After three decades of public financial management reforms, around three quarters of OECD countries are using accrual accounting with some adopting accrual budgeting as well (OECD Accruals 2016 Survey). This is however a sensitive time: questions are increasingly being raised on the cost and usefulness of accrual reforms, whose impacts on public management and performance are not obvious to many stakeholders.

Against this background, this study brings together the experience of eleven countries that have introduced accrual accounting and/or accrual budgeting into their public sector. It aims at summarizing initial objectives of accrual reforms, countries’ own assessment of how well these objectives have been achieved and propose recommendations on how finance ministries should go about achieving maximum outcomes from their transition to accrual accounting.

For additional information, please contact Delphine MORETTI
Tel. +33 1 45 24 99 80 – delphine.moretti@oecd.org

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Foreword

After three decades of public financial management reforms, around three quarters of OECD countries are using accrual accounting with some adopting accrual budgeting as well. This is a sensitive time: questions are increasingly being raised on the cost and usefulness of accrual reforms, whose impacts on public management and performance are not obvious to many.

In many OECD countries, finance ministries’ focus of interest is therefore shifting from finding out how to implement accrual accounting (or budgeting, in a more limited number of countries) to realising benefits from their reforms – and being able to demonstrate these.

Against this background, Section I of this report brings together the experience of eleven OECD countries that have introduced either accrual accounting or accrual budgeting in the public sector over the past quarter century.

The introduction explains how many OECD countries have transitioned to the accrual basis for preparing their accounts and budgets, the objectives of these reforms in different countries, and their assessment of how well these have been achieved.

The following chapters discuss how accrual reforms contributed to improvements in the transparency of the public finances (Chapter 1), accountability for fiscal policy and the use of public resources (Chapter 2) and the management of public funds (Chapter 3).

Section II of this report presents details of country experiences - Australia, Austria, Canada, Estonia, France, Japan, Korea, New Zealand, Spain, Switzerland and the United Kingdom.

The research was conducted by Delphine Moretti, Senior Policy Analyst in the Budgeting and Public Expenditure division, and Tim Youngberry, OECD expert under the supervision of Jón Blondál, Head of the Budgeting and Public Expenditure division. Jaehyuk Choi, Policy Analyst, and Erik Scheller, Intern in the Budgeting and Public Expenditure division, assisted with the preparation of the report.

This report reflects the results of survey and interviews conducted with officials from the OECD Financial Management and Reporting Network in the eleven OECD countries listed above. Norway also contributed to this report for the section on agencies. The authors would like to thank these officials for their insights and help in compiling information on their countries’ practices.

The OECD would also like to express its gratitude to the Government Accounting and Finance Statistics Center (GAFSC) at Korea Institute for Public Finances (KIPF) and Dr. James Do-Jin Jung, the head of GAFSC at KIPF, for their support for this research.
Box 1. What does “accrual” mean?

Before beginning a detailed discussion of the benefits of accrual reform, it is helpful to define what is meant by “accrual”, “accrual accounting” and “accrual budgeting” in this report.

What does “accrual” mean?

The term “accrual” is associated with two related concepts.

First, the recognition of economic events at the time at which they occur, regardless of when the related cash receipts and payments change hands. Economic events can include the delivery of a taxable service by a private company (for which the government accrues tax revenue), performance of a public service by a government employee (for which the government accrues a salary and perhaps a pension expense), or the loss or theft of a government asset such as a vehicle or equipment (for which a reduction in the asset stock will be recognized). These economic events may generate a corresponding or simultaneous cash flow, but in many cases – such as depreciation, revaluations, or impairment – they do not. This is an important difference between cash and accrual bases.

Second, the recognition of all stocks of assets and liabilities in balance sheets. Under accrual accounting, governments recognize all assets and liabilities including financial assets (such as equities), non-financial assets (such as land and buildings), and all liabilities including debt securities and bonds and other liabilities (such as payment arrears and civil service pension obligations). These stocks may be recorded at their historic cost, current market value, or some approximation, that is regularly revalued to ensure the balance sheet reflects the government’s true financial position at a given point in time. Governments that follow pure cash accounting typically account only for their cash holdings on the assets side and, possibly, debt on the liability side of their balance sheets. These are often valued at “book value” or the value at which they were initially acquired or issued.

What is accrual accounting?

“Accrual” concepts are used for producing government accounting and statistics - that is the reporting of past activities of government – in a growing number of countries. Specifically, accrual accounting refers to financial statements that governments produce for reporting their past activities.

Accrual accounting and accrual-based statistics are governed by standards, either set by national standards setters or international standards setters (e.g. International Monetary Fund, or IMF; International Accounting Standards Board, or IASB; International Public Sector Accounting Standards Board, or IPSASB).

What is accrual budgeting?

In theory, the principle of accrual budgeting is simple: it consists of forecasting economic events that will be generated by the government policies on accrual basis and managing obligations as opposed to cash – in other words, accrual budgeting forecasts and makes decisions about how rights to resources are established and received, and how obligations are incurred and settled.

In practice, the term “budget” has different meaning in different countries. In most countries it refers to the appropriations approved by the legislature to incur commitments and/or outlays. In other countries, generally those with a Westminster tradition, the budget refers to a broad statement of government fiscal policy and appropriations are approved by the legislature in separate documents often referred to as “estimates.”

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Executive summary

This executive summary brings together the report’s main findings and considers various success factors for achieving results from accrual reforms. A table summarizes objectives from accrual reforms, main challenges, steps to be taken and points to possible outcomes and benefits.

Being realistic over what accrual reforms can achieve, and at which pace

Case studies show that accruals reforms are lengthy projects. Most countries that adopted accrual accounting considered options to maximize outcomes of their reform when they felt more confident with the quality of their accrual based financial statements and build up resources and capacities for undertaking further steps. Indeed, even those countries that have moved to accrual accounting or budgeting decades ago, acknowledge that, with regards to “getting added value out of accrual financial statements” they are still on a learning curve. Overall, accrual reforms themselves seem to take 5 to 10 years; transparency benefits appear to come relatively quickly once reforms are complete; and policy and management outcomes seem to take more time.

Virtually all countries share the same broad objectives for their accrual reforms, but each country in practice has prioritised more specific outcomes to be achieved so that the accrual framework is of greater use for the management of its public finances. Countries experience shows indeed that all objectives cannot be pursued at once, and better outcomes are likely to be achieved were resources are focused on a limited number of priority outcomes. For example, in Japan, resources have been focused on developing policy unit cost information and cost accounting, while the United Kingdom, after dedicating significant resources to producing whole of government consolidated financial statement, is now focusing on strengthening its balance sheet management. Overall, the main finding of this study is clear: governments and finance ministries should not expect benefits from their accrual reforms unless they prioritise outcomes and actively plan for it.

Insuring leadership after the transition to accrual accounting

Strong leadership and project management by finance ministry after the transition to accrual accounting were identified as critical by many countries interviewed as part of this research for achieving outcomes from the adoption of accrual accounting. Countries also stressed the need to have teams or groups mixing fiscal policy specialists, budget officials, accountants and line ministries representatives for analysing the accrual data and identifying uses for this information. Supreme audit institutions, professional account bodies, and parliament are also important sources of pressure to make use of accrual information. Two recent good practices in that area can be noted: in France, an “Accruals Working Group” was set up in 2016 with representatives of the budget directorate, public accounting directorate and line ministries to move forward the analysis and use of accruals data; in the United Kingdom, a “balance sheet management group” comprising representatives of various groups within the Treasury and line ministries was set up in 2017 to undertake analysis and improve management of assets and liabilities reported in the balance sheet.
Communicating clearly and legibly

A common theme in all case studies is challenges associated with lack of interest in accrual basis financial statements outside of specialists’ circles and the need for government to improve their financial communication. As discussed in this report, in response to this major challenge, virtually all countries have developed reader-friendly summaries and commentaries of technical, complex and sometimes overly detailed financial statements. Many have developed an open fiscal data base, in the hope that accrual information will be used by stakeholders for feeding into their public finances analyses. Two countries, Australia and the United Kingdom, also engaged recently in simplifying substantially the content of their financial statements.

However, this may not be enough to address problems such as lack of understanding of technical accounting terms and what figures reported in financial reports mean in terms of government policies. The main way to promote and increase visibility of financial statements in the public and the media would be therefore by linking its information to economic and social issues (such as how the government sustains economic growth or addresses inequalities), which would likely stimulate greater stakeholder engagement. While this is an emerging area of interest, one interesting initiative in this area is New Zealand government’s publication of its Investment Statement that classifies all assets and liabilities into three functional classes (social, financial and commercial) in addition to the “conventional” balance sheet that classifies them by nature (current – inventories, receivables, cash, etc. - and non-current – intangible and tangible assets).

Harmonising standards

The debate on whether full benefits of accrual accounting can be achieved only by countries that also adopt accrual budgeting is not settled yet, even though countries such as Austria, New Zealand and the United Kingdom consider that using accrual concepts across all the budget cycle (ie. for the budget, accounts and statistics) is an important factor for achieving better outcomes from accrual reforms. In practice, as shown in this paper and in previous studies, a growing number of countries combine accrual and cash accounting bases in their budget system: cash (or modified cash) is favoured for setting spending limits; accrual is used for forecasting or reporting the financial situation. Opposing cash and accruals, in the sense of promoting the usage of accruals only or cash only, seem therefore to be more of an academic debate than a reflection of reality.

This does not mean that efforts are not needed for harmonising standards for reporting government operations. Case studies show that where different standards are used for the budget, fiscal headlines or targets, accounts and statistics, there is a certain level of confusion among stakeholders as to which set of accounts presents a more reliable portrayal of the government financial results and situation. Production of reports reporting similar operations with different standards and reconciliation exercises also have a cost for finance ministries that is not negligible. Initiatives such as using similar standards for fiscal targets, the budget and accounts (New Zealand) or harmonising accrual based accounting and statistical frameworks (Australia and the United Kingdom) could therefore be considered the way to go for getting expected outcomes from accrual reforms in terms of transparency towards stakeholders, or at least to avoid some possible negative effects.

Using accrual data as a building block for richer, more reliable fiscal information

It is often stated in academic literature that accrual accounting is the foundation of good fiscal management, because it addresses weaknesses of cash accounting that governments may be tempted to exploit by deferring cash disbursements, bringing forward cash receipts or failing to disclose public sector liabilities and commitments. Also, academic studies often consider than accrual reforms should lead to new, better ways of assessing the financial position of governments, for example by analysing variations of public sector net worth.
While these arguments are undoubtedly valid, countries do not often mention them as specific objectives, or outcomes, of their accrual reforms. As highlighted in the report, very few countries, for example, have adopted new, balance-sheet based, fiscal headlines following accrual reforms or developed government-specific financial ratios. Rather, the bulk of countries considers that benefits of accrual reforms are more likely to be indirect.

With regards to the reliability of fiscal data, for example, New Zealand and the United Kingdom indicate that, because their budgetary, accounting and statistical frameworks are all accrual-based and integrated, fiscal reporting as a whole is built on a “block” of audited departmental annual reports and accounts. Consequently, external stakeholders have greater confidence in the reliability of data, can better navigate budget documents, accounts and statistics, have a better sense of how these documents relate to each other and greater confidence in the overall reliability of fiscal data. France, which did not adopt accrual budgeting, similarly notes that reconciliation exercises between accrual and cash fiscal balances at year-end helped improving the reliability and understandability of fiscal data.

With regards to accruals generating a richer suite of information for other fiscal reports and increasing fiscal transparency, examples abound. All countries agree that publishing financial statements increases transparency in itself, but many, consider that better outcomes are achieved when this information is put into use for preparing or improving other fiscal reports, such as improving fiscal forecasts as mentioned by the United Kingdom; allowing better long term fiscal sustainability assessments, as mentioned by Canada and New Zealand; identifying fiscal risks as mentioned by Austria; or better informing auditors’ and parliamentary budget office’s work as mentioned again by Canada.

One lesson from this study for finance ministries that wish to convince stakeholders of the usefulness of accrual reforms may well be, therefore, that outcomes should not be assessed only in terms of direct impacts from publication of accrual basis financial statements, which may be limited, but also in terms of indirect benefits on quality and completeness of fiscal reports and overall improvements to fiscal transparency, which are likely to be more significant.

Creating a feedback loop within the budget cycle

Case studies show clearly that policymakers have paid greater attention to the acquisition, disposal, and management of government assets, liabilities and contingent liabilities following accrual reforms. Examples are country specific, covering areas as varied as defence inventories, public sector pension, infrastructure decommissioning costs and medical litigations. There is therefore little doubt that the nature of accountability and depth of scrutiny has shifted from a relatively narrow focus to a larger one following accrual reforms.

It remains however difficult to illustrate with specific examples of how information on assets and liabilities and full costs of programmes impacted budget preparation and/or discussions on sectoral and fiscal policies. Similarly, evidence of impacts on decision making of using the accrual basis for policy costing was difficult to find. Indeed, while all countries were asked to provide illustrations of accrual budgets and/or financial statements had driven decisions made by government and parliament, only three countries (Australia, New Zealand and the United Kingdom) gave specific examples and, in both cases, it was the creation of a fund for financing public sector pensions. Interestingly, a number of interviewees mentioned that, more than pushing policy makers to make better decisions, accrual creates “safeguards” and makes it more difficult for them to make bad ones, such as the creation of liabilities and contingent liabilities as a mean of implementing public policies, for example in the form of deferred benefits or guarantees.

In any case, one finding of this study may be that both academics and practitioners need to think of how accrual data could be put to practical, or more obvious, use in budget discussions. For example, one interviewee mentioned that budget proposals on investment could be grounded on analysis of value and
depreciation of assets reported in the balance sheet, in addition to economic or social considerations. Recently, the decision of the United Kingdom’s government to announce a Balance Sheet Review in its autumn budget statement and to update parliament on progress made at the next autumn budget is a promising initiative for strengthening the feedback loop between accrual financial statements and budget discussions.

