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Perspectives on Accrual Accounting

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PREFACE

The Public Sector Committee (PSC) is a standing committee of the Council of International Federation of Accountants (IFAC) formed to address, on a coordinated worldwide basis, the needs of those involved in public sector financial reporting, accounting and auditing. In this regard, the term "public sector" refers to national governments, regional (e.g., state, provincial, territorial) governments, local (e.g., city, town) governments and related governmental entities (e.g., agencies, boards, commissions and enterprises).

The mission of the PSC is to enhance the performance of the public sector by contributing to better decision making, financial management and accountability by governments. This is to be achieved through the development and promotion of best practice in:

- accounting and financial reporting;
- auditing; and
- financial management.

PSC has been given the authority, on behalf of the Council, to issue standards, guidelines, studies and occasional papers on financial reporting, accounting and auditing in the public sector.

Occasional papers are intended to provide information that contributes to some segment of the body of public sector financial reporting, accounting and auditing knowledge. They are aimed at providing new information or fresh insights into public sector issues and generally result from research activities such as: literature searches, questionnaire surveys, interviews, experiments, case studies and analysis.

The PSC believes that the issue of occasional papers will contribute to the development of public sector financial management and accountability throughout the world.

This third occasional paper aims to inform readers about a range of perspectives on accrual accounting from a number of contributors who have experience in implementing this accounting reform or who have observed its progress.

Acknowledgment

The PSC of the IFAC is indebted to the contributors for allowing it to include their papers in this Occasional Paper of the PSC. The views expressed in the Occasional Paper are those of the authors and are not necessarily shared by the PSC or the IFAC.

Perspectives on Accrual Accounting

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INTRODUCTION

Accounting is Changing as the World Changes

From time immemorial, accounting for governments and government agencies has been on a cash basis. No change was contemplated until the early 1980s when it was considered appropriate that government business enterprises should move closer to commercial accounting principles practiced in the private sector either on a full accrual or a modified accrual basis.

The pace of change has accelerated since then as governments around the world are being asked to do more with less and to be fully accountable to the community for resources entrusted to them.

As resources become scarcer, governments and public sector managers are more conscious of different ways to deliver services to achieve government policies and desired outcomes. Examples of this are competitive tendering and other forms of contracting out of activities which have traditionally been carried out by governments.

Demands for better accountability by governments and in turn by public sector managers is being heard around the world as the public realizes that living on credit is not sustainable for individuals and that the same principle applies to governments.

These forces create an environment in which the public demand reforms in the way governments manage their activities and businesses, and reforms in the way governments fulfil their responsibilities without leaving a huge burden on future generations.

It can be argued that these forces are a precondition for governments adopting financial reforms. An environment of reform tends to lead to decision makers demanding more useful information to assist in deciding between competing courses of action and to discharge their accountability in a meaningful way. The move from a cash basis to an accrual basis of accounting would seem to be a progression in keeping with management and financial reforms in the public sector.

This paper aims to inform readers about a range of perspectives on accrual accounting from a number of contributors who have experience in implementing this accounting reform or who have observed its progress.

The PSC believes that by sharing perspectives of those who have been involved in the use of accrual accounting information for decision making purposes, others may gain insights into the value of this form of financial reporting to their own governments and other public sector entities.

The PSC deliberately set out to obtain the views of a wide range of people with a range of occupational backgrounds. The PSC also set out to focus on people who have experience of changing information outputs. The contributors to this paper are politicians, economists, academics, administrators and accountants.

The International Monetary Fund's recent paper "The Case for Accrual Recording in the IMF's Government Finance Statistics System" [July 1996] is evidence that it is not only accountants who are examining whether governments should move towards accrual accounting as a basis for providing useful information for decision making. The IMF paper concludes that the revised IMF manual should advocate an accrual basis in order to address deficiencies of the existing modified cash basis and to enable a greater degree of harmonization with other macroeconomic statistical systems.

Key Points Made by Contributors

Usefulness of Accrual-Based Financial Reporting

A number of the contributors argue that cash-based financial reporting and accrual-based reporting are both useful and that neither one on its own can provide adequate information to meet the needs of governments.

It is acknowledged that cash-based systems offer simplicity and objectivity in terms of the demands they place on preparers of financial reports [Montesinos & Bargues]. Cash-based information is credited with being useful for assessing compliance with cash budgets [Montesinos & Bargues], and for monitoring and estimating a government's cash resources [Ross & Kelly]. However, it is also contended that cash-based information fails to show a proper picture of financial position and performance [Montesinos & Bargues] and to enable decision-makers to look ahead to estimate whether governments can continue to afford the services they currently deliver, or whether they can afford new services, on the basis of full-cost information [Richardson; Ross & Kelly].

A cash-based system does not provide information about total costs of government programs/activities undertaken today. Only an accrual-based operating statement provides information on the total costs of resources used in the delivery of government services, which is essential information for government decision-makers [Mellor]. Indeed, it is contended that a shift of emphasis to accrual-based information and accrual budgets can create the incentives needed in government for improved economic performance [Redburn; Richardson].

The United Kingdom author, Jones, argues that accrual-based financial reporting reforms are really only of interest to accounting technicians, but others strongly dispute this view [Redburn; Richardson]. There are conflicting views about whether politicians, key users of government financial reports, are interested in the information that accrual-based reporting produces. It is contended that there may be insufficient incentive for politicians to support the shift to accrual-based reporting because it may seem relatively complex and unrelated to politicians' key interests [Jones]. Another view, and one based on recent experience, is that politicians are indeed capable and willing to use the breadth of information provided by an accrual-based reporting system [Richardson].

Asset and Liability Management

Accrual-based reporting means recognizing assets and liabilities in existence as at a reporting date. One of the key advantages of accrual-based reporting is that it offers the opportunity for governments to improve their management of assets and liabilities [Mellor; Redburn; Ström].

It is noted that good asset management is critical in the public sector, particularly given that many of the significant assets are long-lived infrastructure assets that are vital to providing a foundation for economic growth [Mellor]. Under a cash-based system, there is a tendency to focus on whether or not to spend on new assets, whilst under an accrual-based system, the focus also extends to whether to retain or upgrade existing assets. That is, the accrual-based reporting focuses decision-makers on the broader range of options available in managing assets.

There is also the need to focus on financial assets and ensuring that they are measured reliably [Ross & Kelly]. A government cannot make appropriate financing decisions without accrual-based information on financial assets, measured using an objective assessment of their recoverability.

It is argued that accrual-based reporting provides useful information about the real level of a government's liabilities, relating to both debts and other obligations such as employee entitlements and the assets backing those liabilities [Richardson]. For example, until recently, many governments in Canada were not aware of the extent of their liabilities because these had only recently been revealed by accrual-based measures [Ross & Kelly]. Governments cannot hope to govern in a sustainable way unless they are made aware of the liabilities created by the impact of current decisions, such as those concerning pensions for government employees [Ross & Kelly] or those affecting deposit insurance programs relating to a country's key financial institutions [Redburn].

Measuring Performance

Accrual-based reporting means recognizing revenues and expenses that relate to a reporting period.

Accrual-based reporting helps to focus governments on management by results as well as management of resources. That is, under an accrual-based reporting system, management by results becomes more attractive because performance can be measured more reliably when full costs for a period are taken into account [Mellor; Redburn]. Under an accrual-based system, the consumption of resources can be weighed against performance and it is contended that this is one of the most important reasons for focusing on an accrual-based system [Richardson; Ström].

Accrual Reporting and Accrual Budgeting

It is contended that any reform is considered successful only when it brings about changes in the behavior of the people the reform is targeted toward [Mellor]. Accrual reporting is only one part of a comprehensive package of reforms that can lead to improvements in the management of public sector resources. Budgeting and planning on an accrual basis are also essential in enabling governments to realize benefits from the reforms. [Mellor; Richardson].

Transparency

Governments may have incentives to show a financial position and performance that is either better or worse than it actually is [Ross & Kelly]. For example, a government may wish to expand its spending on a range of programs and it may suit politicians to paint a healthy picture of the government's current finances in the belief that their constituents will accept the need to spend more readily in these circumstances.

Soundly-based financial reporting by governments may help to avert undesirable spending behavior by preventing them from providing a distorted picture of the government's finances. It is argued that the adoption of accrual accounting can be expected to improve financial transparency, improving the integrity and reliability of reported information [Mellor; Richardson].

It is also argued that the credibility of government is enhanced and the public can have greater confidence in the government's financial management ability, when the government is recognized for having produced useful and relevant financial information [Richardson].

Costs of Implementing Accrual Accounting

It is noted that accrual accounting is a tool, not an end in itself [Ström]. It is a tool for decision-makers that can help them to make better decisions and improve the allocation of scarce government resources. However, the benefits of this improved decision-making can be difficult to quantify. The costs of implementing new systems and training personnel are usually much easier to measure.

It is acknowledged that the costs of developing information systems can be high [Montesinos & Bargues; Ström]. There are a number of new processes that governments must adopt in order to move from a cash-based system to an accrual-based system and changes are needed throughout government, from the agency or departmental level to the whole of government level.

Change also involves a human cost. Some people will resist change because it involves an effort and may move them from the familiar to the unfamiliar. The providers of information and the managers and politicians that will use the information need to broaden their thinking if they are to benefit by a move from a cash-based system to an accrual-based system.

It is also evident that financial and management reforms need to have the support of politicians if they are to succeed [Richardson]. There needs to be an incentive for change and the reforms in each of the jurisdictions that have moved to an accrual-based reporting system have been backed by legislative change.

In order to gain the support of legislators, those who support a move to accrual-based reporting must be able to demonstrate that the benefits of doing so outweigh the costs.

NEW ZEALAND CONTRIBUTION

“OPENING AND BALANCING THE BOOKS: THE NEW ZEALAND EXPERIENCE”

by Hon. Ruth Richardson
New Zealand’s Minister of Finance 1990-1993

The Fiscal Responsibility Act defines the attributes of good fiscal management, and ensures the Government meets these criteria by requiring a pre-budget opening of the books and a post-budget review of fiscal strategy. The Government is therefore more open and more accountable. The Act creates an incentive for the politicians to pursue policies in the country's long term interests, rather than to suit short-term political ones.

New Zealand’s budget - presented in late June - projects a string of budget surpluses.

Building on the milestone of a financial surplus achieved in the 1993-94 financial year, this is the first time in a generation (some 20 years) that surpluses, not deficits, are the budget norm.

New Zealand’s fall from fiscal grace is as well documented as it has been damaging. Persistent deficits, culminating in dangerous levels of debt, proved (unsurprisingly) to be an enormous drag on the growth and development of the economy and severely compromised growth in income and employment opportunities for New Zealanders.

For the best part of a decade New Zealand has made a determined effort to reverse these negative trends and to build a platform for sustainable non-inflationary growth.

Building Sustainable Growth

In the early 50’s New Zealand had the 5th highest standard of living in the western world. Over the ensuring decades New Zealand failed to tackle the causes of our structural decline, consequently slumping to 25th by the late 80’s. The imperatives for change in New Zealand were three fold -

- Sick economy - one of the worst performers in the Organization for Economic Co-operation and Development (OECD)
- Sick public institutions - lack of efficiency and effectiveness in government agencies
- Sick social policy - neither fair nor affordable

In essence New Zealand suffered from two deficits -

- **Financial deficit -** in continuous deficit for two decades (70s and 80s) pushing net public levels up from 5% of Gross Domestic Product (GDP) to over 50% of GDP
- **Performance deficit -** while public expenditure levels climbed from 30% of GDP to over 42% of GDP over those two decades, the standard and quality of performance in our public institutions and agencies dropped.

The turnaround of New Zealand’s economic and social performance hinged directly on overcoming those two deficits. Public sector reform was an integral part of the wider economic and social policy reform effort.

The essential building blocks of the New Zealand recovery are these:

- price stability - a statutory commitment to low inflation
- fiscal responsibility - a statutory commitment to fiscal prudence
- labor market flexibility - a statutory deregulation of the labor market
- non distortionary taxation regime - a broad base: low rate taxation statute
- openness to internal and external competition - a deregulated environment free from subsidies and government preferences
- targeted social entitlements - social transfers strictly on the basis of need
- a market-style public sector - financial and management reform subjecting the public sector to the same management, employment and accounting disciplines as prevail in the private sector.

The fact that New Zealand has one of the highest growth rates in the OECD (some 6 per cent) with one of the lowest inflation rates (some 2%), accompanied by a rise in employment and a fall in unemployment (some 6%) speaks volumes about the success of this policy setting.

The adjustment programme has seen a wide range of legislative budgetary and public policy initiatives.

The legislative initiatives fall into three main categories:

- Improving private sector performance:
  - ➪ Employment Contracts Act 1991 - securing flexible labor markets.
- Improving public sector performance:
  - ➪ State Sector Act 1988 - securing accountability of state sector managers;
  - ➪ Public Finance Act 1989 - a true government balance sheet;
  - ➪ State-Owned Enterprises Act 1986 - corporatizing state businesses.
- Securing Macro-economic performance:
  - ➪ Reserve Bank Act 1989
  - ➪ Fiscal Responsibility Act 1994.

A Fiscal Framework

The newly passed Fiscal Responsibility Act is landmark legislation which establishes a statutory framework for the responsible conduct of fiscal policy. As Parliamentarians around the world know only too well, fiscal responsibility is hard won and so easily lost. The Act seeks to reverse the usual bias in budgeting that lamentably leads to a deterioration in the fiscal position.

The very first submission to the Finance and Expenditure Select Committee on the measure described it as "one of the most important pieces of economic and fiscal legislation in New Zealand since 1840". The submission went on to urge "the leadership of Parliament" to guarantee that the government's approach to expenditure and revenue is one that will "reduce debt and restore the government's financial position rather than seeing a dissipation of the position in more immediately popular ways".

The Bill, as introduced, was designed to achieve for fiscal policy what the Reserve Bank Act has achieved for monetary policy - a statutory framework that promotes sound, credible policy and which acts as a bulwark against policy stances that would compromise that credible policy setting.

The Bill as introduced by me in September 1993 relied heavily on the discipline that would automatically be imposed on governments who were required to operate fiscal policy in a highly transparent environment. The live issue before the Select Committee was "is transparency enough?"

The weight of evidence presented to the Select Committee supported a strengthening in 3 three ways:

First, a set of explicit principles for the prudent conduct of fiscal policy were written into the law. These were more in the nature of characteristics of responsible fiscal policy rather than the mandatory "balanced budget" targets approach. Much more than a simple balanced budget, the principles target the burden of government claims on the economy as a whole; expenditure, deficits, debt and contingencies.

Second, a statutory framework for the responsible conduct of fiscal policy was sought. Statutory transparency requires frequent and full disclosure of the government's financial position, even extending to a statutory obligation to "open the books" before an election. The temptation to engage in an electoral auction in the run-up to a poll is not nearly so great when the true (often precarious) state of the government's books is required to be disclosed prior to an election.

Third, a set of new budget processes was urged on the select committee so that we might usher in an era of open budgeting and ensure parliamentary scrutiny of the key budget parameters before a budget is presented.

Principles of Good Housekeeping

The new statutory framework recommended by the Finance and Expenditure Select Committee for enactment sought to identify the key characteristics of responsible fiscal policy.

The principles of responsible fiscal management essentially involve good housekeeping. They provide benchmarks against which fiscal policy should be developed and judged.

The five chosen principles are these:

(a) Reducing total Crown debt to prudent levels so as to provide a buffer against factors that may impact adversely on the level of total Crown debt in the future, by ensuring that, until such levels have been achieved, the total operating expenses of the Crown in each financial year are less than its total operating revenues in the same finance year.

The first principle acknowledges that, currently, New Zealand's debt levels are too high and should be lowered significantly in order to reduce the economy's vulnerability to adverse factors. This should be achieved by running surpluses on the operating balance.

(b) Once prudent levels of Crown debt have been achieved, maintaining these levels by ensuring that, on average, over a reasonable period of time, the total operating expenses of the Crown do not exceed its total operating revenues;

The second principle implies that once debt has been reduced it should not (in general) be increased. In particular, a government should not borrow to "pay for the groceries". This principle is a medium to long-term one. In the short term, cyclical factors may well result in temporary, and desirable, deviations from balance.

(c) Achieving and maintaining levels of Crown net worth that provide a buffer against factors that may impact adversely on the Crown's net worth in the future.

