The Need for Adapting Financial Statements in the Public Sector in Bulgaria to the IPSAS Requirements

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Abstract

This paper presents the main results and conclusions of a theoretical-methodological and empirical study on the need to improve the structure and content of the financial statements in the public sector by adapting them to the IPSAS requirements. The survey presents a comparative analysis of the content of the financial statements of public sector in the Republic of Bulgaria with those of the EU. Ideas and views on the benefits of adopting a standardized approach to the preparation of financial statements are presented. It concludes that the adoption of the principles and provisions of the International Public Sector Accounting Standards will create preconditions for an overall improvement in the quality of financial reporting in the public sector, which will produce timely and reliable financial and fiscal data, an opportunity for comparability of financial statements as well as increased transparency and accountability of the public sector. This will bring significant benefits to public sector governance, improve the efficiency and effectiveness of public administration, and facilitate the control over the performance of budgetary enterprises.

Keywords: Public Sector Accounting, Financial Statements, Standardization, Accounting Standards

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1. Introduction

The common understanding in accounting theory and practice is that annual accounting closure, on the one hand, is the final part of the process of converting and structuring accounting information from current accounting and, on the other hand, it is defined as the final part of the preparation of the annual financial statements. In this respect, professional knowledge of the applicable regulatory framework on the structure and content of financial statements is a prerequisite for satisfying the public's interest in reliable public finance information.

At present, the preparation and presentation of the annual financial statements of public sector enterprises (PSEs) in Bulgaria is subject to compliance with the requirements of the Accountancy Act, the Public Finance Act, the instructions from the Ministry of Finance (State Treasury Directorate), incl. guidance on the adoption and application of national accounting standards, orders and letters of the Minister of Finance on the structure and content of financial statements. The fact is that there is a lack of synchronization and adaptation of applicable accounting standards from PSEs to the conceptual framework of the International Public Sector Accounting Standards (IPSAS). The issue becomes significant when taking into account the current global trend for changes in public sector accountability and the need for adequate governance and control. The topicality of problems in the public sector accounting system is evidenced by the many international scientific forums, conferences and publications that raise these issues. They are extremely perceptible in the applicable regulatory framework for the public sector in Bulgaria. In her monographic work, D. Feschiyan draws attention to the inconsistency between the accountability in the public sector of a Member State, based on the cash flow principle (cash basis), and the fact that EU budgetary surveillance uses current accrual-based data (Feschiyan, 2018).

2. Critical Analysis of the Normative Regulation of the Structure and Content of Financial Statements in the Public Sector in Bulgaria

The current Accounting Act stipulates that budgetary enterprises shall conduct their accounting in accordance with the requirements of Chapter Fifteen of the Public Finance Act. The fifteetnth chapter of the Public Finance Act (PFA) is devoted to "Budgetary Accounting". By carefully analyzing we notice the requirement (Art. 164) for the adoption of standards and chart of accounts endorsed by the Minister of Finance in compliance with four important international regulations, namely: "For budgetary enterprises, the Minister of Finance shall approve accounting standards and chart of accounts that are in conformity with:

- The European Union's requirements for accountability, statistics and budgeting of the public sector.
- The accounting framework, principles and concepts of the Methodological Manual on State Financial Statistics issued by the International Monetary Fund.
- The International Public Sector Accounting Standards of the International Federation of Accountants.
- The requirements of the Bulgarian legislation regarding the budgeting, the reporting of the implementation of the consolidated fiscal program, and the management and control of the funds and expenditures of the budgetary enterprise".

Regarding the form, structure and content of annual and interim financial statements of budgetary enterprises, the applicable Accounting Act confers certain powers on the Minister of Finance and again refers to the Public Finance Act.

The order, manner and terms for the compilation and presentation of the financial statements of budgetary enterprises and the publication of the information from them are determined by the Public Finance Act, namely:

- Public sector enterprises prepare and present their annual financial statements based on the standards, guidelines and chart of accounts in compliance with the requirements of the European Union for Public Sector Accounting, Statistics and Budgeting, and International Accounting Standards of the International Federation of Accountants.
- The form, structure and content of the annual and interim financial statements shall be determined by the Minister of Finance;
- The reporting of assets, liabilities, revenues, expenses and operations is consolidated by the Ministry of Finance on the basis of the submitted turnover reports and other information under terms and conditions, periodicity and procedure determined by the Minister of Finance.