Making accrual data useful at operational level

For a number of countries, accrual accounting has proven a useful tool for strengthening assessment of performance of departments or operational units. Practices depend on countries, but include benchmarking of operational costs and greater accountability from managers on financial and operational performance. Decisions about pricing of government services are also, in some cases transparently set, based on full costs rather than simply cash outlaid. Other countries however note that despite encouragements to use information derived from accounting systems for decision making, managers do not know how to make use of it. Getting outcomes from accrual accounting in this area seem to imply defining systems or procedures and requirements and/or incentives to managers to implement or use them.
<table>
<thead>
<tr>
<th>Objective</th>
<th>Issue</th>
<th>Steps to be taken</th>
<th>Expected Outcomes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Getting added value out of accrual reforms</td>
<td>Providing a “true and fair” view of public finances</td>
<td>Accounts publication have no impact on perception of government openness because of initial audit qualifications</td>
<td>1/ Professionalization of the finance function; 2/ Modernization of IT systems and business processes; 3/ Development of risks management and internal control within government</td>
</tr>
<tr>
<td></td>
<td>Producing better analysis on the state of public finances</td>
<td>Accrual data considered irrelevant for analysing government financial position (e.g. lack of meaning of “net worth”)</td>
<td>1/ Develop accounting data sets covering more than 3 years to identify and analyse variations on longer time-scale; 2/ Integrate systematically information from the accounts in fiscal sustainability analysis and fiscal risks analysis</td>
</tr>
<tr>
<td></td>
<td>Raising awareness of the general public on public finances</td>
<td>Accounts are too technical for the media and general public</td>
<td>1/ Simplification; 2/ Brochures; 3/ Open budget data; 4/ Non-conventional public-friendly presentation of the balance sheet</td>
</tr>
<tr>
<td></td>
<td>Defining more comprehensive fiscal objectives</td>
<td>Fiscal policy remains done on cash and/or assessed against statistics</td>
<td>1/ Adopt fiscal headlines/rules set on accrual accounting terms; 2/ Harmonisation of standards (to the extent possible) to avoid confusion as to which sets of accounts presents a reliable portrayal of results against objectives</td>
</tr>
<tr>
<td></td>
<td>Budgeting for cash and non-cash operations</td>
<td>Budget decision making remains done based on cash considerations only</td>
<td>Use policy costing on accrual basis for selected financial operations (e.g. long term and financial operations)</td>
</tr>
<tr>
<td></td>
<td>Reinforcing parliament’s year end scrutiny</td>
<td>Parliament does not scrutinise accounts</td>
<td>1/ Provide technical support to parliament (auditors, parliamentary budget offices); 2/ Highlight and comment information that is relevant to parliamentary work (e.g., high financial impact; significant annual variations; clear link to policy implementation)</td>
</tr>
<tr>
<td></td>
<td>Management of assets and liabilities</td>
<td>No understanding of risks, challenges and opportunities associated with assets and liabilities</td>
<td>1/ identification of surplus assets exercises; 2/ using of capital charges; 3/ overall balance sheet analysis</td>
</tr>
<tr>
<td></td>
<td>Performance evaluation</td>
<td>Performance evaluation makes no use of accrual financial data</td>
<td>1/ develop cost accounting as a tool for benchmarking; 2/ charging of government services using full cost information</td>
</tr>
<tr>
<td></td>
<td>Entity level management</td>
<td>Monitoring based on cash transfers</td>
<td>Develop entity-level i) management and ii) sustainability accrual indicators (e.g. aging of payables, stock of liquid assets, etc.)</td>
</tr>
</tbody>
</table>
SECTION I: ANALYSIS
Introduction

Accrual accounting began to generate interest in terms of its potential to contribute to improved public management and performance in the 1990s. Debates about the merits of applying accrual accounting to the public sector initially concentrated on the inherent differences in the nature of public and private activities, and the appropriateness of accrual accounting for assessing the financial situation and performance of the public sector. Expected benefits associated with accrual accounting (or budgeting) included improvements in transparency and accountability; a more comprehensive assessment of the state of the public finances; and stronger incentives for efficient management of public resources (OECD, 1993). While consensus was building on the merits of introducing accrual accounting, interest shifted to implementation issues (including accounting standards), which were extensively discussed, for example, at the annual OECD Accruals Symposia.

Today, the bulk of OECD countries either have implemented or are implementing accrual reforms:

- A third of OECD countries prepare both accrual budgets and accrual accounts;¹
- Around half of OECD countries produce cash-based budgets and budget execution reports as well as accrual financial statements;
- At the other end of the spectrum, a smaller group of OECD countries prepare only cash (and/or commitments) budgets and cash financial reports.

Even within these countries that have adopted accrual budgeting, accrual reforms have had limited impact on the management of spending authorisations (also called appropriations). New Zealand is the only country where full accrual spending authorisations are used.² Cash spending limits continue being used in a large majority of countries, as they are relatively simple to use for demonstrating compliance and are also closely related to government’s immediate financing requirements. Using the cash basis also has limits, which are acknowledged by most finance ministries. These limits have been addressed by using “multi-year appropriations” or “commitment appropriations” that cover all obligations that the government enters into on a given year, irrespective of the year of the cash outflow.³ Overall, while academic debates tend to present cash and accrual spending authorisations as two end points of a spectrum, with cash spending authorisations covering only cash paid and cash received, and accrual authorisations covering all financial operations irrespective of whether cash is paid or received, they generally not give enough consideration to real-life practices, which show that many countries are somewhere between these two end points.

¹ Where accrual budgets are voted, appropriations can be presented on cash basis (e.g. Canada), accrual and cash bases (e.g. Austria, Australia and the United Kingdom) or accrual basis (e.g. New Zealand).
² Departments’ net assets are included into annual appropriations – meaning that they cannot exceed that level of net assets without authorisation. Under such regime, all assets and liabilities generated by government financial operations are part of the legislative oversight mechanism.
³ For example, the European Commission defines budgetary commitments as “legal promises to spend money on certain projects, contracts, research, etc. - either in the same year as the commitment or later”.

GETTING ADDED VALUE OUT OF ACCRUAL REFORMS
Table 1. OECD Countries: Accounting basis for expenditure authorisation and control

<table>
<thead>
<tr>
<th>Accounting Basis</th>
<th>Countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accrual</td>
<td>New Zealand; United Kingdom</td>
</tr>
<tr>
<td>Accrual and Cash Modified Accrual</td>
<td>United Kingdom; Austria, Australia; Austria; Canada; Denmark; Iceland; Sweden; Switzerland</td>
</tr>
<tr>
<td>Cash and/or Commitments</td>
<td>Belgium; Chile; Czech republic; Estonia; Finland; France; Germany; Greece; Hungary; Ireland; Israel; Italy; Japan; Korea; Luxembourg; Mexico; Netherlands; Norway; Poland; Portugal; Slovakia; Slovenia; Spain; Turkey; USA</td>
</tr>
</tbody>
</table>

Note: A number of OECD countries combines accrual and cash spending limits. Countries that combine accruals and cash give spending authorisation on both accrual and cash bases; other countries that use modified accrual spending authorisations exclude expenses that are not within the government control, such as those arising from depreciations or changes in the market value of assets and liabilities, hence cannot be qualified as "full accrual".

Source: OECD Accruals Survey (2016).

Box 2. - Why not Accruals? The cases of the Netherlands, Norway and Germany

While the great majority of OECD countries have embraced accruals, some have chosen not to. The Netherlands, Norway and Germany are three examples. In Germany, in 2006, the Federal Ministry of Finance introduced the MHR-project ("Modernization of the budgeting and accounting system"). One of the proposed outcomes of the project was that the current cash-based accounting system would be complemented with an accrual-based system. Further, the Federal government as a whole was to produce an enhanced list of assets and liabilities, although it would not produce a comprehensive balance sheet. However, the overall projected was halted in 2010 due to a lack of parliamentary support, due mainly to significant costs associated with such a reform and fear from the parliamentarians that they would lose some influence over the budget.

In the Netherlands, a 2017 government enquiry concluded that in principle a comprehensive accrual budgeting and accounting constituted a more coherent and clearer system for forecasting and accounting for government operations. At the same time the current cash-based accounting and budgeting system were seen as well-functioning, and there was a principal concern that the implementation and transition process in itself to an accruals based system would have a detrimental effect on the capacity of already pressured ministries. Therefore, a move to accruals was inadvisable in the short term. The report recommends that an interim evaluation is to be carried in 2020 to assess the requirements for taking further steps towards an accrual accounting system.

In Norway, a 2015 government enquiry assessed that there were no substantial reasons to move away from the current cash-based system for budgeting and accounting. The enquiry argued that a government using a cash-based budgeting is better positioned to engage in contra-cyclical fiscal policy since, in such a system, there is a direct link between increased budgetary allocations and actual cash-flows. Further, it argued that it was important that the basis for the accounting system was aligned with the basis for the budget since that facilitated the scrutiny of government by the parliament. Hence, given that the basis for the budget should not change, then the basis for the accounting should also not change. Interestingly, for all three countries, the core reason for deciding against a transition to accruals is concern about losing budgetary control.

After around three decades of reforms, a recent OECD survey (2016) showed that introducing accrual accounting or budgeting is no guarantee that its potential benefits will be realised. A majority of countries express satisfaction that the reform objectives around transparency and accountability had been achieved. However, satisfaction with regards to other objectives is uneven. It is still relatively high relating to financial analysis, information on the full costs of operations and awareness of the state of public finances. It drops in the area of assets and liabilities management and efficiency of business processes, which are considered as “on going” or “partially achieved” by a significant number of countries.

**Figure 1. OECD Countries: Achievements of accruals reforms objectives**

![Graph showing achievements of accruals reforms objectives](image)


As a result, focus of interest for most OECD countries has shifted from finding out how to implement accrual accounting (or budgeting) to realising more fully the large range of benefits expected from the reforms. Indeed, virtually all finance ministries recognise that interest for accrual data is limited within and outside government. Some finance ministries also acknowledge that initiatives for using it are still in their infancy. External stakeholders share these views. For example, in the United Kingdom, the House of Commons Public Accounts Committee (2017) published recently a report that welcomed the Treasury’s improvements to the quality, coverage and timeliness of the Whole of Government Accounts but noted that there was more to do to make these accounts more useful to the Government, as well as to Parliament and the public. Similarly, in France, the Court of Accounts (2011) regretted the limited use of accrual data within government and lack of interest for the financial statements in Parliament.

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4 In particular, the PAC recommended that the WGA be published more quickly after the year-end; include more information on the reasons for significant movements on the balance sheet and the associated fiscal risks; explain better where public money is going; and discuss the impact that the Government’s decisions have on the short- and long-term public sector financial position.
Overall, after three decades of reforms, the value of accruals for the public sector remains disputed, or at least unclear. Against this background, this paper aims at highlighting outcomes delivered by accrual reforms and attempts identifying success factors for achieving these. The eleven OECD countries chosen for this study all implemented accrual accounting reforms, and include six countries that also implemented accrual budgeting reforms. As well as taking different approaches to the scope of accrual reforms, these countries vary across other criteria as well. While most countries selected implemented accrual reforms 10 or more years ago, two of the countries selected are at an earlier stage of their reform implementation. The case studies also cover a range of country institutional settings, for example a “Westminster model” of public finance management (Australia, Canada, New Zealand and United Kingdom) and a “Continental Europe model” (Austria, France, Spain, \). Taken together, they provide a diverse group of countries where the issue of outcomes and benefits of accrual reforms can be considered without any significant bias.

<table>
<thead>
<tr>
<th>Countries</th>
<th>Accounting system</th>
<th>Reform period</th>
<th>Budgeting system</th>
<th>Reform period</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>Accruals</td>
<td>1990s</td>
<td>Accruals</td>
<td>1990s</td>
</tr>
<tr>
<td>Austria</td>
<td>Accruals</td>
<td>late 2000s-early 2010s</td>
<td>Accruals Cash</td>
<td>late 2000s-early 2010s</td>
</tr>
<tr>
<td>Canada</td>
<td>Accruals</td>
<td>mid-1990s mid 2000s</td>
<td>Accruals Cash</td>
<td>mid-1990s mid 2000s</td>
</tr>
<tr>
<td>France</td>
<td>Accruals</td>
<td>2001-2006</td>
<td>Cash</td>
<td>-</td>
</tr>
<tr>
<td>Japan</td>
<td>Accruals</td>
<td>2000-2005</td>
<td>Cash</td>
<td>-</td>
</tr>
<tr>
<td>Korea</td>
<td>Accruals</td>
<td>2009-2011</td>
<td>Cash</td>
<td>-</td>
</tr>
<tr>
<td>Spain</td>
<td>Accruals</td>
<td>Late 1980s-2010</td>
<td>Cash</td>
<td>-</td>
</tr>
<tr>
<td>Switzerland</td>
<td>Accruals</td>
<td>Late 2000s</td>
<td>Accruals Cash</td>
<td>Late 2000s</td>
</tr>
</tbody>
</table>


This study uses a comparative case study approach. The case studies themselves are based on answers to a common, predominantly qualitative, questionnaire covering all areas relevant to assessing the use of accrual financial information, as well as interviews. This approach has specifically sought to
understand core objectives and outcomes of accrual reforms and looked at specific elements of how governments achieved these outcomes. The following chapters of this report discuss the key themes emerging from the analysis, before turning to the individual case studies themselves.
1. Transparency

Transparency relates to being open in all communications, transactions and operations to the general public. In the public sector, this means that information published by governments on how public money is raised and used is comprehensive, reliable and understandable. This chapter discusses the extent to which accrual reforms have delivered results in this area and is structured around the three main objectives commonly pursued by governments: i) providing a “true and fair” view of public finances; ii) producing better analysis on the state of public finances; and iii) raising awareness of the general public on public finances.

1.1. Providing a “true and fair view” of public finances

Virtually all countries consider that accrual reforms have profoundly improved the range and manner in which financial transactions are reported in public sector and allowed providing a “true and fair view” of public finances to the general public. In accounting and auditing, the concept of “true and fair view” is generally considered to mean that financial statements are free from material misstatements and faithfully represent the financial performance and position of the entity.

First, accrual reforms pushed governments to innovate in carrying out their financial and accounting processes and making use of new, more advanced technologies (such as integrated financial management information systems). Two countries, Australia and New Zealand, underline in particular that accrual reforms contributed to the professionalization and modernisation of the finance function. This included training of officials in accrual accounting and/or recruiting employees with professional accounting qualifications. Some countries, such as France, also note that accrual accounting reforms resulted in the increasing use of risk-based internal control approaches and in the creation (or reinforcement) of the internal audit function within government.

This, in turn, allowed governments to monitor a wider range of financial transactions, in a more systematic and reliable manner. Several examples have been provided as part of this study. For example, finance ministries had to define and track triggering events for delivery of goods, the provision of a service, or the fulfilment of a contract; clarify in some cases the existence of a valid claim, that is when all requirements and conditions for receiving a subsidy or benefit are satisfied by the third party; and start inventorying and measuring conditional or potential financial obligations of the government, such as cost of decommissioning nuclear facilities or cleaning up contaminated land.

Some countries, e.g. Australia, underlined that “true and fair view” on public finances can be achieved only when an unqualified audit opinion on the financial statements is granted by the supreme audit institution. In fact, in virtually all countries, audit qualifications or findings increased following initial implementation of accrual accounting, but reduced over time as management focused on remedying those issues. This generally took time, highlighting that even in OECD countries that have among the best financial reporting practices, the move to accrual accounting often brought to light weaknesses in internal control and accounting practices that had been previously undetected.
For these countries that have achieved their objective of publishing financial statements that provide a “true and fair view” of public finances, a fundamental question is whether it impacted external stakeholders’ perception of government openness. This question remains difficult to answer with regards to the general public, but it is clear that expert groups (auditors, parliamentary budget offices, specialised NGOs, credit rating agencies, etc.) generally support accrual reforms and consider that financial statements provide a solid and transparent base of information for their use (Moretti, 2017).

1.2. Producing better analysis on the state of public finances

**Financial analysis of government financial statements**

In adopting accrual accounting or budgeting, countries often sought to develop financial analysis of government financial statements in a similar way to private sector practices. This has been achieved only to a limited extent. New Zealand publishes a comprehensive Investment Statement covering the whole balance sheet every fourth year with performance measures for every major asset class, including some financial analysis on e.g. their commercial holdings. However, private sector financial ratios (e.g. liquidity or operating performance ratios) are generally little used in government. Only one country (Spain) has developed a set of ratios for analysing the government balance sheet and operating statement. In the UK, more recently, the Office for Budget Responsibility used various financial ratios during their stress test of the public sector balance sheet in their Fiscal Risks Report.

A more common concern of the general public, according to finance ministries, is to get a sense of trends in government expenses, revenue, assets and liabilities over extended time periods - that is time periods that exceed those, relatively limited (usually two to three years), reported in the financial statements. Therefore, a number of countries (France, Japan and the United Kingdom) are developing and maintaining accounting data sets that cover at least 5 years (a desirable objective being to have data set covering over 10 years, according to some finance ministries).

