chart of accounts to align cost centres with major service types in order to cost output production. In addition, each Directorate was required to identify deliverables with performance measures so that progress towards output delivery could be checked on a monthly basis.

This approach to performance management is simpler than that adopted by various other jurisdictions. Individual outputs are not costed, but total cost of output delivery is obtained from cost centre expense. Performance measures are not comprehensive, but are key indicators of service delivery.

This simplified approach to performance management provides greater accountability for service delivery than under the previous input-focused model, without imposing a heavy data collection and review burden on Line Directorates and Finance.