Brazilian governmental accounting reforms: IPSAS and accrual accounting adoption

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Abstract

Brazilian governmental accounting is affected by two reform processes: the implementation of accrual accounting and convergence with the International Public Sector Accounting Standards (IPSAS). This paper analyses the origins, the process and preliminary outcomes of such reforms. In order to characterize the Brazilian accounting system, we followed the questionnaire from Chan, Jones and Lüder (1996) as a protocol, analysed financial reports and reviewed official literature that regulates Brazilian public sector accounting. The paper finds that the accounting reform has two origins: the need to prepare cost accounting information (year 2000) and the requirement to converge towards IPSAS (year 2009). Reform affects both central government and subnational governments, and is being coordinated by the Treasury's central government. In the process, the Treasury has required the adoption of some sophisticated accounting policies that were beyond the capacity of IT platform installed on either central and local governments, and has had to postpone aspects of their implementation. Treasury has used this as a convenient opportunity to select which IPSAS requirements to implement, taking into account political agendas (e.g. avoiding the recognition of deficit). For these and other reasons, some states' courts of accounts do not require compliance with some of the standards issued by the Treasury, which impairs the comparability of accounting information prepared by different Brazilian public sector entities.

Keywords: accounting reform; public sector; Brazil; accrual accounting; IPSAS; convergence; central government; subnational government; local government; comparative research.

1. Introduction

Brazil is a presidential democracy with a state organized as a federation. The Brazilian federation comprises a central government, and two tiers of autonomous subnational governments:[1] 5,570 municipalities and 27 federal states. Each of them has the authority to levy specific taxes, and hire their work force. Although they are responsible for specific activities and functions, healthcare and education are responsibilities shared by all of them. The central government and states are split into executive, legislative and judiciary branches, while municipalities do not have a judiciary. The accounts of the central government are audited by the Supreme Audit Institution (SAI), while the accounts of both states and municipalities are audited by the states' courts of accounts.

Brazil was colonized by Portugal in 1500, became independent in 1822 and a republic in 1889. During the two centuries that followed, Brazilian political history was characterized by periods of democracy and authoritarianism. The last authoritarian military dictatorship government lasted from March 1964 to March 1985, leaving the Brazilian economy in a state of hyperinflation. In 1988, the current democratic constitution was issued, and it obliged the Congress to issue a new set of laws to regulate public finance, budgeting, and public administration. However, most such laws were not passed until recently; indeed, budgetary Law 4,320 that regulates public sector accounting, issued one month before the military coup in 1964, is still in effect.

In 1994, Brazil started the successful process of controlling inflation and, in 2000, the country established stricter fiscal responsibility mechanisms (under complimentary law 101, hereafter, the Fiscal Responsibility Law – FRL). However, the general finance Law 4,320 issued in 1964 endorsed an accounting framework for both financial reporting and budgeting. Under Law 4,320, budget and financial accounting were integrated into a single system and recorded on the basis of double-entry bookkeeping. Revenues were recognized on a cash basis and expenditures became liabilities whenever a legal commitment was incurred by the government.

There have been two initiatives to modernize Brazilian public sector accounting in recent years. The first started in 2000, when the FRL required the preparation and presentation of cost accounting information. The central government did not expend any effort to comply with these requirements until the SAI required it to do so, in 2004. Once the central government started to develop a cost accounting information system, it found that the cash-commitment regime adopted in the financial accounting system (due to the influence of the budgetary system) was not appropriate to prepare cost accounting figures. Therefore, the central government developed a proxy for accrual accounting expenditures based on the output from financial accounting systems (still based on the cash-commitment budgetary regime). At that time, central government was not implementing accrual accounting yet, but was aware of the limitations of its financial accounting systems. With regard to the cost accounting system, many units of the central government do prepare cost accounting information in compliance with the legislation, but there is a lack of evidence about the managerial use of such information.

The second initiative started in 2007, when a Convergence Committee was set up. The Convergence Committee worked under the auspices of the Accounting Council[2] and had

[1] We used the term 'subnational' to refer to both regional (states) and local governments (municipalities).

[2] The Brazilian Federal Accounting Council is the profession's oversight body under a law from 1946, which lists the services that are exclusive to licensed accounting professionals. Although it is created by law and registration is mandatory, it has financial and political autonomy, but it is accountable to the SAI. A law from 2010 explicitly entrusts the Council with standard-setting powers. However, since ever it issues accounting

the Treasury[3] as one of its members. At that point, the Accounting Council hosted a technical working group to draft the first set of public sector accounting pronouncements (based on IPSAS, but also aligned with the national budgetary law). Practitioners from many states and municipalities entered the debate on that draft during 2007 and 2008. In 2008, the Ministry of Finance decided to require the convergence of the Brazilian public sector accounting standards towards international ones, putting the Treasury alone in charge of the convergence process at all governmental tiers. In 2009, the President reinforced that decision, issuing a Decree that required the convergence of Brazilian government accounting towards IPSAS.[4]

The convergence plan included dissemination to all public sector accountants of the IPSAS in the form of a Portuguese-language version of the IPSAS Handbook. Indeed, the Treasury revised the Brazilian public sector accounting handbook and the chart of accounts, and developed a template for financial statements and an IT rub for the sharing of financial information from every governmental body from the central and subnational governments – these initiatives are fundamental for the consolidation of the whole of public sector accounts. Additionally, the Treasury developed a cost accounting information system for the central government. Subnational governments then had to develop a cost accounting system in compliance with the Fiscal Responsibility Law. Many states have already started to develop their cost accounting systems. However there is a lack of guidance on key issues, such as: what are the cost objects, who are the primary users of cost information, and what their cost information needs are.

