



School of
Management and Law

What is the Accrual Budgeting and its Advantages and Disadvantages



Building Competence. Crossing Borders.

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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

What is accrual budgeting?

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



Budget		Financial Statements
Federal Budget (Vol. 1-3) <ul style="list-style-type: none">Report on the Budget (Vol. 1)<ul style="list-style-type: none">– Comment– Budget<ul style="list-style-type: none">– Budget Cash Flow Statement– Budget Income Statement– Notes– Indicators– Proposed resolutionBudget of Entities (Vol. 2)Explanation and Statistics (Vol. 3)	Supplementary budgetary appropriations I / II	Federal Financial Statements (Vol. 1-3) <ul style="list-style-type: none">Report on the Financial Statements (Vol. 1)<ul style="list-style-type: none">– Comment– Financial Statements<ul style="list-style-type: none">– Cash Flow Statement– Income Statement– Balance Sheet– Notes– Indicators– Proposed resolutionFinancial Statements of Entities (Vol. 2)Explanation and Statistics (Vol. 3)
Separate Budgets (Vol. 4)		Separate Financial Statements (Vol. 4)
Medium-Term Expenditure Framework (Vol. 5)		
		Audit Report

What is accrual budgeting?



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

Switzerland: Budgetary credits

Types of credits (cash basis)	Types of credits NRM (accrual basis)
	Part SC Service charges
	Part WOFE without cash effects (e.g. depreciation)
Part FE cash effects	Part FE cash effects (e.g. salaries)

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

Advantages and Disadvantages

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

Advantages and Disadvantages

Anecdotal advantages

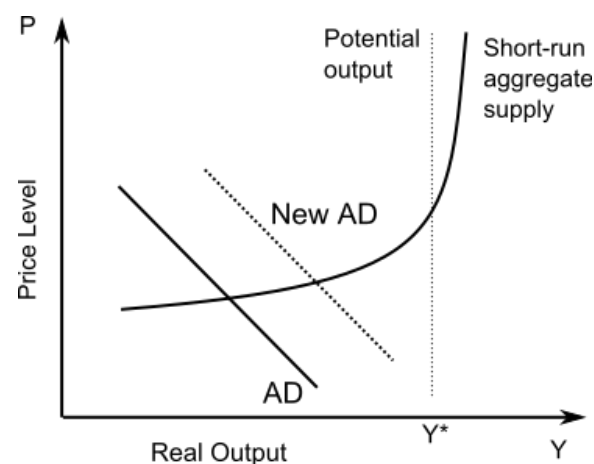
- Performance budgeting and Cost of provision of services
- State of Zurich High School System
 - Before performance budgeting
 - Cost unknown, deemed to be the same at all schools because of identical curricula
 - Full accrual based costing shows gap of 250% between cheapest and most expensive
 - Adjustment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



Advantages and Disadvantages

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



How to implement?

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

How to implement?

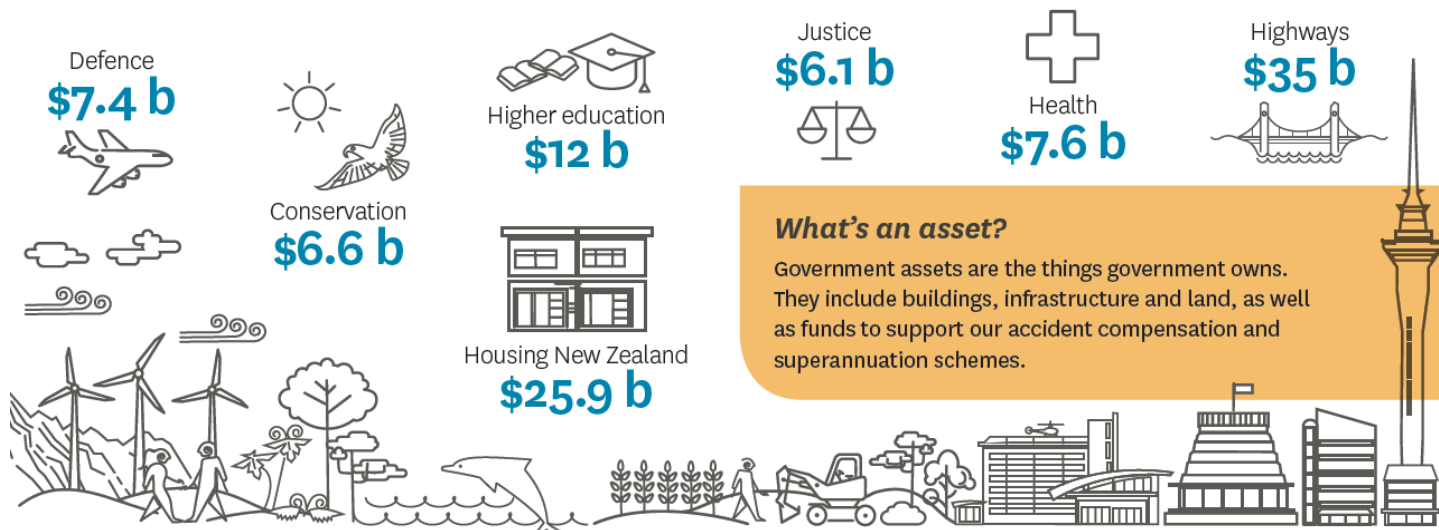
Final, most advanced step: Management of assets and liabilities



– 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.