The principles on the basis of which the financial statements of the public sector enterprises are drawn up are:

- Going concern - when preparing the financial statements, account should be taken of the enterprise's ability to continue its business. When the financial statement is prepared in accordance with this principle and the management body is aware of data leading to uncertainty about the retention of the volume of business, such data must be disclosed.
- Accruals - financial statements, except for the statement of cash execution of the budget, are prepared in compliance with this principle. Subject to the accrual principle, operations and events, as well as revenue from them and related subjects of financial reporting, are reported and included in the financial statements at the time they are incurred and not in the payment or receipt of cash or cash equivalents.
- Consistency in presentation - the presentation and classification of the items in the financial statements shall be maintained in the subsequent periods, unless there has been a change in the activity or change by a statutory instrument.
- Materiality - each material item is presented separately in the financial statement. Information is material if it has a significant impact on decision-making by users of information in the annual financial statement.
- Offsetting - no compensation is allowed between assets and liabilities, revenues and expenses, unless required or permitted by a respective accounting standard.
- Comparative information - the comparative information from the previous reporting period is disclosed, and if there is a reclassification of the positions in the financial statement, the comparative information is translated in accordance with the changes.
- Independence of the individual reporting periods - each reporting period is perceived, analyzed and treated for itself, regardless of its objective relationship with the prior or subsequent reporting period. Compliance with the principle is achieved through the formation and presentation of the change in net assets for the current reporting period (the result of budget execution in a calendar year), positive or negative, in the profit and

loss statement based on the turnover of financial accounts for the accounting year, which are accounting the revenues and expenses.

- Value measurements linkage of opening and closing balances - the objective transfer and receipt of the reporting information from the end of one reporting period to the beginning of the next.
- Historical cost principle - the valuation and disclosure of assets, capital and liabilities of the budgetary enterprise are perceived at the time of acquisition or occurrence. Compliance with the principle is achieved by selecting a valuation base. It is perceived that an asset or liability that is measured at historical cost should be measured at acquisition cost, prime cost, or other cost when required by applicable accounting standards (for example, the fair value of financial instruments).
- Principle of comparability of revenues and expenses - requires recognition of expenses for the period in which the effects (revenues) are received and vice versa.
- Cash principle - based on this principle, a statement of cash execution of the budgets, EU funds accounts and foreign funds accounts is prepared.

Some empirical and theoretical-methodological studies prove that in the public sector there are often deviations from the normatively adopted accounting principles mentioned above (Feschian, 2012).

At present, the content of financial statements in public sector enterprises in Bulgaria is regulated by an Order of the Ministry of Finance. Financial statements include*: a statement of financial position (balance sheet); a statement of financial performance (statement of profit or loss); a statement of cash execution of the budgets, EU funds accounts and foreign funds accounts; notes to the financial statements.*

Horizontally in the balance sheet, assets and financial sources are classified according to the activities in which they are used. The three sectors (reporting groups) in the public sector - Budget, EU Funds Accounts, and Other Accounts and Activities are respected. Each activity is presented individually, as three self-reported enterprises that are then consolidated in a stand-alone column on the horizontal. Vertically in the balance sheet, the assets are classified in two large groups - non-financial and financial assets. In each of their corresponding sections are included groups that characterize them according to the duration of the participation in the reproduction process (short-term and long-term tangible assets, receivables, cash, etc.). Financial sources are classified according to their ownership relationships in the following categories: available capital provided by the operating budget, liabilities (attracted capital), future income and other liabilities. Liabilities are classified as short-term and long-term. Off-balance sheet assets and liabilities are elements of the balance sheet. They are represented by total values. It should be noted that cash and national equivalents in the balance sheet should be in line with the cash execution of the budget, which is an indicator in the component “Statement of cash execution of budgets, EU funds accounts, and other accounts and activities"(Feschiyan & Savova, 2016).

The next mandatory component of the financial statements of the budgetary enterprises is the ***Statement of financial performance***. The Statement contains synthesized accounting information on the performance of the budget for one calendar year. The accounting information reflected in the Statement can be used as a measure for evaluation of the enterprise's performance in terms of service costs, efficiency and performance (Feschiyan et al., 2018).