Initially, the requirement was set for the central and subnational governments to fully adopt the new rules and accounting procedures by 2011 and 2013, respectively. The central government and all subnational entities were expected to prepare consolidated financial reporting for 2014 based on the same chart of accounts and accounting policies. After many postponements, however, Treasury changed its strategy for subnational entities, segregating 'the core' of accrual accounting (asset and liability recognition and measurement) from the adoption of the chart of accounts. Treasury is now negotiating different deadlines for each core accounting procedure at each level of government. On this basis, the content of financial reports might gradually converge towards IPSAS in the following years. The speed of this process will depend on two main constraints. First, at the central and subnational levels, courts of accounts do not support some Treasury's accounting pronouncements. They argue that Treasury's requirements for the adoption of accrual accounting are in conflict with the law that demands the use of a cash-commitment basis of accounting. The second constraint refers to the capability gap between central and subnational government contexts. Heterogeneous accounting work force size and training levels characterize subnational governments' accounting and finance staffs. Although

and auditing standards, which are used in the context of general-purpose financial reporting focused on the private sector. Only since 2007 the Council drove efforts to issue public sector accounting and auditing standards (Feijó, 2013).

[3] The Treasury in Brazil is a branch of the Ministry of Finance. Different from the UK Treasury, in Brazil it does not have powers over planning and budgeting, which are performed by another ministry.

[4] It is worth noting that such a convergence movement in public sector accounting was contemporaneous to a similar movement in private sector accounting, which lasted from 2006 until 2010, and involved both financial institutions, listed companies and small and medium-sized entities.

Treasury has offered workshops to train the trainers, this is clearly insufficient to bridge such a gap.

In short, the Brazilian process of convergence on IPSAS, under the central coordination of the Treasury, is being implemented more homogeneously at the federal level, including ministries and agencies, in a process that might be completed in 2014. Subnational governments, on the other hand, will implement the new accounting standards depending on whether and how states' courts of accounts collaborate with Treasury, and on the availability of technical capability in more than 5,500 municipalities and 27 states.

2. Literature review of accounting reforms

Many countries have invested in reforming public sector accounting, often referred to as New Public Financial Management (Guthrie et al., 1999). The majority of the country members of the Organisation for Economic Co-operation and Development practice some form of accruals in central governments. There is a tendency toward a dominant financial reform path in the near future, but the convergence on accrual accounting, even for EU governments, is not a uniform process. Christiaens, Reyniers & Rolle's (2010) survey shows that a minority of EU countries still uses cash-based accounting (such as Greece and some regions in Germany), while other countries apply IPSAS or the IFRS (France, Lithuania, Sweden, Switzerland and the United Kingdom). The Netherlands and Norway have planned to go ahead and converge toward IPSAS. The majority of EU countries such as Portugal, Spain, Denmark and Finland have implemented accrual accounting in their central government, but do not intend to reform accounting systems on the IPSAS model. In recent years, many developing countries and emerging economies have also embarked on similar reform paths. For example, for African countries such as Ghana, the World Bank and the International Monetary Fund have sponsored major developments in public sector accounting practices, including the adoption of accrual accounting and the deployment of integrated financial management information systems (Simpson, 2012). South Asian countries have adopted or are planning first to adopt cash-based IPSAS as a step towards convergence with (but not fully adopt) IPSAS accrual accounting (Adhikari & Mellemvik, 2010).

Those reforms have been studied, focusing on (i) the technical accounting content (e.g. cash-accounting to accrual-accounting), (ii) combined public financial management reforms (e.g. whether accounting system reforms are followed by budget or auditing changes), and (iii) observed impacts of reforms (e.g. on accountability and on information usage by politicians).

Usually, the literature on New Public Financial Management and International Comparative Accounting studies groups countries according to their cultural orientation (e.g. English-speaking countries vs. Latin-origin countries), their development level (OECD vs. less-developed countries) or their welfare state orientation (strong welfare state vs. neo-liberal states). Grouping countries into these categories might be why there are reasons to believe that these characteristics could influence the content of the paths and velocity of public financial management reforms (accrual-accounting adoption included). As widely reported, Australia, Canada, New Zealand and the United Kingdom have adopted a very broad version of financial management reforms, incorporating market orientation, a decentralized decision–making process, financial performance measures to reflect outputs and outcomes, performance auditing and evaluation of processes and accrual accounting to calculate prices and costs. This path is not necessarily the same for all English-speaking countries, nor do they have the same contextual characteristics. The financial management reforms in the United States, influenced by a strong legalistic framework, are seen as having a future-oriented outlook, and have encountered delays and difficulties such as the weaknesses of the accounting system (Guthrie et al, 2005). The same occurs for other classifications in which we tend to group countries in order to understand reforms, such as in Latin-America countries, less developed economies, BRICS etc.

The literature includes comparative analyses following the Lüder's Contingency Model approach (Caba-Perez et al, 2009; Villegas & Julve, 2012; Harun & Robinson, 2010), or a descriptive single case study to describe the convergence process (Roje, Vasicek & Hladika, 2012), or even surveying the level of IPSAS adoption in a group of countries (Christiaens, Reyniers & Rolle, 2010), or in a group of subnational governments (Sour, 2012; Aquino & Cardoso, 2012; Pina et al, 2009).