The third principle recognizes that there are a wider-range of factors relevant to the fiscal position than a focus solely on debt would reveal. For example, the Crown's balance sheet includes a significant exposure to public service pension liabilities that are not caught within the usual definitions of public debt.

More generally, it is not just the level of debt which is important but also the assets which are backing it. As for the debt principles, the focus on Crown net worth also reflects the thought that, over time, governments should prepare for eventualities that may not be reflected in the current balance sheet. For example, an aging population may imply impending increments to health and retirement income support.

(d) Managing prudently the fiscal risks facing the Crown;

The fourth principle also acknowledges vulnerability issues and requires that governments should actively manage the risks inherent in its assets, liabilities and off-balance-sheet items such as guarantees.

(e) Pursuing policies that are consistent with a reasonable degree of predictability about the level and stability of tax rates for future years;

The fifth principle reflects the importance of stability in tax and expenditure levels for private sector planning and hence growth.

Responsibilities rather than Restrictions

It is important to understand what these principles mean and do not mean.

They *do not* constrain a government from governing and pursuing its own policy programme. Under the legislation, a government will be free to specify the broad strategic priorities by which it will be guided in preparing the budget. Under the legislation, the Government can - and should - advance its broad economic and social policy ambitions. These are not proscribed in any way by the legislation - nor should they be.

What the injection of a set of fiscal principles into the Bill does do is to ensure that a government's objectives, whatever they may be, are pursued in a fiscally responsible manner.

And there's the rub, deliberately so.

The fiscal principles also recognize that, in a practical sense, governments may be forced to temporarily depart from principles of responsible fiscal management on occasions. However, when they do so, the onus would be placed on governments to justify any departures and outline how responsible fiscal management would be restored as soon as possible.

The principles provide strong incentives for governments to operate fiscal policy in a responsible manner.

Proper Financial Accounts

New Zealand now publishes government accounts similar to those of private sector firms, the only sovereign nation to do so. "New Zealand Inc" produces a balance sheet of assets and liabilities and an accrual-based operating statement of income and expenditure. These accounts, which are independently audited, have two benefits: they remove the scope for fiscal trickery, and they encourage governments to focus on the longer-term consequences of policies.

These reforms have been labeled the most far reaching and ambitious of any of their kind in the world, and are regarded as at the leading edge of central government systems internationally.

We accomplished these reforms in two steps.

The groundwork was laid with the passage of the Public Finance Act 1989. This measure which was passed with bipartisan support required a full set of financial statements from the government. Each government entity had to produce a:

- Statement of financial position
- Operating statement (revenue and expenses)
- Statement of cash flows
- Statement of objectives
- Statement of service performance
- Statement of commitments
- Statement of contingent liabilities
- Statement of unappropriated expenditure
- Statement of accounting policies
- Comparative actual figures for the previous year

Under this regime departmental managers became responsible for financial management, had the freedom to manage the balance sheet, achieved comparability with other service suppliers (paid tax, pricing and accounts) and managed all of this under tight budget constraints. Accounting expertise was typically recruited from the private sector and major changes occurred in the culture of the organizations.

Once all the Government departments and agencies had moved onto an accrual basis, the Crown was then able to prepare consolidated statements. Most valuably, for the first time, we were able to begin to interpret our net worth. Not surprisingly it was very negative, but at last we had a reliable measure of improvement over time.

The second step came during my term as Minister of Finance when again for the first time, it was possible to apply these accounting concepts and disciplines to the budget process and fiscal management. The Government's determination to apply sustained fiscal discipline was hugely aided by the availability of such sophisticated and effective accounting tools. The Budget of 1991 yielded a huge fiscal dividend extracted from the application of these modern tools.

The credibility of our fiscal policy framework was further boosted by the requirement that all this accounting and budgeting had to be conducted in compliance with generally accepted accounting practice. Maintenance and enforcement of those accounting standards is entrusted to a private entity independent of the Government. In this way a government, were it to be so tempted, is denied the ability to engage in self-serving interpretations. Again New Zealand is breaking new ground with this practice, as no other sovereign in the world subjects government financial reporting to an independent agency.

Open to Scrutiny

Just as important as the principles that set the scene for responsible fiscal management are the new processes that will govern the preparation and presentation of budgets.

In a world of coalition governments, open budgeting will be a must. By that I mean that those responsible for pulling together a budget will, of necessity, want to have a high degree of public and parliamentary understanding of the parameters within which the budget is being prepared.

It may well be that governments need to get their budget not just presented, but passed, before the beginning of a financial year in order to secure supply in the year that follows.

The beauty of the new process is that it will expose the basis on which the Government is preparing the budget to parliamentary gaze and private contestability before the budget is finally put to bed. It will lead to a welcome and wider sense of ownership of the budgetary issues that the Government must address.

Parliament and the public will become accessories before the fact, not after the fact.

The Act requires the Minister of Finance to publish a Budget Policy Statement (BPS) no later than 31 March each year. The BPS shall:

- specify the government's long-term objectives for fiscal policy;
- confirm that these meet the principles of responsible fiscal management;
- specify the broad strategic priorities which will guide the preparation of the budget for that financial year;
- indicate explicitly the intended track for key fiscal aggregates over the budget planning period;
- indicate compliance of the intended track for key fiscal aggregates with the legislative principles of responsible fiscal management and the long-term objectives;
- justify any departure of the intended track from these principles and objectives;
- compare the long-term objectives and fiscal intentions with those specified most recently and to justify any departure.

The Act requires referral to the Finance and Expenditure Committee of a Budget Policy Statement and other reports required under the Fiscal Responsibility Act.

It is intended that there be Standing Orders requiring the Finance Expenditure Committee to review and report back to the House on the Budget Policy Statement, Fiscal Strategy Report and the Budget Economic and Fiscal Update.

Regular Reporting

Not only is full disclosure required under the financial management reforms, but under further refinements passed in 1994, frequent disclosure is also expected. In what some would regard as staggering speed, the Government is required to produce a set of accrual based financial statements within 6 weeks of year's end. Again the discipline of disclosure has a salutary and significant effect on government fiscal decisions when all involved in taking those decisions know that their impact will be revealed in the financial statements within two months at the most.

Improved Performance and Confidence

The principles of fiscal responsibility, together with the pre-budget opening of the books and the post-budget review of the fiscal strategy by the select committee, provide strong incentives for governments to operate fiscal policy in a responsible manner.

The Act will give taxpayers and investors greater confidence in the management of the Crown's finances and public resources, making New Zealand a more attractive place for investment. Further, it will help sustain good fiscal policy, which, in turn, is necessary to sustain strong economic growth.

FISCAL RESPONSIBILITY ACT

WHAT IT MEANS FOR THE CONDUCT OF FISCAL POLICY

ACT
sets fiscal policy
framework

GOVERNMENT
decides detailed fiscal policy which can be
assessed
against the Act's framework

PARLIAMENT
initiates, from pre-budget examination of budget parameters
and assumptions and post-budget, reconciliation of the
outcome with the announced fiscal strategy

GENERAL PUBLIC
is better informed and better able to judge the merit and
credibility of the government's fiscal policies

CANADIAN CONTRIBUTION

"FROM CASH TO ACCRUAL: THE CANADIAN EXPERIENCE"

by Diana R. Hillier
based on speeches made by
N.Glenn Ross, Chairman 1981 - 83, and
John J Kelly, Director,
Public Sector Accounting and Auditing Board
of the Canadian Institute of Chartered Accountants

Until the 1980's, Canadian governments budgeted and accounted for their financial affairs on a cash basis, and reported on them through a series of separate account and fund financial statements. These accounting practices are still widely used by many governments around the world.

Throughout the 1980s, however, Canadian governments significantly changed their financial reporting practices, moving from cash to accrual accounting and from separate account reporting to consolidated financial statements. In part, those changes were spurred by the work of the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants. But PSAAB could not force governments to adopt its recommendations. Acceptance and adoption of PSAAB's recommended financial reporting practices has only been achieved with the concurrence of governments and the encouragement of legislative auditors who convinced governments that the cash basis of accounting failed to provide them with complete and accurate information for decision making and accountability.

In the past, Canadian governments argued that the cash basis of accounting best meets their needs. It's focus on cash flows enabled them to monitor their spending and formed the basis of government budgetary and expenditure control.

Estimating a government's cash and revenue requirements is important. While financial statements, alone, cannot provide all information needed to make that estimate, they can give information that is vital to doing so. Future revenues have to pay for past debts as well as future services, and spending cannot get too far out of line with a government's ability to raise revenues. Government decision-makers must be able to realistically estimate whether their governments can continue to afford the services they currently deliver, and whether they can afford new services.

The cash basis of accounting simply does not provide sufficient information to assess a government's financial requirements. Focussing solely on a government's outstanding borrowings ignores other liabilities that will be just as much of a drain on a government's financial resources. Similarly, ignoring, or, on the other hand, overvaluing, financial assets doesn't provide the information needed to make informed judgments about the financial resources on hand that can be used to meet obligations and finance future operations. Arguably, one of the reasons that Canadian governments are now grappling with unwieldy debt levels is due, at least in part, to the lack of complete information about what they owed in their budgets and financial statements.

While complete and consistent information does not necessarily result in good decisions, incomplete, fragmented information virtually guarantees bad decisions.

Using the Canadian experience, this paper discusses why governments should adopt accrual accounting and consolidated reporting. It is based on speeches made by successive Chairmen of PSAAB and by its Director. It begins by discussing why governments might want to "cook the books" and how the cash basis of accounting lets that happen. In doing so, it explains why the cash basis doesn't provide governments with information needed for sound decision-making and for full and fair accountability.

Why Governments Might "Cook the Books"

In a speech given in 1982 by PSAAB's first Chairman, N.G. Ross, he posed the following question to a group of legislators - why might governments "cook the books"? The answer - because governments, like any organization, do not like to report bad news. Bad financial news can constrain policy and spending initiatives that a government wants to introduce.

One way to avoid the bad news is to change the rules used to measure and report financial information - in other words, "creative accounting"- to try to convince someone that the government is doing something different that what it is actually doing. For example, a government may want to convince people:

- that their budgetary deficit is less than it actually is;
- that they really haven't exceeded spending authority granted by the legislature;
- that the growth in their total expenditures is less than it really is;
- that the liabilities to be met by future generations are less than they really are;
- that some of their past decisions, described as sound investments at the time, are really still of value to future generations even though they are truly worthless;
- that this year's performance compares favorably with their own or a previous government's past performance; and finally
- that by comparison with other governments their performance is really quite good.

The objective is not always to make things look better than they really are. Sometimes, governments try to paint a black picture - for example, in the first year they are in power after succeeding a government of a different political party, or the first year after having received a strong mandate at the polls.

This may seem to be unfairly criticizing government and, indeed, the temptation to "massage" financial information by using "creative" accounting is not confined to governments. Businesses would also like to write down their assets in a profitable year to minimize taxes, and would be equally quick to claim high values in a loss year when performance is poor.

The cash basis of accounting provides a number of ways to present fiscal reality differently than it really is. Three of the most common ways are - understating liabilities, overstating assets and unconsolidated financial statements. As governments are finding out, by bitter experience, such practices are often short-sighted and, in the long run, unpopular.

Liabilities: The Hidden Debt

Perhaps the most serious shortcoming of the cash basis of accounting is the fact that it fails to provide governments complete information on all that they owe. The cash basis accounts for transactions when the cash is received or paid. Its main advantage is simplicity. Its main disadvantage is the production and reporting of incomplete financial information. Spending controls can effectively be circumvented by simply deferring payment. But even more troubling is that, under the cash basis of accounting, huge amounts owing by governments go unreported and are not taken into account when assessing a government's financial position and results, or determining its future revenue requirements.

In simpler times when governments had few, if any, long-term commitments, the cash basis of accounting worked pretty well. However, since the 1960's, new social programs, such as Old Age Security, unemployment insurance and welfare gave rise to many long-term commitments. In addition, in times of restraint, many Canadian governments promised their employees enriched pension and other post-retirement benefits in lieu of salary increases. On a cash basis, there was no immediate impact on spending, but what was hidden was a series of large and growing long-term liabilities.

Until recently, few governments recognized the enormity of those liabilities. With inflation, their magnitude sky-rocketed and, as the costs were not recognized and reported, no plans were made to meet these liabilities as they came due. For example, by the late 1980's, Canada's federal and provincial governments had accumulated more than $30 billion in unrecorded employee pension liabilities. In some provinces, the size of the unrecorded liability equaled or exceeded their accumulated deficits. And yet, these amounts were not recognized as liabilities, even though they were as real to the government as its outstanding borrowings. In some jurisdictions accounting on the cash basis, employee contributions to pension plans were even recorded as revenues of the province.

The same effect was achieved by accounting for major social insurance plans through special accounts. Because greater revenues come in at the start of a plan, programs like the Canada Pension Plan, and Workman's Compensation, help a government with its cash flow in their early years, and the future day of reckoning is postponed by accounting for them on a pay-as-you-go basis. Indeed, governments have generally avoided setting up such liabilities by wording legislation to limit their legal liability to cash available from contributions. But what government would dare deny its citizens the benefits of a program for which they have contributed over the years by simply claiming they have used their money to finance someone else's benefits?

Out of sight, out of mind, so the saying goes. And so, massive liabilities for employee pensions and other post-retirement benefits and for workers' compensation - amounting to tens of billions of dollars - went unrecorded and unreported. In some cases, information was provided in the supplementary notes to the financial statements. But such disclosure was not enough. Because they weren't recorded and taken into account when determining the total amount of government debt and in calculating annual deficits, these substantial obligations were often not considered when policy and spending decisions were proposed or made.

The problem is obvious. But, too often, governments don't like to be constrained by hard fiscal reality when making decisions that could win votes or calm dissent. Unfortunately, the chickens do come home to roost. If governments don't report all of the debts they owe, how can cabinet, the legislature or the public make informed decisions about, for example, whether a government can afford a new social program or major spending initiative?

Today, the federal and most provincial governments now record their unfunded pension liabilities and take them into account when presenting their financial position. In many jurisdictions, plans are being made to fund those liabilities, including renegotiating their terms with employees and developing realistic employee and employer contribution patterns. In all cases, those obligations are being considered when considering the government's fiscal options and long-term plans.

Financial Assets: What Are They Worth?

If governments account for all debt, they also need to account for the financial resources available to meet that debt - and they have done so. Unfortunately, all too often these assets do not produce the values claimed for them.

For example, the value of a governments' loans receivable are often overstated. Unlike commercial loans, many government loans provide the borrower with concessions - such as below-market interest rates, forgivable conditions or the promise of increased government assistance in the future to help the borrower repay the loan. Yet often all government loans are recorded at face value. That means a reader of government financial statements can't tell which of the loans are earning significantly less than it is costing the government to borrow money, are being repaid through government funding, or are likely to be forgiven. The concessions and their effect on the future revenue requirements are not shown.

For example, when a government lends at rates lower than it pays to borrow money, it does so at a cost. If accounted for on a cash basis, there is little impact in the year the loan is made and, in fact, may be buried in debt service. But over time such costs accumulate. Future government spending options will be affected, since future revenues are being committed to meet the growing difference between the interest rate the government pays for money and the rate it earns on funds it has lent. Decision-makers and the public need to know the cost of concessionary loans when the loan is made. A grant by any other name is still a grant, and the cost of those concessions are, in substance, a grant that should be recognized when the loan is made. Otherwise, the loan shown on the government's financial statements is overstated.

Similarly, loans that will be repaid only if the government gives the borrower funds with which to repay them haven't much value to the government as assets. This situation often exists with other government bodies, such as hospitals, universities or schools. Because the government often gives them grants to repay such loans, the loans may not represent assets of the government, but may be really grants. Showing these loans as assets makes the government's financial position look better than it really is.

To avoid recording overstated assets, governments need to make an annual valuation of their assets and make provisions for losses as they occur. Within the last decade, most governments in Canada have taken a close look at the assets they are reporting and have written them down where there is no underlying value. Loans that are really not loans, and investments that have lost value, have been written down so that the governments do not overestimate their ability to meet their obligations as they come due.

Changing the Reporting Entity

All governments in Canada are required to produce budgets and estimates of expenditure as well as financial statements to report on their financial position and results. But, in the past, none of them defined the activities considered to be part of the government for financial reporting purposes in the same way. In fact, what was considered to be included in the scope of government financial statements often changed from one year to the next.

