Performance Budgeting and Accrual Budgeting: Decision Rules or Analytic Tools?

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Analytic Tools Versus Budget Rules

- An analytic tool assists budget makers in deciding the purposes and amounts to be allocated.
- A decision rule is information that dictates either how decisions are made or the types of decisions.
- Medium-term projections that inform budget makers of the future fiscal outlook are analytic tools.
- Medium-term frameworks that limit future spending or other budget elements are decision rules.
Reformers often seek to convert analytic tools into decision rules because of concern that the information will not be used in deciding the budget.

Over the years, both analytic tools and decision rules have proliferated in budgeting.

Not every tool of analysis is appropriate for making budget decisions: tools expand budget choice, rules constrain them.
Performance Budgeting

- Shifts budgeting from decisions on inputs to decisions on outputs or outcomes
- No standard definition of performance budgeting
- Some governments define performance budgets as budgets that contain information on actual or estimated results
Performance Budgeting

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- Others define performance budgeting as budgets in which increments in resources are linked to increments in results.
- In the broad definition, performance budgeting is only an analytic tool.
- In the strict definition, performance budgeting serves as a decision rule.
Accrual Budgeting

- Shifts budgeting from cash flows (money received and payments made) to revenues earned and liabilities incurred.
- The accrual basis would align budgeting and financial reporting: both would be on the same accounting basis.
- It is feasible to report in terms of accruals and to budget on a cash basis.
Accrual Budgeting

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- If budgeting were continued on the cash basis, financial reports would be analytic tools.
- If budgeting were shifted to the accruals, accounting principles would become decision rules in budgeting.
Expenditure Classification

- The classification of expenditure is often the most important decision rule in budgeting.
- The traditional classification has been by spending units and items of expenditure (inputs).
- Government can have only one decision structure in budgeting.
Expenditure Classification

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- It can have multiple supplementary classifications which serve as analytic tools
- Efforts to replace spending units as the decision structure through program or performance budgeting have been unsuccessful
- The organization structure has survived as the main decision structure because it is the basis for implementing the budget, carrying out authorized activities and maintaining accountability
Criteria for Decision Rules

- Every decision rule biases budget decisions
- Will the rule impair government’s ability to complete its budget responsibilities?
- Is the information required for implementing the rule already available?
- Do budget makers regard the rule as sensible and relevant to their work?
Criteria for Decision Rules

- Does government have adequate means to enforce the rule?
- What happened to past efforts to introduce similar rules?
- How does a proposed rule relate to other ongoing budget rules?
Why Performance Budgeting Should Be an Analytic Tool

- No standard definition or application of performance budgeting
- Strict version -- increments or resources and results -- hard to implement: few countries have succeeded
- Allocating on the basis of results ignores other salient considerations, in particular the need to finance ongoing activities, political promises and interest group demands
Why Performance Budgeting Should Be an Analytic Tool

- Systems that require agreement on objectives and results increase conflict and jeopardizes timely completion of budget work
- Performance budgeting is dependent on performance management and commitment of public employees to produce good results
- Hard to use performance as a decisional rule for outcomes
Why Performance Budgeting Should Be an Analytic Tool

- Basing allocations on outputs requires better cost accounting, including unit costs and distinctions between fixed and variable costs.
- Measuring performance has received most attention in performance budgeting, but not enough consideration of how and whether the measurements are used.
- Developing a ‘services’ (or outputs) baseline would strengthen performance budgeting as an analytic tool.
Why the Accrual Basis Should Be an Analytical Tool

- Many governments report finances (ex post) in the accrual basis: few governments budget (ex ante) on the accrual basis.
- It is not inconsistent to report and budget differently and to reconcile the two types of financial statements.
- Financial reports are subject to audit; budgets are not.
Although cash-based budgeting is subject to manipulation of the timing and recognition of transactions, accrual budgeting is vulnerable to manipulation of key assumptions.

Shifting the budget to the accrual basis weakens the capacity of political leaders to comprehend and take responsibility for accrual entries.

There may be an “accruals anomaly” in government similar to the anomaly in public firms.
The accrual basis provides a more reliable statement of fiscal condition, but in well-run countries, differences between cash and accruals tend to be small.

Accruals do not provide an adequate assessment of long-term fiscal sustainability because they exclude liabilities for general benefits such as social security and health care.
Why the Accrual Basis Should Be an Analytical Tool

- Accruals enable managers to better manage cost only when they have broad operating discretion.
- There are many unresolved issues in accrual budgeting pertaining to the recognition and valuation of assets and liabilities.
Thank You