Some of them have particular approaches, such as Adhikari et al (2012) who compare one of the poorest countries on earth (Nepal) with one of the richest nations (Norway), and one of the world's growing superpowers (Russia) in order to find some contextual factors which could explain the level of adoption. Dasi et al (2013) look at the convergence between budgetary and national accounting systems for 27 EU countries, measuring the adjustments between the non-financial budgetary balance and net borrowing/lending (e.g. the difference between interest paid and accrued). According to Yamamoto & Noguchi (2013), on the other hand, in the case of Japanese local governments' widespread adoption of a modified model as recommended by the Ministry of Internal Affairs and Communications and brought about through a process of coercive isomorphism, there is still a lower perceived utility of accrual accounting information in managing the finances of local governments.

In order to offer a contextual analysis to enhance the understanding of a specific case, and to provide readers a satisfactory level of depth and comparability, we adopted the protocol developed by Chan, Jones and Lüder (1996).

The Chan, Jones and Lüder (1996) approach, based on a contingency model of governmental accounting innovations (Lüder, 1992), recognizes public sector accounting reform (as a dimension of financial management reforms) as being conditioned by social and organizational processes, practices and contexts. The prime contingency model (Lüder,

1992) and its later version (Chan et al, 1996) include a set of contextual and behavioural variables which are potentially relevant in explaining the outcome of governmental accounting innovation process.

These models consider the stimuli (such as financial scandals or governmental financial crises) that raise expectations and improve the behaviour of political stakeholders (such as users and producers of information), and influence administrative stakeholders (i.e. producers of information). Political stakeholders will be pressured by general public demands (i.e. users of information). These groups of actors will interact depending on such contextual variables as: the social environment of the government, characteristics of the political administrative system, and the administrative structure. The intended innovation (e.g. conceptual changes to the accounting system) will be mitigated by implementation barriers (e.g. system of values and education, legal system, etc.). Finally, the innovations will produce effects in the real world, meaning that they will enhance (or reduce) efficiency and influence the contextual and behavioural variables themselves. Some critics of the model do not agree with what happens in the process of innovation (seen as a "black box"), and with whether introducing an accrual system can indeed be considered a public accounting innovation (Chan et al. 1996; Ouda, 2004) or not (Monsen & Nasi, 1998).

The Contingency Model applied to Latin American countries has some specificity, mainly regarding political contexts. Caba-Perez et al (2009) have applied a modified Lüder contingency model to compare the cases of Argentina, Chile and Paraguay, which share similar geographic and social-political contexts, developing democratic systems starting in the 1990s from dictatorial governments throughout the second half of the 20th century. They observed that, despite there being a regime lacking in democratic institutions, in Chile and Paraguay, and despite the influence from international financial organizations to introduce a new accounting system, in the case of Argentina, the administrative structural variables (the organizational architecture and personnel with accounting qualifications) are those that are most significant in bringing about reform. In the case of Colombia, Villegas & Julve (2012) did not find any influence from fiscal crises on accounting reforms. However, they identified evidence that the implementation process in Colombia had not shared believes about its benefits, probably due to a top-down process centrally coordinated by the Comptroller's Office and the National Treasury.

3. Methodology

Considering that this paper aims to analyze the origins, the process and preliminary outcomes of the Brazilian governmental accounting reform, the following methods were adopted. First, aiming to address the comparative research framework questionnaire developed by Chan and enhanced by Chan, Jones and Lüder (1996) as a protocol, we reviewed official documents such as laws, accounting standards, financial statements and audit reports, both from the central government and subnational governments. Secondly, we submitted our answers to 23 experts that directly or indirectly were involved in preparing or auditing public sector financial statements, or in the standard setting process, over the last four years. In order to increase the expected response rate, we contacted them by phone before sending e-mails. Depending on the availability they expressed by phone, we sent the entire document or part of it (i.e. the document was split in two sections: ‘institutional framework’ and ‘accounting policy’). The decision on which section to send to each expert was based on their expertise. This procedure had the purpose of cross-validating the responses, so that the findings presented in this paper faithfully represent a characterization of Brazilian governmental accounting.

Fifteen experts (i.e. four financial reporting preparers, four external auditors, three managers, two internal auditors, and two independent consultants) returned their comments. Nine of them had experience of subnational jurisdictions, and six of the central government. In total, seven of them reviewed the entire document, six reviewed the ‘accounting policy’ section only, and two reviewed the ‘institutional framework’ section only.

Finally, we evaluated and checked their comments against official documents and financial reports, and edited the characterization presented in the following section.

4. An assessment of the current stage of the Brazilian governmental accounting

The main focus of this section is the central government. However, whenever there are significant differences between the current stage of the central government and subnational governments, the differences are presented and explored. Note that whenever any relevant innovation was experienced in the period 2007-2014 in comparison with the status quo established in 1964, it is mentioned in this section. Intending to facilitate the correspondence between the narrative described below with the questions proposed by Chan, Jones and Lüder (1996), the nine dimensions are highlighted in **<u>bold and underlined</u>** letters, and the key-words of the respective questions are presented in ***bold and italic***.

4.1 Institutional framework

The first dimension is about the **levels of <u>professionalism and independence</u>**.

Local governments and the framework for financial governance were implanted in Brazil with the arrival of the Portuguese Crown in 1808, when it escaped from the Napoleonic invasion of Continental Europe (Baleeiro, 1978). Prince João Sixth created the Royal Exchequer, the Royal Finance Council and three General Accounting offices, which creation was the corner stone of the early Brazilian government financial system (Oliveira, 1958). The concepts of income and expenditure at that time followed the cash basis of accounting, i.e. the only kind of asset susceptible to registration would be cash. At that time, double-entry bookkeeping was required by law; however, it took almost one hundred years to be implemented.