**Long-term sustainability of public finances**

Assessing the long-term fiscal sustainability of public finances is a key element of budget transparency (OECD, 2015). Different definitions of fiscal sustainability can be found in literature, but, historically, fiscal sustainability has been defined as a “measure of government solvency” (Shaw, 2017). For example, for the European Commission, “a public entity is considered as solvent if the present discounted value of its current and future primary expenditure is smaller than (or equal to) the present discounted value of its current and future path of income, net of any initial debt level”.

In the private sector, solvency is measured in reference to a firm’s net worth. There has been extensive discussion of whether such an approach could be used for governments, but this method is generally considered questionable (Shaw, forthcoming and Office for Budget Responsibility, 2015). One core reason that prevents the use of government net worth as a measure of public finances sustainability is the “backward looking” nature of balance sheets – ie. balance sheets measure assets and liabilities generated by past government activities and net worth provides information on short term solvency –

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6 One example is Canada where the published accrual information is highly appreciated by the external Canada Pension Plan Investment Board.

7 The OECD recommends that governments publish “a report on long-term sustainability of the public finances, regularly enough to make an effective contribution to public and political discussion on this subject, with the presentation and consideration of its policy messages – both near-term and longer-term – in the budgetary context.”
while fiscal sustainability assessments by nature have a long term time span, hence a “forward looking” nature – i.e. they measure assets and liabilities that will be generated by both past and future government activities.\(^8\)

Accrual accounting is nevertheless useful to long-term fiscal sustainability assessments. The comprehensive approach of accrual accounting in defining and recognising liabilities along a spectrum (from contingent liabilities to provisions and debts) means that financial statements provide a framework to consider all liabilities generated by past government activities. Also, some argue that financial statements provide information that is not available otherwise, such as civil service pension liabilities, provisions and commitments for finance leases and certain contingent liabilities (Office for Budget Responsibility, 2015).

While it is difficult to measure the impact of accrual reforms on improving the reliability of fiscal forecasts, a number of governments explicitly mention changes that would occur to the government’s assets, liabilities and contingent liabilities over the time horizon of the assessment in the key assumptions underlying the projections. For example, in the United Kingdom, the Office for Budget Responsibility estimates the economic value of government’s contingent liabilities, in cases where there is a non-zero but less than 50 per cent probability that the government will face some cost in the future.

**Figure 2. Using Financial Statements to Inform Assessments of Public Finances' Sustainability**

![Diagram](image)

Note: The figure above highlights the components of long term sustainability assessments' forecasts, according to the United Kingdom’s Office for Budget Responsibilities. Those components are assets and net liabilities generated both by past and future government activities. Components highlighted in green can be found in both National Accounts (statistics) and Whole of Government Accounts, or WGA (financial statements), while components highlighted in blue can be found in WGA only. Components in white are assets, revenue and liabilities generated by future government activities. They are not reported in National Accounts and WGA and are forecasted based on past trends and current policies according to hypothesis made by the Office for Budget Responsibility.


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\(^8\) It is considered good practice to examine a time horizon sufficient to assess the budgetary implications of demographic change, spanning 30 years or longer.
Box 3. - Accrual Accounting and Credit Ratings

While budget transparency, in general, has been shown to be associated with better credit ratings (Hameed 2005, Arbatli & Julio Escolano 2012) there is little academic research establishing there is a direct link between accrual-based accounting and better credit ratings.

Perception of government on impact of accrual reforms on their credit rating vary. Australia, Canada and Switzerland, on the one hand, indicate that accrual financial statement are used by rating agencies when they assess the overall financial position and balance sheet strength of the government. Spain and France, on the other hand, are not aware of any particular interest showed by rating agencies towards there accrual-based accounting.

The difficulty of evidencing any link between accrual accounting and better credit ratings may be due to the fact that the intent of credit ratings is very similar to the purpose of long term sustainability assessments - that is assessing and comparing governments’ capacity to generate sufficient current and future cash flows to make principal and interest payments. Therefore, information sources used by credit agencies on current cash flow levels are generally government statistics, which are internationally comparable, and, on future cash flow levels, economic and fiscal outlooks.

While financial statements may not be central to credit ratings, credit agencies underline that they provide useful information on future large liabilities, such as pension obligations.


Fiscal Risks

Fiscal risks are commonly defined as “factors that may cause fiscal outcomes to deviate from expectations, arising from macroeconomic shocks or the realisation of contingent liabilities” (IMF, 2016). While disclosure and management of fiscal risks is not yet a widespread practice in OECD countries, interest is growing as governments acknowledge the recurrence of financial shocks, the exposure of public finances to these shocks and the related need for a better understanding of potential impacts on their fiscal position (Kopitz, 2014 and IMF, 2016).

Accrual accounting, which entails the disclosure of contingent liabilities, and the management of fiscal risks are mutually supporting activities. Virtually all countries recognise that the scrutiny that comes with disclosure of contingent liabilities in financial statements creates pressure to ensure that these risks are identified, measured and managed, and ideally leading to earlier and smoother policy responses. Some countries interviewed as part of this study, such as Austria, Estonia and France, noted that accrual accounting helped in identifying and monitoring risks that were previously not acknowledged or reliably measured. In many cases, risks identified relate to contingent liabilities (e.g. guarantees), provisions (e.g., tax litigations) and long-term debt (e.g. pensions). More generally, it is notable that among those OECD countries that have started publishing comprehensive and regular assessments of fiscal risks, a majority had previously introduced accrual reforms (Australia, New Zealand, Finland and the United Kingdom).9

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9 In 2011, the Ministry of Finance in the Netherlands, with the support of the Dutch fiscal council (the Central Planning Bureau) and the central bank, published a risk analysis of the Dutch public finances, but this exercise has not been repeated yet. The Department of the Taoiseach in Ireland is required to publish an annual national risk assessment (NRA) for debate in the Irish Parliament, and has published two to date. The NRA is not focused on fiscal risks, as it aims more generally on “identify strategic risks that may arise due to potential
One missing piece of the puzzle at this stage may be how accrual reforms have improve (or will improve) management of fiscal risks. For example, recording provisions and contingent liabilities has made governments more conscious of risks and some countries are now trying to subject them to the same degree of scrutiny and control as ordinary spending. The United Kingdom, for example, recently published guidance to improve the management and scrutiny of contingent liabilities. One country (New Zealand) noted that another aspect of the management of fiscal risks is the importance of the statement of financial position in providing an assessment of the resilience of public finances. Because fiscal risks are by definition uncertain, the awareness and understanding of them will never be complete. A recognition that fiscal policymakers are working with incomplete knowledge and an acknowledgement of the complexity of the economic system suggests there needs to be a clear allowance for uncertainty. Such an allowance is provided by the resilience of a government, its capacity to absorb shocks and stresses and capacity to adapt and rebound from them. For large economic shocks, citizens expect their governments to act as a shock absorber, and the statement of financial position in effect provides a much enhanced view of the ability of the government to perform this function. Rather than just a single debt measure, the whole structure of the balance sheet can be assessed, including the reserves and other financial instruments the government owns, and the options it has to adapt its balance sheet in response to shocks.

1.3. Raising awareness of the general public on public finances

In the area of transparency, a larger goal for governments that have engaged in accrual reforms is often to increase interest and understanding of the general public in public finances. One country (New Zealand) reports that the use of accrual budgets and accrual accounts, consistently applied, and in terms familiar to users of private sector financial statements, can provide an aid to understanding the government’s financial position.
However, years into reforms, many finance ministries, e.g. Austria and Canada, acknowledge that interest in financial statements and use of accrual data remains limited, or at least below initial expectations. Accrual financial statements, which are complex, voluminous documents, are generally difficult to understand for non-expert users. Therefore, according to finance ministries, a key aspect to be considered in terms of citizens and generalist media engagement is to have proper consideration of the value and clarity of published information.

Consequently, virtually all governments have developed tools to summarize and explain financial statements, as well as avoid data misinterpretations. Case studies show a variety of practices. Some countries, e.g. New Zealand, Estonia and France, short brochures (often called At a Glance or Citizens’ Guide) are used to highlight information that is key for citizens’ understanding of the government’s financial situation, in plain language and with user-friendly visualizations. In addition, rather than including ever more information in financial statements, some governments, e.g. Australia, have started simplifying and clarifying disclosures in order to make them more user friendly (Moretti, 2017).

As Blöndal (2003) notes there is very little understanding in the media of the underlying concepts of accruals and, as a result, media therefore often have difficulties in interpreting presented figures. Media lack of interest may be a consequence of the focus on government deficits and debt in public discourse. Some finance ministries have responded by developing comprehensive communication strategies. For example, in New Zealand, media “lock-ups” and presentations are organised when financial statements are published similar to when the budget is released).

One issue to address may be that the conventional presentation of a balance sheet (i.e. assets and liabilities classified in non-current and current assets and liabilities, and within these categories, presented by nature) is often too technical for non-specialist stakeholders to fully understand the purpose of government holdings of assets and liabilities and more importantly to make policy decisions on this basis. One notable experience for addressing this problem is New Zealand’s balance sheet presentation in its Investment Statement, which shows how much the government owns and, perhaps more importantly, invests each year in infrastructure and other assets for economic or social purpose.

Where accrual information is not easily accessible, probability that citizens and media will analyse and use this information as part of the debate on public finances situation is very low. A minimum step to take is to publish financial statements on government, finance ministry and/or auditor’s websites. Accrual data underpinning charts and tables in financial statements is also often available online (e.g. Australia, Estonia and the United Kingdom). Lastly, some countries provide accrual data on their open data portals. In the United States, for example, the Digital Accountability and Transparency Act of 2014 requires federal agencies to publish all of their spending data on one platform – that is to bring together three broad categories of federal spending reporting requirements: cash-based agency budgets, accrual-based accounting data, and award data (public procurement). It is however clear that more needs to be done in this area.

In addition to examples provided in case studies, the US Federal Government’s Citizens’ Financial Statements is worth mentioning, which summarizes the U.S. Government’s current financial position and condition, and discusses key financial topics, including the financial sustainability of the federal government’s policies. The Government Accounting Office (GAO) also publishes a brochure called “Understanding the Primary Components of the Annual Financial Report of the United States Government”, whose goal is to make available to “every American” a comprehensive overview of the federal government’s finances.

For example, social assets may comprise hospitals, schools, social housing, as well as student loans, while economic assets may comprise infrastructure and loans provided to businesses.
Table 4. Open Data Practices in surveyed countries

<table>
<thead>
<tr>
<th>Description</th>
<th>Countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Comprehensive Open Data Portals with accrual information</td>
<td>Australia, Estonia, Japan, Spain</td>
</tr>
<tr>
<td>Selected accrual information available at Open Data Portal</td>
<td>Canada, France, Korea, Switzerland</td>
</tr>
<tr>
<td>No Open Data Portal or no information given</td>
<td>Austria, New Zealand, United Kingdom</td>
</tr>
</tbody>
</table>

Source: Authors based on case studies in section II.
Accountability relates to being responsible to someone for actions taken; about being able to explain, clarify and justify actions. In public financial management, it implies that the government has a duty to explain its fiscal policy and account for the use of public resources to parliament and that, conversely, the parliament has the right to question fiscal policy and authorize and scrutinize allocations of public resources to government policies. This chapter discusses to which extent accrual reforms have delivered changes in this area and is structured around the three core stages of the budget process potentially impacted by accrual reforms: i) the setting of government fiscal objectives; ii) the approval of the budget and appropriations; and iii) the scrutiny of year-end accounts.

2.1. Defining more comprehensive fiscal objectives

A large majority of OECD countries use so called “headline measures” as indicators of the executive’s fiscal strategy and management (OECD, 2014). Head line measures can be defined as numerical objectives or limits for expenditure, revenue, debt, or balance set by government on annual or multi-year basis. Sometimes, these head-line measures are qualified as “fiscal targets” or “fiscal rules”. Fiscal targets are constraining on a political basis only and can therefore be revised at executive’s discretion. Fiscal rules are fiscal targets that are legally binding or can only be revised on a low-frequency basis (e.g., as part of the electoral cycle).

Cash vs. Accrual Fiscal Targets

The cash balance and gross debt have been historically the fiscal targets favoured by governments. Case studies show however that accrual reforms had an impact on the way government define their strategic fiscal objectives, as a majority of countries have adopted accrual based head line measures – meaning that the range of possible expenses, revenues, assets and liabilities included within their fiscal target is broader than on a cash basis. For example, the accrual basis deficit measure used by Eurozone countries includes expenses that are due for payment. Another example is the net debt measure used by New Zealand.

Deficit and debt targets are the most common head line measures against which government define their fiscal strategy. Despite the wealth of information provided by accrual financial statements, case studies highlight a reluctance to move away from these “conventional” head line measures. Australia, one of the two countries that uses simultaneously accrual and cash based fiscal targets notes that stakeholders tends to focus on the latter which are more easily understandable or maybe perceived as more reliable and relevant. Balance sheet targets other than gross debt are little used. The United Kingdom has had a fiscal target for Public Sector Net Debt, defined as the public sector’s consolidated gross debt less its “liquid” assets – that is assets that could readily be sold – since the late 1990s. Only two countries (New Zealand and Australia) offer regular projections of their net worth in budget documents, but do not use this measure a fiscal target or fiscal rule. In New Zealand, positive net worth is considered a core fiscal objective because it provides a buffer against potential future economic or fiscal

12 94% of OECD countries have adopted at least one fiscal rule (OECD, 2014).

13 Targets and rules on deficit or profit levels are also called “fiscal balance rules” or “public sector net borrowing rules”.

14 In such a case, the measure of deficit is cash payments minus cash receipts and the measure of debt is the government's overdraft.
shocks and, perhaps more importantly, ensures intergenerational equity. More recently, the United Kingdom has supplemented its target for Public Sector Net Debt with a more comprehensive measure of Public Sector Net Financial Liabilities (encompassing all financial assets and liabilities), but this is not the subject of a formal fiscal target.

Case studies also show that there is not necessarily a clear linkage between concepts used for fiscal targets, annual budgets and accounts within a given country. For example, in France, the budget is prepared on cash basis, financial accounts prepared on accrual basis according to national accounting standards and fiscal targets are set on ESA10 basis. Conversely, Switzerland, which is preparing accrual basis budgets and financial statements based on IPSAS, anchors its fiscal policy with a cash based fiscal rule called the Debt Brake that seeks to avert structural imbalances in federal government finances.

Statistical vs. Accounting Frameworks

In most other countries, fiscal targets are set and reported on statistical terms, meaning that fiscal statistics are core accountability documents with regards to governments’ achievements against their fiscal objectives. This suggests that financial accounts are still considered to suffer a number of limits compared to fiscal statistics, with regards to setting and monitoring fiscal objectives. One of these limits is the lack of comparability because few countries use international accounting standards (Moretti, 2016). Another limit of financial accounts is relatively frequent changes in accounting methods and institutional coverage, making difficult to interpret long series of accounting data sets. The last one, and maybe core one, is timeliness. Statistics are available in most countries every month within a few weeks, when audited accounts are not available until well after the end of the year. Financial accounts can consequently wrongly be perceived by economists, policy decision makers and the media as secondary to fiscal statistics, or of limited added-value.

15 With regards to limited use of net worth as fiscal target, one explanation may be that countries consider it to be difficult to monitor and analyse due to its volatility. Net worth can significantly vary from one year to another due to changes in assets and liabilities reported at market value that are not linked to government fiscal policy and management (Robinson, 2009).

16 Fiscal rules for Eurozone countries are set in the European Union’s Stability and Growth Pact and Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (so called Fiscal Compact). Fiscal rules are set and reported against the European System of Accounts (ESA) and are as follows: general government fiscal deficit rule; debt rule; medium-term structural balance objective; and medium-term expenditure benchmark limiting annual growth in general government expenditure to potential GDP growth.