By excluding something that was formerly included within the ambit of the government's financial statements, a government can easily alter the perceived growth in its activities, and the size of its surplus or deficit.

There are a number of ways that this can be done. The Canadian Constitution requires the federal and provincial governments to each have a consolidated revenue fund. All government revenues are deposited in that fund, and can only be appropriated by the legislature. This consolidated fund was the cornerstone of legislative control over spending. So, traditionally, government budgets and financial statements were confined to transactions of the consolidated fund. Consequently, the government, for financial reporting purposes, equaled the consolidated revenue fund.

If all government transactions are in the consolidated fund, how can they be moved around to manipulate the reported surpluses, deficits or debt? The most obvious is to create a separate state-owned enterprise or corporation. Unless those corporations are consolidated with the accounts of the government, their assets, debt and operations are excluded from the financial picture presented by the government's financial statements. The picture of the government's overall financial position and results is, therefore, fragmented at best and often simply impossible to understand.

In addition, in creating such organizations, governments may sell property to them that has not been accounted for in the government's financial statements. For example, the government can create a realty corporation to manage the government's property by selling the corporation its land and buildings. In doing so, the government can record the proceeds as revenue, inflating the current year's operating results. If the corporation financed the purchase with debt, the government has not only created revenue, but off-loaded debt.

Another example is a financing authority established to obtain reasonable financing for local governments and other government bodies, such as hospitals and universities. The financing authorities raise debt on behalf of the other organizations because the government can obtain more favorable terms than the organizations themselves. They then loan the money to the local governments and government agencies. However, unless the financing authorities are consolidated with the government's accounts, the billions of dollars of debt raised in those organizations becomes "off-balance sheet" financing for the government - and the government's reported debt understated. In addition, because the government is often the primary source of funding for many government agencies, the government may give them the money needed to repay the loans. From the perspective of the government as a whole, those loans may be, in substance, grants.

An equally successful, and much less obvious device, is to create a fund or special account within the central accounts of the government (essentially, embracing fund accounting). In this way, revenues and expenditures are attributed to the fund/account and do not get added into the gross revenues and expenditures of the government. Also, any excess revenue gets included among liabilities on the government's books and any deficiency of revenue appears as an asset, rather than affecting the government's surplus or deficit of the year. Thus, until 1986 when the government made substantial changes in its accounting policies, the $4.5 billion deficit in Canada's unemployment insurance fund was recorded as an asset on the government's books. More recently, some provincial governments have created budget stabilization funds, which because no money was actually set aside in the fund, was used primarily to manipulate the surplus or deficit the government reported.

Clearly, in order to get an overview of the government as a whole, the scope of government budgets and financial statements needs to be broad enough to aggregate all government activities, regardless of the form of organization used to carry them out. Focussing on the consolidated revenue fund is not enough. Government's financial statements and budgets need to reflect the full nature and extent of the financial affairs for which the government is responsible. If not, decision-makers and other users of government financial statements receive a fragmented or misleading view of the government's operations.

Over the past decade, the federal and virtually all provincial governments in Canada have expanded the scope of their summary financial statements to consolidate all organizations, funds and special accounts.

In Summary

The cash basis of accounting no longer serves the needs of government, both from the perspective of the information needed for effective decision-making and for accountability.

Budgets lay out government spending and show how it is to be financed. Financial statements describe a government's financial position and actual results. Both address the key question of the "affordability" of government programs and operations - and both are accounting documents. Proper accounting principles are, therefore, essential to realistic and consistent measurement of the financial information presented in both budgets and financial statements.

Private businesses are just as self-interested as governments. But private capital markets cannot function without a high degree of credible financial information. For that reason, regulators and others have insisted that business abide by generally accepted accounting principles, which have clearly ruled out the worst practices and made consistency a virtue.

Government is also going through a credibility crisis that it cannot afford to ignore. Even though the accounting standards recommended by PSAAB in Canada must be adopted voluntarily, virtually all governments in Canada have changed their accounting practices and moved further along the spectrum to accrual accounting, at least in their financial statements. The Canadian experience supports the fact that, while cooking the books may seem to be desirable, it may not be the best, or most popular, solution in the long run. Accounting cannot solve a government's fiscal problems, but it can provide information that is relevant to the decision-makers who are charged with doing so - and to the public to whom those decision-makers are accountable.

SPANISH CONTRIBUTION

"BASES OF ACCOUNTING AND REPORTING FOCI IN SPANISH GOVERNMENTAL ACCOUNTING"

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THE INTRODUCTION OF ACCRUAL ACCOUNTING IN GOVERNMENTAL ACCOUNTING SYSTEMS IN SPAIN

Main Features of the Traditional Cash Based Accounting System

The traditional accounting model for public administrations in Spain was based on cash budget and other cash information.

The elements reported in financial statements were restricted to cash and near cash items, being cash receipts plus short term receivables; cash disbursements plus short term payables; and cash and near cash balances.

Single-entry was the recording procedure used for the traditional reporting model, which paid special attention to compliance with budgetary, contractual and other legal requirements, including spending limits, as well as management accountability. This system did not produce articulating financial statements, and the most important disclosure related to adopted budgets and their execution. Complementary data were reported, such as non-financial assets, non-budgetary financial items, etc.

The New Conceptual Framework for Non-Business Public Entities Accounting: The Duality in Governmental Accounting Principles

The current system of governmental accounting in Spain dates from 1977, when the General Budgetary Law, introduced the bases for the development of a new accounting information system for the public sector in Spain.

For governmental entities, a General Governmental Chart of Accounts (Plan General de Contabilidad Pública, PGCP) works as a conceptual "core" for the accounting information systems. The first chart was issued in 1983, and continued in force until 1st. January 1995, when a new PGCP was put into effect. (See MONTESINOS, 1994a, 1994b).

Operative accounting standards and rules for an effective implementation of this reform were not ready for specific applications until 1986. In that year, a Royal Decree introducing the Accounting and Budgetary Information System (Sistema de Información Contable y Presupuestario, SICOP) was issued; the same year, the most significant operative accounting standards (instrucciones) were also published. By this computer information systems for the implantation of the system at a state level were also available (Vid. MONTESINOS & VELA, 1992).

The Chart of Accounts for Governmental Accounting in Spain includes basic principles, a detailed list of accounts with their debit and credit rules, financial statements models with their notes and valuation rules.

The Local Accounting and Budgetary Information System was developed by the SICAL (Accounting Information System for Local Governments), with similar principles and objectives to those set up for central administration by the SICOP.

On the other hand, Regional Autonomous Communities have issued their own governmental accounting standards, normally by adapting PGCP to specific characteristics of Regional Administrations.

In 1991, the General Internal Audit and Accounting Office (Intervención General de la Administración del Estado, IGAE), issued "Governmental Accounting Principles" (IGAE, 1994). This pronouncement is very close in its structure, content and characteristics to other national and international conceptual statements in the field of Business Accounting, such as the 1990 Spanish 1990 PGC for business enterprises and the 1989 IASC (International Accounting Standards Committee) Framework for Preparation and Presentation of Financial Statements (IASC, 1989).

After the issuance of several specific concept statements (IGAE, 1994a), a new Governmental Chart of Accounts (Nuevo Plan General de Contabilidad Pública, NPGCP) was adopted in 1994, as a General Framework for different levels of administrations (central, regional and local). The NPGCP is in force for central administration since 1st. January 1995.

For government enterprises, accounting principles do not differ from those of private sector business enterprises, even though their activities are more strictly regulated, particularly in relation to public contracts and the duty of reporting to external audit institutions[1].

For the other public entities[2], there are some differences from the GAAP used for business enterprises, reflecting some of the transactions and events that are unique to the public sector. However, these differences are nevertheless consistent with the general conceptual framework of accounting.

For example, the 1994 PGCP enunciates twelve accounting principles, nine of which are the same as those Business entities (see exhibit 1). However, the accounting principles are applied differently to business and public entities.

Exhibit 1
Business and Governmental Accounting Principles in the Charts of Accounts

1990 BUSINESS REPORTING PRINCIPLES	1994 GOVERNMENT REPORTING PRINCIPLES
1. Conservatism	1. Conservatism
2. Going Concern	2. Going Concern
3. Recording	3. Recording
4. Historical Cost	4. Historical Cost
5. Accrual basis	5. Accrual basis
6. Matching	6. Matching
7. No compensation	7. No compensation
8. Consistency	8. Consistency
	9. Materiality
	10. Accounting Entity
	11. Transaction allocation

1 A general study on Accounting Principles in Spanish Governmental Reporting system can be found in VELA, 1992.

2 As the IFAC describes, these public entities are: a) Administrative and service delivery units funded exclusively or predominantly by general government revenues; and b) government themselves, either at a national, regional or local level [IFAC, 1993, CH.1, #.014].

12. No affection

Accordingly, many of the basic accounting rules are common to business enterprises and public sector entities. In fact there is a methodological duality in governmental accounting system: an accrual accounting system for financial statements and a modified cash system for budget transactions.

The standards on general principles and procedures for Management Accounting, and guidelines for reporting harmonization performance measurement will be developed out of the text of the PGCP (Vid. POU, 1993; MONTESINOS & VELA, 1994a; MONTESINOS & VELA, 1994b).

Moving Through Accrual Bases of Accounting

Bases of accounting establish criteria used to determine when transactions and their effects are recognized in the accounting system. The bases of accounting used for reporting purposes range from the cash basis to the full accrual basis, with intermediate "modified cash" and "modified accrual" positions (See IFAC, 1991, pp. 9-12; IFAC, 1993, pp. 4-8); LÜDER, 1994, pp. 2-9).

In Spain, in the public sector financial statements, such as balance sheet and income statement, are prepared using a modified accrual basis. The two most significant exceptions to full accrual basis are the following ones:

a) Governmental capital assets, when for direct public use by citizens, are recognized as capital investments during construction and are written-off (expensed) when completed. This is the case for infrastructure, defense and cultural assets. Consequently, no depreciation expense is recognized for these capital assets.

The lack of recognition of depreciation expense for these capital assets, especially infrastructure assets, makes it difficult to determine the true cost of services, the operating result and its impact on equity.

b) Capital subsidies are recognized using a modified cash basis and transferred to income when collected or when receivable within three months or less. As a consequence of this, there are no deferred revenues to be recognized in future periods.

These exceptions produce a deviation from the economic results and equity that would be obtained using a pure accrual basis. Accordingly, it would be fair to describe the Spanish system as a modified accrual basis of accounting.

For budgetary reports, there is no clear definition of the basis of accounting to be used. In accordance with the General Chart of Accounts, budgetary revenues and expenditures are recognized when the administrative decisions have been adopted, independently of the time when they are accrued.

Uncollectible or risky receivables are written off in the budget execution reports, only when an adverse adjustment or lack of legal support for recovery exists. Uncollectible accounts allowances are included in the balance sheet and the statement of financial performance, according to accrual basis rules.

More than one year term commitments are included as long term liabilities in the balance sheet but are reported in the notes to the annual budget.

Reporting Foci in the New Reporting Framework

Reporting foci are the criteria used to define what assets and liabilities are recognized in determining the entity's financial position. The inclusion or non-inclusion of assets and liabilities in the statement of financial position depends on the reporting focus adopted (See IFAC, 1991, p. 2; IFAC, 1993, pp. 12-18); LÜDER, 1994, pp. 3-9).

According to IFAC (1993, par. 073), there are three main bases for reporting on assets:

1. Current financial resources;
2. Total financial resources; and
3. Economic resources.

Lüder (1989, p.20; 1994, pp. 2-3) includes liabilities, and defines three types of "measurement" foci for net asset positions:

1. The net-monetary-debt measurement focus, where only monetary assets and monetary liabilities are recognized.

2. The net-total-debt measurement focus which includes, in addition to net-monetary-debt elements, the receivables and realizable physical assets (as additional assets) and payables and accrual liabilities (as additional liabilities).

3. The equity measurement focus encompasses in the financial position all the entity's assets and liabilities. In addition to the net-total-debt focus, this one includes as assets the non-realizable physical assets.

In Spain, the modified economic resources/equity focus underlies the general framework for preparation and presentation of financial reports for all the non-business entities in public sector.

In a similar way to basis of accounting, there is a dual accounting treatment -from a measurement focus point of view- for strictly financial statements and budgetary reports.

Budgetary reports recognize revenues and expenditures when cash is collected or paid, or when related receivables and payables have a short term to maturity, normally three months or less. Budgetary reports are for short-term financial purposes and not economic and equity reporting purposes, and expenditures rather than expenses are recognized in budgetary reports. Accordingly, the budgetary reporting focus can be categorized as a "current financial resources" focus.

BENEFITS AND COSTS OF MOVING FROM CASH TO ACCRUAL ACCOUNTING

Limitations of the Old Cash Based Accounting System

The old cash based reporting system made available only a limited amount of information on the economic and financial position of public sector entities.

Simplicity, objectivity and the need to assess compliance with cash budgets are the main advantages of the system. However, there are important limitations in cash system, especially when the following subjects are considered:

a) A statement of financial position was not presented.- Lack of double-entry records and monetary evaluation of physical assets made impossible the preparation of a statement of financial position.

Capital amounts related to the current year plus interests were compared with short-term items related to budgetary revenues, but the system did not provide information on total borrowing and indebtedness. Total assets and equity amounts were not reported and financial reports did provide the basis for an evaluation of the entity's financial position and financial performance.

Those wishing to assess the government´s credit rating, customers, suppliers and other users of government financial information, as well as public sector managers themselves, could not obtain adequate information from the cash based system.

b) Economic result was not disclosed.- Entity's economic result, as the saving or disaving in the period, was not estimated, and an operating statement was not presented. Budgetary revenues and expenditures, as well as budgetary and non-budgetary receipts and payments were the only flows reported. No information was provided on equity and change in equity.

c) No performance indicators were available.- As economic flows were not estimated, the lack of information on period expenses and matching revenues constituted an important limitation in assessing economic and financial performance. As a consequence of this limitation, performance indicators as total or segment revenues/expenses balances, different expense or revenue items per person and by year, etc., could not be determined.

Although the system was useful for demonstrating compliance with cash budgets and legal controls, it was not concerned with enabling assessment of effectiveness, efficiency and economy, even though the law may have envisaged this.

d) No information on the cost of services was provided.- Cost of services information is a useful and necessary tool for performance evaluation and control, price fixing policy, public contracts policy and other decision-making purposes. Cost of services information was required, but a lack of relevant information about expenses and inadequate management accounting records in the old cash oriented system made impossible to fulfil this requirement.

e) True financial and economic position was not disclosed.- When the old cash based accounting system was in use, articulated financial statements reporting public sector entities' financial position and its changes were not reported. As a consequence of this limitation, the true and fair view of the entities' financial and economic position could not be disclosed with the governmental cash based accounting system. At the same time, however, accounting practices and procedures in business enterprises provided a true and fair view of financial and economic position, according to GAAP. The relative position of public sector entities was unclear.

Benefits of the New Accrual Accounting System

The transition towards an accrual accounting system in Spanish Governmental Accounting for the presentation of the financial reports offers important benefits when compared with the traditional situation:

a) Presentation of statement of financial position.- The presentation of a balance sheet with subclassifications of assets, equity and liabilities items, provide a rationale picture of the financial position of governmental entities, instead of the non-articulated lists of the old accounting system. Other additional and more detailed financial information is included in the notes, which develop and complement the balance sheet figures.

This new financial statement aids management and external users' decision-making. Notwithstanding the fact that infrastructure assets are not included, from a financial point of view, the information remains useful since all the realizable items are considered. The liabilities are all of economic results.- Expenses and revenues are accrued in preparing the presented, including information about terms to maturity and guarantees. The reported information on financial position allows rating agencies to evaluate the public sector's ability to met its future obligations. The new system can also aid in the assessment of the viability of future projects and ability to assume more debt.

b) Presentation of operating statement, with the exceptions of depreciation on infrastructure assets and amounts relating to capital subsidies. Movements in wealth and the impact on intergenerational equity are reported in this statement, providing very useful information for long-term evaluation of public sector entities' financial performance and future economic viability. Useful segment information on operating and financial segments, is provided to facilitate comparative analysis and forecasts.

c) Implementation of performance indicators and management accounting information systems.- The information provided about accrued expenses and revenues in the economic result account is a very useful aid for performance evaluation and for economic decision-making. Nevertheless, better management accounting information systems are needed to provide management and external users with more detailed information on performance indicators.

