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MIDDLE EAST INTERNATIONAL CONFERENCE ON CONTEMPORARY SCIENTIFIC STUDIES-VII



March 3-4, 2022
Beirut Arab University, Lebanon

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SAMIRA KHADHRAOUI ONTUNC

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ACCRUAL BASED ACCOUNTING AND BUDGETING SYSTEM IN PUBLIC FINANCIAL MANAGEMENT

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Introduction

Government accounting is an important tool that provides accountability and transparency in the use of these resources against the society, which finances basic public services from taxes collected from citizens (Öz, 2008, p.6; Karaaslan, 2014, p.7). Changes have been made in accounting practices over time so that government accounting can provide reliable, real information. Especially with the public reform that started in the 1990s, the leading countries in terms of economy have made the transition from the common state accounting systems and the cash-based accounting system to the accrual-based accounting system, which provides more detailed information to users and managers. It is foreseen that the application of the accrual principle will increase the accountability and transparency of fiscal reports prepared by governments and their institutions (Martí, 2006, p.45).

It is envisaged that the accounting records will be kept on an accrual basis by showing the public revenues and expenses in the accounts of the financial year in which they are accrued. On the other hand, it was decided to keep the records of budget accounts on a cash basis by adopting the method of accounting for the year in which budget revenues are collected and budget expenses are paid. Despite the use of accrual basis in accounting, International Public Sector Accounting Standards Board (IPSASB) is not impose in the use of accrual basis in budgeting. Accrual budgeting is a new development for most governments (Monteiro & Gomes, 2013, p.104).

The aim of this study is to evaluate accrual-based accounting and budgeting from a theoretical perspective. Some budgets record government expenditures at the time of payment (on a cash basis) and some budgets record expenditures at the time of the event take place (accrual basis). In the study, the positive and negative aspects of switching from cash-based budgeting to accrual-based budgeting are emphasized by scanning the relevant literature. Proponents of accrual-based budgeting point to many specific benefits. However, the transition of accruals to budgeting is still a controversial issue.

Transition from Cash-Based Accounting to Accrual-Based Accounting in Government Accounting

In the public financial management cycle, accounting follows budgeting and precedes auditing to produce financial information useful for understanding and assessing a government's financial conditions. Financial accounting — the branch of government accounting concerned with measuring the financial consequences of actual transactions and events — is regulated by rules to ensure the quality of both the inputs and outputs of the accounts of governments (Chan & Zhang, 2013).

Changes have been made in accounting practices over time so that government accounting can provide reliable, real information. As an example, we can give government accounting systems and examples applied in keeping records.

There is a spectrum of accounting bases that ranges from cash, at one extreme, to full accrual, at the other (Allen & Tommasi, 2001, p.291). The methods used in keeping records in the government accounting system are shown in Table 1.

Table 1: Accounting Record Keeping Methods

Cash Based	Cash payments and receipts are recorded as they occur.
Modified Cash based	Cash receipts and disbursements committed in the budget year are recorded and reported until a specified period after year-end.
Modified Accrual Based	Accrual accounting is used but certain classes of assets (e.g. fixed assets) or liabilities are not recognised.
Accrual Based	Transactions and economic events are recorded and reported when they occur, regardless of when cash transactions occur.

Source: Peter Van Der Hoek, 2005, p. 35.

The method followed in keeping the accounting records affects the quality of the information provided. Various methods have been developed and applied to ensure that the information provided by the accounting information system is clear, accurate, reliable and timely. One of these methods is the accrual-based accounting system. In the accrual-based accounting system, payments are recorded as soon as they are born, regardless of whether they are received in cash or paid in cash.

Accrual accounting requires entities to maintain complete records of assets and liabilities (IFAC, 2011, p. 13). The full accrual basis recognises transactions and events when they occur irrespective of when cash is paid or received. Revenues (income) reflect the amounts that fall due during the year, whether collected or not. Expenses reflect the amount of goods and services consumed during the year, whether or not they are paid for in that period (Allen & Tommasi, 2001, p.292). Especially with the public reform (New Public Management) that started in the 1990s, the leading countries in terms of economy have made the transition from the common state accounting systems and the cash-based accounting system to the accrual-based accounting system, which provides more detailed information to users and managers (Aydın & Akdoğan, 2019, p.2).