17 There are “historical” reasons explaining this situation. Before accrual reforms, government fiscal reporting practices were generally viewed as weak and fiscal statistics considered a more reliable source of fiscal data. Fiscal statistics were indeed compiled by agencies independent from government within a few months after year-end, prepared under international principles or rules (GFSM or ESA frameworks) and had a broad institutional coverage (generally, general government).

18 In a majority of OECD countries, financial statements are prepared according to national standards and published between 3 to 8 months after year end. They also often have an institutional coverage limited to budgetary central government or central government. (Moretti, 2016)

19 This is considered a problem in particular where fiscal targets are set, monitored and compared at regional level (e.g. Eurozone).
Table 5. Selected OECD Countries: Head Line Measures, Fiscal Targets and Fiscal Rules

<table>
<thead>
<tr>
<th>Country</th>
<th>Cash basis</th>
<th>(Modified) Accrual basis on statistical terms¹ (ESA10 or GFSM2014)</th>
<th>Accrual Basis on accounting terms (national GAAP, IPSAS or IFRS)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>Underlying cash balance: ie., cash flow arising from operating and investing activities</td>
<td>Net Operating Balance and Net Lending (GFSM2014)</td>
<td></td>
</tr>
<tr>
<td>Austria</td>
<td></td>
<td>Fiscal balance (ESA10), debt rule (ESA 10) and structural balance rule (ESA10)</td>
<td></td>
</tr>
<tr>
<td>Canada</td>
<td>Financial source/requirement: ie., difference between cash inflows and outflows</td>
<td></td>
<td>Budgetary Balance: ie., difference between revenue and expenses on accrual basis</td>
</tr>
<tr>
<td>Estonia</td>
<td></td>
<td>Fiscal balance (ESA10), debt rule (ESA 10) and structural balance rule (ESA10)</td>
<td></td>
</tr>
<tr>
<td>France</td>
<td></td>
<td>Fiscal balance (ESA10), debt rule (ESA 10) and structural balance rule (ESA10)</td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>Primary Balance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>New Zealand</td>
<td>Residual Cash (IPSAS)</td>
<td>Revenue; Expenses; Operating Balance before gains and losses, or OBEGL; Net Debt and Net Worth (IPSAS)</td>
<td></td>
</tr>
<tr>
<td>Spain</td>
<td></td>
<td>Fiscal balance (ESA10), debt rule (ESA 10) and structural balance rule (ESA10)</td>
<td></td>
</tr>
<tr>
<td>Switzerland</td>
<td>Debt brake rule: ie., balanced cash revenue and expenditure</td>
<td></td>
<td></td>
</tr>
<tr>
<td>United Kingdom</td>
<td></td>
<td>Welfare spending “cap”, Public Sector Net Borrowing and Debt (ESA10)²</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>5</td>
<td>6</td>
<td>2</td>
</tr>
</tbody>
</table>

Note: Accrual-based aggregates can be measured in compliance with accounting standards (IFRS, IPSAS, national standards) or statistical frameworks (ESA10 or GFSM2014).

¹ The ESA10 framework is using some but not all accrual concepts, in particular it excludes depreciation and civil and military pension costs from the deficit.

² The United Kingdom, in recent periods, has used an accrual based fiscal target, the Public sector net debt (PSND), but this target is not used by the current government. Recently, the government have begun reporting and forecasting in each budget Public Sector Net Financial Liabilities as a supplementary indicator of fiscal performance.

Source: authors based on case studies in section II and Lledo V. et al. (2017).
Table 6. Selected OECD Countries: Time-lag for publishing year-end accrual based financial statements

<table>
<thead>
<tr>
<th>Country</th>
<th>Time-lag</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>3 months</td>
</tr>
<tr>
<td>Austria</td>
<td>9 months</td>
</tr>
<tr>
<td>Canada</td>
<td>6 months</td>
</tr>
<tr>
<td>Estonia</td>
<td>8 months</td>
</tr>
<tr>
<td>France</td>
<td>5 months</td>
</tr>
<tr>
<td>Japan</td>
<td>7 months</td>
</tr>
<tr>
<td>Korea</td>
<td>5 months</td>
</tr>
<tr>
<td>New Zealand</td>
<td>3 months</td>
</tr>
<tr>
<td>Switzerland</td>
<td>3 months</td>
</tr>
<tr>
<td>Spain</td>
<td>9 months</td>
</tr>
<tr>
<td>The United Kingdom</td>
<td>3 months and 12 months</td>
</tr>
</tbody>
</table>

Note: For the United Kingdom, departmental Annual Reports and Accounts are published prior to the Whole of Government Accounts. Usually this is done 3 months after the end of the fiscal year, although by statute departments have up to 10 months to do so.


To address this problem, some countries have engaged in harmonising their statistics and financial accounts. One country (Australia) has developed its national accounting framework for the public sector by transposing IFRS after considering their relevance in the public sector context and including any necessary adjustments specific for the public sector, but also adopted an accounting standard that aims to harmonise accounting and statistical practices to the extent possible. Benefits of this approach are, of course to improve the clarity and transparency of government reporting, but also to remove the source of confusion as to which set of accounts presents a more reliable portrayal of results against stated government fiscal objectives. For similar purpose, another country (the United Kingdom) uses similar criteria for defining the institutional coverage of its financial accounts and fiscal statistics.

2.2. Budgeting for cash and non-cash operations

Only a quarter of OECD countries prepare forecasts of its annual revenue and expenditures on accrual basis (Moretti, 2016). Within this group of countries, some present only forecasts of their revenue and expenses and some also forecasts assets and liabilities (such as, for example, the value of pension liabilities at year-end). Countries that have adopted accrual budgeting generally use based costing in decision-making for new policy and use for preparing their medium-term expenditure and/or revenue forecasts to varying degrees. Those that do consider that this helped ending the practice of governments using operations like asset sales or using timings of payments as a mean for meeting their fiscal objectives.
What is policy costing on accrual basis?

Policy costing processes differ from one country to another, including the nature of the new policy proposals (government’s proposals as part of the budget cycle, pre-election political party’s proposals) the type of impacts measured (economic and/or fiscal); the methodologies used; the role of the finance ministry/treasury and the independent fiscal institution in preparing the costing; and transparency requirements.

For calculating the fiscal impacts of a given policy, the costing methodology will consist generally of forecasting cash flows over a given period (between one to ten years usually) and measuring the effect on government cash basis fiscal aggregates – that is the cash fiscal balance and, sometimes, borrowing. Cash flows typically distinguish between capital, operating and transfer costs.

For those countries that do accrual basis policy costing in addition to the cash one, forecasts will be prepared in accordance with accrual accounting concepts (i.e. costs are measured when they are incurred, instead of when they are paid) and will include depreciation, amortization of assets and financing costs, where relevant. This means that new initiatives and programs proposed by ministries or departments are to be evaluated against their full cost. The forecast will also measure the effect on government fiscal aggregates other than the cash basis fiscal aggregates – that is the accrual fiscal balance (e.g. Australia) and net worth (e.g. New Zealand).


Academic research (Khan, 2013) and case studies identify three main benefits associated with accrual budget forecasts. The first one is the so called “alignment” of budget and accounts, which are presented according to similar rules and principles (even though it could be argued that similar alignment can be achieved under a cash and commitment budgeting and accounting system). Arguably such an alignment can also increase accountability. The second benefit is that accrual budgeting requires, in the preparation of the budget, the application of recording and measurement that align with accrual accounting standards set by an independent standards setter, which improves the reliability, credibility and clarity of forecasts and fiscal policy. The third benefit is the use accrual based costing in decision-making for new policy, giving decision-makers a richer suite of information on which to make decisions.

While differences between forecasts on cash and accrual basis will be limited in most cases, decision making on policies and programmes that have long life spans and delayed financial impacts can benefit from the longer term perspective and more comprehensive impact analysis allowed by accrual accounting. Reforms to civil service pensions were provided as an example by three countries. 20 Interestingly, in the United States, even though most federal commitments are presented in the budget on a cash basis (except for activities that are financial in nature, such as credit programs or leases), lawmakers require the Congressional Budget Office to prepare costs estimates for other types of legislative proposals on accrual basis (that is using a number of methods associated with accrual accounting: measurement at fair value, control approach, etc.) to illustrate their long-term net costs (Congressional Budget Office, 2018).

20 Australia established a sovereign wealth fund to fund the retirement pension of public servants and military personal, due to growing liabilities accrued in budget documents and year end accounts. New Zealand’ decided to move from defined benefit schemes for employee pensions to defined contributions schemes. Finally, the UK’s publication of Whole of Government Accounts which recognised, for the first time, the liabilities associated with public service pensions is seen as an important contributing factor in significant reforms to civil service pension contributions and benefits a few years later.
2.3. Reinforcing parliament’s year-end scrutiny

In virtually all OECD countries, a core goal for governments that engaged in accrual reforms was to improve accountability for public resources. If governments’ accounts are complete, timely and reliable, and the scrutiny process will be more effective, the recommendations of the parliament (and more specifically, its finance committee or public accounts committee) can filter in to the budget, creating “continuous and virtuous cycles of improvements” (Wehner, 2003) in public spending and fiscal policy.

Overall, accrual reforms and the wealth of information provided in financial statements has not perceptibly increased the time spent by parliament on scrutinising year-end accounts and discharging government for its implementation of the budget. In some countries, parliaments tend to be more focused on approving budgets than on the more technical year-end financial scrutiny, irrespective of the accounting system used by government. In other countries, year-end scrutiny is well developed but remains focused on use of spending authorisations and does employ accrual information to its full potential.

However, recent parliamentary questions and inquiries mentioned in interviews for this study illustrate the increased level of scrutiny on public finances permitted by accrual reforms. Examples provided show that parliamentary interest is usually raised by items reported in financial statements that firstly, are significant in terms of financial impact (e.g. guarantees, provisions for decommissioning of infrastructure); secondly, vary significantly from one year to another (e.g. payables); thirdly, provide insight on public policies’ quality (e.g. provisions for clinical negligence) or fourthly, are related to observations made by the SAI and/or PBO (e.g. Canada). The UK House of Commons’ Public Accounts Committee also published a series of reports on management of UK balance sheet as a whole.

Stakeholders outside of finance ministries have also an important role to play in making accrual information understandable and useful to parliament (Moretti, 2017). In particular, the level of scrutiny that a parliament can deliver depends very much on the quality of the audit reporting (Wehner, 2003). In most countries, effort for facilitating scrutiny of accrual financial information is therefore shared between the Finance ministry, auditors and, in some cases, the parliamentary budget office. For example, in Austria, the Austrian Parliamentary Budget Office publishes an annual analysis of financial statements, with that analysis being available to Parliamentarians and the general public.

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21 As is well known, there is always a trade-off in the way parliament engages in the budget process. At one side of the spectrum, in Westminster tradition countries, the vote of the budget is a vote of confidence towards government, and focus of parliamentary work is on year-end financial scrutiny. At the other side of the spectrum, the congressional system of the United States gives a budget writing function to committees and scrutiny is not the focus of parliamentary work. However, despite very different starting points, increasing the quality and range of parliamentary scrutiny of government results can be considered as an objective in most OECD countries.
3. Improvements to Resource and Performance Management

Effective resources management is about measuring and optimizing costs from government activities, including defining the appropriate nature and level of assets holdings and liabilities for delivering these services. Performance management is about linking costs and results in order to assess efficiency of programmes and activities. It also involves improving approaches for charging users. This chapter discusses to which extent accrual reforms have delivered results in this area.

3.1. Management of government balance sheet

One of the common objectives of accrual reforms was to increase the range of financial transactions monitored and reported by government, enable innovations in carrying out financial and accounting processes and lead ultimately to overall improvements in government resource management. This is an area in which accrual reforms appear to have delivered the desired outcomes. Examples of such innovations include the monitoring of a wider range of financial and non-financial transactions, such as acquisition and sale (or disposal) of fixed assets, equity stakes in public corporations; performing regular reviews for identifying write-offs of unrecoverable debts or overpayments and recognising losses of stocks or other assets; developing toolkits or checklists for defining and harmonising the reporting of obligations entered into by the government (grants, investment contracts, etc.). Some countries also mention that accrual accounting reforms also resulted in the increasing use of risk-based internal control approaches and in the creation (or reinforcement) of the internal audit function within government.

Case studies also comprise examples of improvements to management of assets and liabilities in virtually all countries. Firstly, most governments have sought to improve their cash management practices – that is both ensuring suppliers are paid on time and reducing administrative delays for recovering payments from third parties (in particular taxes). Secondly, management of other groups of assets and liabilities were increasingly scrutinized following their accrual reforms leading to changes in management methods. Examples provided in case studies include defense inventories (accrual adoption revealed in some cases excessive inventories in defense ministries leading to improvements of processes for acquisition, disposal and maintenance) or PPPs and concessions contracts (measurement of concession and PPPs assets and liabilities led to better understanding of the scale of public sector assets that were under private sector management, leading to improvements in monitoring and strategic decision making).

The identification of surplus assets is also a clear objective in a number of countries, such as New Zealand and the United Kingdom. Inventorying of asset holdings and determining if these assets are needed to deliver government services is expected to result in the identification and disposal of assets that are surplus to requirements (such as government offices or equity holdings), creating additional cash inflows for government services.

New Zealand and France have also sought to improve government resource management by introducing a “capital charge”, which aim was to encourage departments to use their resources efficiently by charging them against the value of their assets. In the case of New Zealand, for example, the charge was based on the government’s borrowing costs and levied against the average value of the net assets of

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22 Accrual accounting cannot be considered as the only factor explaining improvements to cash management practices, but is part of the reasons why some countries have paid increased attention to their working capital level. Accrual accounting cannot be considered as the only factor explaining improvements to cash management practices, but is part of the reasons why some countries have paid increased attention to their working capital level.
each organisation over the previous year. Fewer assets would mean a lower charge, with a portion of related savings kept in the department’s budget as an incentive.

An important emerging trend is the analysis of the balance sheet “as a whole” on a regular basis. This is done so far by two countries (New Zealand and the United Kingdom), with two core objectives: describing and analysing the composition and variation of assets and liabilities to external stakeholders (one important aspect of this description being to outline impacts of management decisions) and measuring risks, challenges and opportunities associated with assets and liabilities for government finances and policies. In New Zealand, this review is done at least once every four years and an Investment Statement is published to present results of that analysis. This statement classifies all assets and liabilities into three functional classes (social, financial and commercial) and provides easier to understand (?) financial and non-financial performance measures of the main assets and liabilities over time. The United Kingdom has recently set up a Balance Sheet Management Unit and announced a Balance Sheet Review in its 2017 Budget. This Balance Sheet Review will look into how to make more effective use of public sector holdings, looking at areas such as estates optimisation, improving the return on investments, and reducing the cost of liabilities. The stated objective is to release resources for further investment in public services and improve the sustainability of the public finances.

3.2. Evaluating performance against full-resources consumption

Optimising costs from government activities

In some cases, accrual reforms and evaluating the full costs of government activities were considered a prerequisite for ultimately achieving the larger goal of optimizing costs from government activities (e.g. Canada and Japan). Linking full costs (inputs) to results (outputs) would enable a more accurate and comprehensive assessment of the efficiency of government programmes or operational units, leading to better management and decision making. Another underpinning objective, in some countries, was a more competitive approach to public service provision. The assessment of the full cost of public services vis-à-vis the full cost of similar services in the private sector would, for example, inform decisions on contracting out (OECD, 1993).

