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## Research Article

### Potential Challenges and Implications of Implementing Accrual Accounting in the Public Sector in Sri Lanka

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#### ABSTRACT

This study investigated revenue recognition, expense recording, asset presentation, and liability reporting in accrual-basis accounting in financial statements as it examined the difficulties of implementing accrual accounting in the public sector in Sri Lanka. Questionnaires were used to gather data, and ordinal regression analysis was used to examine participant replies. The findings showed a strong association between potential challenges and a number of independent variables, such as accountants' proficiency with accrual accounting, non-accountants understanding of financial statements, non-finance managers' support, regulatory and legal barriers, and the availability of qualified personnel. The results emphasized the difficulties in making the switch to accrual accounting in the public sector and offer guidance for practitioners and policymakers who want to solve these issues.

**Keywords:** *Accrual-basis accounting, Public sector, Sri Lanka*

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#### Introduction

Effective public financial management is vital for a nation's development, economic growth, and the advancement of the public sector. In Sri Lanka, this involves strategic handling of financial resources within governmental entities, encompassing planning, budgeting, allocation, and utilization of public funds to achieve various objectives, such as delivering public services, raising economic growth, and maintaining fiscal stability.

The authority for financial matters rests with the Parliament of Sri Lanka, covering public expenditure management, revenue

generation, budgeting, and managing public debt. The annual budgeting process involves consultations with ministries and stakeholders, defining fiscal goals and allocating funds to critical sectors like healthcare, infrastructure, and education. Financial reporting and accountability, the final phase of the financial management cycle, rely on the National Audit Office, which presents audited financial reports to Parliament annually. Various entities, including ministries, provincial councils, and local governments, submit their financial reports to ensure accurate assessments.

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Accrual accounting views as a cornerstone in public sector accounting owing to its capacity to furnish a precise illustration of country's financial status, future development and operational performance. It facilitates enhanced monitoring of both revenues and expenditures of the country. Moreover, accrual accounting serves to bolster transparency and accountability within the public sector by furnishing a precise reflection of financial transactions and commitments, thereby instilling greater trust in the management of public management resources. Sri Lanka experienced an economic crisis characterized by a shortage of foreign currency reserves, resulting in delays in importing essential goods from abroad. The government's inability to instill confidence in Sri Lanka prevented it from attracting foreign direct investment. Foreign investors, internal loan providers, and international banks require information regarding the assets of the Sri Lankan government as well as its revenue streams in order to assess the feasibility of providing loans and formulate recovery strategies. Cash-based accounting fails to offer creditors accurate insights into the government's assets and revenue. In contrast, accrual-based accounting fulfills this need, providing essential information to all stakeholders in government. Despite its significance, the government has not yet embraced accrual-based accounting in the public sector. This absence raises suspicions warranting research into the challenges hindering the adoption of accrual-based accounting. The research interest lies in investigating the obstacles associated with implementing accrual-based accounting in Sri Lanka's public sector.

The central government and provincial councils primarily practice on cash-based accounting systems, whereas local governments and independent government entities exercise accrual-based accounting methods. The Institute of Chartered Accountants of Sri Lanka introduced 20 Public Sector Accounting Standards (SLPSAS) to ensure adherence to standards, although their application varies in the public sector. There are many potential challenges in effectively implementing accrual-based accounting in the public sector in Sri Lanka. Over 1500 officers from the Sri Lanka

Accountant Service play essential roles in managing public finances transparently and efficiently.

## **Literature Review**

### ***Public Finance Management and Practices in Sri Lanka***

The administration of public finance in Sri Lanka is governed with the Constitution, Provincial Council Acts, Local Government Acts, Administrative, and Financial circulars. The Parliament of Sri Lanka holds exclusive power over public finances, as per Article 148 of the Constitution, which includes imposing taxes, authorizing expenditures, and overseeing public finances.

The Finance Minister, accountable to Parliament, manages public finances and may delegate responsibilities to the Secretary of the Ministry of Finance and the Secretary of the Treasury. Budgetary allocations are made by Parliament, and Chief Accounting Officers and Accounting Officers supervise budget execution, responsible, and accountable to the Parliament. They can delegate powers, and responsibilities to officers under Financial Regulation 1992.

