Accruals

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Agenda

- **Cash vs. Accruals**
  - Concepts and Definitions
- **Accruals in OECD countries**
- **Implementation Issues**
- **IPSASB**

Cash vs. Accruals

- **Basic Definition**
  - Cash = When money changes hands
  - Accruals = When the underlying transaction takes place

- ***Example***
  - Contract signed on 31 December 2010
  - Payment made on 1 January 2011

  - Accruals = recognized in 2010
  - Cash = recognized in 2011

Cash vs. Accruals

	Accruals	Cash
Operating Statement	YES	NO
Balance Sheet	YES	NO
Cash-flow Statement	YES	**YES**

Accruals adds information to cash.
It does not replace cash.

Cash vs. Accruals

- **Key "bottom-line" differences**
  - –Employee pensions and retirement health benefits
  - –Interest on debt
  - –Capital expenditure and depreciation

Accounting vs. Budgeting

- **Accrual Accounting**
  - –Applied to financial statements, but not necessarily the budget
  - –Based on private sector accounting
- **Accrual Budgeting**
  - –Replaces cash as the measure to allocate scarce resources
  - –Little or no similarity to the private sector

Accrual budgeting requires accrual accounting; Accrual accounting does not require accrual budgeting

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Overview

- **In 1989, New Zealand implements full accrual accounting and budgeting**

- **Very controversial topic in the 1990's**
  - Strong proponents and strong detractors

- **Growing consensus in early 2000's**
  - Many countries have implemented accrual accounting and most are considering it
  - Only New Zealand, Australia, and the UK adopted full accrual budgeting
  - Australia is moving back to cash appropriations
  - Need for great care in interpreting some countries' claim to be using accrual budgeting

Accrual Accounting
Reasons for Adopting

- **Improved cost information to decision-makers**
  - Total costs; not just immediate cash outlays
- **Improved discipline and accountability in budget execution**
  - No possibility to "defer" reported costs
- **Illuminate long-term fiscal sustainability through a comprehensive balance sheet (assets and liabilities)**
  - But taxes and social security pensions

Accrual Budgeting
Reasons for Not Adopting

- **Difficult for politicians (and the public) to understand**
  - –The 3 countries that apply it all share the Westminster tradition of governance where parliament has little if any influence on the budget
- **Easy to manipulate**
  - –Non-cash items — such as depreciation—can be manipulated as much as or more than the timing transactions
  - –New "matching principle" required
  - –Manipulation inherent in accrual budgeting could undermine fiscal discipline rules
- **Accrual budgeting for specific transactions can address some of the weaknesses of cash budgeting**
  - –Civil service pensions
  - –Interest on debt

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Implementation Issues

- Recognition criteria
- Valuation issues
- Setting accounting standards
- Asset registers
- Opening balance sheet values
- Appropriations for non-cash items
- Cash management
- Control of capital asset acquisitions
- Upgrading accounting skills

Recognition Criteria

- **Heritage Assets**
- **Military Systems**
- **Infrastructure Assets**
- **Social Insurance Programs**

Valuation Issues

- Historical cost
- Current market value

Accounting Standards-Setting

- **A degree of independence is essential**

- **Two models:**
  - –Single standard setter for both private and public sectors
  - –A separate advisory group to the Ministry of Finance

- **International Public Sector Accounting Standards Board (IPSASB)**
  - –OECD – first entity in the world to adopt IPSAS
  - –Used as a basis for national standard-setters
  - –See next section

Asset registers

- **Countries did not have up-to-date asset registers**
  - Property, plant and equipment
- **A key obstacle in adopting accruals**
  - Very time-consuming
- **…and a key benefit of having adopted accruals**

Opening Balance Sheet Values

- **Important to optimize them** when switch to accruals is made since they tend to get "locked in"

- "**Asset-rich**" agencies get excess appropriations in the form of depreciation

- "**Asset-poor**" agencies have continual funding problems

Appropriations for Non-Cash Items

Model A - Appropriate Cash

- Cash appropriations for full costs
- Empowers agencies
- Fosters ¨culture change¨

Model B – Do Not Appropriate Cash

- Cash for cash costs; notional “receivables” for non-cash costs
- Avoids control risks
- No “culture change”

Cash Management

Key issue when cash appropriations are made for non-cash items (Model A).

<u>Two options:</u>

1. Only allocate cash to agencies when they require it. In effect, translates Model A into Model B.

2. Agencies receive cash "in their account" for non-cash items as well

- Control systems required

Control of Capital Asset Acquisitions

- **Conceptual issue –** Does accumulated depreciation gives agencies the “right” to future capital spending in that amount?

- **Control issue –** roles of agency, Ministry of Finance, and parliament

- Depreciation as **pool of funds** when an agency´s mission changes

Upgrading Accounting Skills

- **Accruals requires professional judgements to be made**
  - Higher level of accountancy skills required
- **In-house training and external recruitment**
- **Over-investment in accounting skills?**

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IPSASB In Brief

- **Independent Accounting Standard Setter**
- **Part of IFAC – the accountancy professional body**
  - Different from IFRS institutional arrangements
- **Sets standards for public sector entities, except state-owned enterprises (SOEs)**

- **18 members, including currently 3 public members**
  - Most now with a government background
- **IMF, World Bank, OECD as permanent observers**