The use of double-entry bookkeeping began in 1892 in São Carlos, a local government of the State of São Paulo, influenced by Italian concepts, by initiative of its accountant, who was born in Poland and graduated from Zurich. Until then, bookkeeping used to be a record of collections and disbursements, in central and local governments generally (Mancini, 1978). Note that the first Brazilian business school was established ten years later.

This accounting innovation was transferred to state government few years later, as the former CFO of São Carlos became the new Chief Accounting Officer of the State of São Paulo. The innovation process also included a visit to the Italian Treasury and its General Accounting Office, in 1911.

This innovation began to be transferred to the central government in 1914, pushed by the need to prepare a statement of the financial position of the country to attend to requests from English banks from which the central government intended to borrow money (Oliveira, 1958). At that time the only statement the central government could prepare was one that was eight years out of date (D'Áuria, 1953). Finally, in 1922 a Code of Governmental Accounting was developed, also influenced by Italian practices, including the double-entry bookkeeping.

Four decades later, in 1964, Law 4,320 on public finance was issued to replace the 1922 Code in the Central Government and the decrees that had ruled subnational budgets and accounting since 1940. The 1964 law was shorter but quite similar in content to the 1922 Code except for some innovations in budgetary matters. For example, the Code of 1922 required the classification of budgetary expenses in terms of departments and type; the law of 1964 added the requirement to also present budgetary expenditure through a programmatic classification. In 1964 the budget became the most prominent issue in the regulation of public finance; as evidence, only 30 out of 115 items of the Law 4,320 are dedicated to accounting matters.

Finally, signs of weakness regarding the accounting framework started to be clear during the 1970s, when governmental investments in Brazil intensified and financial government accounting disclosure failures became evident. Petri (1987) observed that a sign of such a weakness was that infrastructural assets were not recognized nor presented on the balance sheet, while the long-term borrowing that financed them was recorded. This procedure unbalanced the statement of the financial position, causing negative equity figures that distorted the economic reality of government bodies.

The ***accounting system for the national government is controlled by the executive branch of the government***. During the late 1960s, a decree arranged the Federal Administration into central and sectorial bodies in order to get greater coordination among Ministries and the Ministry of Finance. This structure has remained in force until now. Indeed, in 2001 a law was to improve the governance of public finance in Brazil, providing a set of four federal complementary management systems. The planning system is a responsibility of the Ministry of Planning, Budgeting and Management. The systems of financial management and accounting are responsibilities of the Treasury. Finally the system of internal control is maintained by the Internal Control Office, a branch of the President's cabinet.

The accounting and financial management systems are operated by an IT system known by the acronym SIAFI, which means "financial management integrated system". SIAFI integrates two aspects of financial management. First, the system integrates every unit of the national government administration (i.e., executive, legislative and judiciary branches), including governmental business enterprises (GBEs) that depend on Treasury appropriations to balance their deficits. Second, the system also integrates budgeting, accounting, and financial reporting, and is the most relevant "raw material" for the internal auditing performed by Internal Control Office and for the external auditing performed by the courts of accounts.

Another important feature of SIAFI is the use of a single treasury account that is mandatory by law, and was developed in 1986. It is hosted in the Central Bank and managed by the Treasury. Single treasury account covers the operations of all central government entities besides the social security fund. Brazilian Banks collect money from taxes, fees and other sources of revenue on behalf of single treasury account by means of an interface with SIAFI (Pattanyak & Fainboim, 2010).

While the SIAFI is an IT solution governed by Treasury and its adoption is mandatory for the central government administration, the same cannot be said with regard to states and municipalities. However, Treasury encourages the adoption of the SIAFI IT solution by subnational governments with minor changes. Each state and each municipality has the authority to develop (or acquire) its own IT accounting solution that meets the integration criteria established by Law 4,320. As a matter-of-fact, most of the accounting systems used by states and municipalities are very similar to each other, and are all inspired by SIAFI. Although the Treasury does not control the accounting system for subnational governments, during the years 2009-2010 a set of rules was issued establishing fundamental qualitative characteristics for the governmental accounting systems, concerning both central and subnational governments.

In Brazil, there is no ‘public finance professional certificate’, but one general certificate as ‘professional accountant’ issued by the Federal Accounting Council. Hence, ***the chief accounting officer is not required by law to be a public finance professional***, but an accountant registered at the Federal Accounting Council.

Contrary to what happens in some other countries like the USA, ***the auditor is independent of the government unit being audited***, but is still inside the government (i.e. it is an agency of the Legislative branch on whose behalf it works). The public sector auditors are public servants who work for the courts of accounts. Courts of accounts are autonomous governmental bodies that assist the legislative branch, in monitoring the executive branch.

Another institutional framework dimension **is whether the private-sector is able to influence public sector accounting standards**. ***Accounting and financial reporting standards are based on legal requirements***. Since 1964, Law 4,320 sets general standards of public finance for all tiers of government. The current Constitution (in force since 1988) requires the Parliament to issue a new set of laws to regulate the several aspects of public finance, budgeting, and public administration. However, no such set of laws has been passed to date. Therefore, the law of 1964 is still in effect. The Treasury has authority to issue public sector accounting and financial reporting standards that must be implemented, at least by the central government.

A decree from 2009 recognizes Treasury as the central body of the federal accounting system and establishes its authority to issue accounting standards and the chart of accounts for the whole of government. There is a debate about whether Treasury accounting standards are mandatory for subnational governments too. The treasury secretariats of some subnational governments argue that they can issue their own accounting and financial reporting standards in compliance with the federal law 4,320 not following exactly the Treasury pronouncements, without prejudicing the consolidation of the whole of government accounts.