Financial transactions follow a strict process. The Financial Regulations' third chapter outlines the structure of public finance administration and defines the roles and responsibilities of each officer involved. A crucial process governs all financial transactions, necessitating sequential steps:

1. Authorization for financial activity (FR 136)
2. Approval for financial activity (FR 137)
3. Certification of the financial activity (FR 138)
4. Payment for the financial activity (FR 139)

Professionals from the Sri Lanka Accountants' Service, notably in Certification and Payment roles, play crucial roles in certifying financial activities and ensuring accurate payments.

The budgetary process is vital in the public finance management. The National Budget Department is responsible for the annual budget preparation. After departmental budgets are submitted, they are aggregated and presented to the Cabinet and Parliament for approval.

Thorough debates occur during the parliamentary process, and casting votes in the Parliament for the budget. Then, the budget becomes an appropriation act, granting legal consent for the implementation of the budget proposals in the forthcoming year.

Financial reporting and accountability are reinforced by Public Finance Circular No. 02/2020, requiring financial statements from various entities to be furnished to the National Audit Office. These statements include financial position, annual performance reports, cash flow, and trial balance.

The National Audit Act No. 19 of 2018 mandates annual performance reports alongside financial statements, even though the public sector primarily uses cash-based accounting. This request pointed out that public sector entities are transitioning from cash-based accounting to accrual-based accounting. Implementing accrual-based accounting systems can bring about changes in the reporting of financial statements, and the classification of expenditures, revenue, assets, and liabilities. Research highlights the complexities faced by public accountants in adopting accrual-based financial statements within government entities.

Department of State Accounts is responsible for generating and distributing monthly and annual financial statements for the country. In line with modern practises, public sector entities in Sri Lanka adopted a computerized accounting system known as the Computerised Integrated Government Accounting System (CIGAS)

### **Non-Current Assets**

Public finance management in Sri Lanka places significant emphasis on the administration of non-current assets. Each year, considerable funds are allocated through the Appropriation Act for the acquisition of non-current assets, including infrastructure, buildings, training costs, and financial investments, managed by the government and state-owned entities. This practice is known as public asset management. Efficiently managing non-current assets is crucial as it involves responsible handling of public funds invested in these assets. Department Heads and financial personnel are tasked with ensuring the effective and optimal use of

public assets, directly contributing to national development, economic growth, and the well-being of citizens. The process of public asset management spans from asset procurement to disposal and is governed by Financial Regulations, circulars from various government departments, and SLPSAS 7. The recent CIGAS application underscores the importance of accurately reflecting purchased assets in financial statements. Asset verification, maintenance, and disposal processes are meticulously followed within government organizations. Depreciation practices vary, with accrual-based entities incorporating it while others often do not. Control ledgers and Boards of Survey are mandated to maintain oversight and ensure accountability for immovable assets. Loss of assets follows a well-defined procedure, reinforcing prudent asset management and financial transparency in the public sector.

### **Evolution of Accrual-Based Accounting in the Public Sector**

During the late 1980s and early 1990s, New Zealand implemented a transformative set of reforms within its public sector, collectively referred to as the New Public Management (NPM). These reforms included a shift from cash-based to accrual accounting, aiming to fill more business-like practises in the public sector to enhance its efficiency and effectiveness. Similar changes were witnessed in other developed countries, such as Australia. The Financial Management and Accountability Act 1997 mandated Commonwealth agencies in Australia to adopt accrual accounting. This transition aimed to boost resource management, financial reporting, and accountability within the Australian public sector. Other developed nations like the United Kingdom, Canada, and France also embraced accrual-based accounting systems for financial reporting.

AMBE Alfred Nobe conducted research on public sector accounting and financial system reforms in Cameroon and Nigeria. The study advocated for accounting and financial management reforms that prioritise government accountability through techniques like accrual accounting, decentralised budgets, performance metrics, transparent costing and outcome-based budgeting. The research

identified both universal support for such reforms and challenges stemming from organizational gaps, socio-political differences, technological issues, and behavioural considerations. Collaboration between the Executive and parliamentary bodies was highlighted as crucial for the successful implementation and monitoring of accrual accounting reforms.