- **Less than 10 staff**

IPSASB Standards

- **1 Cash-basis standard**
- **32 Accrual-basis standards**
- **28 Standards derived from IFRS**
  - Includes all relevant IFRS
  - "Improvements" programme
- **4 "Original" Standards**
  - Disclosure of Information about the GGS (Financial Statistics)
  - Revenues from Non-Exchange Transactions (Transfers and Taxes)
  - Presentation of Budget Information
  - Service Concession Arrangements (PPPs)
- **Important standards still outstanding**

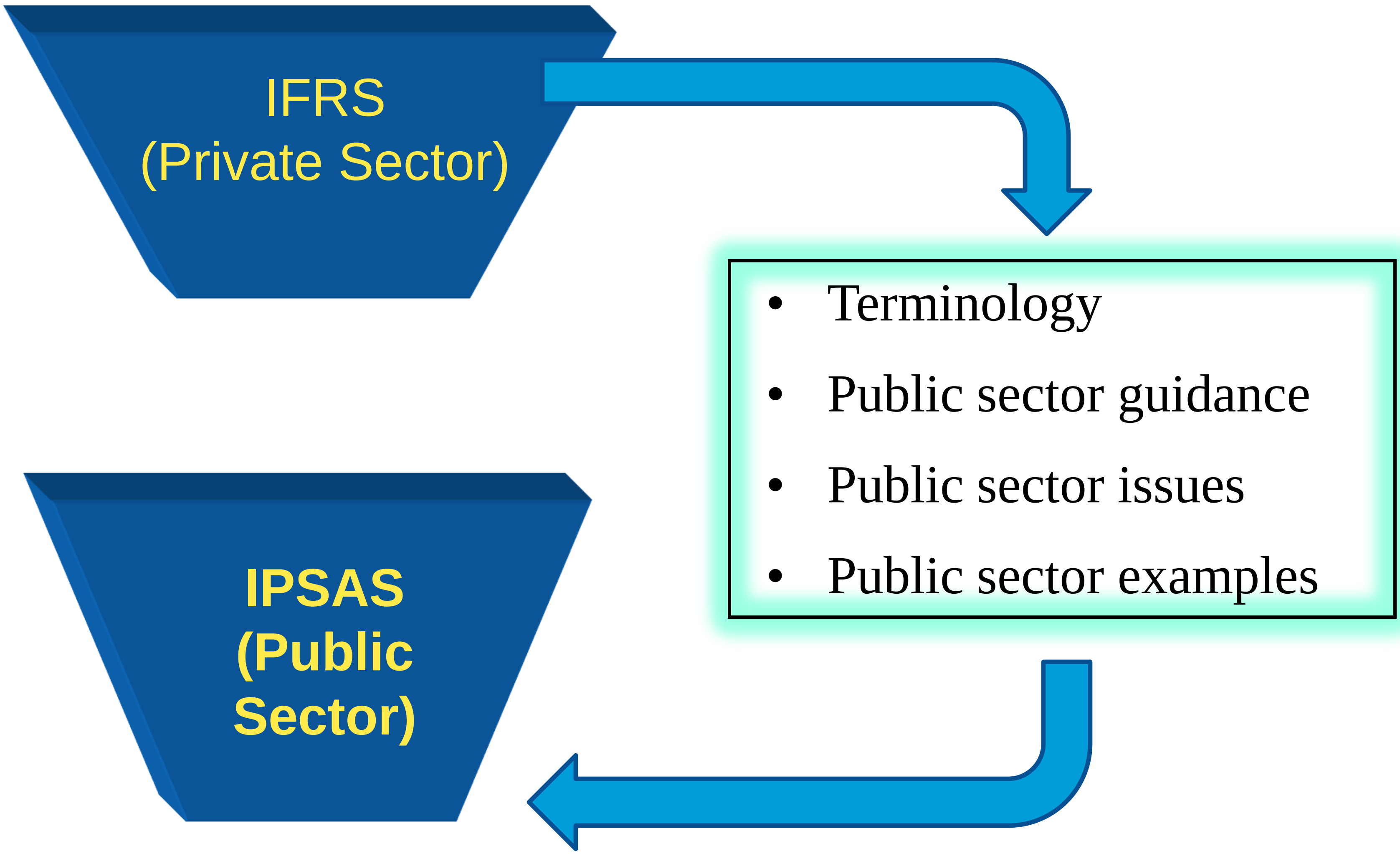
IPSASB's Strategy

Developing a **conceptual framework** for the public sector

Public sector critical projects (public sector specific, IFRSs convergence, maintenance)

Communications and **promoting adoption & implementation**

Derived from IFRS



Convergence with IFRSs

- **Increased Liaison with IASB**
  - Updating IPSASs if IFRS change in order to avoid unintended divergence
  - Close day-to-day co-operation on staff level in areas of common interest, namely the conceptual framework
  - Regular meetings on chairman and board level

Cash-Basis Standard

- **Part I – Mandatory Requirements**
  - It defines the cash basis of accounting, establishes requirements for the disclosure of information in the financial statements and supporting notes, and deals with a number of specific reporting issues.

- **Part II – "Encouraged" Disclosures**
  - It identifies additional accounting policies and disclosures that an entity is encouraged to adopt to enhance its financial accountability and the transparency of its financial statements. It includes explanations of alternative methods of presenting certain information.

Conclusions

- **Make the introduction of accruals part of an overall public administration reform that concentrates on abolishing input controls and giving more operational freedom to managers**
  - Put another way, allow managers the ability to use the accrual information they produce

For further information

- *OECD Journal on Budgeting*
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