Value of assets in 2017, NZ \$ billions.

Source:
NZ Treasury, 2018

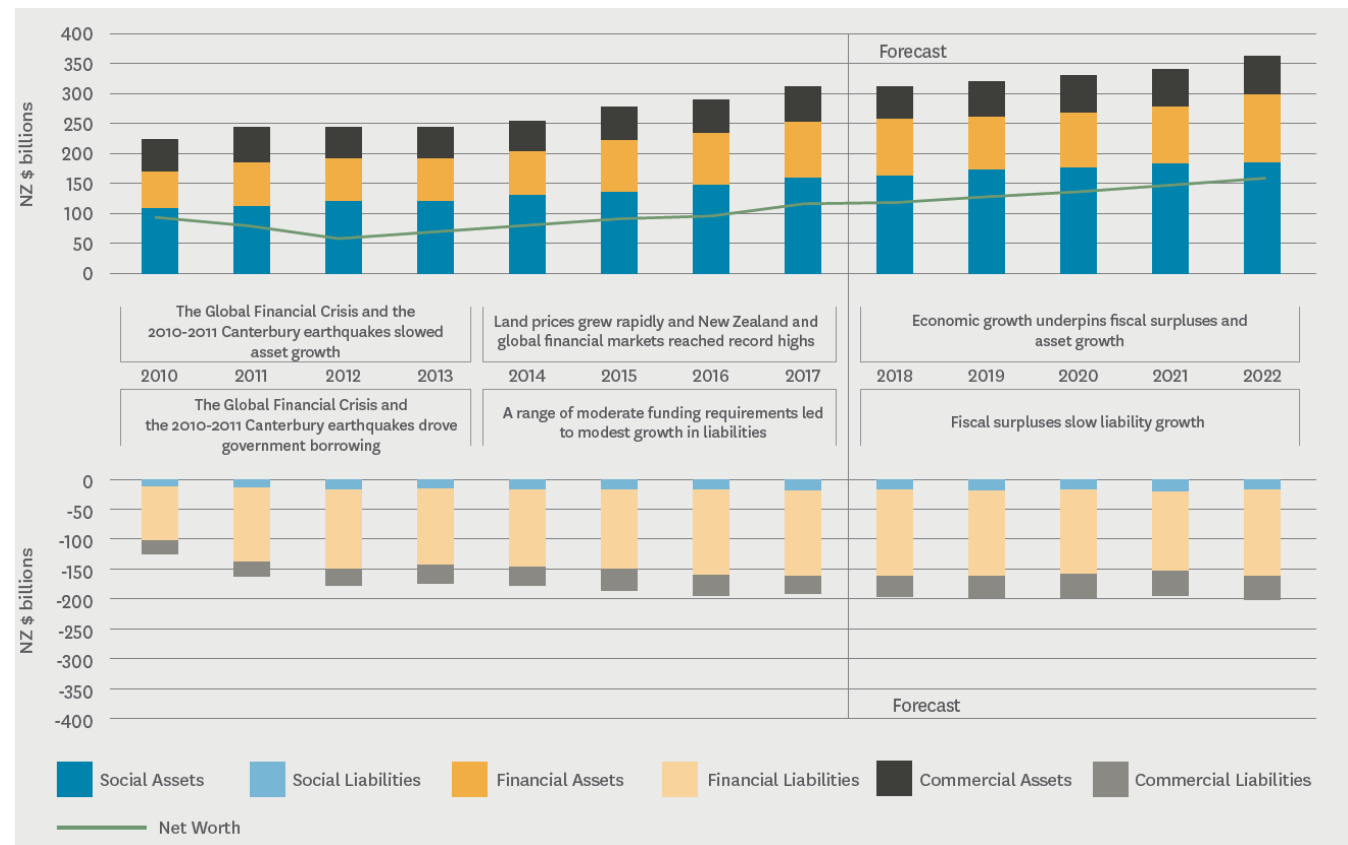
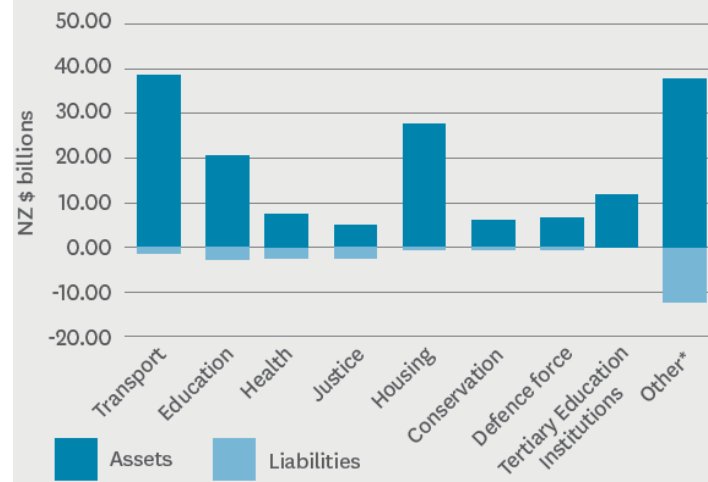
How to implement?

Final, most advanced step

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



Social assets and liabilities by sector



Source:
NZ Treasury, 2018

Conclusion

- 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