Ali Rkein (2008) investigated into accrual accounting and public sector reforms in Australia. He noted a global trend of governments striving to reform their public sectors, often driven by concerns about accountability, responsiveness, and efficiency. Accrual accounting emerged as a pivotal component of this transformation due to its ability to provide more comprehensive financial information in line with a commercial focus. While accrual reporting improved data accuracy, it did not profoundly alter the accountability mechanisms at various levels of government.

Rozaidy M, Siti N.A.K, Rasid M, and Raman N (2017) undertook a study analysing gaps in the application of van Helden and Northcott's method for classifying themes in published papers on public sector accrual accounting. Their research highlighted areas of underemphasise and potential for further investigation, with a focus on factors influencing accrual accounting implementation.

Adela D, Cristina S N, and Crina F (2011) explored the impact of accrual accounting on public sector management in Romania. The research showcased how Romania's adoption of accrual accounting yielded advantages across fixed assets, liabilities, revenues, and expenses. The study traced the benefits of transitioning from cash to accrual accounting, indicating a correlation between regulatory changes and the practical implementation of accrual accounting standards.

Zarah P (2016) investigated the innovation of public sector financial management through accrual accounting in Indonesia. The research concluded that accrual accounting significantly enhanced the quality, relevance, and reliability of financial information, enabling a better assessment of financial statements.

Vickneswaran A (2019) focused on government accountants' perceptions of public sector accounting practices and standards in Sri

Lanka. The research revealed that while many public sector institutions in Sri Lanka hadn't fully embraced accrual accounting, those that did witness positive impacts on financial reporting and asset management procedures.

In summary, these studies collectively underscore the global trend of transitioning from cash accounting to accrual accounting in the public sector. This shift aimed to provide more comprehensive financial information for informed decision-making across various levels of government.

### **Research Problem**

In Sri Lanka, the public sector employed over 1500 accountants across the central, provincial, and local government levels. However, it's noteworthy that a majority of these public accountants do not currently adopt or adhere to the accrual accounting system or public accounting standards. Their financial reporting primarily involves creating performance-oriented financial statements for audit submission and parliamentary review.

Within these financial statements, public sector organisations disclose their total assets, capital, including capital assets reserve, and net worth to the treasury, as well as their liabilities in the statement of financial position. Moreover, the performance report accompanying the financial statements outlines various revenue categories, such as revenue receipts and non-revenue receipts, as well as expenditures covering recurrent, advance B, and capital expenditures. Assessing the public sector's performance is done through a comparison between budgeted and actual expenditures.

However, certain discrepancies have been identified. For instance, the F.R.94 stipulates the need for a separate statement detailing committed expenditures for the current year that haven't been paid within the same year. This commitment should ideally be incorporated within the main financial statement. Additionally, a critical aspect that demands attention is asset management. Despite significant investments in non-current assets by the government annually, these capital investments are not adequately reflected in the statement of financial position.

It is interesting to note that while public sector financial statements in Sri Lanka may look like those of the private sector, the actual adoption of accrual accounting practices for financial statement preparation is lacking. Consequently, the researcher is particularly intrigued by the challenges associated with implementing an accrual accounting system within the public sector in Sri Lanka.

### Research Objective

The researcher is to identify potential challenges in implementing an accrual accounting system in Sri Lanka.

### Research Hypothesis

- H1: There may not be any potential challenges in implementing accrual accounting in the public sector.
- H2: There are some potential challenges in implementing accrual accounting in the public sector.

### Research Methodology

In this study, the researcher employed a questionnaire-based approach to collect data from 210 active members of the Sri Lanka Accountants' Service, who work as public accountants within the country's public sector, out of a total population of approximately 1510 public accountants. The questionnaire, consisting of 41 potential challenges related to implementing accrual-based accounting in the public sector, was constructed based on existing research and the researcher's personal experience in public accounting. These challenges

were categorized into five sections: General Challenges, Revenue Recognition, Expenditure Recognition, Asset Management, and Liability Recognition.

Participants were asked to express their viewpoints on these challenges using a structured response format: Strongly Agree (SA), Agree (A), Neutral (N), Disagree (D), and Strongly Disagree (SD), corresponding to numerical values of 5, 4, 3, 2, and 1, respectively.