Such objectives have been technically difficult to achieve. For full costs to be apportioned to results, it is not only necessary to maintain a system of accrual accounting, but also to record output volumes and have a financial administration or management accounting system that splits out all costs – that is all direct and indirect costs – to the different outputs. Complex problems have been involved in both areas for countries, such as developing a systematic and rational methodology for allocating indirect costs and assessing output data relevance and quality. These difficulties explain why a limited number of countries report results in this area so far. One country, Japan, has introduced a cost accounting system that allows producing annual Policy Unit Cost Information. Another country, France, develops a cost accounting system

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23 Direct costs include the salaries, wages, and benefits of employees while they are exclusively working on the delivery of the service, as well as the materials and supplies, and other associated operating costs such as utilities and rent, training and travel. Likewise, they include costs that may not be fully funded in the current period such as compensated absences, interest expense, depreciation or a use allowance, and pensions. Indirect costs include shared administrative expenses within the work unit and in one or more support functions outside the work unit (e.g., legal, finance, human resources, facilities, maintenance, technology).

24 Cost accounting is usually defined as a system of accounting that captures an entity's costs of production for certain goods or services by assessing the input costs of each step of production as well as fixed costs such as depreciation of capital equipment. Cost accounting will generally first measure and record these costs individually, then compare input results to output to allow management assessing performance.
accounting module within its integrated financial management system, which is currently being tested in two line ministries. Two countries, Australia and New Zealand, mentioned that accrual accounting allows benchmarking certain activities with the private sector, which would not be possible with cash basis information.

**Charging for government services**

Accrual information served in some cases to develop a formal framework for determining charges for government services. Under such frameworks, accrual accounting data is used to ensure that the full cost of services delivered to citizens/users is identified and that fees and charges are set accordingly. For example, Australia developed formal guidance on what costs should be included in determining the charge for a particular activity including direct and indirect costs, capital related costs (such as amortisation and depreciation) and other non-cash costs (such as accruing employee benefits). New Zealand also has a comprehensive cost recovery framework that includes guidance on understanding the costs of production (including operating and capital costs) as well as demonstrating efficiency in the application of those costs to the cost recovery activity. Interestingly, one country (Norway) that uses the cash basis of accounting uses accrual concepts in its regulation covering the setting of government fees and charges. More specifically, the relevant regulation permits that if the cost of a major investment should be reflected in a fee it can be spread out over the expected lifetime of the asset.

**3.3. Entity level management**

There seems to be a greater consensus on accrual accounting benefits for monitoring of financial performance of individual entities than for the whole of government. Even some of those countries that use cash and/or commitment for central government have required agencies, social security funds, local government or state owned enterprises to adopt accrual accounting. In most cases, this is because accrual accounting is considered a good way to prevent entities from over-committing, or incurring expenses that will need to be funded at some point in the future. It is also because accrual accounting allows comprehensive oversight of entities’ financial performance.

With regards to agencies, in Canada, for example, certain indicators for assessing agencies’ financial performance are based on the balance sheet, e.g. aging of gross non-tax accounts receivable as of year-end and percentage of payments to suppliers in the fiscal year that were made on time. In New Zealand, the Treasury considers, among other indicators, how much of an entity’s fixed asset has been consumed (through accumulated depreciation); when it will need to be replaced; and the stock of liquid assets in the entity that is available to replace the asset: this analysis informs the starting point for discussions with the entity on its financial sustainability.

Another example is the use of accrual accounting information to assess the financial sustainability and service delivery responsibilities of local governments. In Australia, for example, a review of local governments’ financial sustainability conducted by a state government based on their accrual financial statements resulted in changes to the assessment of infrastructure priorities, as well as policies to merge individual local governments to improve their financial sustainability.
SECTION II: COUNTRY EXPERIENCES
Australia

Australia uses accrual budgeting and accounting, but manages appropriations on cash basis

In Australia, accruals reforms commenced in the late 1980s and were completed within approximately ten years. Accrual accounting was introduced as a mean for adopting more commercial and business like practices into the public sector. Following the move to accrual accounting, the government implemented accrual budgeting to enable a clear line of sight between the budget and year end accounts. Budget and year-end accounts since then are prepared on a full accrual basis using Australian Equivalents of International Financial Reporting Standards, across all levels of government.\(^\text{25}\)\(^\text{26}\)

After this first wave of reforms, a number of post implementation reviews were undertaken, which resulted in some changes to the overall budget and financial management framework. Most significantly, the framework moved away from full accrual based appropriations to a model based on cash requirements for the budget year. The appropriation amount is determined by adjusting accrual expenses for significant non-cash items. This means that total accrual expenses have depreciation, amortisation and other large non-cash items deducted to arrive at the appropriation amount.

Financial statements are used by expert groups, but widening their audience requires improving their timeliness and simplifying their content

At federal government level, a Final Budget Outcome report (FBO) is published within three months of the end of the fiscal year. This document covers general government sector and reports outcomes compared to the approved budget. In addition, Consolidated Financial Statements (CFS), covering the whole of federal government, are published within five months after the end of the fiscal year.\(^\text{27}\) CFS provides detailed comments on budget outcomes and are accompanied with a brochure. The FBO receives significantly more attention from media and the public than the CFS. This is partly due to the timeliness of which the FBO is issued, within three months of year end compared to five months for the CFS, its focus on general government outcomes, and a press release and press conference held by the Treasurer. Consequently, there have been recent changes to the level of disclosure to try and improve the usefulness and clarity of the CFS.

In addition to the publication of reports in pdf format, financial data for the Budget, CFS, FBO and monthly financial statements are provided on a dedicated website as well as on an Open Data Portal for further analysis by the public. The government has also supported the development of innovative analytical approaches to government financial data through a government supported “govhack” – an open forum which encouraged the public to develop innovative software offerings. One approach that

\(^{25}\) There are three levels of government: Federal (National); Sub national (known as States) and Local Government (Municipal) in Australia.

\(^{26}\) The accounting standard setting framework allows the Australian Accounting Standards Board (AASB) to insert additional paragraphs that clarify or provide specific instruction to public sector entities. The AASB also issues standards for specific application in the public sector, which are either developed by the AASB or use International Public Sector Accounting Standards as a reference point.

\(^{27}\) These statements consolidate all entities controlled by the Australian government in the general government, public non-financial corporations and public financial corporations sectors.
was developed through that support was theopenbudget.org which takes a different approach to presenting budgetary information, including graphics and “drilldown” functionality as well as a per capita calculation for spending in the various functions/units of government.

The relevant committee reviews the FBO and CFS annually in conjunction with a report from the SAI, and testimonials from the SAI and the relevant ministries. Parliamentary interest in the FBO is mostly concentrated on fiscal outcomes and debt levels of the general government, although there is also interest in the asset holdings of the Sovereign Wealth Fund. The analysis usually focuses on the cost of specific line items and the overall cost control of the government. The committee issues annually a report with observations on, for example, the clarity, usefulness and completeness of the financial information.

Accrual financial statement is used by rating agencies. Data presented on an accrual basis are used by rating agencies when they assess e.g. the overall financial position and balance sheet strength of the government.

**Macro fiscal policy is largely focused on the cash basis head line target**

They are two prime fiscal targets in Australia: one is cash based and the other one accrual based. Both fiscal targets are measured based on the Government Finance Statistics (GFS). The cash based measure is Cash/Surplus deficit aggregate adjusted for assets acquired by finance lease and earnings from the Future Fund (Australia’s Sovereign Wealth Fund). This measure treats capital and recurrent spending in the same way. The accrual based measure is the Net Operating Balance, calculated as Revenues Less Expenses. This measure makes a broad distinction between investment in capital assets, which provide a stream of benefits over time, and recurrent spending. The cash basis Cash/Surplus deficit aggregate is the headline fiscal measure that focuses most of the parliamentary and general public attention. This is mainly because fiscal policy settings have been based on a target surplus as measured by the cash based measure.

Macro-fiscal policy decisions can however be driven by concerns around accrual basis measures. One example is the decision to establish a SWF in part driven by concerns around the growing liability for public sector employee pensions. The establishment in 2006 was intended to offset the projected costs of funding public sector pensions in the future: the government was concerned with the growth in the liability (as evidenced in accrual financial statements) and the significant intergenerational equity issues that arose from funding public employee pensions from recurrent revenues.28

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28 In 2006 and following strong budgetary surpluses, the Australian Government decided to establish a Sovereign Wealth Fund (SWF) that would be hypothecated to fund the retirement pensions of public servants and military personnel. The decision was based on the accruing and growing liabilities for these pensions as evidenced in the accrual based budget and ex post financial statements. The government’s intention was to set aside money to fund these pensions, with the expectation that further contributions from the government plus returns earned by the SWF would be sufficient to fund these pensions in the future. The policy settings for the SWF were legislated such that the financial return target for the SWF was to be Consumer Price Inflation + 4.5% per annum, over the life of the SWF. The financial returns were then quarantined in the SWF to ensure that the growth in value was preserved to enable the SWF to meet its policy objective of funding the anticipated pension obligations of federal public sector civilian and military employees in the future. The Australian Government is restricted from drawing from the SWF until at least 2020. To date, the SWF has generated returns of 7.7% per annum since the SWF was established. The returns are calculated on an accrual basis with full accrual based financial reports prepared by the SWF in accordance with Australian Accounting Standards.
**Oversight of individual entities relies partly on accrual measures**

Individual entities in the Australian government are held accountable against both accrual and cash measures. The primary control is that agencies are not allowed to incur an operating loss without the approval of the Finance Minister. This provides a mechanism to prevent entities from over-committing, or incurring expenses that will need to be funded at some point in the future and recognises the full accrual cost of government services and operations in the year in which they are provided. Individual entities are also held accountable for ensuring appropriation limits and conditions are observed. Appropriations are cash-based and entities have process and system controls in place to ensure that appropriations are only spent for the intended purpose and that appropriation limits are not exceeded. On occasions, entities have spent outside the purpose of an appropriation or have exceeded the limit. In these cases, the breach is reported to Parliament as part of the annual financial statements and audit report for that entity.

Another example is the use of accrual accounting information to assess the financial sustainability and service delivery responsibilities of local governments. In Australia, local governments have very different resources along with significant differences in service delivery responsibilities; in many cases, greater service delivery responsibilities sit at lower levels of government, which have limited capacity to raise their own revenues, relying on transfers from higher levels of government. A review of local governments’ financial sustainability conducted by a state government based on their accrual financial statements resulted in changes to the assessment of infrastructure priorities, as well as policies to merge individual local governments to improve their financial sustainability.

**Measuring full costs of public services allows benchmarking and better pricing**

Accrual financial information is used to benchmark efficiency both within government, and compared to the private sector in areas such as corporate services and ICT-costs. This has led to a number of initiatives to increase efficiency and realise savings such as a property consolidation, efficiency dividends and the creation of a fund to support reforms that modernise government services e.g. through better use of government data.

The Australian Government has a formal *Charging Framework* and *Cost Recovery Policy* that sets out the principles and policies for determining whether an activity should be cost recovered, and how to determine appropriate costs for that activity. The framework applies to activities where the government charges the non-government sector for a specific government service such as, regulation, goods, services, or access to resources or infrastructure and is based on the concept that where an individual or organisation creates a demand for a government service, then they should generally be charged for it, unless the government has decided to fund the activity from general revenues of government. It includes guidance in relation to the types of costs, such as capital and operating, direct and indirect and the manner in which the costs should be allocated to those activities. One of the key criteria in determining the charge is whether expenses and revenues for the activity need to align over a reasonable time period. Typically this would be a financial year, however if necessary it can be based on the “business cycle” for the specific activity.
Box 5. - Financial Sustainability Assessments of Local Government Units

In response to fiscal challenges facing the local government sector, the New South Wales (NSW) government developed a framework to assess the financial sustainability of local governments in that state. The framework used a range of indicators, based on audited accrual based financial statements and assigned a weighting to each indicator to arrive at an overall score for each local government's financial sustainability.

The analysis and ratios used in the assessment included both accrual and cash based measures. Examples include a Capital Expenditure Ratio, defined as the ratio between annual capital expenditure and annual depreciation, used to indicate the extent to which a Council is forecasting to expand its asset base, a Building and Infrastructure Renewals Ratio defined as the proportion spent on infrastructure asset renewals and the asset's deterioration measured by its accounting depreciation, and the Cash Expense Cover Ratio, measuring the number of of months a Council can continue paying for its immediate expenses without additional cash inflow, and defined as the ratio between Current year's cash and cash equivalents and twelve times the total expenses less depreciation and interest costs.

As each council was assessed they were grouped into a range of categories ranging from very strong to very weak in terms of financial sustainability. The results of the Financial Sustainability Rating were used by the NSW government in assessing individual local governments as part of initiatives to understand infrastructure spending in NSW and to inform the government’s policy on the possible amalgamations of different local governments to improve their financial sustainability.

Source: New South Wales Treasury Corporation (2013), Financial Sustainability of the New South Wales Local Government Sector

Accrual reforms have led to major improvements to business processes and internal control

The introduction of accrual accounting was accompanied with a devolved approach to management. This meant individual entities needed to implement new financial management information systems and financial control processes to meet the demands of the new accounting framework. This included the introduction of asset registers, workflow based approvals, identification and measurement of assets and liabilities.

New systems and processes took some time to settle with a substantial number of process and control weaknesses in the early phases reported as part of the National Audit Office’s report to Parliament, which ultimately led to significant improvements to financial processes recognised in particular by the external auditor.29

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29 For example, see Australian National Audit Office reports from that time on Financial Statements of Commonwealth entities; anao.gov.au.
Austria

Austria’s framework, which combines cash and accrual bases, is currently under review

In 2007 and 2009 Austria’s federal parliament decided on a far reaching comprehensive budget reform package. This budget reform was implemented in two stages, the first stage as of 1 January 2009 and the second one as of 1 January 2013. A core issue following the adoption of the new Organic Budget Law was the move to both accrual budgeting and accrual accounting. The annual budget law is prepared on accrual and cash accounting bases within binding cash ceilings set on a four-year period in a legally binding medium-term expenditure framework. The annual financial statements are composed of a full suite of financial statements and disclosures, including an operating statement and cash flow statement that are fully comparable to the initial budget.

A first internal review of the budget and accounting framework under the new Organic Budget Law was undertaken in 2014 focussing on specific areas, such as administrative costs related to various reporting and information requirements and the sequence of activities in the budget process. In addition, the Organic Budget Law required a formal external evaluation to be commissioned within five years of implementation, i.e. by 2017 at the latest. This was assigned by the government and is currently being carried out by the IMF, OECD and Alpen Adria University. This evaluation may lead to amendments to the current budgeting and accounting frameworks.

Accrual accounting has increased transparency on public finances, but generates limited interest

Accrual accounting and budgeting is believed to have improved the transparency on the government operations in Austria, as integrated cash flow statements, operating statements and statements of financial position satisfy the objective of providing a comprehensive, true and fair view of the government financial situation. The previous cash based budget was not seen as providing sufficient financial information in advance. Consistent use of both accrual and cash basis between budgets and year end accounts is also considered as a key motivating factor for using accrual data: this making accruals more relevant then if only used in year-end accounts.

Accrual financial statements and related audit reports form the basis for parliamentary scrutiny. The Court of Audit (CoA) prepares the annual report based on the financial statements provided by each line ministry and tables it for discussion in the budgetary committee of the National Assembly. The President of the CoA and the minister of Finance stand in the budgetary committee for discussions and questions by the parliamentarians. The Parliamentary Budget Office publishes an analysis of financial statements to support parliamentary scrutiny, which discusses, among other things, differences between accrual and cash headline measures, developments from one year to the next and compares differences between budget and outcomes. Parliamentary scrutiny remains, though, to a large extent focused on cash flow statement and ESA-based indicators, and less so on accrual data, the balance sheet and operating statement. There is also some ongoing discussion on the quality of the accrual data in the financial statements. The National Assembly approves this Annual Report by law.