It is worth noting that this system of regulation relies on budgetary information. It was only recently (after 2007) that financial reporting became an issue on the agenda for the setting of public sector accounting standards.

The way the ***accounting profession has participated in setting governmental accounting standards has differed over the years***. During the period 1950s-1964, when Law 4,320 was discussed and issued, many workshops and roundtables were organized by the Ministry of Finance and by the Legislative branch, and the accounting profession participated in the standards setting process. During the years that followed, Brazil can be either characterized as an authoritarian military dictatorship and/or as a hyperinflationary economy; in such a scenario, the standards setting process was less susceptible to profession participation. After 1997, under a democratic government and with inflation under control, the accounting profession returned to the standards setting arena. The Fiscal Responsibility Law was issued after some workshops and roundtables, but professional accountants participated on an individual basis (i.e. not representing the Accounting Council or any another professional organization). Since 2007, after the establishment of the Convergence Committee, under the auspices of the Accounting Council, the accounting profession started to formally participate in the standards setting process, either represented by the Accounting Council, or by individuals that attended to the workshops organized by the Treasury and/or sent letters commenting on drafts of the standards that Treasury published for public consultation.

The Convergence Committee has a broad objective of providing technical support for the convergence of Brazilian (public- and private-sector) accounting, auditing, ethical and professional education standards towards the standards and pronouncements issued by the International Accounting Standards Board (IASB), the International Federation of Accountants (IFAC), and the International Organization of Supreme Audit Institutions (INTOSAI). Therefore, the Convergence Committee was organized in working groups, in which one was responsible for the convergence towards IPSAS, and another for convergence toward the International Standards of Supreme Audit Institutions (ISSAI).

The output of the IPSAS working group (under the umbrella of the Convergence Committee) was the issuance of a set of public sector accounting standards broadly based on IPSAS' principles and also aligned with Law 4,320. The main objective of this set of ten standards was to start to build the capacity needed fully to adopt IPSAS in the near future. The Federal Accounting Council also issued another standard for public sector cost accounting information. They do not present detailed accounting requirements; instead, they present general concepts and fundamental principles. Note that only six standards are somehow aligned with IPSAS.

The institutional framework dimension of **functional integration** deals with the influences of budgetary laws and norms on accounting policies and procedures and how the accounting system is structured. Since 1922, financial reporting requirements and procedures operate according to tight budgetary rules. Budgetary and financial accounting systems share a single framework (i.e. integrated accounting system, accounting policy handbook, chart of accounts, recognition and measurement basis). Only recently, the Treasury developed an interpretation of Law 4,320 in accordance with which financial reporting does not need to follow the cash-commitment budgetary basis of accounting. Instead, financial reporting must apply the accrual basis of accounting. Hence, ***some financial accounting concepts (e.g., journal entry and standardized reports) influence***

public budgeting, but the opposite is also true: some budgeting concepts have influenced financial reporting. For example: (i) financial reports used to be tailored to meet the information needs of the courts of accounts and other institutions that monitor the execution of the budget; and (ii) the cash-commitment regime designed to control money flows was also used for financial reporting purposes.

Budgetary and financial reports are subject to the legislative audit performed by the courts of accounts. SAI and the states' courts of accounts only perform budgetary and fiscal compliance auditing. We do not find evidences of any accounting assurance.

The central government accounting system has been computerized since 1987, when the central government started to use a computerized and integrated system for managing its finances (SIAFI). Following the central government's initiative, subnational governments also developed (or acquired) and implemented their computerized and integrated systems.

When SIAFI was developed, in 1986, it was called 'the central government management information system'. However, when other information systems were developed (e.g. human resources and payroll, cost accounting, fixed assets management) and integrated into the SIAFI platform, ***it came to be regarded as a part of the overall management information system***.

Finally, the fourth institutional framework dimension is the level of <u>**centralization**</u>. ***The central government issues the accounting pronouncements for the central and subnational governmental units***. However, there is a debate, involving the courts of accounts and the Treasury, about whether Treasury has the authority to dictate accounting practices for subnational governments, and whether states' courts of accounts have incentives to enforce them. There is a provision in the Law of Fiscal Responsibility that imposes a Fiscal Management Council which would be composed of experts from all tiers and branches of government, and of independent experts. The Council should perform ongoing monitoring and evaluation of the policies and workability of the fiscal management system. This task ranges from dissemination of practices on improving efficiency, to the adoption of rules for the consolidation of public accounts, standardization of the rendering of accounts, and fiscal management reports and statements. Unfortunately after 14 years of the mandatory creation of a Fiscal Management Council, it remains on the public finance reform agenda. Therefore, states and municipalities comply with those accounting requirements issued by Treasury that are enforced by their respective state's court of accounts. As a matter of fact, each state's court of accounts, according to their convenience and the information systems already in place, select which accounting requirements to enforce on a 'cherry picking' basis.

At the central government and big-sized states and municipalities, each department has its own accounting office, whose activities are coordinated by the central accounting office at the Treasury. However, at the remaining states and municipalities, the reality is quite different. It means that accounting is highly centralized in the central government with respect to standards and in terms of IT platforms (e.g. SIAFI). In subnational governments the reality is quite diffuse. For example, in big and middle-sized states and in big-sized municipalities, there is an office of the chief accountant (CAO) working in the respective treasury, and each department has its accounting office that works under the coordination of the CAO of the treasury. However, in small-sized states and middle and small-sized municipalities, at most, there is a single accountant to take care of all departments and the treasury. Note that in some cases, in very small municipalities, the accounting function is outsourced to local (and small) accounting firms.