Revenues as an element of the financial statements, incl. of the Profit and Loss Statement, represent an increase in the economic benefit over the reporting period in the form of an increase (inflow) in assets or a reduction in liabilities that results in an increase in the net assets and the capital of the budgetary enterprise other than that resulting of a financing budget decision. ***Expenses*** as a subsequent component of the financial statements of budgetary enterprises represent a reduction in the economic benefit over the reporting period in the form of a decrease (outflow) in assets or a rise in liabilities that results in a reduction in the net assets and the capital of the budgetary enterprise other than that resulting of a financing budget decision. The above two items are recognized in the Profit and Loss Statement of the budgetary enterprise, subject to the accrual principle. Therefore, revenues and expenses arising from the operations of the budgetary enterprise are recognized and reflected in the Statement at the time they occur, regardless of the time of their monetary manifestation.

On the face of the ***Statement of financial performance*** of public sector enterprises, information is provided on the expenses incurred, including:

- ***current non-interest expenses*** (including material costs, external service costs, salary and other remuneration costs, social security contributions and allowances, and other non-interest expenses);

- ***interest expenses*** (including interest expenses on loans and debts and other interest expenses);

- ***book value of sold non-financial assets*** (including book value of sold materials, goods and production; book value of sold non-financial long-term assets and seized non-financial assets);

- ***transfers to households*** (including social security payments and capital transfers to households), ***grants and transfers to other persons*** (including current grants and transfers to other persons and capital transfers to other persons);

- ***cost and asset acquisition corrections***;

- ***expenses on assets capitalized in the "Other accounts and activities" reporting group***.

This data is compared with:

- **Revenues, benefits and donations in the form of:**

- ***current revenues*** (including taxes, insurance contributions and revenues equivalent to them; revenues from fees, licenses and charges; revenues from administrative fines and penalties; revenues from services; revenues from rentals, concessions and interest; revenues from dividends and equity participation, and other current revenues);

- ***revenues from the sale of non-financial assets*** (including income from the sale of materials, goods and production; revenues from the sale of non-financial long-term assets and seized non-financial assets);
- ***revenues from insurance benefits***;
- ***revenues and benefits from donations*** (including grants and donations from the EU and from the country; other grants and donations from abroad; grants received under international and other programs);
- ***revenues corrections*** (including corrections for income tax on business).

- **transfers between budgetary enterprises in the form of:**

- ***cash transfers between budget organizations (nett);***
- ***attributed transfers between budget organizations (nett).***

- **net result of financial operations** (including net result of sale of financial assets and net exchange rate differences from foreign exchange operations);
- **changes in net assets (in the direction of increase or decrease) from impairments and other events in the form of:** ***transferred net assets*** (including between budgetary enterprises, from/to other enterprises) **„+“** ***net result of impairment of assets and liabilities*** (including impairment of non-financial assets, financial assets and liabilities) **„+“** ***increase in net assets from other events*** (including increase of non-financial and financial assets from other events; increase from seized assets; write-offs; decrease in liabilities and other events) **„-“** ***decrease in net assets from other events*** (including decrease of non-financial and financial assets from other events; write-off of public and other receivables; increase of liabilities from other events).

The economic nature of the third component of the financial statement – ***the statement of cash execution of the budget, EU funds accounts and foreign funds accounts*** – reflects the dynamics of cash flows (Feschiyan et al., 2018). This statement provides systematized information on budget revenues and expenses, transfers and transactions with financial assets and liabilities. The information is structured in six main sections:

Section 1 «Revenues»

Section 2 «Expenditures - recapitulation by paragraphs»

Section 3 «Transfers - recapitulation»

a) «Transfers»

b) «Temporary interest-free loans»

Section 4 «Shortfall/Surplus» = (Section 1) - (Section 2) = Recapitulation of all activities + (Section 3) = Recapitulation of all transfers

Section 5 «Operations with financial assets and liabilities»

Section 6 «Maximum amount of commitments and liabilities in the current year»

The annexes to the financial statements are related to the specific activity of public sector enterprises and are intended to provide information on (Feschiyan et al., 2018):

- the accounting policy applied during the accounting period;
- the status and changes in assets, liabilities, revenues and expenses;
- clarifications on the execution of the budget account and off-budget accounts and funds;
- other material information about the financial and property state of the budgetary enterprise.