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30 The annual budget law is composed of an income statement and cash flow statement, broken down into i) global budgets, which set the annual amount of expenses (accrual) and expenditures (cash) for each ministry’s policy area; and ii) detailed budgets, which set out the annual amount of expenses (accrual), cash appropriations, and multi-year commitment levels for administrative units.
Interest of the general public in accrual financial data is also considered limited, despite the publication of regular reports by various institutions that analyse and contextualise this information. In general, the Ministry of Finance provides reports on a monthly, quarterly and annual basis. For example there is the monthly report on budget execution which contains both cash and accrual information. A comprehensive budget report accompanies the annual budget figures and describes main spending, key priorities and overall fiscal circumstances. Moreover, there are special reports for the financial statements, e.g., summary reports prepared by the CoA, and brief reviews as well as analyses by the PBO.

All published reports are available on each institution’s website. Furthermore, the government is considering developing an Open Budget Database to increase interest in and legibility for the public of both accrual and cash financial data.

**Accrual financial data is used mainly for identifying fiscal risks**

Accrual financial statements aided in the discussion, identification and measurement of fiscal risks, such as guarantees, provisions, contingent liabilities and other long-term liabilities, that can impact the annual budget and medium-term situation of public finances. However, the fiscal policy decision making process remains largely focused on cash basis forecasts, which feed the medium term expenditure framework. Accrual forecasts are used inter alia mainly for calculating the deficit figures (e.g. the Maastricht deficit) and only very little for allocating accrual spending authorisations to ministries and agencies.

In Austria the outcome-oriented budget management is based on two elements: presentation in the budget plus an outcome-oriented assessment of consequences for legislative measures and large planned projects. However, the use of accrual-based financial information for performance evaluation and benchmarking is still very limited in Austria. This may be due to a perceived lack of reliability of the accrual data (compared to cash data), the predominant role of ESA-based financial objectives and uncertainties on how to best make use of information on full costs of operations within the administration.
Canada

Canada uses accrual budgeting and accounting, but manages appropriations on cash basis

Canada commenced its move to accrual accounting in the mid-1990s and completed the transition within ten years. One key objective of the reform was to provide more comprehensive and up-to-date financial statements and greater accountability by the Government to Parliament and the Canadian public.

The government moved to accrual budgeting in its 2003 budget to align the presentation of its forecast results with the adoption of full accrual accounting for financial statement reporting purposes in 2002-03. Appropriations for government expenditures remained however authorised and reported on cash basis.

Accrual financial data is systematically disclosed and analysed, but generates interest mainly in experts groups

The Public Accounts of Canada (PAC) include discussion and analysis of various areas of the consolidated financial statements. In addition, the Annual Financial Report (AFR) of the Government of Canada is released annually by the Department of Finance. The AFR reviews the government's spending and revenue performance over the previous fiscal year and discusses the factors affecting these results. On a monthly basis, the Department of Finance also releases the Fiscal Monitor, which provides monthly and year to date financial highlights on a period over period comparative basis. Accrual data is also available in the Government of Canada’s Open Data Portal in the form of 23 datasets, those considered to be of the greatest interest to the general public. While these datasets consist of information which is already included in published Public Accounts of Canada, it further improved transparency, as well as accessibility. Despite this wealth of information, general public interest in accrual financial data is limited. The media will report on annual and monthly results, and there are occasional questions from parliamentary committees, but minimal analysis on financial statements is provided in the press.

Specialised public groups in the finance and investment sectors have a strong interest in how accrual concepts are used in specific instances, such as by the Canada Pension Plan Investment Board’s use of accrual accounting in managing the Canada Pension Plan investments. Accrual financial information is not the primary basis for determining ratings, but ratings agencies show interest in some accrual based financial statements. Areas which ratings agencies are interested include assumptions used in the budget planning process, contingent liabilities, federal future employee benefits relative to federal pension fund assets and implementation of infrastructure projects.

Observations of the Auditor General of Canada on financial statements focus most of parliamentary interest

Under the Financial Administration Act, the PAC must be tabled in the House of Commons within nine months after the end of the fiscal year. They are referred to the Public Accounts Standing Committee, which will meet with the Comptroller General of Canada, the Deputy Minister of Finance and the Auditor General of Canada.

31 Accrual budgets in Canada present all new initiatives included in Budgets and Fall Economic Statements with a five year accrual profile.
The Committee issues a report after it completes its review. The report will, in general, include recommendation and observations concerning, amongst other things, the timeliness of the financial reporting, and the understandability and completeness of the financial information.\textsuperscript{32}

Generally, the majority of the parliamentary interest is related to observations of the Auditor General of Canada. In 2015-2016 this included: Transformation of Pay Administration, Management estimates – selecting discount rates; National Defense – Inventory and liability for contaminated sites. Some other topics of interest include: reporting of losses, travel expenditures, professional services, lapses and Canadian Mortgage Housing Corporation loans.

\textit{Accrual-based information is regularly used for macro fiscal analysis}

There is no legislation governing fiscal targets in Canada, but a number of headline measures focus government and parliament's attention. The first one, the Budgetary Balance, is accrual basis. It records government revenues and expenses when they are earned or incurred, regardless of when the cash is received or paid.\textsuperscript{33} The second one, the Financial Source/Requirement, is cash basis. It measures the difference between cash inflows and outflows and related borrowing need.

Long term fiscal projections presented in a separate report use the Government’s accrual accounting framework as their starting point, implicitly using the same accounting policies as used in the preparation of the Government’s annual audited consolidated financial statements shown in the Public Accounts of Canada.

\textit{Assets management has improved following the adoption of accrual accounting}

Accrual accounting has encouraged better stewardship of physical assets and decisions about whether to buy, lease or sell buildings and equipment, as accrual accounting focuses on the consumption or use of resources. In addition, a more complete recording of the Government's liabilities encourages the development of better plans for managing those liabilities, according to the government.

Authorities also have the view that accrual accounting more accurately reflects the cost of owning and operating capital equipment, hence providing a better means to relate the costs of programmes to the performance results being achieved. However, expenditure management initiatives are seen as more important to the internal control environment than the accrual accounting to realise savings and increase productivity.

\textit{Agencies and SOEs financial performance evaluation use accrual based measures}

Canada developed a \textit{Management Accountability Framework}, which is a framework for management excellence, accompanied by an annual assessment of management practices and performance in most departments and agencies of the Government of Canada.\textsuperscript{34} From an agency

\textsuperscript{32} In addition to the review of the Standing Committee on Public Accounts other parliamentary organisations make occasional reports about specific areas. They include the Parliamentary Budget Officer; the Senate Committee on National Finance; and the Standing Committee on Government Operations and Estimates.


\textsuperscript{34} The MAF is a key tool of oversight that is used by the Treasury Board of Canada Secretariat (TBS) to help ensure that federal departments and agencies are well managed, accountable and that resources are allocated to achieve results. It also ensures that Treasury Board Policy Suite requirements and expected results are met.
perspective, the MAF includes certain indicators which are based on the balance sheet. Examples of these indicators includes aging of gross non-tax accounts receivable as of year-end and percentage of payments to suppliers in the fiscal year that were made on time.

Financial performance evaluation for state owned corporations is fully done on an accrual basis. The Financial Administration Act provides the general governance and accountability framework for state owned enterprises, including financial reporting requirements. Most SOE’s are required to submit annual operating and capital budgets to the Treasury Board Secretariat for approval to ensure financial sustainability, proper stewardship of resources and alignment with government priorities.
Estonia

Estonia adopted accrual accounting about thirteen years ago and just finished rolling out accrual budgeting

In Estonia, transition to accrual accounting and compilation of consolidated statements was decided in 2003. The timescale for the reform was short: in 2004 accrual basis consolidated financial statements were published for the State subsector, and in 2005 the coverage was extended to the whole of the public sector.

Following this initial reform, an accrual budgeting reform proposal was issued in 2008, as part of a broader reform agenda that included activity-based budgeting and an enhanced system of strategic planning and management. A pilot exercise was launched in 2010, with the final decision to transition to accrual budgeting taken by the end of 2015. Estonia implemented its first accrual based state budget in 2017.

Transparency is a key objective of reforms, which has already been achieved

The core objective of the accrual accounting reforming was to provide a true and fair view of public finances.

Accounts are prepared according to IPSAS in order to increase usefulness for interested groups. Financial statements include a summary and analysis section to make them more user-friendly. They are also accessible on a dedicated website, which receives an increasing number of visits.

Government is working on achieving other reform objectives

Estonia’s accrual based budget includes revenues, expenses, investments, financing activities and a forecast of cash flows. A forecast of the balance sheet will be implemented in 2020.

The main objective of the introduction of accrual budgeting was to align the basis of the budget with the basis for the financial statements, and as a result reduce the volume of reports. According to authorities, “another objective was to unify the accounting principles of budgeting and the calculation of position of the government sector”.

Estonia considers accrual-based budgeting a pre-requirement for performance based budgeting and the country will implement a performance based state budget in 2020. One of the ambitions of the move towards performance based budgeting is to enable the government and interested public members to compare the effectiveness of different public services, and to enable comparisons between public services with private sector alternatives.

While parliamentarians remain primarily focused on ESA10 fiscal targets (deficit, debt to GDP ratio), interest in the financial statements has increased over time with questions asked on the level and annual variation of liabilities, liquid assets and cash reserves. Parliament is also increasingly discussing the overall financial situation of the public sector and impacts on next year's budget.

The Ministry of Finance also believes that accrual reforms enabled better understanding of the nature of government liabilities and the scope of government owned assets. Accrual accounting has also helped Estonia to identify fiscal risks and informed analysis of the long-term fiscal sustainability.
Accrual financial statements are used to monitor ministries, agencies and other public sector entities. All ministries publish accrual consolidated financial statements, covering relevant agencies, that are used for regular monitoring of their budget execution.
France

France is operating cash, commitment and accrual accounting systems

In France, the adoption of accrual accounting at the State level took place as part of broad set of budgeting reforms in the early 2000s. As part of these reforms, it was decided that the State would operate simultaneously two accounting systems: a cash and commitment accounting system (so called “budgetary accounting”) and an accrual accounting system (so called “general purpose accounting”).

The State completed its transition to accrual accounting in about five years. Since the reform took place, efforts have been focussed on improving the quality of financial data, the internal control environment, and internal audit functions. As a result, since the first State financial statements on accrual basis were published (2006), nine audit qualifications have been removed (there were 13 qualifications in 2006 and four qualifications in 2016).

Interest in accrual basis financial statements is building progressively in parliament

For the State, the core accountability document at year-end is the Budget Execution Law (Loi de règlement, or LR), which reports all financial operations undertaken by the central government during the fiscal year. While the cash deficit focuses most parliament attention, parliament has scrutinised increasingly a number of key aggregates over the last years. These aggregates are: 1) the contingent liabilities, 2) payables and 3) provisions for tax litigations. The Public Accounting Directorate believes that there might be three main reasons for this interest. First, these liabilities are significant in terms of financial impact (e.g. guarantees, within contingent liabilities). Second, they are not reported and measured in the cash basis budgetary accounts (e.g., provisions for tax litigations). Third, they provide useful insights on public policies (e.g., provisions generated by litigations over new tax policies) or financial management (e.g., annual variation of payables).

Evidence shows that financial statements increased fiscal transparency, but efforts are still needed to improve their accessibility

Accrual accounting is considered a success with regards to transparency. A recent survey undertaken with key stakeholders in France by the Court of Accounts (Cour des Comptes, or “CC”) shows indeed that the introduction of general accounting has substantially improved the understanding of the State’s financial position. Also, data from the Finance Ministry web portal shows also that the financial statements are generating significant views and downloads. However, there is still a perception in Government that interest in accrual data remains limited.

To address this perceived issue, two documents are currently published alongside the financial statements: 1) the Management report (Rapport de présentation), which comments on core events of the past fiscal years and financial operations that impacted the State accounts, provide explanations on variations of main aggregates, and also includes a bridge table between the cash basis deficit and accrual basis loss; 2) a four-pager summary of the financial statements, which presents the key aggregates with infographics. Two additional initiatives are currently being rolled out to increase the accessibility and

35 The law shows final budget outturns for each public policy (so called mission) and programme against parliamentary authorisation, the cash basis deficit or surplus, and accrual basis profit or loss. It includes two main sets of appendices: 1) the Performance Reports (Rapports annuels de performance, or “RAP”), which provide detailed schedules of government expenditure outturns (on cash and commitment bases) and performance results; and 2) the State financial statements.
usefulness of the financial statements. First, a so-called Memento will be published from 2017, which will present data sets covering over ten years and comment and analyse trends in assets, liabilities, revenue and expenditures reported in the financial statements. These data sets will not be part of the financial statements per se, and will not therefore be submitted to pro-forma requirements, nor audited. They will constitute supplementary information for parliamentary and citizens’ information and aim at increasing the usefulness of the accrual data for oversight of the government financial situation and decision making. Second, the accrual data will be made available on the Finance Ministry’s open fiscal data base. The level of detail of the accounting data that will be made available to the public is currently under discussion.

**Accrual accounting has helped to bring about substantial improvement to financial and accounting processes**

Assets and liabilities are now comprehensively inventoried and reliably measured, allowing a better understanding of the impacts of some policy decisions. One example of progress made in the understanding of the nature and value of assets entrusted by the State to “concessionaires”. Following the adoption of accrual accounting, administrations were requested, for the first time, to perform exhaustive inventories of on-going concessions and gradually carry out measurement of the value of the related assets – motorways, water works, railway assets (including tunnels and other infrastructure), airports, ports, etc.

The introduction of accrual accounting has made an essential contribution to the modernisation of the government finance function. Risk management tools have been adopted widely since then, particularly internal control and internal auditing, the use of which had previously been confined to a limited number of services. Internal control and accounting procedures associated with accruals have also helped to identify a number of operational issues. One example provided as part of this research is defence assets management: year-end inventories allowed identifying, and addressing, issues with the turnover in stocks.

**Accrual financial statements are little used for macro fiscal policy in France, but have allowed highlighting a number of risks to public finances**

Accruals data is used to a certain extent for informing long-term sustainability assessments and national accounts (statistics). While there is neither systematic, comprehensive or regular analysis of the balance sheet nor any report on fiscal risks in France, the accrual basis financial statements have highlighted a number of risks to public finances and generated consequently increasing attention from parliament and, to some extent, the general public (e.g. guarantees, tax credits and provisions for tax litigations).

**Accrual accounting is used for monitoring the financial situation of individual public entities**

Public agencies, local government, social security funds and SOEs have historically used accrual accounting in France. Accrual aggregates and ratios are therefore regularly used to monitor the financial situation of these entities.
Japan

Accrual financial statements are supplementary information to core cash basis fiscal reports

Japan is operating a cash basis budgeting system. Budget and year-end reports are prepared on cash basis and the fiscal target, referred to as the Primary Balance (PB), is also cash based. Cash basis fiscal reports are indeed perceived to have advantages over accrual basis ones regarding certainty, objectivity, and accessibility.