4.2 Accounting and financial reporting policy

As suggested by Chan, Jones and Lüder (1996), accounting and financial reporting policy is assessed on five dimensions. The first dimension is the **objective of the accounting system**. The Brazilian central and subnational ***governments' accounting systems are designed to facilitate budgetary control***. In contrast with the USA national government, in Brazil there is no clear division between budgetary and financial accounting and their standard setters. In the USA the Office of Management and Budget (OMB) takes care of budgetary accounting, while the Federal Accounting Standard Advisory Board (FASAB) is in charge of the financial one. The Treasury is the main public sector accounting standard setter in Brazil. For budgetary issues such a responsibility is shared with the Federal Budget Secretariat. The focus of budgetary Law 4.320 and the main purpose of SIAFI (implemented in 1987) is the budget; however, the chart of accounts also allows the recognition of non-financial assets and liabilities. Consequently, public sector practitioners believe that the scope of governmental accounting is limited to the preparation of budgetary information and maintaining monitoring mechanisms over the budget. So, the ***accounting system was originally designed to prepare information tailored to meet the needs of legislative oversight***. ***There is no evidence that the accounting system was originally designed to facilitate monitoring by creditors, other resource providers, or the general public***.

The second dimension is **accounting recognition and measurement**. The law 4,320 requires the use of ***double-entry bookkeeping***, and it is the basis for recording any transaction in the Brazilian public sector accounting system, including in SIAFI (since 1987).

In regard to the ***accounting of individual funds***, in Brazilian governmental accounting these have a different meaning when compared to other jurisdictions' practices. Funds are neither necessarily reporting units, nor are automatically embodied as legal persons. The concept of 'fund', in accordance with the finance law in Brazil, is an earmarking of tax revenue. Therefore the disclosure of those activities financed by earmarked revenue will depend on their embodiment in a specific legal person. This has not been implemented to date, notwithstanding the provisions in the Fiscal Responsibility Law to create a social security general fund as a binding reporting unit to the Department of Social Welfare of the central government. In subnational governments such a separation process has been implemented faster.

Historically ***financial accounting has been based on cash commitments not on accruals***. This did not mean that non-financial assets and liabilities are not recognized, but that the focus of accounting did not cover infrastructure assets (e.g., roads, bridges, sewage systems, etc.). Even receivable taxes were not recorded until they became delinquent ones. The focus of the accounting system was the legal obligation and responsibility regarding the custody of such public goods (e.g., cash, furniture, equipment, inventories and offices) by a public agent. Additionally, the basis of accounting was not strong enough to record the effects of depreciation and changes in value. Since 2010, the central government has adopted initiatives to move financial accounting towards accrual accounting, but it is not yet a "full accrual" basis. For example, to date, in accordance with the Treasury's accounting handbook (Treasury, 2013), revenues from non-exchange transactions are recognized on the basis of collection, including the revenues from property taxes. The recognition of infrastructure assets and their depreciation, although suggested by the accounting handbook, is not recorded by Central Government due to the limitations of SIAFI and challenges associated with the measurement of their fair value and post-employment employees' benefit liabilities remain off balance sheet.

Post-employment employees' benefit liability is a remarkable example. In 2000, the fiscal responsibility law determined that employees' benefits should be accounted for in accordance with the accrual basis of accounting. In 2011, SAI found that the central government had never complied with such a requirement; this liability neither have been accrued nor disclosed, until 2011. Therefore, SAI presented a qualified opinion in this regard. In 2012, the central government disclosed this liability in the notes, but did not accrue it. In 2012, SAI reiterated its qualified opinion, and SAI criticized the assumptions on which the central government measured its liabilities. In accordance with SAI's analysis, the amount of post-employment benefit liabilities disclosed by the central government was probably materially underestimated.

In regard to subnational governments, to date, they had the option of establishing either a fund or an agency to manage pensions and post-employment benefits. These institutional arrangements reported a separate set of financial statements that are consolidated in their financial statements; their accounting policies are very similar to the IPSAS 25. Besides, subnational governments in Brazil have disclosed payroll expenditure on a cash basis, as a single line item of the statement of financial performance; in other words, they do not present it disaggregated by department or agency.

On one hand, ***Governmental business enterprises (GBEs) economically independent of the government budget follow private sector accounting standards and are accounted by the controlling governmental entity in accordance with the equity method (i.e., they are subject to the one-single-line consolidation method)***. On the other hand, GBEs that are economically dependent on the government budget, usually follow both public sector and private sector accounting standards and are consolidated (i.e., line-by-line consolidation method) by the parent governmental entity.

Historical cost has been the basis of valuation. No other basis of valuation than historical costs (i.e replacement costs) has been used. However, once the convergence process began, other measurement criteria were introduced. For example, (i) 'fair value' is being used as the deemed cost of items of property, plant and equipment that were not recognized before convergence (i.e. items that were off balance sheet at the date of transition); (ii) subsequently, whenever the capital asset suffers a material change in fair value, it must be revalued.