Performance indicators involve disaggregation of amounts in the economic result account. Non-financial information, such as input and output measures, are also considered in order to present a complete picture of performance relevant to the particular features of each entity.

A basic outline of an Analytical Management Accounting model for governmental agencies has been drawn up by the IGAE. This model, known as the Contabilidad Analítica Normalizada para Organismos Autónomos (Standardized Management Accounting for Autonomous Agencies) Project, is offered to governmental agencies. They need to adapt the model to suit particular features of the agency.

The main aims of this project is to allow a fair estimation of costs and revenues, useful for decision-making, pricing policy and performance control purposes. As a general rule, however, simpler and easier methods of calculating the cost of services should be developed, because most agencies face financial and human resources limitations. Budgetary resources allocated to this project will be curtailed in the current year, and alternative and less expensive short-term solutions should be sought.

Costs of Changes in the Governmental Financial Reporting System

Changes in the governmental reporting system have required human, physical and financial resources, as well as to users' understanding of financial information.

Implementation of the new system requires specific staff training, and sometimes the recruitment of new staff. There has been a need to acquire new computer hardware, develop new software and make improvements to internal control procedures. These human and physical resources have required an investment of significant financial resources. Normally, this would have limited the development of the new system, had it not been for strong political support for the project. Last two years, however, resource constraints had an impact on the development of the CANOA project and other NPGCP connected projects.

The most significant obstacles to the new double-entry, accrual based system have been related to resistance from those who are unwilling to change old habits. In most of the entities, however, most staff have been in favor of the changes and have contributed to the successful implementation of the new system.

SUMMARY AND CONCLUSIONS

The Spanish governmental accounting information system has moved since 1986 from a traditional single-entry budgetary system to a system based on GAAP.

The new governmental accounting system is built on a modified accrual basis and recognizes elements of the financial statements according to a modified equity reporting focus. As shown in exhibit 2, the basis of accounting and reporting foci for the budget remains on a modified cash basis.

Local authorities recognize economic and financial transactions, since 1992, using GAAP as set up by general governmental accounting standards. Even though difficulties have arisen in this process, specially for small local entities, general criteria for bases of accounting and measurement foci will presumably remain the same as the criteria in force for the other entities in the public sector.

Exhibit 2
Governmental recognition accounting policies

FINANCIAL REPORTS	BASES OF ACCOUNTING	REPORTING FOCI
FINANCIAL STATEMENTS	MODIFIED ACCRUAL	MODIFIED EQUITY
BUDGETS	MODIFIED CASH	CURRENT FINANCIAL RESOURCES

Limitations of the old cash based accounting system, and benefits of the new accrual based system refer mainly to the presentation (or the lack) of information on financial position, economic results, performance indicators and cost of services. Cost/benefit analysis has no doubt a positive balance in favor of the new system implementation and results.

ABBREVIATIONS

AECA. Asociación Española de Contabilidad y Administración de Empresas (Spanish Accounting and Business Administration Association)

CANOA. Contabilidad Analítica Normalizada para Organismos Autonómos (Standardized Management Accounting for Autonomous Agencies)

IGAE. Intervención General de la Administración del Estado (General Internal Audit and Accounting Office)

IASC. International Accounting Standards Committee

ICAC. Instituto de Contabilidad y Auditoría de Cuentas (Accounting and Auditing Institute)

IFAC. International Federation of Accountants

NPGC. Nuevo Plan General de Contabilidad Pública (New Governmental Chart of Accounts)

PGC. Plan General de Contabilidad (Chart of Accounts for Business Enterprises)

PGCP . Plan General de Contabilidad Pública (General Chart of Accounts for Governmental Entities)

SICAL. Sistema de Información Contable para las Administraciones Locales (Accounting Information System for Local Governments)

SICOP. Sistema de Información Contable y Presupuestaria (Accounting and Budgetary Information System)

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SWEDISH CONTRIBUTION

"FULL ACCRUAL GOVERNMENT ACCOUNTING IN SWEDEN"

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A paper presented at the 18th Annual Congress of the European Accountants' Association in Birmingham on 11 May 1995

Since July 1st 1993, the Swedish state sector uses full accrual as the general basis for accounting. On the whole, the experiences gained from this reform, which is part of the "most important change in Government administration in Sweden since the 17th century" have been encouraging, but it will, of course, take several years before the whole impact of the reform is recognized throughout the sector.

Organizational Structure

The state sector in Sweden has a setup which is almost unique in the world. At present, only Finland - which was united with Sweden until 1809 - has organized the Government activities in the same way, but now other countries are moving towards this model, with Great Britain as one notable example. The public sphere consists of the state, on one hand, and local and regional councils on the other hand. Large parts of public activities, such as primary and secondary education, health care, local roads and transports etc. are run by the communities, which are separate legal entities. The taxes raised to finance these activities are collected through the National Tax Board, but do not, in principle, appear on the State budget. The state assumes responsibility for higher education, law enforcement, defense and other traditional areas including the major transfer systems.

The most striking feature of the Swedish model is that the Government consists of the Cabinet (where all decisions are made jointly by all ministers under the Prime Minister's presidency), and thirteen ministries of a rather moderate size. This is the policy setting body, whereas the actual operations are carried out by a large number of independent agencies, or authorities. Their size, structure and types of operations vary considerably. Once the state budget has been approved by Parliament, all appropriations are placed at the disposal of the Government, which in its turn delegates both responsibility and funds to its agencies. This, normally, takes place through a Government approval document, issued just before the beginning of the financial year (which will be extended from July 1st 1995 to December 31st 1996 in order to phase the Swedish Government sector with normal calendar year according to European Community standard).

All accounting takes place at agency level (the ministries being treated, in this respect, as separate agencies). In 1979, a Government accounting ordinance was issued in order to regulate the agencies' accounting principles. However, exceptions from accrual accounting provided for in the ordinance were applied to a majority of the agencies, allowing them to use old methods and standards. In 1991 the ordinance was amended, and roughly one-third of the agencies changed their accounting every year until, finally, the last exceptions were abolished in 1994. The Parliament has chosen also to follow the accounting ordinance regulations, and therefore the same accounting principles are now observed throughout the whole state sector. (In the local and regional communities, the same principles have become standard, but are not compulsory). As a consequence, it is now possible, for the first time ever, to draw up annual accounts for the State of Sweden, based upon generally accepted accounting principles, and consisting of an operational statement, a balance sheet and a statement of source and application of funds.

Accounting Principles

In the 19th century, expenditure was recorded when decided upon, rather than upon execution. As a result, accounting reports were interesting for following up commitments, but it was never possible to establish the state's cash position. A fraud scandal at the Office of the Paymaster General in the beginning of the 1900's resulted in the creation of a

Government's check account with the Bank of Sweden. Also, accounting principles were laid down on a cash basis. Currently, only actual payments were to be recorded, and accounts were arranged in full accordance with the state budget structure. This meant i.a. gross accounting, separating income from expenditure. Only at the end of the fiscal year, the agencies were allowed to record their debts and claims, in order that the outcome of the state budget should not depend upon e.g. late payments. For some areas, mainly the public enterprises, assets were shown in a separate system of funds, but only if they were "productive" (i.e. carried a yield to the ordinary state budget).

As the state sector expanded in the 1960's, and along with computerization, there were new demands for accounting information. The so-called programme budget scheme was introduced, but the ideas were never fully implemented. However, cost of staff (including roughly calculated social security fees), office premises and in some cases interest on capital were to be distributed to the various programmes in order for appropriations to cover the total cost of programme activities. The attempts were only partly successful, however, and plans to include e.g.. depreciation were never carried out. With the new ideas, and with a central computerized accounting system, responsibility was increasingly delegated to the agencies. This also enhanced the development of a postal giro system, in which all agencies receive the payments and make the disbursements for which they are responsible, but where the balances are cleared with the Government's check account with the Bank of Sweden on a daily basis. The system makes it possible both to have clear responsibility for cash management at agency level, and to utilize the savings potentials on a central level by not keeping cash balances at lower levels.

The new accounting ordinance stipulates that each agency follow generally accepted accounting principles, wherever appropriate for government activities. The ordinance (as well as another ordinance on annual reporting) closely resembles the accounting act and the limited companies' act, except for rules relating to taxation and protection of the interest of shareholders and creditors. The reasons for these exceptions are obvious: government agencies don't pay tax on profit, and since the State is one legal entity, the creditors have the best possible guarantee for their claims. Therefore, "true and fair picture" takes precedence over cautious valuation of assets. Expenditure that would be treated as expense in a company should be booked as an asset in the agency if it represents a substantial value for future operations. (However, state owned companies and funds created by the Government obey the same rules as their private or local council owned equals, i.e. company legislation.) This has meant that the same methods can often be used for solving accounting problems in a government agency as in any company.

Accounting at Agency Level

According to the accounting ordinance, the agencies must record all "economic events" (and these only) on a current basis. Economic events are defined as the following:

- Payments: receipts and disbursements (normally by postal giro) - on a cash basis
- Claims and liabilities - which means that income and expenditure is recorded currently on a modified accrual basis
- Settlements. This type of transactions typically includes the use of appropriations, or accounting for revenue on the state budget, or to settlements with the government's check account.

Before closing the books (when preparing the annual accounts) such items should be recorded in the accounts that are needed in order to show the relevant revenue and cost relating to that fiscal year. Examples of these "periodisation items" are cut-off (accrued) items such as the part of invoiced office rents relating to another year. The value of assets and debts should also be assessed, and in this context, depreciation cost should be recorded. This results in full accrual accounting. The agencies are free to record this type of item more frequently than yearly - some do it monthly in order to improve their own management information.

The economic events are said to be external if they relate to any entity outside the agency itself, which includes other agencies within the same legal entity (the State) as well as private companies or organizations. Settlement with the State budget, or with the government's check account, is also considered to be external from the agency's point of view. The accounts reflecting these external economic events are arranged in such a way as to facilitate the production of an operational statement and a balance sheet according to fixed schedules. (Therefore, a standard chart of accounts can be used by most agencies without alterations).

The Agency's Annual Report

These two documents have the same main layout as the corresponding documents (income statement and balance sheet) of a private company. There are, however, some differences. The main source of income shown in an agency's (1) **operational statement** is revenue from appropriations, which is recorded when the agency utilizes its rights to incur expenditure to the state budget. There is a "settlement with the appropriation" when an expenditure arises that is to be covered by the state budget, normally when the invoice is received and recorded (irrespectively of the date of payment of the invoice). The transaction results in a revenue from appropriations (credit) and a claim on the government (debit). This claim is settled when the money is transferred from the government's check account to the agency, either daily or monthly.

Another particular feature in the operational statement is the sections for "Collection of taxes and legal fees" **-** which are not at the agency's disposal - and "Transfers" i.e. funds from the state budget paid to individuals or organizations. In this case, the agency acts as a "pipe line" for funds to or from the state budget, such as income tax or pensions, rather than performing its own operations.

The (2) **balance sheet** deviates from that of a company mainly in the sections "Settlements with the government" (see above) and "Agency capital", corresponding to Equity in a private company, but naturally with a completely different meaning. Assets are always recorded at acquisition value, with straight-line depreciation according to the expected economic lifetime of the particular assets.

Information from the balance sheet and operational statement accounts is combined in the (3) **statement of source and application of funds**, which contains up to five sections: operations and investment, and (where appropriate) loaning, collection of taxes, and transfers. Each section is adjusted for short term claims and liabilities, whereby the cash flow from the section is shown.

In the (4) **appropriation report**, a specification to the balance sheet item "Settlements with the government", outcome is shown against allocated appropriations and estimated state budget revenue.

However, the most important document in the agency's annual report is the (5) **report on the results of operations**. Here, the agency accounts for its major types of output with cost per unit, quality and measurable effects. The development of costs per branch of operations is also accounted for and commented upon. This information is taken from the management accounting of the agency, where internal economic events show the distribution of cost and revenue between various objects within the agency. It is obtained through the use of object codes in various structures (organizational units, output, branch of operation, project etc) attached to the accounts according to the needs of the particular agency. Since the government decided, in 1988, to shift from management by resources to management by results, this kind of information is of key importance, both for the ministry, and for the agency's own management and control. The consumption of resources **-** not the acquisition or payments **-** is weighed against the agency's performance, and this is one of the most important reasons for changing from cash or modified accrual accounting to full accrual accounting. Since accounting for fixed assets is another result of this accounting, the financial control and basis for decisions on investments has also been improved.

The annual report, including these five documents, is sent to the ministry concerned, and is examined by the National Audit Office, which issues an audit report on every agency, as well as a report on the general accounting standard in the state as a whole.

Accounting on State (Central) Level

Accounting information is to be transmitted electronically to the Swedish National Audit Office, which is also responsible for the aggregated accounts of the state. Every month, all agencies are required to submit information on

- outcome of appropriations (amounts settled) and state budget revenue - for forecasts of the state budget outcome
- income and expenditure according to economic categories - for macroeconomic analyses and financial statistics
- payments - for reconciliation purposes at top level.

Annually and semi-annually, the contents of the agencies' balance sheet and operational statement are also to be submitted to the National Audit Office to be consolidated into the **Annual Accounts of the State**. This requires specification of the transactions with other government agencies. The annual accounts cover the legal entity of the State of Sweden, except the National Bank, which is treated in international practice as a separate legal entity. Public utilities and government agencies financed with fees are also included, although they are considered as belonging to the private sector in national accounts. Additional information is provided about areas where the state exercises a decisive influence (such as limited companies partly owned by the state), and about funds that are a concern of the state although not formally part of that legal entity (e.g.. public pension funds). In case the true value of an asset (market value, replacement cost) differs considerably from what is shown in the balance sheet, it should be given in a note. Combined with a cash flow statement for the whole state, this will give a much better overall picture than the state budget alone does. Among other aspects, it includes all state activities, not just those financed by the state budget, and the Annual accounts shows the assets owned by the state to be considered when the state debt is analyzed.

The Way Forward

The accounting reform has required a massive effort on all levels. Accounting systems have been modified, the professional skill of the hitherto rather low ranked accounting staff has been raised, and new accounting methods have been developed or introduced from the private sector. The agencies' balance sheet had to be reconstructed to include assets formerly only recorded as expenditure, such as office machines or national roads. However, pieces of art, historical monuments etc. were not included due to the valuation problem. Whether defense material should be recorded as assets or written off directly is still being discussed.

One negative aspect of the new accounting principles is that accounting has become very complicated. On the other hand this is a result of the various - and sometimes colliding - demands for information from politicians, ministries, statisticians, and agency managers at various levels. Up to now, most of the attention has been focussed upon financial accounting, and improved management accounting methods need to be developed. Some of the traditional requirements may have to be reconsidered, and the development of a new state budget structure will remove some of the complexity. The accounting model is also neutral to the various ways of financing activities through appropriations, internal loans, sales income, grants or capital yield. The similarity with private company accounting may lead to misinterpretation of the meaning of an agency’s annual report, but it also makes recruitment of trained accountants possible for a government agency, which was until recently a world of its own.

A general observation is that the quality of government accounting has been improved considerably. Although some agencies may just be able to produce the correct documents without really understanding their meaning, financial issues are attracting more interest than before, and sound economic thinking is encouraged. Relevant accounting information is a tool which can be used - depending on political courage - to solve the present financial difficulties in the Swedish state sector, and to make government activities more efficient.