The significant deficiencies in the structure and content of financial statements in the public sector are:

- Due to a number of methodological deviations, the correct presentation of property in the balance sheet, the reliable valuation of the receivables and liabilities, as well as the correct formation of the overall result of the business (Feschiyan, 2018) of the public sector enterprises.
- At present, the balance sheets of public sector enterprises are prepared to the level of "first-level dispensators of budgetary credits (funds)". A consolidated balance sheet at national level is unfortunately not prepared (Feschiyan, 2015).
- A cash flow statement and statement of the owned (disposable) capital of public sector enterprises is not prepared.
- The form and content of the statement of cash execution of the budget also needs improval. A mixture of accounting principles and methods, and a variety of components are used in its preparation: revenues and expenses are presented on a cash flow basis, other are based on the modified cash method, and transfers on insurance transactions are based on the accrual method. The report presents the paragraphs and sub-paragraphs of the Unified Budget Qualification of revenues and expenses, natural indicator codes, name of the types of incoming and outgoing cash flows, plan indicators and reporting data in BGN, foreign currency and aggregate. The result of budget execution is set at several levels. No information is reported for the previous reporting period, which reduces the comparability of the information in the report.
- The regulated general disclosure requirements for the annual financial statements in the Accountancy Act are not applicable to the public sector. Budgetary enterprises in Bulgaria remain subject to specific requirements as specified by the ***Ministry of Finance***.
- There is no publicity and transparency in the disclosure of financial statements in the public sector. The issue of the mandatory publication of the financial statements of public sector enterprises has not been fully resolved. Only cash inflows and outflows are reported, and therefore the property of the state, its assets and liabilities are unknown. It is possible that unexpected assets and liabilities arise, and such in fact arise. Taxpayers cannot judge

whether the government's promises are justified, and they have no basis for trust in government.

We conclude that there is an objective need to prepare the financial statements in accordance with IPSAS requirements. This will lead to an improvement of the financial management information base in the public sector and will make the requirements for the public and private sector more uniform. If the preparation of financial statements is done in accordance with IPSAS, reliable valuation of the assets, capital, liabilities, revenues, expenses and financial result of the state institutions will be achieved and, ultimately, their financial management will be improved.

3. Prospects for improving the financial statements in the public sector

The true way of improving the financial statements in the public sector is to adapt them to the conceptual framework of the International Public Sector Accounting Standards (Feschiyan, 2015). Standardization in public sector accounting should be an objective process whose origin and development leads to the establishment and application of generally accepted accounting rules and principles that satisfy users of accounting information on the financial and property position and the financial performance of budget enterprises. The standardization of public sector accounting should lead to the unification of the elements, structure and content of financial statements.

In September 2018, the International Public Sector Accounting Standards Board published a Public Sector Accounting Manual in three volumes (IPSASB, 2018). Currently, 40 IPSAS based on the accrual principle[3] and one unnumbered standard applying cash-based reporting have been adopted and approved.

In addition, IPSASB continued its work on updating and completing the list of applicable accounting standards for the public sector by developing and publishing two new standards - IPSAS 41 Fiancial Instruments *(which is expected to replace the current IPSAS 29 Financial Instruments: Recognition and Measurement)* and IPSAS 42 Social Benefits (*a typical public sector standard that does not have an analogous international accounting standard*). The provisions of both standards provide for their application by SMEs for annual accounting periods beginning on or after January 1, 2022.

The current International Public Sector Accounting Standards (Feschiyan, 2015) aim to create comparable, relevant and understandable financial information, both for internal government purposes and for international institutions, rating agencies, capital markets, etc. They provide guidance on the structure of financial statements, including the minimum requirements for each primary report, accounting policies and explanations (and illustrative appendixes). The idea is that the application of the International Public Sector Accounting Standards should provide a basis for the presentation of general purpose financial statements

[3] Of the 40 IPSAS adopted, 39 standards are applicable, and one is free-coded (IPSAS 25 Employee Benefits is fully superseded by IPSAS 39 Employee Benefits, effective for accounting periods beginning on or after January 1, 2018)

that will ensure the comparability of the enterprise's financial statements with those of prior periods of the enterprise itself and also with the financial statements of other enterprises outside the public sector. The application of IPSAS will improve the publicity and transparency of public sector financial reports.