Historically, ***the government's capital assets in the public domain were not recognized***. The acquisition or construction of capital assets was accounted for in the budgetary system as a capital expenditure, and not necessarily recorded as an item of property, plant and equipment in the financial reporting system. Therefore, all three tiers of the Brazilian federation hold capital assets off balance sheet. Since 2010, significant efforts have being made by the Treasury in order to recognize items of governmental property, plant and equipment. The most relevant challenges in this regard are: (i) identifying such items, (ii) assessing who controls the asset, (iii) determining the items' fair value (i.e. deemed cost); and (iv) determining the items' useful life. As a matter of fact, in the 1950s, while Brasilia (the national capital) was under construction, the central government transferred to

Brasilia's administration the right to use a determined area to build the main bus and train station. In accordance with this arrangement, the central government is the owner of the land; the local government builds the station building and can use the land for an undetermined period of time; but the central government can cancel the agreement at any point in time without any obligation to reimburse or pay any fee (or penalty) to the local government. To date, the central government had never suggested that it had the intention to cancel the agreement. Public sector accounting is facing the challenge of assessing who controls the land and building of the main station, whether the central government or the local government. Note that there are similar arrangements between states and municipalities in regard to the land and buildings of many school facilities. Adopting the view that it should define a clear accounting policy for such transactions and circumstances, Treasury decided that, for the time being, assets with these characteristics should not be recognized.[5] Therefore, nowadays, capital assets are only partially recognized. Indeed, ***their depreciation was not recognized***. Starting from 2010, Treasury required the recognition of property, plant and equipment acquired on or after 2010, and established a timetable for the recognition of depreciation expenses, as follows: (i) until 2011, aircrafts, ships, computers and motor vehicles; (ii) until 2012, communication equipment and manufacturing machinery; and (iii) until 2013, other equipment and furniture in general. Note that items acquired on or after 2010 should start to be depreciated immediately.

Long-term liabilities are partially recognized in financial reporting, and the ***majority of obligations are recognized in accordance with the budgetary cash-commitment regime***. However, relevant long-term obligations related to employees' benefit plans are not fully recognized. Historically, borrowing (i.e., debt) is recognized in the statement of financial position. However, liabilities associated with pensions and post-retirement benefits have been partially recognized since 2007 in response to SAI's recommendation in this regard. Even utilities payable and employee-related liabilities are not properly accrued over the financial year for future payments.

For all levels of government, the annual surplus/deficit is not based on accruals, but based on a cash-commitment basis. Therefore fiscal monitoring is restricted to the short term. As the primary surplus is measured on cash basis, the payments of budgetary commitments tend to be postponed to generate a better fiscal picture, what means window dressing the fiscal performance.

The third dimension is **<u>financial reporting</u>**. ***Books are closed promptly three months after the end of the fiscal year***. The fiscal year is comprised of a 12 months period that begins on first January.

Government managers are not given interim (e.g. monthly, quarterly) financial reports. Interim reports are available only for fiscal purposes. The fiscal responsibility law demands fiscal management reports to be published each four months, and a summarized budgetary realization report every two months. Hence, a complete set of financial statements of the government is mandatorily available only once a year, though from 2011 Treasury started to publish quarterly financial statements.

[5] Note, however, that the Accounting Handbook suggests the recognition and depreciation of infrastructure assets; but due to SIAFI's limitations and measurement challenges, Treasury postponed their recognition.

In regard to the issuance of financial reports to the public, Treasury has issued a standardized set of financial reports that is followed by all municipalities and states. Even municipalities in the Amazon, for instance, have to fill in standardized forms with a high level of grouping of assets, liabilities, equity, revenues and expenses accounts. These jurisdictions are able to send their standardized accounts to Treasury through a network of branches of a state owned bank (Caixa Econômica Federal). This allows any citizen to assess accounting data from any municipality and state through the Internet, on the Treasury's webpage, on a yearly basis[6]. Besides, any person connected to the Internet can exhaustively research the fiscal management reports issued every two months.

The fourth dimension is the **content of financial reports**. In regard to the ***aggregation of financial data (e.g. in terms of types of funds) in external reports***, the budget accounts are disaggregated by ministries (departments) and agencies. In turn, assets, liabilities and other items are disclosed together by unit of the federation; There is no financial reporting for ministries or agencies at any other division of governments. The Treasury expects to perform consolidation adjustment in 2015. Nowadays, in general the consolidated financial reporting (CFR) is just a sum of balances and the whole of government accounts is a sum of CFRs.

Historically, the financial reports prepared by the governmental accounting system included: (i) budget statement, presenting the approved and actual amounts of revenues, expenditures and deficit or surplus; (ii) cash report, presenting the amount of cash inflows and outflows realized in a period; (iii) statement of financial performance; and (iv) statement of the financial position. However, since 2011, ***Treasury has required public sector bodies to prepare not only the above four reports but also the following: (v) statement of cash flows; (vi) statement of changes in net assets; and (vii) the notes***.

The actual results are compared with revenue projections and appropriations. Such a comparison is presented in the budget statement and in the fiscal management reports required by the fiscal responsibility law.

The ***budget statement does not present economic forecasts or analysis***, but a comparative column presents the differences between approved and actual amounts of revenues and expenditures. However, reports required by the fiscal responsibility law present some detailed analysis of such variances.

The ***financial reports do not present non-financial data on service efforts or accomplishments***. However, reports required by the fiscal responsibility law and the multi-year plan do present this non-financial data. Additionally, reports tailored to meet information needs related to performance assessment of human resources, usually linked to remuneration schemes, also present such non-financial data.