Annexes

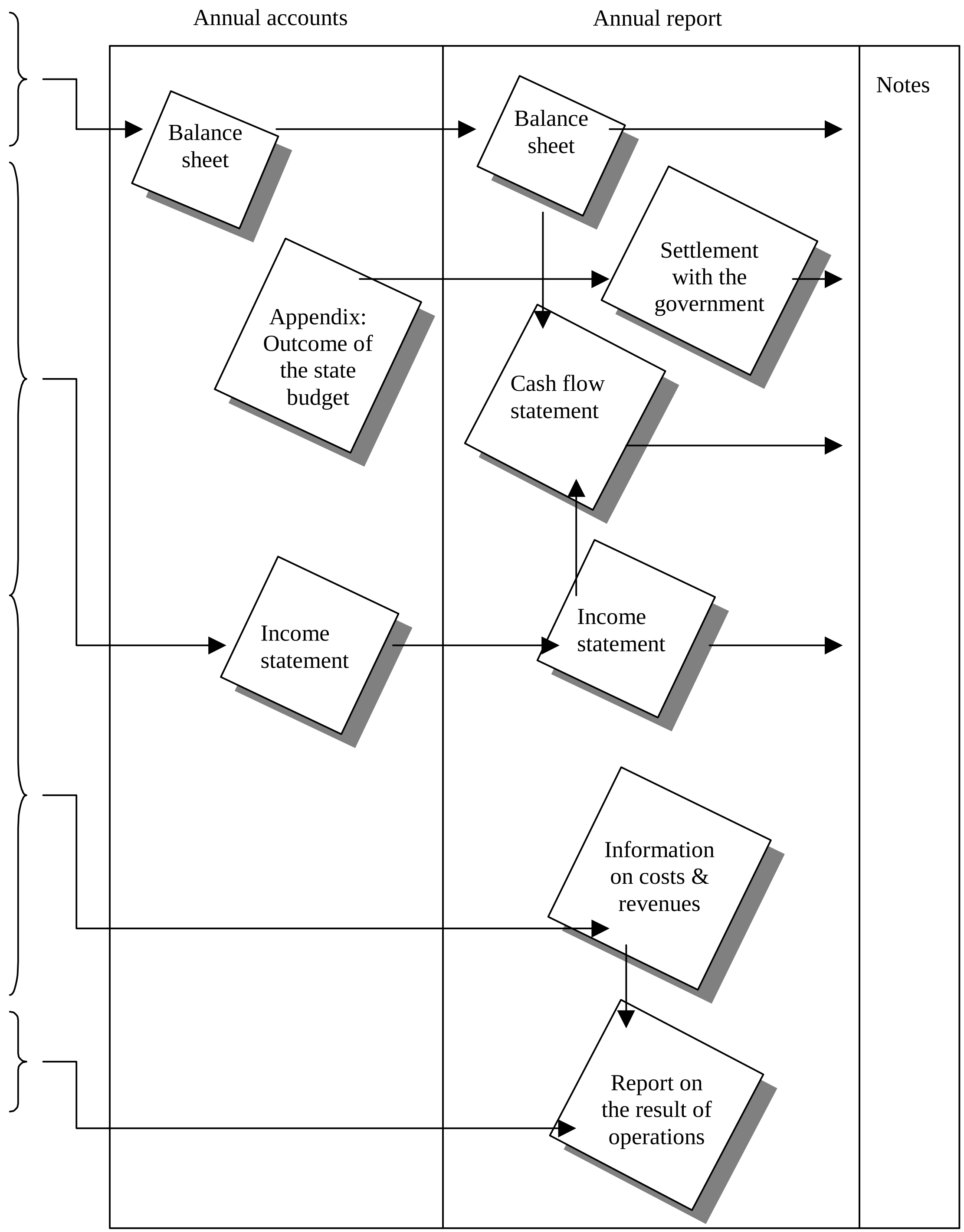
Chart of accounts and chart of object codes, and their connection to...
....the various documents of the agency's annual report
Balance sheet schedule
Operational (income) statement schedule

Further Reading

The Swedish National Audit Office:
Accounting Model for Swedish Government Agencies *(1993)*
Internal Accounting - some ideas *(1994)*

Ministry of Finance/Budget Department:
Management of Government Administration and Financial Conditions for State Agencies *(1993)*
In search of results and financial incentives - recent advancements in the Swedish Central Government budget process *(1994)*
Annual performance accounting and auditing in Sweden *(1995)*

Chart of accounts	External events	Account class 1	Assets
		Account class 2	Liabilities & capital
		Account class 3	Revenue from operations
		Account class 4	Labor costs
		Account class 5	*Costs for premises, office services*
		Account class 6	External services, machinery, equipment etc., depreciation
		Account class 7	*Collections, transfers*
		Account class 8	Financial revenue & expense, Extraordinary revenue & expense
	Internal events	Account class 9	Internal revenue & expense
Chart of object codes	Organizational categorization		Organization unit
	Functional categorization		Branch of operations/functions
			Activity
			Product/performance/output
			Project
Other information systems • Personnel information • Production statistics etc			



Assets	**Liabilities**
Current assets • Cash and bank balance etc • Balance at the National Debt Office • Shares and participations • Accounts receivable-trade • Claims on other agencies • Other claims • Work in progress • Stocks and stores • Advances to suppliers	**Current liabilities** • Liability to the National Debt Office • Liabilities to other agencies • Accounts payable-trade • Personnel tax deduction at source • Funds deposited • Other liabilities • Advances from customers
Cut-off items	**Cut-off items**
Settlement with the government	
Fixed assets *Financial capital assets* • Shares and participations • Bonds and other securities • Long-term receivables from agencies • Other long-term receivables • Advances to suppliers	**Long-term liabilities** • Liability to the National Debt Office • Liabilities to other agencies • Funds deposited • Advances from customers • Other long-term liabilities
Tangible fixed assets • Stock reserves for situations of war or emergency • Fixed assets under construction • Technical fixed assets, machinery • Other fixed assets, means of transport and equipment • Ships, airplanes	
• Long-term leasing of machinery, equipment	**Capital**
• Buildings • Long-term leasing of building • Land and other real estate *Intangible assets* • Rights • Costs for research and development • Other intangible assets	• State capital • Gifts and donation funds • Special reservations • Change in capital carried forward • Change in capital deriving from the income statement
Contingent liabilities etc	
• State guarantees for loans and credits • Other contingent liabilities	

Income Statement		
Revenue from operations		
• Revenue from appropriations	xxx	
• Revenue from charges and other remunerations	xxx	
• Revenue from grants	xxx	
Total		xxx
Costs of operations		
• Operating costs	xxx	
• Depreciation	xxx	
Total		xxx
		xxx
Financial revenue and expense		
• Interest revenue	xxx	
• Interest expense	xxx	
Balance		**xxx**
Collection of taxes and legal fees		
• Revenue from collection	xxx	
• Collections credited to the state budget	xxx	
Balance		**xxx**
Transfers		
• Appropriation funds received from the state budget	xxx	
• Grants given etc	xxx	
Balance		**xxx**
Extraordinary revenue and expense		
• Revenue	xxx	
• Expense	xxx	
Balance		**xxx**
Change in capital for the year		**xxx**

UNITED KINGDOM CONTRIBUTION

"RESOURCE ACCOUNTING AND BUDGETING: ANOTHER FALSE TRAIL?"

by George Jones
Professor of Government, London School of Economics

I began this article thinking that I could easily describe the implications of resource accounting and budgeting (RAB) for governments, their political directors (i.e. Ministers and councillors), Parliament, councils and the public. However, as I explored the topic, I became infected by a deep scepticism. RAB seemed incompatible with democratic politics because it embodied a rationalist approach. Its requirements entailed too great a change in the political process and in the behavior of politicians to sustain its viability.

Benefits of RAB

RAB was initiated in the private sector and is now practiced in a closely related format by local authorities, the NHS and agencies, and it is proposed it be extended throughout the whole of government (HM Treasury, 1994). RAB seems to be a sensible approach, which should promote responsible decision-making in government. Accounting for and planning the use of resources (assets, cash, capital and non-cash) will be integrated with revenues generated by those activities and with setting the objectives of policy and standards of performance. Thus the true costs of government activities will be revealed by taking into account all costs. Officials and their political masters should have their respective responsibilities clarified; their performance made more accountable; and the public empowered to assess their performance. Assessment of financial performance will move beyond the use and application of cash to encompass all resources, thus promoting efficiency. Instead of concentration on the details of annual budgeting, there will be concern about the quality of assets, their age, capacity and realistic valuation. Efficiency in departmental management, and accountability by Ministers to Parliament, by councillors to councils, and by both to the public, will presumably be encouraged. Thus the role of politicians seems likely to be improved by RAB, because it should make them better informed about the cost consequences of their policies. There are, however, some fundamental defects of RAB that need to be examined.

The Myth of Private Sector Superiority

RAB is based on the assumption that private sector methods are superior and should provide the model for the public sector to follow, instead of basing its arrangements on the distinctive features of the public sector (see Ranson and Stewart, 1994). The main distinctive features of the public sector is that it exists to achieve political purposes. Public sector management methods should serve the needs of politicians not of technocrats, either accountants or managers. Government departments are not business organizations. Their cultures are different. RAB requires changes in the cultures of both politics and of management in government, but it goes against the grain of the former.

A Mistaken View of Governing

RAB is based on a false notion of governing. It assumes that governing requires the setting of clear specific objectives; and that government consists of discrete programs to which coherent sets of activities can be related, driven by the specific objectives. But government is more about managing networks within constraints, about regulating relationships, not about achieving set objectives. It is about coping with ambiguity, conflict and instability. The so-called rationality of focusing on objectives is to view people as like rats in a maze with the clear objectives of seeking food or a way out.

The task of government is to balance between conflicting pressures, trying to produce enough of a consensus that will get it through to the next crisis. Governments operate with multiple objectives, deliberately ambiguous and often contradictory to maximize support. Stating clear specific objectives is a disadvantage. It will alienate those who disagree, and store up future trouble if these objectives are not attained. RAB is based on a system that provides opponents with ammunition to fire back at the Government.

Government in the UK has a plural executive, the Cabinet, whose collective nature permeates decision-making in Cabinet committees, departments, and other networks where civil servants work. Interactions between Cabinet members determine decision-making, and the conclusions reflect a highly political process of bargaining between them. One cannot expect clear specific objectives to emerge from such a process in which compromises have to be created to gain acceptance. Even Cabinet Committee EDX, charged with public expenditure, is part of this system of collective decision-making. Its deliberations too are imbued with politics and the need to reach a consensus.

A Mistaken View of Politics

RAB is based on a misconception of how politicians behave and what they are interested in. RAB is too technical and complex to interest any but the few aficionados. It does not relate to their political interests, and is not at the top of their political agendas. Are they likely to give it the political commitment needed to spread it through the public sector by 1999-2000?

A politician’s time-frame is sometimes said to be limited to winning the next election, but even that may be too long term. Political horizons are short term: avoiding trouble next week, or even today, in Parliament or the media; avoiding disaster in the next set of opinion polls. But RAB entails taking a longer-term view. RAB seeks to depoliticize politics and government, or rather it hopes to concentrate politicians on making their purposes clear, leaving the implementation of those objectives depoliticized. But politics, as Peter Self said, is like lightning, and can strike anywhere. Often political controversy erupts over what to many may appear matters of implementation.

The main concern of Ministers and local councillors charged with governmental responsibilities is not with attaining set objectives, but in avoiding mistakes. They cannot politically tot up mistakes and successes and hope that a final balance sheet in favor of successes will win public approval. They cannot afford a single mistake, since political opponents, affronted interest groups and the media will pounce to exploit that error. They cannot be risk-taking entrepreneurs, since one mistake may spell political failure and ruin a political career. This no-risk culture permeates from the politicians to their officials who have to act as if they were their political masters and avoid action that could embarrass their bosses in parliamentary and public arenas.

Representatives have to respond to what their constituents press them about, which is not usually about policy objectives but about problems from the impact of implementation on them personally, their families and the communities to which they feel attached. Public opinion is divided. People disagree about what they want, other than the eminently sensible combination of improved services and lower taxation, and they support different causes with varying intensities. Politicians have to gain the support of voters, who are inconsistent, fickle, and respond to fashion, and are aroused more by notions like fairness and equity, green and envy, than efficiency.

A Mistaken View of Public Management

RAB is an inadequate basis for public sector management. It assumes managers should be set clearly determined objectives and specifications of performance beforehand. But managers might perform better if set only broad goals and allowed discretion over how to achieve them. Setting standards in advance stultifies thought, since only the standard has to be reached, then thought can cease. Vital learning from experience, and feeding back to policy-making is discouraged.

RAB arrogantly assumes government is in control and can work out the causal linkages between its various interventions, outputs and outcomes. No such certain relationships have been established; and, given the large number of possible variables at work in shaping performance, are they ever likely to be established? Government is not in control of events. It is dependent not only on a turbulent environment, but also on other organizations not under its direct control. Managing complex networks of others is the essence of public sector management, not dashing after a set of objectives.

The task of public sector management is more to be accountable to politicians than to be efficient. It may not be able to do both. It is better to do the right things inefficiently than to do the wrong things efficiently. In any case, RAB is based on a defective notion of efficiency. Metcalfe and Richards (1987) have written of 'the limitations of the model of rational efficiency based on given objectives'. They note: 'Adaptive efficiency embraces the revision and redefinition of objectives'. In requiring set objectives, RAB promotes inefficiency.

Accountants' Revenge?

RAB may weaken control of public expenditure by those responsible for guarding the public purse, like the Treasury and treasurers. Their attention is likely to be diverted from a manageable concern with cash inputs (revenue raised), and with the money spent in a particular year, all of which can be measured with some confidence, to a more speculative concern with outputs and results achieved over a longer period, and with the full costs and benefits of operations, over all of which there is scope for considerable disagreement. Assessing governmental performance is fraught with problems because it offers scope for political judgements involving political values in measuring quality of service.

RAB offers more opportunities for advocates of expenditure to promote their case. By focusing on objectives, they will come up with bids for obviously desirable programs and projects, and will reinforce their claims with appeals to future beneficial outputs, outcomes and results. The system tips the balance more in favor of expenditure advocates than watchdogs, and constitutes an inflationary pressure.

It is not appropriate to value all public assets and liabilities by private sector concepts. Certain assets and liabilities have no private sector equivalent—infrastructure, like roads, and heritage items like Norman castles, defense equipment, taxation powers, public debt, pension and social welfare benefits, and superannuation liabilities. Can the public sector budget for *x* number of frauds in departments or *y* number of prison escapes?

To operate the new sophisticated system, new professionals will be required, able to talk the language of RAB. The main beneficiaries will be accountants. Perhaps RAB represents the revenge of accountants against economists, the previous witch-doctors whose mumbo-jumbo has dominated policy analysis and demoted political thinking. Accountants do not come cheaply. They will be recruited in a price-sensitive market-place, and there will have to be considerable investment in training and retraining. RAB will be a costly venture. Are there not other causes more worth spending scarce public money on?

RAB will encourage further centralization in an already highly-centralized state. Central government will require more central budget staff, to try to trace all resources as they contribute to performance, to follow public money wherever it goes—into NDPBs, local authorities, and voluntary bodies in receipt of public money. In turn, they will have to employ budget staff with new skills to respond to the new demands of the central budget staff. This centralization will be costly.

The Impact on Audit

RAB may erode the process of audit, by turning attention away from traditional auditing concerns, like compliance with spending limits. RAB may entail less information and less detail going to audit bodies. Parliamentary authority will be exercised at a higher level than now, in 60 large blocks instead of the current 165. Parliamentary authority may be weakened by allowing departments to raise and dispose of large sums of money without detailed parliamentary and audit scrutiny.

Auditors will continue to give priority to exposing fraud, corruption, waste and misappropriation, which is what parliamentarians will insist on. There would be public outcry about relaxing regularity and propriety audits, especially when examples of misconduct, encouraged by the current fashion for contracts, were uncovered.

Although the annuality rule has been relaxed in recent years, the principle of full annual parliamentary authority has been maintained by requiring departments to include in the subsequent year's Estimate any money carried forward. With RAB, Parliament and auditors will still want to preserve the annuality principle. They will insist on controls over unused funds or resources at the end of each year.

With RAB, governments will still operate traditional accounting and budgeting (TAB), and audit bodies will still need to focus on their traditional concerns with the true and fair criteria, regularity and propriety. 'No country is considering dispensing with cash reporting' (OECD, 1993). They will need to assess whether resources were obtained and used in accordance with legal constraints and contractual requirements. Performance budgeting alone is not yet reliable and systematic enough to win the confidence of auditors.

The danger is that with both TAB and RAB government managers will be subjected to too many detailed controls and will be over-audited. Their discretion will be curtailed and their skills at tackling problems diminished.

Conclusions

One wonders who is pressing for RAB? It cannot be the general run of civil servants now weary with initiative fatigue. It cannot be politicians most of whom do not understand what it is about and, if they did, would oppose it as undermining their role. Perhaps it is a small, powerful group in the Treasury, influenced by avant-garde accountants, and the rest follow like sheep or fashion-junkies.

