What is the Accrual Budgeting and its Advantages and Disadvantages
Overview

Content

• What is accrual budgeting?

• Advantages and Disadvantages

• How to implement?

• Conclusion
What is accrual budgeting?

As analyzed by OECD (2016)

- Differentiate between
  - Accrual forecast: i.e. forecast of accrual financial statements
  - Accrual appropriations: i.e. budget appropriations are made on accrual basis
- Only accrual appropriations is «full accrual budgeting»
  - However, some cash budgeting countries include partial accruals
  - Yes, some accrual budgeting countries include only partial accruals
- Bottom line: Different shades of grey!
What is accrual budgeting?

Limited use globally: Only 7 countries use it in full, i.e. appropriations include all accrual elements (in alphabetical order)

- Austria
- Australia
- Canada
- Estonia
- New Zealand
- Switzerland
- UK

- Partly accrual: e.g. Chile, Denmark, Finland, Sweden, USA
Political vs managerial rationale

• Political rationale
  • Traditionally focussed on cash («spending on behalf of voters»)
  • Increasingly interested in cost of service and productivity

• Managerial rationale
  • Focus on efficiency and effectiveness
  • Use of capital
What is accrual budgeting?

Integrated Public Financial Management

Budgeting  Accounting  Audit  Governmental Financial Statistics
### What is accrual budgeting?

**Reconciliation between Budget and Financial Statements matters**

**Switzerland: Federal Budget and Federal Financial Statements**

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<thead>
<tr>
<th><strong>Budget</strong></th>
<th><strong>Financial Statements</strong></th>
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<td><strong>Federal Financial Statements</strong> (Vol. 1-3)</td>
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<td>- Report on the Budget (Vol. 1)</td>
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What is accrual budgeting?

It’s not «cash or accrual budgeting», it’s «cash and accrual budgeting»

Switzerland: Budgetary credits

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<tr>
<th>Types of credits (cash basis)</th>
<th>Types of credits NRM (accrual basis)</th>
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<tr>
<td>Part SC Service charges</td>
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<tr>
<td>Part WOFE without cash effects (e.g. depreciation)</td>
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<tr>
<td>Part FE cash effects</td>
<td>Part FE cash effects (e.g. salaries)</td>
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Acronyms:
SC = Service Charge
FE = Financial Effects
WOFE = Without Financial Effects
Advantages and Disadvantages

Little to no empirical work

- Scholarly work is rare
- If you find some, it’s descriptive (e.g. Brusca et al, 2015; FEE/Caperchionne, 2007)
- Anecdotal evidence for both advantages and disadvantages, but no statistical data
Anecdotal advantages

- Coherence between budgeting and accounting
- Build and use of wealth is mirrored
- Investments are not treated the same as consumptive expenditure
- Lesser likelihood of political cycles because spending of wealth/equity is monitored
- Cost of provision of services is visible in budget: Essential for performance budgeting
Anecdotal advantages

- Performance budgeting and Cost of provision of services
- State of Zurich High School System
  - Before performance budgeting
    - Cost unknown, deemed to be the same at all schools because of identical curricula
    - Full accrual based costing shows gap of 250% between cheapest and most expensive
    - Adjustment towards standardised cost somewhere around 120% for all
Anecdotal disadvantages

- Increase of complexity
- Little interest by politicians and economists
  - Resistance of macro-economists is based on Aggregate Demand Theory: Government spending (cash) is part of Aggregate Demand (AD) in macroeconomic theory
  - Important part for AD-AS (and consequently IS-LM) models
    - (However, there are other question marks to AD-AS and IS-LM … such as liquidity preference assumption)
- Resistance to change
Evolution, not revolution

- Cash information is still available in an accrual budgeting system
  - No need to scare users of cash information!
- Cash and accrual budgeting can run in parallel

- Show value of accrual budgeting, e.g. in service costing and performance budgeting
- Political and Managerial logic in parallel

- Make it the main model only once value has become visible
- Use it for management of assets and liabilities
Final, most advanced step: Management of assets and liabilities

- Example of New Zealand:
  - 2017: «Investment report» becomes main financial report. It examines the balance sheet of the government including the changes to the balance
  - Classifies (by function) all assets and liabilities in three groups
    - Social: To provide services to citizens and enterprises
    - Financial: To manage financials of the government
    - Commercial: For profit

This value amounts to nearly $65,000 in assets and $41,000 in liabilities for each person in New Zealand.

Defence $7.4 b
Conservation $6.6 b
Higher education $12 b
Justice $6.1 b
Health $7.6 b
Highways $35 b
Housing New Zealand $25.9 b

What’s an asset?
Government assets are the things government owns. They include buildings, infrastructure and land, as well as funds to support our accident compensation and superannuation schemes.

Source: NZ Treasury, 2018
How to implement?

Final, most advanced step

– Example of New Zealand:
  – Management of Assets and Liabilities through the three functions

Source:
NZ Treasury, 2018
• The question is not cash or accrual budgeting. It’s cash and accrual budgeting!
• Accrual budgeting is more important for managers than for politicians, but politicians increasingly need it, too
• Initially, the main use of accrual budgeting is for service costing
• Later, it can also be used for the management of investments or assets and liabilities in general
• Anecdotal evidence is mainly positive, with main criticism from classical (aggregate demand) macroeconomists – however, cash information remains available for them