The adoption of accrual accounting was therefore undertaken as a trial process, with the government’s opening balance sheet prepared as a first step. The full adoption of accrual accounting started in 2000 and it was completed in approximately five years, but accrual basis financial statements are complementary to cash basis fiscal reports according to legislation. For this reason, there is no formalised process of review by parliament of these financial statements. The statements are, although, distributed to every parliamentarian who have the opportunity to direct questions to the government. Further, the statements are submitted to a control by Japan’s Board of Audit.

Adoption of accrual accounting was considered a prerequisite for strengthening financial and operational performance evaluation in Japan’s public sector

In conjunction with the implementation of accrual accounting, Japan introduced the Incorporated Administrative Agency system. This system aimed at comparing financial results and measuring performance of operations of individual entities, with the ultimate goal of improving their service delivery and productivity in the public sector. Financial statements and PUCI can therefore be used by parliamentarians to assess policies of the government and the related cost of services.

As part of this project, each ministry is required to prepare so called Policy Unit Cost Information (PUCI) for each of its policy units. PUCI measures operating costs of each policy unit in order to facilitate annual financial and operational evaluation and to ensure the transparent and efficient allocation of resources. Financial information used in PUCI is fully accrual based. Incorporated Administrative Agencies’ operating costs are also measured on accrual basis and compared annually.

Financial performance of individual entities is monitored with accrual basis financial statements

Agencies prepare accrual based financial statements which are used for performance monitoring. Agencies, referred to as incorporated administrative agencies, disclose balance sheets by accounts and some balance sheets items (total assets amount and main assets breakdown) by segments. These financial statements need to be submitted to the relevant minister within three months of the end of the accounting period for approval. Incorporated administrative agencies have incentives to manage efficiently their balance sheets and financial operations. For example, if profits are recognised after offsetting losses

36 The Primary Balance is an indicator that shows to what extent the expenditure required to implement policy measures in a given timeframe is covered by tax revenues in the same timeframe.

37 Incorporated Administrative Agency means a corporation, incorporated pursuant to the laws as an agency managed under the medium-term objectives, a national research and development agency or an agency engaged in administrative execution.

38 Typically, a ministry has between 5 and 15 policy units. There are 140 policy units in total across the government.

Unclassified
Carried forward from the preceding years, agencies can appropriate all or those parts of the profits which are considered as generated by their management efforts. These profits may only be spent on specific areas that have been stipulated for surplus spending in the agencies Medium-term plan. This approach provides incentives for management to try to increase profits.

Accrual financial statements from SOEs inform management policy. Each SOE prepares individual accrual financial statements, following private sector practice, which is used by the government to monitor the company, assess its management plan and decide on dividend policy.

**Substantial efforts are done to improve accessibility of accrual financial data**

Japan prepares a number of documents to further explain the government’s accrual and cash based financial reports, at government and individual ministries level. These include an annual Public Finance Statistics Book and Japanese Public Finance Fact Sheet. These documents include the use of graphs, and tables showing the current fiscal position as well as trends over time. There is also an explanation of the impacts and consequences of particular fiscal policy directions. As part of the publication of the annual financial statements, brochures and leaflets are also made available on the MoF’s website. The brochure and leaflet provide different levels of detail, with the leaflet being briefer and simpler than the brochure. The aim is to provide easily understandable information for interest parties who may not be familiar with the government’s overall financial position.

Detailed information on the accrual financial statements is made available through an Open Data Portal. As a part of accrual financial statements, further disaggregation of each line item, such as a breakdown of loans by borrowers, a breakdown of securities by issuers, breakdown of tangible assets etc., is provided on the Open Data Portal. This also includes policy unit cost information, and individual full cost information for some government activities. The main intention is for the government to disclose its financial information in a level of detail similar to what private companies in Japan provide in their financial statements.
## Box 6. - Japan: Cost Accounting

Japan historically maintained a *Policy Evaluation System* for measuring and comparing operating expenditure (excl. capital and wages expenditures) of each administrative service within government. Following the publication of the first central government accrual based financial statements in 2013, the government tried measuring “full costs” associated with so-called “public operations”.

In practice, each ministry was requested to define 1 to 4 public operations within its activities’ scope and measure full costs associated with each one of them, based on the accrual data, as follows:

<table>
<thead>
<tr>
<th>Full cost information</th>
<th>Cost of employees</th>
<th>Cost of equipment</th>
<th>Cost of office buildings, etc. (depreciation cost)</th>
<th>Cost of operation</th>
</tr>
</thead>
</table>

For each public operation, a “cost per unit” was calculated by allocating costs to the “number of users” or “number of working days” of a given administrative service, as follows:

<table>
<thead>
<tr>
<th>Operation of correctional institutions (Ministry of Justice, FY2015)</th>
<th>Full cost: JPY 291 883 million</th>
<th>Number of inmates: JPY 62 378 people</th>
<th>Cost per inmate (1day): JPY 12 820</th>
</tr>
</thead>
<tbody>
<tr>
<td>Passport-related operations (Ministry of Foreign Affairs, FY2015)</td>
<td>Full cost: JPY 19 415 million</td>
<td>Number of passports: 3 013 516 books</td>
<td>Cost per passport: JPY 6 443</td>
</tr>
<tr>
<td>Operation of national park management (Ministry of Land, Infrastructure, Transport and Tourism, FY2015)</td>
<td>Full cost: JPY 12 329 million yen</td>
<td>Number of annual visitors :33 005 360 people</td>
<td>Cost per annual visitor: JPY 374</td>
</tr>
</tbody>
</table>

Information for each public operation is made public by the government. Expected outcomes of cost accounting are improving transparency on the government policies and operations, but also informing the budget process with data (e.g., is the full cost of operations varying from one year to another? If yes, why? what are the main sources of costs: operating expenditures? wages? amortisation of equipments? etc.).

Government notes that as at today some challenges are still to be overcome to improve the reliability and usefulness of the information, including defining a methodology for allocation wages and amortisation of equipments from shared services. In addition, the cost per unit is measured on a very limited number of services (compared to the large range of policies and services delivered by the government).

Source: authors, based on information provided by the government of Japan.
Korea39

Korea has completed a swift transition to accrual accounting but the budget is still established on a cash basis

Korea moved to accrual accounting between 2009 and 2011, following a proposal from the Ministry of Finance. The core objectives were to increase transparency and enhance the credibility of government finances. The general view from authorities is that the preparation and implementation of the new accounting basis faced no major challenges, due in part to a new integrated IT-system for all budget operations that already were in place.

The current year-end National statement of accounts includes a financial statement on accrual basis including a relatively comprehensive balance sheet, the budget outturn on cash basis and a performance report.

Korea continues to operate a budget were the core elements – the tables of total and net revenues and expenditures – are presented on cash basis. This is supplemented with information on commitments, and the estimated balance sheet and income statement of the funds. The legislature authorises the current and capital expenditures, commitments, financing flows, and the debt ceiling.

Ongoing efforts to increase accessibility to and usefulness of accrual figures

Public interest in accrual figures continuous to be relatively low. While the state-funded Korea Institute of Public Finance is already publishing a booklet named National Accounting for Beginners they, therefore, plan to expand their list of publications to increase the accessibility to the financial statements. Additional titles will aim at explaining the financial statement in a plain language along with infographics, as well as offering accessible analysis of key figures over time with the goal of giving the readers and intuitive understanding of the financial status of the Korean government. Furthermore, the institute offers training programs for high ranking officials in accrual accounting.

The Korea Institute of Public Finance, in addition to the more direct efforts, also runs a research program trying to develop new ways to make use of accrual information. This research covers, e.g., the effect of accrual-based figures for economic forecasts and the development of accrual indices to evaluate the sustainability of public pension systems.

The Ministry of Finance publishes accrual financial data in a dedicated online database; Open Fiscal data. Korean accrual financial information is structured in a 5-level chart of accounts. Currently, data on level 1-3 is disclosed, while the most detailed data on level 4 and 5 is seen as for internal management purposes.

Note: Example from Korea’s 5-level chart of accounts. Source: Korea Institute of Public Finance

39 This information was compiled by KIPF.
Accrual financial statements examined by the supreme audit institution are submitted to and reviewed by the parliament. While parliamentarians still focus on the, also provided, cash-based information, interest in accrual figures is considered to grow over time. The parliament has repeatedly passed recommendations asking for more detailed accrual information to be presented to them.

**Accrual information has proven valuable over multiple policy areas**

The introduction of accrual accounting has significantly improved the government's information on assets held, including incentivising the government to conduct periodic reviews to determine their current value. On the liabilities side, the regular publication of provisions for the future pension for civil servants and military personnel was a key driver behind growing concerns for the cost of the system, triggering a pension reform in 2015.

For state-owned enterprises accrual information plays a central role both for dividend policy, and for the charges set by public utility corporations. As for local government – were individual municipalities switched to accrual accounting already in 2002 – accrual information has proven valuable in managing long-term investments such as waste management facilities.
New Zealand

Consistent use of accrual standards throughout the budget cycle allows greater clarity, comparability and reliability of fiscal information in New Zealand

New Zealand completed its transition to accrual budgeting and accrual accounting in six years, from about 1988 through to 1994, as part of a broad set of public financial management reforms. The main motivations for reforms were to assist the Government to translate its strategy into action; promote informed decision-making and accountability; and encourage a responsive and efficient public sector.

Following reforms, fiscal targets, budget, accounts and performance evaluation are all prepared according to IPSAS standards. Both the initial move to accrual accounting and subsequent alignment of budgeting and accounting standards have increased fiscal transparency in New Zealand, according to Treasury and a number of independent evaluations commissioned by government. Among various benefits identified, evaluations mention the clearer read of fiscal reports prepared according to high quality standards; the easier navigation and comparison from one report to another as they are prepared according to consistent rules and principles; and improvements to government’s forecasting ability thanks to the “feedback loop” between audited accrual accounts and accrual forecasts. Therefore, while cash flow statements are also produced as part of the public reporting arrangements, the main focus of stakeholders with regards to public finances scrutiny is now on accrual information.

General view is that accrual basis fiscal reports are accessible and legible for all groups of stakeholders

Government is of the view that the use of accrual budgets and accrual accounts, consistently applied, and in terms familiar to users of private sector financial statements, can provide an aid to understanding the government’s financial position. A feature of cash budgeting is the use of funds to make internal allocations, and unless the purpose and rules around the transfers to and from those funds is known to users, reports on these funds are not easily able to be understood. Because under accrual accounting the basis of the report is an entity, rather than a set of fund accounts, this barrier to understanding the impact of public finances is reduced by accrual accounting and budgeting.

Legislation requires that each public sector entity, including the whole-of-government, prepare annual financial statements, which are systematically audited by the Controller and Auditor-General. All of these audited financial statements are tabled in Parliament and scrutinized by relevant select committees, which draw conclusions and recommendations depending on material transactions and events during the year and audit observations. A special feature of the scrutiny process in New Zealand is a thorough questionnaire sent from parliament to the relevant line ministry before each vote on appropriations. This questionnaire covers questions on capital expenditure and financial risks where answers are considered to be facilitated by the accrual based system used.

Commentaries explaining the results and accompanying press releases are prepared as part of the publication of the monthly, annual, and forecast financial statements of government. In addition, media “lockups” to explain results are organised prior to the presentation of annual financial statements and 5-year Budget forecasts. Also, “snapshot” and “at a glance” documents aimed at citizens are released at the same time than the annual financial statements and budget. The general view is that these initiatives have

40 One example of this is the audit and scrutiny of outstanding accidents claims obligations, which has led to both better claims management and improvements to the underlying actuarial assumptions to the liability.
helped generating significant media and public attention, outside of expert groups such as rating agencies which strongly support the production of accrual basis fiscal information (e.g. rating agencies especially appreciate the 5-year accrual budget forecast).

**Accrual data is used in all aspects of fiscal policy**

The New Zealand government’s fiscal strategy and longer term and shorter term fiscal targets are set on accrual terms. In particular, the prime fiscal performance target is an aggregate referred to as Operating Balance before gains and losses, or OBE/GAL. The other important fiscal target is net debt. Therefore, all policy initiatives included in submissions put forward to the Government for decisions must include the estimated (cash) impacts on the financial position (net debt) and the estimated (accrual) impact on the financial performance (on OBE/GAL) of the Government. Some significant past policy decisions have reflected the impacts of using of accrual based information for fiscal policy, for example, a move from defined benefit schemes for employee pensions to defined contributions schemes.

Accrual accounting has also helped New Zealand better identifying and measuring its fiscal risks coming from contingent liabilities and assets. Accrual financial statements are therefore one of the core sources of information for the government’s Fiscal Strategy Report, the specific chapter on fiscal risks in the budget forecasts, and the Statement on the Long-term Fiscal Position (LTFS) of the government covering at least the upcoming 40 years.

**The balance sheet receives specific attention through the production of an Investment Statement every four years**

Under the Public Finance Act 1989, the government is required to produce an Investment Statement at least every four years. The Investment Statement measures the government’s performance in managing the State’s balance sheet. It provides information on the shape and health of the government’s portfolio of assets and liabilities at the end of the last full financial year. It outlines how the balance sheet has changed in recent years and includes forecasts on its anticipated composition and size through for the next two years. It also describes the performance of the government’s major asset and liability classes and discusses frameworks for good balance sheet management to underpin living standards in New Zealand.

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41 A number of other fiscal indicators are also used and are reported to Parliament, although they are not subject to approval by Parliament.

42 This Statement is one of a number of publications that the Treasury produces to provide transparency around the Crown’s finances. Other reports include the Financial Statements of the Government of New Zealand, the Economic and Fiscal Updates and the Statement on the Long-term Fiscal Position.
Box 7. - New Zealand: Managing the Crown’s Balance Sheet for Citizens

To put the Crown’s balance sheet size into context, there were approximately 4.5 million people living in New Zealand at the end of the last financial year. That means the Crown owned about NZD 54 000 worth of assets and owed NZD 39 000 in debt on behalf of every New Zealander at that time. That means many families’ indirect share of the Crown’s assets and liabilities would typically be second only in value behind the family house and mortgage.

Against this background, New Zealand government believes well-managed Crown’s balance sheet is crucial to supporting the provision of state-funded services while also underpinning the overall economy’s performance, and contributes to increasing living standards.

In particular, the government observed in recent reports that government assets come with both benefits and costs. Based on the public sector discount rate the opportunity cost of Crown asset ownership is around NZD 25 billion per annum. This does not include the costs of utilisation, or upkeep. Capital is not free. Capital that does not provide benefits greater than the costs of ownership incurs costs on citizens. Citizens are therefore entitled to expect the government to make the best use of these assets and to manage liabilities to minimise costs. Achieving this allows for more and better public services – more schools or better healthcare for example – or lower taxes, which increases incomes.

Source: authors, based on public information.

Both accrual and cash measures are used for assessing entities’ financial and operational performance, generating clear efficiency gains

The Treasury analyses accrual basis financial reports of all government entities. This analysis includes: assessing entity cash holdings, as excess cash held by entities outside the core government sector can affect whole of government financing costs; monitoring cost recovery activities (referred to as Memorandum accounts) to ensure that revenue and expenses are aligned (if necessary, pricing adjustments can then be made to ensure that the pricing appropriately recovers the costs); and considering fixed asset sustainability by considering how much of the asset has been consumed (through accumulated depreciation); when it will need to be replaced; and the stock of liquid assets in the entity that is available to replace the asset. This analysis informs the starting point for discussions with the entity on its financial sustainability.