The needs of macro-economic management still require information on the amount of cash raised and spent, as the best indicator of the impact of the public sector on the economy, while the cash surplus or deficit best describe the relationship between fiscal and monetary policy, and capture the monetary effects of Treasury financing on the economy. So, both RAB and TAB will run together, with RAB perhaps a growing adjunct to traditional cash budgeting. It will be burdensome to managers and auditors to have to operate two systems and it will be very costly to set up the new system, with its requirements for investment in management information systems, new skills, new staff, and cultural change. Why is the Treasury so sure RAB will give value for money? It looks just another rationalist fashion, like PPBS, PAR, MBO or output budgeting, flashing across the sky and doomed to fizzle out after wasting much of the time and mental energy of busy people that could have been spent to better effect.

RAB may be useful in limited carefully-defined parts of the public sector (similar to the private sector, yet for some reason not privatized), but not across all the public sector, or the government as a whole, or in whole departments, where politicians are involved and have their purposes to pursue. The constructive task for public sector managers is to investigate in detail those specific instances where resource accounting, if not the full panoply of RAB, is appropriate and can help their political masters achieve their public purposes. They should work with the grain of politics not against it.

Politicians would be better advised to focus their energies not on the time-wasting distraction of RAB, but on giving political leadership. If governing is to be something more than avoiding mistakes, it should be to provide political leadership. Perhaps some advocates of RAB feel Ministers need it as a discipline since they operate in the reactive mode outlined above. Their self-discipline seems feeble and the only effective disciplines seem to be external. But instead of pursuing RAB, which gives the appearance of doing something and may help at the margin, they should act as political leaders.

Further Reading

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UNITED STATES CONTRIBUTION

"HOW SHOULD THE GOVERNMENT MEASURE SPENDING? THE USES OF ACCRUAL ACCOUNTING"

by F. Stevens Redburn, Economist with the Office of Management and Budget

What would be the benefits of replacing the federal government's cash basis budgeting approach with an accrual accounting system? F. Stevens Redburn contends that such a shift would improve budgeting for federal insurance programs. Accrual accounting records incomes and outlays went they are earned or incurred, unlike the cash basis method which tracks the government's cash transactions and debts. Redburn argues that this seemingly technical change would have significant political implications by modifying how we assess the ongoing costs of various programs. He illustrates how accrual accounting and cash basis budgeting lead to different understandings of problems by focusing on the federal deposit insurance program's recent history.

The 1993 federal budget, submitted to Congress in January 1992, proposed to change the way outlays for deposit insurance and other insurance programs are calculated. If the proposal is adopted, both the timing and magnitude of these programs' contribution to the federal deficit would be restated. The intention is to provide a clearer current picture of how much insurance programs cost and, as a result, to improve incentives to control these costs.

The budget accounting for insurance would be changed from a "cash" to "accrual" basis, recording costs as they arise and often well in advance of the time when cash is needed to satisfy claims. Therefore, program outlays, rather than measuring the net of all annual cash flows, would reflect the difference between costs estimated to have risen in a given year and premiums collected in the same year.[1]

At first glance, a reform of this nature may appear to be of interest mainly to budget technicians. However, technical changes sometimes have larger implications. In this case, earlier budgetary recognition of insurance losses could shift political incentives in favor of program reforms aimed at controlling costs. Such changes in the way budget outlays are calculated have broader implications, as well, for the way the government and the public measure and view federal spending.

Pending enactment of legislation to implement the change, the 1993 budget shows how it would affect the statement of outlays for the two largest insurance programs-deposit insurance and the Pension Benefit Guarantee Operation (PBGC)-in 1992 and thereafter. Over a long time horizon, the contribution of each program to the deficit would change little. However, within the six-year budget planning horizon, each program's estimated outlays would change each year with conversion from cash to accrual accounting (Table 1). Although the accounting shift would reduce their apparent contribution by nearly $100 billion over the following four years . Such large swings occur because cost recognition is accelerated and because cash flows that are not related to cost have been removed form the outlay calculation, as explained below.

Background

A primary function of public sector budgeting is to plan and control the use of public resources. For this purpose, the budget should be an accurate and timely record and projection of the cost of programs and commitments. A second use of the budget is to guide fiscal and monetary policy. For this purpose, the federal deficit is sometimes used as a rough measure of the government's call on the private economy's resources.[2] A third, perhaps less important , function of the federal budget is to record and control the governments's cash transactions and net borrowing from the public. No measure of the federal deficit is ideal for all three purposes. Moreover, "the search for the single perfect deficit measure may be futile" (Blejer and Cheastey, 1991, p.1644).[3,4]

Table 1
Change in Outlay Estimates for Insurance Programs
If Converted from Cash to an Accrual Basis, 1992-1997 (in Millions of Dollars)

		1992	1993	1994	1995	1996	1997
Cash basis	Deposit insurance*	80,115	75,692	(17,219)	(15,441)	(15,155)	(39,926)
	PBGC	(538)	(493)	(455)	(416)	(373)	(327)
Accrual basis	Deposit insurance*	48,455	57,432	7,002	2,345	(2,670)	(6,549)
	PBGC	6,362	2,909	2,140	1,874	3,010	1,848
Accrual less cash	Deposit insurance*	(31,660)	(18,260)	24,221	17,786	12,485	33,337
	PBGC	6,900	3,402	2,595	2,290	3,383	2,175
	Combined	(24,760)	(14,858)	26,816	20,076	15,868	35,552

Note: Parenthesis indicate negative numbers
* Deposit insurance includes the Federal Deposit Insurance Corporation's Insurance Fund (BIF) and Savings Association Insurance Fund (SAIF), the Resolution Trust Corporation, the National Credit Union Share Insurance Fund and other, smaller accounts not affected by the change.
Source: OMB Budget of the United States, table 37-12.

Most countries keep budget accounts on a cash basis. The systems of national accounts used by the OECD and the United Nations treat the government sector and its transactions on an accrual basis but are not used for budgeting. New Zealand introduced a new system of budgeting in 1989 that uses accrual concepts. In an accrual system, outlays and income are recorded when they are incurred or earned . This method of recording better measures the net effect of fiscal policy on economic activity in the current year. A cash budget, on the other hand provides a better measure of current borrowing need and thus of the government's effect on the money supply or capital markets (Wasserman, 1976).
The US budget has been specifically a cash budget.[5] For most programs, net cash flow (gross spending less offsetting collections specific to that account) adequately measures the magnitude of their cost in a given period and their net draw on fiscal resources (general taxes and borrowing). Fortunately, for most federal programs, net cash flows the difference in timing when costs are recorded on a cash rather than accrual basis is modest.

The United States is moving away from a strict cash budget toward a blend of cash and accrual concepts. For some years now, budget experts have argued that spending for programs that involve long-term commitments – such as credit and insurance – is better measured by focusing on the subsidies conveyed or costs as they arise, rather than on cash flows. In the case of credit and insurance programs, as general guarantee first issued in one year may lead to measurable liabilities some years later. These liabilities, in turn, may be incurred far in advance of the actual cash payments needed to satisfy particular claims. Moreover, some of the cash flows are temporary transactions that net out over time and are not related to actual costs. If the proposed accounting change for insurance commitments as they accrue, without regard to when cash payments are made to satisfy the government's obligation-for instance, to pay of the depositors of a failed bank or savings and loan.

Deposit insurance provides a good example of the conceptual and timing problems associated with insurance and credit programs. The insurance of deposits dates from the 1930's. Liabilities were small until the 1980s, however, when hundreds of savings and loan institutions and banks began to lose money. During that period, the federal government's liability grew rapidly; but federal cash expenditures increased much more slowly. Cash was not require to cover losses of a failed institution and protect depositors until a decision was made to close it. By the early 1980's, although hundreds of thrifts were insolvent, few had been closed. In some cases, years passed and losses multiplied before action was taken.[6]

Even as spending to close failed thrifts accelerated in the last part of the decade, budget projections of deposit insurance losses lagged far behind. One reason for the lag may have been excessive optimism. However, the system of cash accounting and budgeting, combined with political incentives to minimize the apparent size and projected growth of the federal deficit, also encouraged delay in recognizing emerging problems. Had budget conventions required that costs be reflected in the deficit as they accrued, federal outlay estimates would have included the costs required to deal with hundreds of insolvent savings institutions as early as 1980. As the condition of the backlog of failed thrifts continued to deteriorate, including these growing liabilities int he computation of the annual budget deficit would have raised deficit estimates each year by millions of dollars.

The fact that budgets did not record costs until institutions were closed was itself an incentive for delay. From a political and budgetary perspective, postponing closure meant delaying having to recognize costs that had accrued and would eventually have to be paid. In the end, the backlog of thrift insolvency costs exceeded $100 billion and overwhelmed the Federal Savings and Loan Insurance Fund.[7]

To evaluate the potential benefits and other implications of treating insurance programs on an accrual basis, I first place the 1993 budget proposal in the context of the more general direction of U.S. budget reform, then briefly describe how costs will be estimated and recorded on the proposal accrual basis. Finally, I explore the implications of the proposed change for the measurement of the budget deficit, relative to the broad purposes of the budget stated above.

Reforming the Budgetary Treatment of Federal Credit Programs

The prolonged 1990 “Budget Summit” negotiations between the administration and Congress produced the Budget Enforcement Act of 1990 (BEA), which among other things, instituted a number of major budget process reforms. Among them was the Federal Credit Reform Act (one title of the BEA), which requires a new method of budgeting for the cost of government direct loan and loan guarantee programs. The changed budgetary treatment of these credit programs provided a precedent for the subsequent proposal, in the 1993 budget, to reform treatment of insurance programs. Meanwhile, the Credit Reform Act required the Office of Management and Budget (OMB) and the Congressional Budget Office (CBO) to study whether parallel changes might be made for deposit insurance.

For direct loan programs, such as a change in budget accounting was first recommended by the 1967 President’s Commission on Budget Concepts.[8] The commission proposed that, when government loans were made, instead of recording the cash outlay, equal to their face value, the budget instead should record the subsidy value of the loans, including the present values of the loans, including the present value of any interest reduction as well as an estimated provision for losses over the lifetime of the loans. Thus, Congress would be required to acknowledge and appropriate the estimated cost of making the loan, regardless of the timing of the cash outlays and repayments (President’s Commission, 1967). The commission might have but did not propose an analogous change in the budgetary treatment of federal loan guarantees. Had they done so, they might have proposed that, when the federal government put its guarantee behind a private loan, it record an outlay for the implied subsidy, i.e., its expected share of default losses plus any interest rate reduction - even though it was not providing up-front cash for the loan (Office of Management and Budget, 1991; Congressional Budget Office, 1991).

Starting with the 1972 budget, the special analysis of credit programs included subsidy cost estimates for both direct loans and loan guarantees. These estimated were improved over time. In the 1987 budget, the administration first proposed “credit reform” - that the budget estimates for credit programs, both direct loans and loan guarantees, reflect the value of the subsidy conveyed by the extension of the credit in the year the loans were made instead of the cash transactions. During the following three years, staff of the Office of Management and Budget, the Congressional Budget Office, and the congressional committees intensively debated the concepts and measures to be employed. As required by the 1990 Credit Reform Act, the 1992 budget and appropriations processes were the first to employ the new subsidy cost measures formally to estimate outlays and the deficit and make spending choices.

A major first-stage effect of changing the way the budget treats credit programs has been to focus much greater attention and expertise on computing their long-term costs. The implementation of "credit reform" triggered a large-scale effort by program financial administrators to develop and refine methods of estimating subsidies and to change their loan tracking and accounting systems to capture all relevant information about loan performance. In some cases, revolutionary changes in these systems were needed to generate the information needed to project losses as a function of loan and borrower characteristics and future economic conditions likely to affect repayment. To estimate the cost of each year's cohort of new loans, the budget now looks far into the future to estimate how many loans can be expected to default and what the losses will be as a result, then discounts these costs back to the present. This cost plus the present value of any interest rate subsidy, offset by fees or premiums, must be appropriated *for the year the loans are made*.

As new information and methods are developed to project defaults, credit subsidy estimates may be expected to oscillate noticeably from year to year for awhile, then presumably stabilize. Table 2 shows how much the estimates for some major credit programs changed from the 1992 to the 1993 budget.

Applying Credit Reform Principles to Insurance

Even as credit reform was being implemented, discussion turned to the possibility of applying a similar approach to other long-term federal commitments such as insurance. However, additional conceptual and measurement barriers had to be surmounted before the logic behind credit reform could be extended. Unlike loan programs, for which discrete annual books of business and specified terms can be identified, insurance commitments are typically ongoing and open ended. For some insurance programs, costs cannot be estimated easily on an actuarial basis, leading to questions about the meaning and reliability of subsidy estimates.

In recognition of these problems, the 1991 OMB and CBO studies outlined alternatives for presenting accrual information in the budget and possibly using it to recalculate the deficit. OMB's report demonstrated specific methods that could be used to estimate costs as they arise and to project these over the six-year budget planning horizon.[9]

As applied to deposit insurance and other insurance programs, the credit reform model would require that accruing costs contribute to the deficit in the year they arise. Cash flows that are not part of the cost of the program would be tracked in a separate "financing account" outside the budget totals.[10] Thus, in any year that the estimated newly accrued liability plus administrative expense exceeded estimated premium income, the insurance program would show positive outlays, adding to the federal deficit. Because past cash outlays did not reflect costs that had accrued but not ben paid for prior to the accounting change, a transition period would be necessary during which outlays also would include the cost of liquidating those previously accrued costs.

New Costs

For three categories of insurance, newly accruing costs would be computed as follows:

Deposit insurance. Costs can be estimated by looking at the financial condition of individual depository institutions. The federal government's accrued liability would be measured by the number and size of economically insolvent institutions and the depth of their insolvency. Program outlays would record the annual change in cost (net *new* cost). This would include new costs resulting from new insolvencies, further deterioration of previously insolvent depositories, and increases in the risk of failure of solvent firms minus cost reductions resulting from the recovery or improvement of previously insolvent depositories and decreases in the risk of failure of solvent firms minus cost reductions resulting from the recovery or improvement of previously insolvent depositories and decreases in the risk of failure for solvent firms. The net of these costs and cost reductions would be offset by premium collections.

Table 2
Change in Credit Subsidy Estimates for Selected Major Credit Programs, 1992 vs. 1993 Budget

Credit Program	Weighted Average Subsidy as a Percent of Disbursement	
	1992	**1993**
Direct Loans		
Agricultural credit insurance fund	21.6	19.7
Rural development insurance fund	14.7	13.7
Rural development loan fund	50.0	52.3
Rural housing development loan fund	27.2	38.5
P.L. 480 export credits	75.9	67.1
VA loan guaranty revolving fund	11.5	8.4
SBA business loans	29.6	18.7
SBA disaster loans	22.5	8.2
Overseas Private Investment Corp.	9.6	13.9
Foreign military financing	12.7	17.5
Export-Import Bank	3.4	6.1
Total, direct loan subsidies	17.9	9.4
Guaranteed loans		
Agricultural credit insurance fund	3.6	3.6
Commodity credit export credits	2.7	2.8
Rural housing insurance fund	13.9	14.7
AID housing and other credit	2.5	17.3
Guaranteed student loans, Stafford	22.6	17.6
Guaranteed student loans, PLUS	7.6	8.5
Guaranteed student loans, SLS	13.2	12.2
FHA single family (MMI)	-2.6	-2.7
FHA gen. and special risk	0.6	2.0
VA guaranty and indemnity fund	1.2	1.3
SBA business loans	1.1	1.8
Export-Import Bank	4.4	6.3
Total loan guarantee subsidies	2.5	2.8

Note: Totals for direct loans and loan guarantees are weighted averages for these and other programs.
Source: Excerpted from *Budget of the United States*, 1992, Part 2, Tables A-7 and A-8, pp. 224-225, and *Budget of the United States*, 1193, Part 1, Tables 13-2 and 13-3, pp. 271-272; see budgets for full program descriptions and methods of estimation.

