Accrual Budgeting: The Pitfalls

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Outline

- Constructs of the cash budget system of government
- What is an accrual budget then?
- What would be different?
- Does accrual accounting necessarily imply a move to accrual budgeting?
- Selected benefits of accrual budgeting
- Other fiscal policy and management considerations
- Selected data issues
- Discussion

Constructs of the cash budget system of government

The budget must assure -

- Fiscal sustainability; and
- Fiscal stability (promotion of macro-economic stability through managing financial impact of government operations)

Of primary concern – the annual cash flow deficit, its impact on debt and the sustainability of tax and expenditure policies

Policy choices → revenue, expenditure and debt implications

Spending authority (limits) → appropriation in law

Budget execution → expense control totals track payments against limits set law

Annual lapse of spending authorities

What is an accrual budget then?

Accrual = basically to account for financial impact of transactions / events when they happen, and not when cash actually flows

Not a normal budgetary term from a financial management perspective – even developing a good cash flow budget would depend on accrual information

Do we mean an "operating" budget (in normal financial management terms)? If indeed -

- The expense control totals now need to track expenses on an accrual basis, and not on a cash flow basis; and
- Any resulting deficit can no longer be interpreted as a cash flow deficit, but only as a measure of the extent to which revenues cover operating costs (including costs incurred today but not yet paid).

What would be different?

Expense control totals now track expenses on an accrual basis – e.g.

- accounts payable for goods / services received
- inventory used counted as expense, irrespective of when purchased
- depreciation of fixed assets, etc.

Such “new” expenses items need to be budgeted, limited as need be and appropriated in law

The budget no longer presents a cash deficit / surplus

It may appear that direct control over cash outcomes will be lost

Ex-post monitoring of ministry accounts becomes extremely important

Should non-cash expenses (such as depreciation) be funded?

Does accrual accounting necessarily imply a move to accrual budgeting?

- Does having a balance sheet and income statement mean we don’t need a cash flow budget or controls?
- No
- Options:
  - Continue to appropriate and control cash, and report cash expenditures in a budget execution report only (i.e. not in the “statement of financial performance”)
  - Include non-cash expenses in budget, but don’t appropriate cash for them – budget would present full accrual costs and cash required. But what about items such as accumulated depreciation? Does this become a “right to capital spending”?
  - Or should non-cash expenses be funded, with control over Ministries’ use of cash surpluses? And how will capital acquisitions then be handled?

Selected benefits of accrual budgeting

Matching of revenue and expenses to more accurately determine cost of operating government

Improve the costing of services / products

Improve the management of assets, and working capital (debtors, creditors, stock)

Better view on impact of decisions on long term sustainability of public finances

Catalyst for performance orientated management reforms

Other fiscal policy and management considerations

Views on accountability

- Revenue, expenditure, assets and liabilities
- Service delivery performance
- Control over public entities

Dealing with "new" financial liabilities and assets, inventory and PPE

- develop the necessary accounting policies
- determine the impact of newly disclosed financial liabilities and assets, inventory and PPE on fiscal stance
- review current accountabilities and develop regulations for the financial management of newly disclosed financial liabilities and assets, inventory and PPE
- develop a financial liability management framework for public entities, other statutory funds and other spheres of government

Other fiscal policy and management considerations

Maintaining the focus on fiscal balance over time by limiting cash deficits

Be clear and careful with “deficit” measures –

- Cash deficit measures ability to finance all cash outlays in a financial year with the cash revenue raised in that same financial year (net financing need)
- Accrual deficit measures annual operating cost, including costs that are incurred today but not payable for years to come

Consider the interpretation and guide the use of at least the following new measures for the consolidated budget entities –

- net debt (financial assets minus financial liabilities);
- change in net debt from year-to-year;
- surplus / deficit in the Statement of Financial Performance; and
- accumulated surplus / deficit

Consider the interpretation and guide use of the new measurements also for the consolidated accounts

Selected data issues....

Find ways to minimize the cost associated with obtaining opening balance data for property, plant, equipment and other infrastructure.

IPSAS - disclosure requirements need not be satisfied if the information is not material

Accounting policies should be developed to respond this requirement, which may mean that for certain classes of fixed assets, such as equipment that will fully depreciate during the period of data collection, historical cost data will not be required and that government can start to account for such assets from a future date onwards.

For other classes of property, plant and equipment, IPSAS 17 also determines that it should only be recognized as an asset if – (i) it is probable that future economic benefits or service potential associated with the item will flow to the entity; and (ii) the cost or fair value of the item can be measured reliably.

Find the trade-offs and agree the approach with the Auditor-general

Thanks for your time!

QUESTIONS?