The European Union applies an accounting system based on the accrual principle – ABAC (Accrual Bassed Accounting).

Currently, EU's financial statements include:

- Budget statements - they provide information on how the annual budget has been spent and are therefore prepared on a cash basis.
- General statements - they reflect all expenses and revenues over the financial year and are intended to determine the financial position of institutions. They are considered a reliable information base since 2005, as a result of the full application of the accrual principle. General financial statements also have a prospective role by providing information that is useful in prognostication of the amount of resources needed for ongoing operations as well as the resources that can be generated by continuing operation and associated risks and losses. It should be noted that when switching from the cash principle to the accrual principle, the EU's budget surplus of 20 billion EUR has become a negative own capital amounting to over 60 billion EUR. This is because the transition from cash-based reporting to the application of the accrual principle takes place in three main stages:
    - "Partial" accrual stage - short-term assets and liabilities are accrued.
    - Moderate accrual stage - in addition to short-term assets and liabilities, the government debt is also accrued.
    - Full accrual stage, which also includes long-term assets and liabilities, including pension liabilities.

The accrual of government debt and pension liabilities is the reason for the conservative attitude of many EU Member States towards the full application of the accrual principle. Generally, conservative Europe "flees" from the full implementation of the accrual principle in its overall manifestation, and most importantly the third stage - the accrual of long-term assets and liabilities, and especially of pension liabilities. An example of this is France, where after transition to accrual, the government has decided that pension liabilities amounting over one trillion shall be only made public and shall not be entered as a long-term liability in the balance sheet.

It should be noted that the European Federation of Chartered Accountants strongly recommends the use of accrual accounting by governments and public sector organizations as it enhances the transparency of their financial statements and provides better information for the purpose of planning and management. In an EU publication on "Modernizing the EU Financial Statements" yet in 2008, David Devlin, Chairman of the European Federation of Chartered Accountants, said, "We hope that the example of EU and those public organizations and governments, which have already introduced similar standards, will encourage others, which will result in a more transparent, clear and comparable financial information in the public sector within Europe and beyond its borders." In this respect, Bulgaria has suffered many criticisms. As stated in the first paragraph of this article, the form and content of the financial statements of public sector enterprises in Bulgaria are regulated by an Order of the Ministry of Finance and include a balance sheet, a profit and loss statement, and statement of cash execution of the budget, as well as an appendix. It is clear from the presented components that the requirements of IPSAS 1 Presentation of Financial Statements and of IPSAS 2 Cash Flow Statements are not met. This discrepancy with the form and content of the financial statements regulated by IPSAS is in violation of the requirements presented in Art. 164 of the Public Finance Act. The most significant flows in the components of financial statements have already been presented, such as a balance sheet with poor information reliability, especially in the long-term assets section (Feschiyan, 2013), and the lack of reliable methods for assessing long-term assets in the public sector; the problem of preparing the balance sheet to the level of a first-level budget dispensator, without consolidation at national level - a state (government) (Feschiyan, 2013); the absence of a statement of the available capital, as well as a statement of cash flows due to non-compliance with the accrual principle. We have also pointed out the pending full regulation of the compulsory release of the financial statements of budget enterprises (Feschiyan, 2013).

4. Conclusion

We have already argued the thesis that the financial statements prepared in accordance with IPSAS improve the information database for the financial management of public sector enterprises and make the requirements for the public and private sectors more uniform. In the preparation of a financial statement in accordance with IPSAS, which contains the balance sheet, profit and loss statement, cash flow statement, statement of available capital and appendix, the property and financial results of public sector enterprises is reliably measured and presented, and the information database for their financial management is improved. However, when only incoming and outgoing cash flows are accounted for (as is still the case in our country), none can assess the property of the state, its assets and liabilities. It is therefore necessary to prepare the financial statements in compliance with the IPSAS requirements. The adoption of the principles and provisions of the International Public Sector Accounting Standards will create prerequisites for an overall improvement in the quality of financial statements in the public sector, which will produce timely and reliable financial and fiscal data, the ability to compare financial statements, greater transparency and accountability of the public sector. This will bring significant benefits to public sector governance, improve the efficiency and effectiveness of public administration, and facilitate the control over the performance of budget enterprises.

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