The Effect of Change in Public Administration on Government Accounting and Budgeting

Government accounting and financial reporting aims to protect and manage public money and discharge accountability. In traditional public administrations, the central role in public sector accounting systems is the national budget. While national governments are unique and sovereign institutions in political terms, the budget expresses a national government's sovereignty in financial terms. It is an instrument of fiscal policy on revenue and spending to achieve macroeconomic objectives, which should provide benchmarks for performance measured partly by the accounting system. Due to this close relationship, 'it is often difficult to tell where budgeting ends and accounting begins'. Their complicated relationship may be seen in differences that reflect in focus, time perspective, conceptual model, recording system and measurement method, although they both produce financial information (Jovanović & Vašiček, 2021, p. 99).

In the New Public Management model, the primacy of politics gives way to the primacy of management, whereby the principles and tools put the latter at the centre of the process of

change. The New Public Management finds practical and actual implementation through the introduction and development of managerial and accounting tools, often focused and tailored on managerial needs and influenced by economic and managerial rationality: output-based budgeting, accrual and resource accounting, annual reports, extended performance measurement and reporting, managerial control systems, balanced scorecards, etc. The focus of accounting tools and processes gradually shifts from spending power and incremental budget allocation to costs and revenues, assets and liabilities, definition of goals in terms of outputs, and efficiency and effectiveness. Accounting tools become the fundamental means through which managers or external agencies and bodies are made accountable for the results attained (Liguori vd., 2012, p. 906).

Accrual Based Budgeting

A government accounting system's goals are to provide the information needed for budgetary planning and the monitoring of its execution in accordance with legal and budgetary constraints, as well as information for managing and supervising the operations of individual state entities and the state as a whole and to provide the information necessary for macroeconomic management (Jovanović & Vašiček, 2021, p. 105). Presentation of budget information in financial statements is a feature of public sector reporting. A public sector budget is a parliamentary mandate and a report to the public at large. Thus, budget plays an essential role in governance. Parliaments around the world pay more attention to budgets than to financial statements. Budget systems were in place long before financial statements were introduced in the public sector (Van Schaik, 2021, p. 1).

The International Public Sector Accounting Standards Board (IPSASB), the international standard-setting body for public sector financial reporting, issued IPSAS 24 Presentation of Budget Information in Financial Statements in 2006 for entities that prepare their financial statements in accordance with IPSAS and make their budget publicly available. IPSASB requires these entities to include certain budget information in the financial statements. IPSASB does not impose any obligations on entities regarding the preparation of budgets because budgeting is considered to be outside IPSASB's mandate.

One way of classifying budgets is by the accounting process used to allocate resources. When budgets are allocated in this way, some budgets record government expenditures at the time of payment (cash basis), while others record expenditures at the time of the transaction (accrual basis). In cash budgeting, income and expense are recorded financially when cash is added to or received from the safe. In this scenario, the date of the event that created the transaction is not important. Allocating resources on a cash basis means that budgetary authorization of expenditure effectively corresponds to the outflow of resources of equal value. For the vast majority of government transactions, falsification of financial information usually does not involve significant amounts of money, given that the time elapsed between the activity occurring and the financial transaction is relatively small (Blöndall, 2004).

In accrual budgeting, on the other hand, there are differences in some criteria regarding the recognition and valuation of assets, liabilities, incomes and expenses. In this budgeting system, accrued accounting records and measures are used in the budgeting process (Martí, 2013, p. 33). In accrual budgeting, it is no longer focused on how much money will be spent, but on how much cost (accrual) can be realized. The introduction of accrual-based budgeting in the public sector is one of the most important innovations in government accounting.

Benefits of Accrual Budgeting

Proponents of accrual budgeting point to many specific benefits of this budgeting system. One of the main goals that motivated the introduction of the accrual basis in the public budget was to make the public budget more transparent and to improve the efficiency of public spending and accountability. Transparency is achieved because by considering the expenses incurred at the time of the money-generating event with the time during which the financial asset is disbursed being insignificant, one can obtain the real cost of government action allowing one to compare the cost of the activity if undertaken by the government and the cost of outsourcing the activity. Therefore, accrual budgeting acts as a decision tool for managers and as a way to measure results (Monteiro & Gomes, 2013, p. 106).

In accrual budgeting, decision making is achieving sufficient cost. When making decisions, only cash expenditures will no longer be taken into account. Decisions will be such that they are used more than expenditures. Second, planning a budget is also undertaking the activity that is planned and pays for the money. The financial impact of the budget also details the reporting periods. There will be more information checks for administrators. The budget accrues salaries for certain salaries (employee retirees, interest public debt, etc.). Accrual accounting places a premium on confidence in audits and a willingness to accept fluctuations in valuations. Practice in Australia and New Zealand has shown that the use of accruals in the budget has led to a better realization of future unfunded liabilities, better infrastructure management and a more efficient budget reallocation process (Athukorala & Reid, 2003, p.24).

