

Better Financial Information for Better Decision Making

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INTRODUCTION

Accrual accounting is a method of recording financial transactions where the full characteristics of those transactions are recorded in the period to which they relate. Cash accounting simply records the cash effects of a transaction in the period in which they occur.

Accrual accounting is the accepted method of accounting worldwide for the private sector and now, increasingly, the public sector.

Many governments in Europe and worldwide have now adopted accrual accounting. Furthermore, the European Commission has recently completed a project to introduce accrual accounting for its own financial statements from 2005 onwards.

This paper provides a short briefing about why accrual accounting is so widely accepted and describes the benefits it offers to those involved in the political process.

WHAT IS ACCRUAL ACCOUNTING?

Accrual accounting is a method of recording financial transactions whereby matters relevant to a period are recorded in that period and a comprehensive statement of the position of the organisation at the end of that period can be prepared.

Accrual accounting helps governments obtain a better picture of the performance of their policies. In particular it reports on revenues earned and resources consumed in a period. Previously under the cash accounting regime only moneys received and paid were recorded, which was of limited value for assessing performance.

WHY IS ACCRUAL ACCOUNTING BETTER?

Accrual accounting facilitates better planning, financial management and decision making in government as well as a robust and accepted way of measuring the economy, efficiency and effectiveness of public policies.

Further, accrual accounting allows accurate comparison to be made between different governmental organisations both nationally and internationally. It also facilitates comparisons of public sector with private sector organisations.

REAPING THE BENEFITS

In many countries, however, the full benefits of accrual accounting have not yet been realised. This is because it is often not being used to its full potential. For this to change, positive political will and support and cultural change are needed so that public sector bodies can begin to see the advantages of making full use of the methodology. Politicians must also feel able to make their decisions based on the accurate and comprehensive information that accrual accounting provides.

STANDARDS AND PRINCIPLES

It is worth noting the key principles and rules underpinning accruals account:

- Income is only recorded when it becomes due rather than when it is received;
- Expenditure is only recorded when it is incurred rather than when the cash goes out;
- Assets should only be included where they clearly belong to the organisation and have potential to provide service benefit;
- All likely liabilities must be included;
- Information must be recorded in the correct period and must be consistent period to period;
- The question of whether an organisation is solvent must be reflected.

THE ROLE OF THE AUDITOR

Financial statements must be prepared in line with the above generally accepted accounting principles and in accordance with accepted financial reporting standards. Part of the duties of an auditor is to check that financial statements have been prepared in accordance with these principles and standards. Auditors themselves must abide by professional standards in completing this work.

Other duties of an auditor in the public sector are to check compliance with regulations and often to check on the veracity of reports of budget outturns.

UNDERSTANDING ACCRUAL BASED FINANCIAL STATEMENTS

Despite the benefits of accrual accounting, there is a risk that its introduction, whilst providing more complete information on financial performance and position for those who have sound accounting interpretation skills, might actually make financial statements more difficult to understand for those who do not have such skills. For instance, commonly used terms such as “assets”, “liabilities”, “income” and “expenses” can mean little unless they are properly explained.

Unless users understand material prepared on an accrual accounting basis, they may not be in a position to understand, comment and act upon it. In the government sector, this means that, when suitable arrangements are made, there is a danger that the legislature will not be in a position effectively to hold the executive to account and the executive will not be so able to defend its position robustly.

However, accrual accounting can easily be presented in such a way that non accountants can understand its key messages. There is therefore a need to insist, as a decision maker, that the information is presented so that the key features of that information can be readily identified. In particular, it is vital that key performance information is highlighted.

CONCLUSION

Accrual accounting is generally accepted as the most accurate and comprehensive way of preparing accounts.

However, in government, the full benefits of accrual accounting have not yet been realised. Part of that realisation involves decision makers relying more on the information provided by accrual accounts for their decisions. To do this, the information must be prepared in a clear and comprehensive format. This in turn will enhance the decision making process and the role of the legislator.