Pension guarantees. Costs can be estimated by looking at both firms' financial condition and how fully they are funding their government-backed pension plans. The federal government's accrued liability thus depends on the probable timing and number of future firm bankruptcies, the probability that a firm's pensions will be under funded when it fails, and rules governing the ordering of claims in bankruptcy. Program outlays would record the annual change in this liability, reflecting both changes in anticipated plan funding and firms' pension obligations and financial condition, offset by premium income.

Other insurance programs. For some other federal insurance programs, such as those that insure against certain classes of natural disasters, costs may be estimated actuarially. Costs in any one year would reflect the estimated long-term average frequency of loss-generating events such as floods or crop damage and the federal obligations expected as a result. Program outlays in any in any period would be the difference between this loss rate and premium collections.

In all cases, the methods used to estimate costs require probabilistic modeling techniques that capture the likely sources of cost variation and how these are expected to change over the budget horizon. For programs such as deposit insurance and PBGC, which insure against the failure of private firms, the appropriate framework is similar to that used to establish prices for stock options and similar contingent contracts (Merton, 1977; Rodriguez, Cooperstein, and Redburn, 1992). Applied to private firms, this approach derives costs estimates from measures of current earnings and market capitalization, expected trend and volatility of earnings, frequency of external monitoring, and the scope and the terms of the government's guarantee of the firm's liabilities. Such techniques are relatively new; their application to government guarantees is more recent still and potentially controversial (cf.,Kuester and O'Brien., 1991).

Outlays During the Transition

Because the accounting framework is being changed, a transition period would be required during which outlays would also record the liquidation of costs that had accrued prior to the change (old costs). Without this addition, the accounting change would cause these old costs to be ignored. The administration's proposal is that the costs that accrued prior to the change would be estimated at the time of the change and reflected in the outlays when an insured event resulted in cash spending - for instance, when a bank was closed. That way, if the cost estimated to have accrued prior to the accounting shift were never realized (e.g., if a bank seen as insolvent subsequently recovered), not only would this cost not generate an outlay but the savings resulting from recovery would be reflected in the net flow of accruing costs as a cost savings. Thus, during the transition, outlays would be the sum of net new costs as they arise plus liquidation of old costs as insured events occur less premium collections.

As noted, cash flows that do not reflect program costs would be recorded outside the budget in a financing account, as is the case for credit programs. For deposit insurance, this would include temporary flows associated first with the acquisition of assets from failed institutions and later with the sale of these assets. On a cash basis, large outflows of cash swell outlays in periods when many institutions are closed; and cash recoveries may swamp new closure spending in following years. Although these temporary "working capital" flows cancel out over time, they greatly distort the deficit in some years. For deposit insurance, a major effect of the proposed change would be to reveal the underlying pattern of net costs that is obscured by these temporary flows.

Budget Process

The president's budget proposes the allocation of dollar resources, measured chiefly as budget authority and outlays, by programs, for the current fiscal year, the budget year, and the following four years.[11] Where policy changes requiring changes in law would have budgetary consequences, it also presents alternative estimates showing the budgetary effects of these changes.

Congressional action on the budget depends on whether spending is discretionary or mandatory. Discretionary programs require specific funding in annual appropriations acts; mandatory programs (such as Social Security benefits) are generally permanently funded in the authorizing legislation. A few, so-called "appropriate entitlements" also require appropriations action, even though their spending is driven by legislative and administrative formulas. Although the administration and Congress cannot control appropriated entitlements as certainly as discretionary funds, they have he opportunity to review and potentially amend the entitlement legislation in the annual budget process. For example, the need for appropriations could be reduced or eliminated by identifying formula changes of offsetting collections that would reduce future net outlays. Alternatively, the Congress might adopt program reforms that were estimated to reduce the rate at which costs accrue.

The proposed legislation to implement accrual accounting for insurance programs would treat insurance programs as appropriated entitlements. Appropriations action would be required whenever premium revenues were insufficient to cover the sum of costs in a given year.

Implications

The changes budgetary treatment of insurance programs, in common with similar changes in the treatment of credit programs and perhaps of other long-term commitments, must be evaluated by its effect on budget decision making and incentives for good policy and management. At the same time, its effect on the meaning and measurement of the federal deficit and possible implications for the budgetary treatment of other federal programs must be considered.

Advantages

The first and perhaps the most important practical test of the value of the proposed change is whether it will avoid the kind of massive breakdown of fiscal discipline and administrative controls that contribute to the savings and loan debacle. The change seems likely to improve the political incentives for timely reforms to limit future costs or, at least, to pay for them as they arise. It should accomplish this, in principle, by making the cost visible earlier and, most important, by raising the deficit estimates as a result. Conversely, the change would eliminate any obvious incentive to delay administrative actions, such as closure of a failed bank, that would result in higher near-term cash outlays.

A number of analyses have supported the hypothesis that faster action to remove failed firms from the marketplace would have substantially reduced the total cost of the thrift debacle (cf., Barth, 1991). Faster action would not only have directly avoided costs by closing institutions that were, in effect, playing with taxpayers' money but also eased the competitive pressure on other depository institutions. It is barely conceivable that the political process would have permitted such a mountain of losses to have built up if the administration's budget requests had shown the cost growing by tens of billions of dollars from year to year and Congress had been required to appropriate funds each year to cover a growth of costs far exceeding premiums collected from the industry. It is far more likely that, driven by the visible cost of further delay and overall Gramm-Rudman-Hollings limits on spending, Congress and the administration would have agreed earlier on action to remove insolvent institutions from the marketplace and better control risk-taking with insured deposits.

If the primary purpose of budgeting is to control resources, the pattern of the thrift debacle suggests the need for an approach to budgeting that, for such programs, recognizes costs as they arise and thus provides both means and incentives for better cost control. An accrual approach seems to offer these advantages.

A second test of the value of the change is whether it facilitates the enactment and enforcement of budgetary controls that would limit future costs. The potential for control is enhanced by early recognition of growing liabilities. However, exercising control over insurance programs is problematic given that the government has either an explicit of or implicit contractual obligation to the insured. Barring retroactive repudiation of the government's guarantee, it must either collect the funds necessary to cover losses through premiums, borrow against future premium income, or tap general revenues to cover losses.

One potential mechanism for control is a requirement that, at least over multi year period, scheduled premium collections be sufficient to cover projected costs. A more draconian approach would be to limit appropriations to definite amounts, thereby forcing agencies to take action within their existing authority to limit costs. The prospect of either higher premiums or administrative actions to limit costs might induce the administration and Congress to consider more fundamental cost-limiting program reforms as an alternative.

A third test of the appropriateness of the proposed change is whether, for insurance programs and similar commitments, budget outlays would better reflect the timing and magnitude of the economic effects of those commitments. It has been noted that cash payments made to protect depositors, pensioners, or others benefiting from federal insurance have no macroeconomic effect. That is, payments do not increase the wealth or incomes of the insured and the combination of borrowing and spending has no overall effect on the credit market. However, this does not mean that there are no economic consequences to government insurance. Because government guarantees convey a subsidy, they change economic behavior. Extending protection to depositors or other private creditors and investors makes them less sensitive to risks being taken with their money. This "moral hazard" problem is inherent in any insurance. Unless it is carefully managed, the increased risk-taking incentive will over time lead to careless or reckless business practices. This leads not only to larger government liabilities but also to economic loses through inefficient use of private capital, higher government borrowing to cover losses, higher interest rates, and ultimately higher taxes. Although insurance subsidies may be stimulative in the short run, the net long-run effect is likely to be lower economic growth.

A careful analysis of the economic effects of the savings and loan disaster shows these to be quite complex and long lasting (Congressional Budget Office, 1992). Loans for unnecessary or poorly conceived investments wasted capital. The loans that financed these investments often went sour; and as they did, the losses reduced or wiped out the capital of the savings and loans or banks that made them. As this translated into additional insolvencies, the resulting increase in federal deposit insurance liability could be measured and, as proposed, recorded as a budget outlay. Using an accrual approach, therefore, the budget would record losses at an earlier stage and roughly at the time losses in the capital stock are generated by bad credit decisions made still earlier.

A final advantage of expressing insurance outlays on an accrual basis has to do with its effect on the apparent size of the federal deficit. The very uneven patten of spending for insurance programs causes fluctuations in the deficit, measured on a cash basis, that can obscure the longer-term or underlying degree of fiscal imbalance. Fluctuations are caused not only by the uneven incidence of insured events, including natural disasters, but also by the large temporary cash flows for purchase and resale of assets taken from failed depositories. As noted earlier, accrual budgeting removes both sources of fluctuations and thus provides a smoother tome path of program outlays. In the aggregate, this results in a more stable and truer measure of the structural imbalance between receipts and spending.

Disadvantages

The potential advantages of changing the budgetary treatment of insurance programs may be offset or negated by potential disadvantages. The methods used to estimate costs as they arise are subject to challenge.[12] If, in, the process, budget estimates become less generally accepted, the anticipated improvements in information and control may not be realized. Moreover, if the meaning and calculation of the overall budget deficit becomes less clear to most observers, this would detract from any improvements in the measurement and control of individual program costs.

Whether budgeting for insurance programs is on a cash basis or an accrual basis, uncertainties abound. Economic cycles, adverse court rulings, and mysterious variations in the pattern of disasters will cause major unanticipated swings in losses. In fact, estimates made for individual years will almost always be wrong. It is important, however, to distinguish between uncertainties inherent in forecasting insurance costs for the next, or in any future, fiscal year and *new* uncertainties that arise with the need to estimate annual changes in program liability rather than the cash flows associated with the actual insured events. With a shift to an accrual framework, some uncertainties are added and others are removed. Where liability estimation requires looking far into the future (e.g., estimating the current growth rate of government's pension guarantee liability for firms that may fail many years from now), a new element of uncertainty is added. On the other hand, the switch to accrual eliminates some uncertainties. Cash flows depend on the timing of a firm failure, a regulatory closure decision, or the incidence of disasters. However, the rate at which costs accrue is independent of the actual timing of insured events, and therefore to that degree, easier to estimate. Of course, over time, estimates of accruing costs must be reconciled with the actual cash payments that result.

Whether budget estimates prove to be more or less reliable under an accrual system, it can be argued that the complexity of the models used to estimate costs and the use of a nontransparent measure of costs rather than the more observable cash flows for budgeting makes the budget more arcane and the meaning of the deficit more obscure. With the reduction in transparency comes increased potential for gaming the numbers. This argument must be in terms of degrees rather than absolutes, of course, because cash-flow estimation also involves modeling and provides plenty of opportunity to play games.

Is Accrual Treatment Appropriate for Other Federal Programs?

The federal budget is now a blend of cash and accrual concepts. In addition to credit programs and the proposed treatment of insurance program, some federal employee annuities are budgeted on an accrual cases internally but not for the purpose of calculating total outlays or the deficit. For many programs, the cash/accrual distinction is not material because there is little or no lag between when liabilities arise and when they are paid. However, there are other major federal retirement programs now on a cash basis for which a case could be made in favor of accrual treatment. Among the major candidates for such treatment are social insurance programs, federal retirement programs, and disaster relief.

Some have advocated what could be viewed as analogous budgetary treatment of certain capital investments. In the latter case, accrual might involve depreciating these investments over the life of the assets created, a standard practice in business accounting. However, such treatment is contrary to the intent of the accrual purpose for insurance, in that it would postpone rather than bring forward the budget's recognition of the cost of these investments. In any case, the question of federal capital budgeting raises a number of other conceptual and practical issues.[13]

From the preceding discussion, and keeping in mind that the budget is primarily an instrument to plan and control spending, four criteria can be used to decide whether costs are best recorded and estimated on a cash or accrual basis: (1) how much time usually elapses between the time costs first arise and can be identified and when those obligations are satisfied; (2) what effect accrual treatment would have on the magnitude of errors in the budget estimates; (3) whether serious incentive problems could be corrected by recording costs as they arise; and (4) at what point a legally or morally binding commitment exists, or that costs are appropriately regarded as actual rather than contingent liabilities. Table 3 illustrates the application of these criteria to potential candidates for accrual treatment.

Table 3
Criteria for Accrual Treatment, Applied on Selected Federal Programs

Program	Elapsed Time from Liability to Payment	Effect on Errors in Estimation	Incentive Problem	Binding Commitment
Deposit insurance	Months or years	Small	Yes	Explicit
Pension benefit guarantees	Years to decades	Probable Increase	Yes	Implicit; Strong
Flood insurance	Says to months	Small	No	Explicit
Disaster relief	Days or months	Small	No	Weak to moderate
Federal retirement	Years to decades	Probable increase	Yes	Implicit; strong
Social Security	Years to decades	Probable increase	Yes	Implicit; moderately strong

Disaster relief programs provide a useful example of the application of these criteria. These programs are functionally similar to insurance, i.e. they replace unexpected private losses and thus minimize personal and economic damage. Because most disaster spending occurs within one or two years after the event, there might be only a small shift in the time pattern of projected spending if budget estimates for individual years would change only modestly. Second, whether costs are projected on a cash or accrual basis, frequent large errors in estimation will be a problem, for disaster relief as well as disaster insurance programs. This is because actuarial estimates of disaster insurance programs. This is because actuarial estimates of disaster frequency must be used in either case, whereas actual spending will reflect the highly erratic timing of actual events. Third, a principal argument in favor of accrual treatment seems to be absent here, because political and bureaucratic incentives work in favor of prompt action both to recognize and, by providing relief, to liquidate liabilities. Finally, in contrast to disaster insurance, disaster relief liability does not arise form a standing explicit contractual commitment but is contingent on a presidential declaration laying out the scope of the disaster. The liability thus arises not in the immediate wake of the event but only if and when a disaster is declared.

Social security programs (including old age, survivors, and disability insurance) offer a second interesting case. Here the shift from cash to accrual would dramatically alter the timing of cot recognition, in some cases by decades. Cash outlays today are a reflection of obligations that accredit over many prior years. Costs accruing today represent the government obligation being generated by current employment. Second, a shift to accrual would increase errors in outlay estimation. Although the rate at which these costs will accrue in the next several years is rather easily forecast the change to accrual treatment would increase estimation errors because it is still easier to estimate cash flows over the budget planning horizon related to current and expected retirements and disability claims. Third, with regard to incentives, the case for accrual treatment is ambiguous. It is sometimes argued that in years when current Social Security contributions exceed current cash payments to recipients, the resulting reduction in the apparent size of the deficits tempts policy makers to relax budgetary discipline. In the immediate future, accrual treatment would eliminate or greatly reduce the apparent contribution of Social Security to deficit reduction. However, the incentive problem posed by large Social Security surpluses can be and has been addressed in other ways. For instance, the “firewalls” established by the 1990 Budget Enforcement Act were intended to make it difficult to spend the projected buildup of Social Security reserves on higher benefits or lower Social Security taxes. Moreover, few would take current positive cash flows as a measure of the true actuarial position of the Social Security Trust Fund; therefore, the temptation to spend surpluses is tempered by widespread awareness that these surpluses will be needed in the future.[14] A final, and perhaps decisive, consideration is the degree to which Social Security represents a binding commitment to current workers. The history of legislation that has periodically increased or decreased benefit levels and contributions requirements implies that this commitment is highly qualified. The Social Security Amendments of 1983, for example, made changes in both contribution and benefit levels that dramatically altered estimates of expected costs. Had Social Security been budgeted on an annual basis so that prior year outlays had been recorded under the old benefit rules, the 1983 changes would have required an enormous retroactive correction to those estimates.

Where there is sufficient doubt about the appropriate treatment, alternatives should be examined that would add clarity and control without shifting to an accrual framework. For deposit insurance, for instance, excluding the cash flows associated with provide a clearer picture of the cash flow of costs as realized on a cash basis. Where cash budgeting discourages mandatory program reforms that would result in a short-term increase in spending, this disincentive for reform could be reduced by exempting this spending from the pay-as-you-go rules; these rules require offsetting spending reductions or other offsets whenever a legislative change would enlarge the deficit.[15] Finally, supplementary accrual analyses can be published as part of the budget without changing the way outlays are calculated.

Conclusion: The Changing Meaning of the Federal Budget Deficit

Although the case for accrual treatment of programs varies, no bright line separates those for which accrual treatment is best from those for which cash flows are the best measure of expenditure. It is likely that the future budgetary treatment of insurance programs-as well as other potential candidates for accrual treatment-will turn not only on the conceptual question of what constitutes a government liability and when but also on the more practical questions of how reliably costs can be measured and how best to control spending.