The research employed descriptive analysis to systematically evaluate the collected data and utilized

Cronbach's alpha coefficient to assess data reliability. To validate the research hypotheses, Ordinal Regression analysis was conducted to statistically test the formulated hypotheses within the research framework.

### Analyzing Data

A descriptive analysis of general potential challenges pointed out that the majority of the respondents strongly agreed that a Public accountant is capable of managing accrual accounting. Table 1 presents the respondent's feedback concerning the potential challenges in implementing accrual accounting in the public sector. Respondents expressed strongly agreement and agreement with potential challenges numbered 1, 3, 6, 7, 9, 10, 12, 13, 16, 17, 19, 20, 25, 28, 29, 31, 37, 39, and 41 while they agreed with neutral for items 2, 4, 5, 8, 11, 14, 15, 18, 21, 24, 27, 30, 33, 34, 36, and 40 but the respondents strongly disagreement and disagreement with item 22, 23, 25, 32, 35, and 38.

Descriptive Analysis

Table 1

No	Potential Challenges	Median	Std. Deviation	Meaning
01	Public Accountant who is able to manage accrual accounting.	4	1.302	A
02	There is a lack of support from political leaders.	3	.873	N
03	There is a challenge for non-accountants in understanding information from financial statements.	5	.990	S. A
04	There is a shortage of skilled staff to implement accrual accounting.	3	1.389	N
05	There are some legal or regulatory obstacles preventing the public sector from effectively implementing accrual accounting.	3	.810	N

No	Potential Challenges	Median	Std. Deviation	Meaning
06	There is a lack of support from Non-Finance Managers.	5	.991	S.A
07	There are difficulties due to widespread areas of implementation. Ex Ministry of Defence, Ministry of Forest, etc.	4	1.132	A
08	The existing CIGAS system can be adopted or modified to adopt an accrual accounting system.	3	.819	N
09	There is a relevant accounting standard to recognize revenue in SLPSAS	4	1.235	A
10	It is impossible to measure non-exchange revenues in accrual accounting. Ex Tax income, Revenue Licence, Royalty Revenue	4	1.112	A
11	The next year's budget includes taxes receivable and payable.	3	1.229	N
12	It is possible to recognize revenue under the matching concept in the public sector.	4	.877	A
13	It is measurable for all expected revenue under a computerized financial and accounting system.	5	.990	S. A
14	Applying the accrual basis has an impact on current revenues.	3	.874	N
15	Revenue could be reliably measurable on an accrual basis.	3	1.309	N
16	Revenue refunds are measured reliably and recognized against previous revenue.	5	1.273	S.A
17	It is no difficulty in disclosing information related to revenue recognition under accrual accounting.	4	.707	A
18	Committed expenses could be reliably measurable under accrual basis.	3	1.122	N
19	The parliament approved expenditure or work could be completed in current finance year.	4	1.229	A
20	There is an even the accounting basis used to measure and present budgetary information can be different from the basis used for legislative authorization of expenditure. Actual expenditures.	4	.936	A
21	The borrowing cost could be reliably measurable according to SLPSAS 4.	3	1.078	N
22	Employee benefits could be reliably measurable according to SLPSAS 19.(Pension and other employees' benefits)	2	.875	A
23	It is reliably measurable expenditures occurred for services provided to other public departments. No any income	2	.848	D
24	There is no difficulty to disclose information related with expenditures recognition under accrual accounting	3	1.296	N
25	It is reliably measurable capital expenditures and maintaining expenditures.	5	1.215	S. A
26	It reliably determines a non-current asset's useful lifetime.	2	1.234	D
27	It can be reliably determined what the scrap value of non-current assets is at the end of their useful lifetime.	3	.787	N
28	There is no difficulty in determining the value of the existing non-current asset.	5	1.205	S.A
29	The borrowing cost is recognized according to SLPSAS 4 for asset recognition.	5	1.210	S.A
30	There is a proper mechanism to remove a non-current asset after its useful lifetime.	3	.903	N