In regard to ***internal transactions (e.g. transfers) disclosed in the external financial report***, several services are performed by subnational governments with the financial support of the central government. There are cases where top-down transfers are mandatory like block grants for states and municipalities as a share of taxes collected by the central government. In other circumstances social policies, mainly in the field of health

[6] http://www3.tesouro.fazenda.gov.br/estados_municipios/sistn.asp.

and education, are performed by local governments and have financial support from the state and central governments. In all these situations, the grantor government records expenditure while the grantee government records the transfer as revenue source. However, note that internal financial transactions between bodies in the same level of government are eliminated and are not presented in the external consolidated financial reports. The most recent innovations in the governmental chart of accounts allow such eliminations. Until the year 2013, only revenues and expenses associated with internal financial transactions could be eliminated; the respective assets and liabilities could not be eliminated because their chart of accounts was not structured for that.

The last dimension of the accounting and financial reporting policy is **information dissemination**. Detailed and consolidated budgetary and financial reports from the central government and subnational governments are ***sent to the respective legislature (including the courts of accounts)*** for the purpose of budgetary and fiscal monitoring. The same set of information is ***made publicly available through the Internet***, including the consolidated whole of public sector accounts (WPSA). However, the Brazilian ***governmental accounting system does not prepare 'general purpose financial statements'*** (GPFS). As a matter of fact, the concept of GPFS started to be introduced into the Brazilian governmental accounting literature in 2011, when Treasury published the 2010 WPSA, where it presents two set of reports, one formatted in accordance to the budgetary statements templates and another formatted in accordance with the structure recommended by IPSAS 1 – *Presentation of Financial Statements*, in addition to the respective notes. The dissemination of GPFS enhanced in the following years. Treasury included financial ratio analysis to the 2011 WPSA; and prepared the 2013 WPSA in accordance with some accounting recognition and measurement criteria similar to those required by IPSASB's accrual accounting standards.

Despite some innovations on WPSA, it cannot be considered GPFS because: (i) many accounting recognition and measurement criteria are still tight to budgetary rules; (ii) the criteria of consolidation is not pure control, but a mixture of control and fiscal dependency and that is factor that weakens the whole of government accounts; (iii) a statement of cash flows is not published; (iv) WPSA is not audited, neither the consolidated financial reports from the central government or from each state and municipality that are consolidated under the umbrella of WPSA; (v) WPSA is not a consolidation (properly said), but an aggregation of balances from similar accounts; and (vi) in spite of the efforts made by the Treasury, there is a significant lack of consistence among information provided by each state and municipality. Whether all these challenges are sorted out, the accounting system might meet the informational needs of bondholders, grantors, donors, lenders, taxpayers, citizens, public service recipients and general public, and could be denominated GPFS.

The budget proposal is formally presented to the legislative, but (ex post) ***financial statements are formally presented to the court of accounts***, which is associated with the legislative branch.

In Brazil, the financial statements of the central and subnational governments are public available at the Treasury's website. Therefore, ***financial reports are disseminated within the government and to the public, and they are available for use by capital market participants***.

5. Main findings and concluding remarks

Public sector accounting was developed in Brazil in the early twentieth century, and the budget had, and still has, a significant influence on it, including on the consolidation of the whole of public sector accounts. The budgetary and the financial accounting co-exist on the same accounting platform with a high standard of uniformity in the three tiers of the Brazilian federation. The bases of accounting for budgetary and financial accounting are different, but they are executed simultaneously, which makes the process of accrual reform and convergence towards IPSAS more complex.

The interference of other groups of users in the setting of accounting standards is constrained by the Treasury, because it is de jure and de facto the setter of public sector accounting standards. However, the accounting profession as a private actor has increased its participation in setting public sector accounting standards since 2007. Final decisions on the direction of reforms remain with the Treasury, such as speeding-up (or delaying) the adoption of accrual accounting and/or cherry-picking the elements of IPSAS to converge with. Despite the fact that convergence with IPSAS was determined by a presidential Decree in 2010, its implementation has been slow and gradual.

The move to accrual accounting in Brazil was motivated by two facts. First, the fiscal responsibility law requires the presentation of cost accounting information and the SAI has demanded such information from the central government since the mid-2000s. The outputs of government accounting systems in place were not appropriate to produce cost figures. Second, the convergence towards IPSAS revealed a gap between them and the accounting practices of the public sector in Brazil. In essence, the move to accrual occurs simultaneously with the convergence to IPSAS, and its process is centralized on the Treasury, which has set objectives that are beyond human and technological capabilities needed for their adoption.

Indeed, the most relevant challenge for subnational governmental accounting reform is the lack of enforcement. As Brazilian federalism grants autonomy to subnational governments, there is no incentive for subnational governments to comply with the Treasury’s recommendations beyond the formal adoption of the chart of accounts and the template for financial statements, which are mandatory for preparing the WPSA. Additionally, the courts of accounts from many states and municipalities do not required compliance with the Treasury’s accounting handbook. Consequently, Treasury has postponed the implementation deadline for many accounting policy innovations by subnational governments.

Based on an austerity agenda, Treasury solved such a lack of enforcement, and is requiring the IPSAS accrual accounting reform for the entire nation (i.e., central and subnational governments) through its authority to prepare the WPSA. At the end of the day, WPSA legitimates the Treasury’s authority over states and municipalities to implement its chart of accounts, financial statement templates and the IT hub system. But is an awkward solution, because the raw materials for WPSA (i.e., information provided by subnational governments) are not audited neither by the Treasury nor by the courts of accounts. Therefore, we cannot assure about the quality of financial reports from subnational governments or the WPSA.

Considering the role played by WPSA on accrual accounting and IPSAS reform in Brazil, further research on Brazilian WPSA is desirable, as well as investigations about the interpretation and consistence in the implementation of the accounting policies required by the Treasury's accounting handbook. Both research venues are necessary for enhancing the international comparability of Brazilian governmental accounting reforms.

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