Investment intensive entities are subject to a review on a two-yearly basis to assess their management of investments and assets. The reviews result in an “Investor Confidence Rating” (ICR) which is made public. The ICR provides an indication of the level of confidence that investors (such as Cabinet and Ministers) can have in a department or agency’s ability to realise a promised investment result if funding was committed. The ICR provides an incentive mechanism that rewards good investment management performance and proactively addresses performance gaps. Entities that receive a good rating may obtain greater autonomy, higher financial delegations and less monitoring and reporting. Entities that do not rate as well may obtain less autonomy, lower financial delegations and may attract additional monitoring and support central agencies. The ICR helps individual agencies identify where they need to lift capability to maximise the value of their investments and assets and is one component of the information that is considered by Cabinet when it prioritises investments.

State-owned enterprises are subjected to scrutiny from the parliament, the relevant ministry and a special Commercial Operations group within the Treasury based on their individual accrual financial

Better cash management practices adopted parallel to accrual accounting led to significant savings. Through utilising supplier credits and eliminating idle balances, overall interest cost where reduced with ca NZD 35 million per annum (in 1990 value).
statements. One feature is a yearly shareholder expectations letter covering e.g. expected dividends and, when appropriate, the capital structure of the enterprise. A SWF, the New Zealand Super fund, was created in 2001 in order to make future retirement costs more affordable. Accrual financial statements are used to assess the performance of the fund by the Government, the Parliament and the public. All annual financial statements are audited. Expectations on Chief Executives and governing bodies of entities are set out in a public document agreed by Cabinet. The circular covers the management of investments and physical and intangible assets and shows the government’s intention that there must be active management of government resources and alignment between individual investments and long-term priorities. Financial management is an explicit component of Chief Executive performance evaluation and includes cost control, forecasting, managing fiscal pressures and risks, managing resources, and stewardship of assets.

When undertaking cost benefit analyses or benchmarking activities, the government uses accrual based cost evaluations. This has encouraged greater cost awareness amongst programme managers. A 1996 study by Treasury staff pointed out that richer management information” made a key contribution to allowing managers to re-evaluate and change their inputs to increase efficiency. The same study underscored that the system has aided public expenditure control by more clearly defining the costs and benefits associated with different options.

**The setting of fees and charges are done under an accrual based framework**

New Zealand has a comprehensive cost recovery framework that includes guidance on understanding the costs of production (including operating and capital costs) as well as demonstrating efficiency in the application of those costs to the cost recovery activity. Under this framework, costs are considered on a full accrual basis to ensure that the full cost of services delivered is identified and fees and charges set accordingly.

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44 For example, a number of cost measure ratios are benchmarked to provide confidence that “back office” functions are delivered efficiently.

Spain

Spain completed its accrual accounting reform progressively, in about 25 years

The accrual accounting reform started in the 1980s, and followed a gradual path in Spain. In 1986, public entities were required to maintain double entry book-keeping; in 1990, some accrual concepts were introduced in the public accounting framework; and from 2007 to 2010 public entities finally transitioned to accrual accounting.\textsuperscript{46} Budgets in Spain remain however prepared on close to cash basis (so called rights and obligations basis). Fiscal rules are set in statistical terms and compliance assessed against national accounts.\textsuperscript{47}

Better transparency on public finances is the main outcome of the reform

The annual publication of audited financial statements is believed to have contributed to better accountability and transparency. In these financial statements, a number of ratios are included in order to highlight the state and evolution of public finances. In addition, accrual data is made available to the public on an Open Data Portal at the level of financial statements line items. Both accrual and cash based aggregates and ratios are used to monitor the financial situation of agencies and state owned corporations. These ratios differ depending on the activity considered.

<table>
<thead>
<tr>
<th>Box 8. - Accrual-basis financial ratios</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1/ Balance Sheet Ratios:</strong></td>
</tr>
<tr>
<td>Instant liquidity: cash and cash equivalents / current liabilities; Liquidity in the short term: cash and cash equivalents +receivables / current liabilities; General liquidity: current assets / current liabilities; Inhabitant's debt: current + non-current liabilities / number of inhabitants; Debt: current + non-current liabilities / current + non-current liabilities+ equity; Relation of debt: current liabilities / non-current liabilities; Cash flow: current + non-current liabilities / cash flow from operating activities.</td>
</tr>
<tr>
<td><strong>2/ Statement of Financial Performance Ratios:</strong></td>
</tr>
<tr>
<td>Revenues structure: Taxes/operating activities revenues; Transfers and grants/operating activities revenues; Sales and rendering of services/operating activities revenues; Rest of operating activities revenues.</td>
</tr>
<tr>
<td>Expenses structure: Wages, salaries and employee benefits/operating activities expenses; Grants and other transfer payments/operating activities expenses; Acquisitions/operating activities expenses; Rest of operating activities expenses/operating activities expenses; Coverage of operating activities expenses; Operating activities expenses.</td>
</tr>
<tr>
<td>Source: authors, based on information from Spanish IGAE.</td>
</tr>
</tbody>
</table>

\textsuperscript{46} Authorities note that accrual basis financial statements have been hence published since 1986.

\textsuperscript{47} Fiscal targets, like those of other members of the Eurozone, are set by the European Union's Stability and Growth Pact and Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (so called Fiscal Compact). These fiscal objectives are as follows: general government fiscal deficit rule; debt rule; medium-term structural balance objective; and medium-term expenditure benchmark limiting annual growth in general government expenditure to potential GDP growth.
Switzerland

The Swiss Confederation uses the accrual basis for budget and financial statements, but adopted a cash basis fiscal rule

Accrual reforms in Switzerland were initiated in the 2000s by the Director-General of the Swiss Federal Finance Administration with the support of the Minister of Finance, the Government, and the Parliament. Its objective was to ‘close the gap’ between the Federation and cantons in terms of financial transparency.

Following reforms, both budgets and financial statements are prepared on an accrual basis using IPSAS standards. Financial statements are prepared by individual ministries and agencies, as well as at whole of government level. Budgets are accompanied by an Integrated Task and Financial Plan, which contains estimates of expenditure and revenues covering the budget year and three following years. Appropriations are made on an accrual basis.

Despite its accrual reforms, the Swiss Confederation anchors its fiscal policy with a mechanism called the “Debt Brake”. The Debt Brake is cash based measure that seeks to avert structural imbalances in federal government finances. The Debt Brake is reported in conjunction with the accrual based financial reports.

Whilst general interest in the accrual financial statements is limited, particular areas attract attention

The Parliament makes a report on the annual financial statements each year. The focus of the report varies over time with recommendations usually concerned with the reporting process (including timelines) and the internal control environment. However, the main area of interest is the (cash) financing statement due to the prominence of the cash basis fiscal rule in macro fiscal policy. Compliance with the fiscal rule is indeed closely scrutinised by Parliament and other institutions, which leads to interest in particular areas of financial statements that impact the Debt Brake.

Accessibility for the general public has been improved by making accrual financial information available on an Open Data portal. The Swiss government has created an Open Data portal to provide greater accessibility to government information, including financial information. The accrual financial data that is included in the portal is reported at the financial statement line item level. In addition to making data available on the portal, the annual financial statements are supplemented with a brochure and “at a glance” documents to make the information more accessible and understandable to the general public. Further, rating agencies do make us of the accrual data provided.

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48 The Federal Budget Act was revised following several consultations between the administration and parliamentarians.

49 Those areas include liabilities, specific cost categories (e.g. ICT costs, payroll costs) and the government’s overall financial position.

50 https://opendata.swiss/en/dataset?political_level=confederation&groups=finances
**Accrual data is used for evaluating the operational performance of administrative units**

The statement of financial performance is supplemented by cost accounting at the level of the administrative units. This approach encourages cost awareness and the economical use of funds and encourages administrative units to improve the efficiency of their operations. It also facilitates a comparison of cost performance between similar functions of government. Fees and charges for government services are based on accrual information. Each area is subjected to legal requirements that establish the basis and details for setting the level of fees and charges.

**Changes to financial processes in the context of accrual reforms have led to efficiency gains**

The implementation of accrual accounting necessitated new ICT systems to underpin public financial management. This has improved the linkages between budgeting and *ex post* reporting data thus providing a clearer line of sight between budget and actual financial results. Overall data quality has improved due to better system controls being implemented as part of the new ICT systems. Linking cost accounting, budgeting and accounting together have led to better and more readily available data and generated efficiencies in the production and reporting of this information.
United Kingdom

**The UK uses accrual budgeting and accounting, but continues using cash basis appropriations (so called spending totals)**

The UK completed its transition to accrual budgeting and accounting in about ten years. The reforms started in 1993 and were concluded in 2002. The transition process and the accompanying accruals based budgeting and accounting arrangements, was led by Her Majesty’s Treasury (HMT). The timescale for implementation was set to accommodate the scale of systems changes in departments as part of the normal replacement cycle and to allow monitoring and assessment of departments’ progress through a series of pilots, dry runs and “trigger points”, but nevertheless encountered some delays.

Following these reforms, both the budget and year-end financial statements are prepared on accrual basis. The annual **Budget** is composed of an income statement that forecasts government expenses and revenues on a full accrual basis. Central government departments and the majority of individual public sector entities prepare financial statements on an accruals basis, as per International Financial Reporting Standards (IFRS) as adapted for the public sector. A consolidated set of all public sector entities financial statements is produced annually, known as the **Whole of Government Accounts** (WGA).

Each year Parliament gives statutory authority for the consumption of resources, capital spending, and for cash to be drawn from the Consolidated Fund (the government’s general bank account at the Bank of England) by Acts of Parliament known as **Supply and Appropriation Acts**. Up to five different accrual-based spending totals are set for each department, alongside an amount of cash required in total to service each of these budgets.

**Macro fiscal policy is done on accrual basis**

In the United Kingdom, fiscal policy is done mostly on accrual basis. New policy proposals are measured **ex ante** on accrual basis IFRS. This measurement is done for expenses and revenue, but does not include balance sheets impacts. Likewise, medium term forecasting is done on accrual basis IFRS.

Three fiscal targets are in the 2017 Charter for Budget Responsibility, all set in statistical terms (ESA10). The targets are set for the deficit (so called Public Sector Net Borrowing, or PSNB), debt, welfare spending. In recent periods, the United Kingdom also used ESA10 based Public sector net debt (PSND) and Public Sector Net Financial Liabilities (PSNFL) as supplementary indicators of fiscal performance.

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52 PSND is defined as the public sector’s consolidated gross debt, less its ‘liquid’ assets – that is assets could readily be sold. PSNFL captures a wider range of financial assets and liabilities than recorded in public sector net debt excluding public sector banks. This new supplementary fiscal aggregate announced by government in the Autumn Statement 2016.
The United Kingdom started publishing in 2017 a *Fiscal Risks Report* drawing on various information sources including WGA. In this report, one chapter explores in particular risks associated with the public sector balance sheet and divide them into four sub-categories: risks from balance sheet transactions such as student loans or financial assets sales (whose timing can impacts forecasts of government revenue); risks from balance sheet transfers, for examples the reclassification of entities such as housing associations within the public sector; risks from valuation changes; and risks from balance sheet “surprises” that is impact on assets and liabilities of government possible future interventions. This report also analyses a number of headlines measures as part of the stress test of the public sector balance sheet, including the government fiscal targets indicators such as government liquidity and financing burden, based on IMF recommendations.

**General consensus is that accrual reforms enhanced accountability and improve decision making**

The adoption of accrual-based budgeting and accounting across the whole public sector derived from the motivation across Parliament and government to enhance accountability, improve decision making and strengthen public management. Recent reports and assessments published by the Treasury, the government, House of Commons and National Audit Office show that accrual accounting and budgeting are considered to have met these objectives.

With regards to management, recognition of provisions and contingent liabilities has prompted much more active management of stocks and controls over new flows. Also, the UK’s publication of Whole of Government Accounts which recognised, for the first time, the liabilities associated with public service pensions is seen as an important contributing factor in significant reforms to civil service pension contributions and benefits a few years later.

Recent parliamentary questions and inquiries into a number of provisions reported in the public sector balance sheet (provisions related to nuclear decommissioning, clinical negligence and tax administration legal disputes) illustrate the increased level of transparency, and related scrutiny, permitted by the adoption of accruals. The Parliament and National Audit Office also just completed a major series of enquiries into the management of the balance sheet.

**Accruals reforms have increased overall confidence in the consistency and reliability of fiscal data**

The fiscal, budgetary and accounting frameworks are all accrual-based and linked, and, perhaps more importantly, structured around a “block” of audited departmental annual reports and accounts.

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53 From 2017 onwards, the Office for Budget Responsibility started publishing a Fiscal risks report (FRR). This report will complement existing medium-term forecasts and long-term projections by focusing on identifiable risks to the public finances.
Getting Added Value out of Accrual Reforms

Box 9. - United Kingdom: Accrual-based fiscal framework

The budget and appropriations are IFRS-based. Fiscal rules are set on ESA basis. Departmental Annual Reports and Accounts are also IFRS-based. They include an audited outturn of spending authorisations granted by the parliament (so called core tables) and audited financial statements. The audited outturn and financial statements are used to prepare IFRS-based WGA and ESA-based National accounts. The Economic and fiscal outlook, Fiscal sustainability report and Fiscal risks report draw, in turn, on the aggregates published in WGA and national accounts.

Note: ESA and IFRS are both prepared on an accruals basis (recognition of economic events regardless of when cash transactions occur) and they each prepare a statement of financial position, income and expenditure analysis and details of other changes; although with presentational variances. However, there are some differences in how the accruals concept is applied at a detailed level (e.g., provisions). (Source: WGA)

Source: authors, based on public information from HM Treasury and National Audit Office.

Efforts to improve the clarity and usefulness of financial data have been made regularly, as experience of using accrual data and producing accrual basis financial reports has grown.

- The 2011 Clear Line of Sight (Alignment) reforms simplified government’s financial reporting to Parliament. The reform aligned, as far as possible, the recording of government spending in Supply Estimates with the spending limits set by Treasury and the spending reported in the WGA and Annual Reports and Accounts;

- The format and content of the WGA has been improved, progressively, to better address user’s needs. For example, the introduction section (the “Overview”) evolved from a “summary” to a “snapshot” on key issues. In its current version, it answer a number of simple key questions.

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54 What does the government receive from taxes and other income? What does government spend on providing services and running costs? What does the government pay to finance its liabilities? What are the most significant assets owned and controlled by government? What liabilities does government have?
provides data sets over a five-year period to show trends in spending and raising revenue and report issues in targeted areas of interest for users (rates of frauds and errors, debt management);

- The WGA include two bridge tables with the national accounts: 1) Net liabilities (WGA) to Public sector net debt (National Accounts) and 2) Net expenditure (WGA) to Current deficit (National Accounts).

The Treasury is now reviewing the content of the accounts to determine whether the disclosures are proportionate and focussed on the material items in the accounts.

**The UK government recently launched a Public Sector Balance Sheet Review**

Under the impulse of the Public Accounts Committee, the Treasury is seeking to make better use of WGA to both improve public financial management and inform policy. To achieve this objective, one recent initiative of the Treasury has been to set up a *Balance Sheet Analysis unit* tasked with undertaking analysis of the public sector balance sheet to understand its expansion since the financial crisis and improving the management of assets and liabilities. The work of the unit has already seen the publication of guidance in July to improve the management and scrutiny of contingent liabilities, mentioned above.

As part of this work stream, the UK government formally launched a Balance Sheet Review at the 2018 Autumn Budget. The review aims at supporting the sustainability of the public finances but also helping in identifying resources for further investment in public services. As part of this review, the Treasury will work closely with other government departments in carrying out the review to improve balance sheet management by, for example, looking at ways to pool investments to minimise the cost of multiple management fees or making money out of government’s ideas, by selling some intangible assets like software. The government has committed to providing an update at Budget 2018 – we believe that the balance sheet review is an asset with the potential for significant return.
References