No	Potential Challenges	Median	Std. Deviation	Meaning
31	It can be reliably determined the value of inventory, and other current assets.	5	.755	S.A
32	There is a provision for bad debt for accounts receivable.Ex Advance B Accounts, etc.	1	1.289	S.D
33	There is no difficulty in disclosing information related to current and non-current assets.	3	.688	N
34	It can be reliably differentiable infrastructure asset, heritage assets , property in investment etc.	4	1.198	A
35	It is reliable to measure the capital contributed by other government entities.	1	.688	S.D
36	It is a reliably measurable Reserve, including a description of the nature and purpose of each reserve within net assets/equity.	3	1.282	N
37	It is a reliably measurable Reserve, including a description of the nature and purpose of each reserve within net assets or equity.	4	1.110	A
38	It is reliably measurable that the committed expenditures but not paid during the financial year as current liabilities. Ex transfer payable, pension payment, etc.	3	.755	N
39	It is possible that the entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date.	4	.936	A
40	There is a separate provision to repay the short-term liability in the budget.	3	1.208	N
41	There is no difficulty in disclosing information relevant to current liability, and non-current liability.	5	1.150	S.A

S.D=Strongly Disagreed, D= Disagreed, N=Neutral, A=Agreed, S.A=Strongly Agreed

### Testing hypothesis

Table 2 explains the reliability of the data for the study purpose. In general, a Cronbach's Alpha value of .959 is considered good. It sug-

gests that the 41 items in your scale are working well together to measure the intended concept, showing a high level of internal consistency.

Table 2. Reliability Statistics

Cronbach's Alpha	N of Items
.959	41

### H1: There may not be any potential challenges to implementing accrual accounting in the public sector.

Table 3 provides insightful details regarding the model fitting process. The remarkably low p-value of the chi-square statistic ( $< .000$ ) strongly suggests that the Final model significantly improves predictions compared to the basic intercept-only model. This signifies that the model accurately predicts the association

between the dependent variable and Potential Challenges in Implementing Accrual Accounting in the Public Sector, considering several independent variables: Public Accountant who is able to manage accrual accounting, There is a challenge for non-accountants in understanding information from financial statements, The existing CIGAS system can be adopted or modified to adopt an accrual accounting system, There are difficulties due to widespread areas

of implementation. Ex Ministry of Defense, Ministry of Forest, etc., There is a lack of support from Non-Finance Managers, There are some legal or regulatory obstacles preventing the public sector from effectively implementing accrual accounting, There is a shortage of skilled staff to implement accrual accounting.

To evaluate how well the fitted model aligns with the observed data, it is reliable to measure the capital contributed by other government entities, it is reliably measurable reserve, including a description of the nature and purpose of each reserve within net assets etc.

Goodness-of-Fit statistics are employed; the Pearson Significant value of .465 indicates a satisfactory fit of the model to the data. Furthermore, the pseudo-R-Square values,

specifically Nagelkerke's value of 52.3%, highlight that over 52% of the variance in the dependent variable (Potential Challenges in Implementing Accrual Accounting) is elucidated by the eight independent variables. The ordinal regression analysis underscores a favorable level of accuracy in predicting the relationship between

Potential Challenges in Implementing Accrual Accounting and the four independent variables, as indicated by the Nagelkerke value of .523. The research effectively supports the alternative hypothesis, indicating a direct association between Potential Challenges in Implementing Accrual Accounting and general challenges in implementing accrual-basis accounting in the public sector.

*Table 3. Ordinal Regression Analysis*

Model	-2 Log Likelihood	Chi-Square	Df	Sig.
Intercept Only	474.788	137.84	49.00	.000
Final	336.945			
Pearson		569.297	567	.465
Deviance		304.516	567	1.000
Cox and Snell				.481
Nagelkerke				.523
McFadden				.261

Link function: Logit.

## Conclusion

This research illustrated on the multifaceted challenges encountered when implementing accrual accounting in the public sector. The study showed the importance of addressing these challenges to ensure the successful adoption of accrual-based accounting practices. The findings suggest that a full approach is needed, involving both technical solutions and organizational changes. Strengthening the skills of personnel, enhancing communication between financial and non-financial managers, and addressing legal and regulatory obstacles are crucial steps toward overcoming the hurdles identified in revenue recognition, expenditure recording, asset presentation, and liability reporting. As governments continue to modernize their financial management systems, understanding and addressing these challenges will be essential in achieving transparent and accountable public sector financial reporting.

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