Challenges of Accrual Budgeting

The most striking, and also most often used, argument is that cash budgeting is a concept allowing easy and well-functioning planning and control of monetary spending of government. For centuries, governments used to formulate and execute a budget covering all expenditures and all revenues expected for the budget year. Comparing cash-based appropriations with the actual cash outflow is easy and clear in this case. In contrast, in the case of accrual budgeting the control of spending by the Ministry of Finance (or another responsible ministry) would be more ambiguous because sector departments have more discretion to determine their expenses (for example, regarding to depreciation of assets). Therefore, the risk of overspending may be higher in the accrual case than in the cash budgeting case. A related argument is that the cash budgeting concept is more clearly focused on the authorisation function of the budget: the legislation authorises the government to spend certain expenditures (Reichard & Van Helden, 2016, p.52-53).

Extending accruals to budgeting is controversial. Much of that controversy arises from the government administration itself and Parliaments. Before this change is contemplated, a significant amount of time needs to be invested in educating and consulting with government managers and other interested groups, like parliamentarians. In those countries that have adopted accruals, the change has been linked to other public management reforms (Athukorala & Reid, 2003, p.24).

It must be recognized that budgeting is, by its very nature, a political act. Due to their technical nature, accruals can confuse decision makers and reduce transparency and clarity, and thus parliament's role in the budget process. Australia, the United Kingdom and New Zealand were the first countries to adopt a full accrual basis for both financial reporting and appropriations. These three countries that accept the accruals are the Westminster countries that give priority to the executive in budgetary matters and a limited role to the Parliament (Blöndall, 2004, p.116). In the Westminster-style parliamentary countries, reforms have progressed more and faster than in other countries, and the main reason for this is thought to be constitutional. In the

Westminster system, reforms that devolve more powers from the legislature (parliament) to the executive branch (government), which already has significant financial powers, may not be perceived as a major change. Accrual budgeting and financial reporting change the financial information available to the legislature and the public. It is argued that this will also change the balance of power and reduce the control of the legislature over the executive government (Newberry, 2015, p.112).

Conclusion and Evaluations

Budgeting has an important role for public institutions. A large part of a nation's income is allocated and managed through public budgets. As both resource providers and service recipients, citizens deserve access to comprehensive, easy-to-understand, forward-looking, and both financial and non-financial information to properly and fairly evaluate the actions of politicians and public sector management. In order for government accounting to provide reliable and true information, changes in accounting practices have been encountered over time. States have switched from cash-based accounting system to accrual-based accounting system with the new public management approach. Except for a few countries (New Zealand, Australia, and the United Kingdom), very few countries reflect this change in their state budget record-keeping systems.

In this context, many countries of the world, especially European countries, have started to work on the accrual budget system. Although cash-based budgets are currently being prepared by public institutions in Turkey, it is stated by the Strategy and Budget Directorate, which is affiliated to the Presidency, that they will be prepared on an accrual basis in the near future. In the part of the work to be done after the transition to the program budget system, which was started to be used in public administrations within the scope of the central government in 2021, information on "Starting studies on the accrual-based budgeting system so that the risks and liabilities for the future period can be seen more clearly" are included (T.C. Cumhurbaşkanlığı Strateji ve Bütçe Başkanlığı, 2022). Considering the planning and studies on making the budgets of public institutions on an accrual basis in the coming years, academic discussions and studies on accrual-based budgeting gain importance for Turkish public financial management. The benefits or challenges of accrual budgeting for public financial management should be emphasized. In this study, the possible positive and negative effects of adopting accrual budgeting on public financial management are revealed. In the literature, accrual budgeting is still one of the most controversial issues in public accounting.

In government accounting records, all financial transactions are accounted for as soon as they are accrued, while the government budget is kept according to the cash-based accounting system. Although the realization of the implementations according to these two different recording methods may seem like a contradiction, the main reason for recording the economic events that are accounted on an accrual basis and concerning the budget of that year on a cash basis is to be able to determine the budget realizations. Because the state budget is a savings for estimating expenditures and revenues for the relevant fiscal year. Thanks to the use of the cash-based registration system in the state budget, it is possible to monitor the activity results and budget realizations together with the results. In this way, the state budget becomes an auxiliary tool for decision makers (Ağdeniz & Küçükaycan, 2021, p. 372-373). But cash budgeting provides information to assess only the short-term economic impact on fiscal policy. Accrual-based budgeting is needed to assess future financial impacts. Therefore, accrual and cash basis in budgeting should be seen as complementary rather than competing methods, and accrual budgeting should be started after necessary reforms in public financial management.

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