A final consideration is how the cumulative effect of shifting individual programs to accrual treatment alters the meaning of the federal deficit. Already, the budget presents multiple deficit measures, useful for different purposes (see Office of Management and Budget, 1992, part 3, and Director’s Introduction). Further movement toward accrual would, in particular, widen the difference between the budget deficit computed on this basis and an estimate of the federal government’s annual borrowing need. If the need to plan and control costs as they arise is viewed as paramount, then the convenience and seeming clarity of one all-purpose measure of the federal deficit may have to be sacrificed to this goal.

Notes

1. "Accrual" accounting requires the "recognition of the financial effects of transactions, events and circumstances in the period(s) when (they) occur, regardless of when cash is received or paid" (Federal Accounting Standards Advisory Board, 1991, p.5.) Although the federal budget is usually described as being on a "cash" basis, notes rather than cash are used to satisfy some obligations, and interest payments are recorded as they accrue.

2. These two purposes were affirmed by the President's Commission on Budget Concepts (1967). For the second purpose, more precise measures are available: for fiscal policy, the National Income and Products Accounts prepared by the Department of Commerce provide the best measure of the economic effect of government's transactions with other sectors; for monetary policy, the estimate of net borrowing from the public serves as the best guide for direct credit market impacts.

3. Eisner (1986, 1989) has proposed additional adjustments to the nominal deficit measured in these terms for changes in the nominal market value of existing financial assets and liabilities. He argues that the resulting deficit measure is a better estimate of how the federal government is affecting economic growth.

4. Blejer and Cheasty (1991) review many of the analytical issues concerning measurement of the fiscal deficit.

5. An exception to this is interest on public issues of public debt, which is estimated and recorded as it accrues.

6. For detailed accounts of the reasons for the delay and discussion of its cost consequences, see Edward J. Kane, The S&L Mess: *How did it happen*? (Washington, DC: Urban Institute Press, 1989) and Jams R. Barth, *The Great Savings and Loan Debacle* (Washington, DC: American Enterprise Institute Press, 1991).

7. The Financial Institutions Reform Recovery and Enforcement Act of 1989 abolished the Federal Savings and Loan Insurance Corporation (FSLIC), established the Resolution Trust Corporation (RTC) to resolve the backlog of insolvent thrifts, and created a new Savings Association Insurance Fund (SAIF) under the Federal Deposit Insurance Corporation (FDIC) to finance future thrift failures.

8. The Commission also recommended what it termed accrual treatment of expenditures other than credit and insurance and of corporate income taxes (President's Commission, 1967, chap.4). In its terms, accrual treatment of expenditures would have shifted the timing from when cash is disbursed to when the money is spent, for instance by a local government or contractor, to create a tangible product or service. Accrual treatment of corporate income tax receipts would have shifted the timing from when payments are received to when corporate profits generate tax liability. These recommendations were not adopted, largely because of the practical difficulty of developing reliable estimates but perhaps also because they do not carry the same implications for budget choices and administrative behavior as do the current treatment of credit programs or the proposals for insurance.

9. The General Accounting Office (GAO) took note of these studies, observing that "estimates of deposit insurance outlays would fluctuate less, and deposit insurance expenditures would be recognized in the budget more promptly, if deposit insurance expenditures were subject to budgetary treatment similar to that provided for credit programs by the Credit Reform Act of 1990" (GAO, 1992, p.7). GAO has frequently advocated greater use of accrual concepts in Federal program accounting.

10. The financing account preserves the information provided by traditional cash accounting and, over time, provides a reality check on the new estimates of accruing cost.

11. Budget authority is authority provided by law to enter into obligations that will result in immediate or future outlays of government funds. Outlays are payments that satisfy government obligations. When measured on an accrual basis, the outlays are made to a financing account outside the budget from which actual cash disbursements are made then or later. Outlays during a given fiscal year, whether calculated on a cash or accrual basis, may be for payment of obligations incurred in prior years or in the same year and may be from unexpected balances of budget authority provided in prior years or the year in which the money is spent. The deficit is the amount by which outlays exceed receipts in a given fiscal year.

12. U.S. Comptroller General Bowsher, in a letter to Senator John Glenn on February 28, 1992, said that, while GAO believed "the concept of reporting accruals in the budget is sound and could result in improved disclosure of program costs," nonetheless the Administration’s proposals were suspect, in part, "because of uncertain assumptions and poor data that underlie the calculation."

13. GAO (1988) has proposed the creation of a separate federal capital budget, as part of a broader restructuring of the budget, and others have made similar proposals. Boskin (1982, p. 298) argued that an excess of expenditures over receipts in a properly defined capital account need not count as an addition to the deficit, because "the new debt is matched by a new government asset."

14.The trustees’ actuarial analyses of the social security programs (Old-Age and Survivors Insurance and Disability Insurance) are widely circulated. As of January 1992, the trust funds were estimated to have an actuarial deficiency of $1.1 or $4.4 trillion, or an actuarial surplus of $1.9 trillion, depending on economic and demographic assumptions (see OMB, 1992, part One, pp. 280-281). The actuarial deficiency was $1.1 trillion according to the assumptions typically judged to be the base case.

15. The pay-as-you-go (PAYGO) rules were established as part of the 1990 Budget Enforcement Act. For an explanation, see OMB (1992, part One, p. 409).

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AUSTRALIAN CONTRIBUTION

"WHY GOVERNMENTS SHOULD PRODUCE BALANCE SHEETS"

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This contribution to a controversy argues that accrual reporting at the whole of government level is appropriate and necessary as it provides a full picture of a government's financial position, discloses the impact of policy over the longer term (and therefore the sharing of the burdens between current and future taxpayers), focuses the attention of governments and public sector managers on the management of total resources and obligations and introduces discipline in financial reporting and therefore ensuring the integrity of the reported information.

Yet, accrual reporting, whether at the whole of government level or individual agency level, will not bring about changes of behavior necessary to realize the full benefits of financial and other management reforms unless it is complemented by an accrual planning and budgeting regime to ensure that financial performance is planned and assessed on the same basis.

Many governments and commentators are coming to accept that accrual reporting is useful at the departmental level as it discloses the full costs (including non cash costs) of government programs and/or activities, and assists in the better management of all resources under the control of the departments relative to the traditional cash based reporting regime. However some sceptics may question whether it is appropriate to extend accrual reporting to the whole of government level and, whether any use can be made of financial information disclosed in the operating statement and, particularly, the balance sheet for macro economic management purposes.

The financial reform experience in New South Wales and New Zealand in recent years would support the following two propositions:

a) accrual reporting at whole of government level is necessary and appropriate; and

b) accrual reporting by itself will not bring about fundamental changes in behavior required to realize the full benefits of financial and other management reforms. As reporting is but one aspect of the whole management cycle (planning, short-term budgeting, implementation, performance monitoring and reporting), it is a truism that management planning and budgeting in the public sector (for example the parliamentary appropriation process) should be undertaken using the same basis of accounting to ensure that the benefits of reforms are achieved.

Defining the Issues

It is generally accepted in the private sector (and among accounting professionals) that the financial report of an organization comprises three primary statements namely:

- operating statement (or profit and loss statement);
- balance sheet; and
- cash flow statement.

For the general government sector and non profit-oriented organizations, the conventional format of a profit and loss statement is not appropriate nor meaningful. Instead the emphasis of the operating statement should be the cost of providing services (i.e., expenses) and how these expenses are funded by governments from year to year (i.e., revenues) with the consequential impact on the financial position (i.e., the balance sheet). The statement of cash flows provides information on how liquid resources (i.e., cash and cash equivalents) are used by an organization or a government for current operations as well as their impact on future activities through changes in assets and liabilities.

It is reasonable then to ask the following questions:

i) what information do these three statements, particularly the balance sheet, provide that the traditional statistical reports on government finances do not disclose? and

ii) what use can be made of these data in:
- management of public sector resources? and
- macroeconomic management?

Accrual Reports Provide a Full Financial Picture

Accrual accounting is a mechanism which condenses a large mass of data into a single set of meaningful and useful information. An accrual accounting system records transactions as they occur irrespective of cash movements; it distinguishes expenditure which provides economic benefits in the short term (i.e., for current consumption) from that which will benefit the agency and the community well into the future (i.e., capital expenditure). In principle, whole of government accrual reports are likely to be easier to understand and interpret by readers than the existing array of financial reports which provide an incomplete picture of government finances, and which are based on concepts and principles only understood by a select few.

The *operating statement* provides information on *total* costs of government programs/activities undertaken today, whether they involve cash or not. It shows whether taxes and other revenues of today are sufficient to cover today's costs (i.e., the operating result of a reporting entity). If today's revenues are less than today's costs, the balance sheet would reflect this deficiency as a reduction in net worth, and *vice versa*; if today's revenues are greater than today's costs, this would be an improvement in net worth. Changes in net worth can be effected by:

- an increase in liabilities either by borrowing to fund the deficit or obligations to make payments in the future, for example superannuation unfunded liabilities;

- an increase in assets which would provide future economic benefits to the reporting entity.

The *balance sheet* (or statement of financial position) is simply a list of assets and liabilities of the reporting entity with the difference between assets and liabilities being the equity of the 'owners', or net worth of the reporting entity in the public sector. It provides the link between operations of agencies and governments from one reporting period to the next. A time series of the balance sheets would give an indication of the 'financial health' of a reporting entity.

Thus, accrual reporting through the operating statement and the balance sheet provides a framework for resource and liability management by departments and the government as a whole.

Resource Management

Under the existing framework of government in New South Wales and other jurisdictions in Australia, departments generally have responsibility over shorter term assets and liabilities such as accounts receivable (debtors) and payable (creditors), inventory and cash. It is thus reasonable to expect departmental managers to manage these items as efficiently and effectively as possible; for example the level of inventory in a public hospital, and the health system as a whole, should be set and maintained at the lowest possible level consistent with operational requirements. A high inventory level together with a low turnover rate can be costly in terms of holding costs, borrowing costs and obsolescence. Principles of inventory management apply equally to public sector agencies and private companies.

Asset management is particularly important in the public sector due to the very long life of many physical assets. Because of the way capital expenditures are reported under the traditional cash basis, there is a natural tendency in the public sector to acquire or build new assets rather than adopting a systematic whole of life asset management.

Accrual accounting assists in re-focussing public attention on the state of long term community and infrastructure assets, (such as hospitals, schools, roads) and the linkage between assets and service delivery objectives. From a resource allocation perspective, it may be more effective and efficient to undertake a major refurbishment of a hospital than to build a new hospital a few kilometers down the road, or *vice versa.*

Asset information disclosed in the balance sheet together with depreciation charges and maintenance costs in the operating statement would be useful in financial planning and decision making over time.

Liability Management

Debt management has occupied an important place in government financial management. This focus is, to a large extent, due to the fact that government debts and debt costs are regularly reported and commented on by a great number of commentators ranging from politicians and journalists to credit rating agencies.

Similarly, the reporting of increasingly high levels of unfunded superannuation liabilities in recent years has undoubtedly focussed government's and the public's attention on the generosity of past public sector superannuation schemes. Thus action was taken to close these generous defined benefit schemes to be replaced by more affordable accumulation style schemes in many Australian jurisdictions. Some governments also took the opportunity to introduce funding policies to manage these liabilities over the medium term rather than adhering to the traditional policy of 'pay as you go' management (or lack of management).

Accrual reporting also encourages a longer term planning perspective by focussing on assets and liabilities, and the nature of each major item in order to determine their impact on future cash flows. This is important as the existence of a high level of committed cash flows arising from existing policies and liabilities would impose constraint on what a government can do in the future.

Improved Transparency

The adoption of accrual accounting is expected to improve financial transparency as there are externally imposed rules and standards as to how activities and transactions should be accounted for. It also improves the integrity and reliability of the reported information and reduces the opportunity for manipulation inherent in a cash based accounting system.

It has been suggested that improved transparency and the reduced opportunity for intervention may not be a goal shared by all participants. Experience with financial reforms in Australia would seem to suggest that this has not been the case; the resistance to the adoption of accrual reporting at the whole of government level mainly comes from the lack of experience in articulating how these accrual numbers can be used for macro economic management purposes, and further, it is because the focus for change has been on accrual reporting rather than the fact that accrual accounting is simply the framework needed to enhance public sector management in the achievement of the government's social objectives and priorities.

Linking Accrual Reporting with Financial Planning and Short-Term Budgeting

Fiscal cash measures provide an indication of the stance of fiscal policy and its impact on the economy at a certain point in time. Cash-based information alone does not provide an indication of long-term fiscal strength and the relationship between revenues, expenses and changes in net worth, and the trade off between the burdens of current and future taxpayers.

Whole of government accrual reports provide a more complete picture of government finances and assist in assessing the financial performance and financial position of a government, the sustainability of its policies and intergenerational equity issues.

Intergenerational equity is concerned with the appropriate balance between taxes, user charges and borrowings to finance today's current expenses and capital expenditures. Generational accounting measures the degree to which 'the burdens projected for future generation exceed those of current generations'. For example, the recording of accrual superannuation costs makes transparent the transferral of costs from current taxpayers to future taxpayers where there is an increase in the level of superannuation liabilities.

The distinction between current and capital expenditures and changes in the balance sheet would provide an indication as to the impact of government fiscal policies on current and future taxpayers. For example, a comparison of depreciation expense and capital expenditure on fixed assets in a reporting period and over time would give a broad indication of whether today's consumption has been made good to maintain the stock of assets constant.

Fiscal sustainability: net worth only provides a snapshot of the fiscal position at a given point in time. They do not provide information on whether net worth may improve or deteriorate over time without policy adjustments. Thus, forward projections of assets and liabilities and changes in net worth over time would be useful in assessing fiscal sustainability of a particular government policy.

Another benefit of accrual reporting is that it focuses policy attention on *financial position*, on the whole balance sheet, not just cash flows or debts. Without a whole of government balance sheet, proceeds from privatization may be used to report an improvement in the cash budget position. In the context of whole of government accrual reporting, the privatization of an asset, be it a building or a government trading enterprise, is merely the conversion of one asset on the balance sheet into another type of asset (i.e., cash). Thus, privatization involves a restructuring of the balance sheet; it does not change a government's financial position except to the extent that the restructure results in a gain or a loss, and allows the government to reallocate the proceeds of privatization.

Accrual reports provide a useful database which contains the basic ingredients to facilitate meaningful financial analysis in forward planning and budgeting either at the whole of government level or individual agency level.

Any reform is considered successful only when it brings about changes in the behavior of the people the reform is targeted toward. Changes in behavior are only possible when performance is planned and assessed on the same basis: 'there should be symmetry between the way departments (and governments) plan and manage their resources and parliamentary approval for such resources by moving to a resource based supply system'.

Extending accrual reporting to accrual budgeting and further, moving the cash based parliamentary approval system to a total resource based appropriation process would be a big step forward in bringing about this desired change of behavior. It recognizes the self evident truth that accrual accounting is only a means to an end, and that reporting is but one element of the whole management function; accrual accounting and reporting simply provides the overall framework and reporting structure for the implementation of financial and other management reforms which have as objectives a more efficient, effective and responsive public service.

Conclusion

This discussion piece has argued that accrual reporting at the whole of government and individual agency level is appropriate and necessary as it provides more comprehensive information on the total costs of government programs and activities and a more complete picture of government finances. Accrual reporting by itself would not bring about fundamental changes in behavior necessary to realize the full benefits of financial and other management reforms; it requires changes to the way governments manage their finances and to the parliamentary approval process.

If it is essential that fairly fundamental changes should be made to the way politicians, policy makers and operational managers go about their business, are the changes worth attempting and worth the effort of so many people? This writer believes that they are. For politicians, they benefit from the effort, as accrual reporting on a whole of government level would increase their control over all resources. It would give them better information to make decisions regarding priorities and assist in the better allocation of resources in accordance with these priorities. And last but not least, the information would enable the public to be better informed in assessing performance of governments.

For policy making agencies such as treasuries and departments of finance, it is worth the effort because it provides a more comprehensive database, a more consistent reporting framework to assist in the development of policies and the assessment of their sustainability in the longer term and to be able to undertake comprehensive financial analysis with a longer term financial planning perspective.

For operational managers, it is worth the effort as they will have more complete information to make decisions, and to have their accountability and performance assessed on a more comprehensive and consistent fashion.