

## EVOLUTION OF THE ACCOUNTING SYSTEMS OF THE BUDGET SECTOR

*Traditional management of the budget sector, focused on the execution of a budget as a main financial plan of the state and a local government unit for a given year, is related to a cash basis accounting system. The change in the public sector management methods, caused mainly by the NPM, but also by other economic and political factors (such as high budget deficit, growing public debt, low or even negative GDP growth, high unemployment, negative results of public opinion polls), resulted in the development of the accrual accounting systems. Because of the specific features of this sector, connected with limited possibilities of applying economic yardsticks, emphasis has been put on the implementation of audits, being a tool that contributes to a proper resources allocation, in accordance with the “3-E” principle*

**Introduction.** According to R. Mattessich the shape of a particular system of accounting in every case is subordinated to the assumed purpose and scope of the necessary information (Gierusz, 2005, p. 14). The final design and structure of the accounting system is, on one hand, a derivative of requirements and specific tasks imposed to the system, on the other hand – a consequence of factors specific for a particular environment, and especially of legal regulations binding in a given state (Elliott, 2005, p. 134, Nobes, Parker, 2000, p. 19). The following article presents the development of accounting systems in the core part of the public sector, i.e. in the budget sector. A short characteristic of the evolution of governmental accounting systems shows that the main, but not sole, stimulator of their transformation is a change of the approach towards the management of the sector, creating the new demands with regard to information, placed on accounting.

This article has been created in the framework of research conducted by the author, seeking to answer the question: which of the accounting systems meets the needs of the budget sector in the best way.

1. The traditional way of managing the public sector and the accounting system based on cash principle

In the government sector the traditional government accounting system (TGAS) is based on cash principle. For many years it was connected with the administration of public resources – and this is the origin for its English designation: the Public Administration System (PAS) (Ouda, 2004, p. 86) – and with a budget based on “classical” budget principles (Owsiak, 2006, p. 122-126, Ziółkowska, 2000, p. 75-78).

PAS system was a highly centralized system. It was focused on the execution of instructions (especially in developing countries), on conforming to written rules and regulations restricting the independence, it rewarded docility and created risk avoidance, but on the other hand it did not require responsibility. Its main feature was the focus on inputs rather than on results of operations. In this system, there was no link between inputs and results of operations, expenses were more important than the costs incurred. The role of the officials (administrators) was reduced to filling instructions. They had also no impact – or incentive to make the impact – on the way of management by increasing the efficiency of units subordinated to them. The assessment of their activities did not include the results and their performance, costs incurred, and the relationship between inputs and the results obtained, which can be regarded as a measure of productivity, and between productivity and results, i.e. the measure of efficiency.

The accounting system associated with this way of managing the public sector focused mainly on the basic terms of the budget: the plan of budget revenues and expenditure for a given year, and more specifically the cash execution of the planned amounts. In this perspective, the transactions are disclosed in the accounts only when the actual inflow of cash to a bank account or payment takes place. According to the cash principle the purchased goods and services are treated as consumed (used) only when they are actually paid. This means that in the accounting based on a “clean” cash principle only payments made and the level of funds on a bank account are recognized.

Objections lodged to the cash accounting model (the main ones are the following: a small range of information provided and the possibility to manipulate the result of the implementation of the budget) have become the reason for its modification and the development of an intermediate model between the cash and accrual model – the so-called modified cash basis accounting). Measured in this model are both operations and the level of cash, as well as any steps preceding the change in their balances, i.e. receivables and liabilities. In addition, steps preceding the creation of commitments, i.e. all occurrences legally committing budget funds for expenses, may also be disclosed (this approach is called commitment cash basis accounting).

Taking into consideration the limitations of the cash accounting mentioned above, one may ask why the governments of most countries continue to use the cash accounting principle? It seems that the answer should be associated with many factors of different impact strength, including political aspects, tradition, the resistance against changes, as well as the lack of adequately trained personnel. Moreover, the cash accounting model allows for creating a result of operations according to the needs of decision makers. Politicians can present positive results of their efforts or easily reduce their negative effects showing, for example, that (Hillier, p. 13):

- the budget deficit is smaller than in reality,
- the planned limit of expenses is not exceeded,
- the increase in overall expenditure is smaller than actually performed.

On one hand, the cash accounting is subject to justified criticism, on the other – one should also emphasize its advantages. A synthetic presentation of advantages and disadvantages of cash accounting and its modified form is shown in Table 1.

**Table 1. Advantages and disadvantages of cash accounting and its modified form**

<i>Cash accounting model</i>	
<i>Advantages</i>	<i>Disadvantages</i>
<ul style="list-style-type: none"> <li>– cohesion with the cash way of budgeting</li> <li>– simplicity and comparability of cash information</li> <li>– ensuring efficient monitoring and control of the budget execution</li> </ul>	<ul style="list-style-type: none"> <li>– a narrow range of information covering only the cash flow and cash balance</li> <li>– the possibility of creating a result of the budget</li> <li>– lack of information for a rational management of public resources</li> <li>– insufficient information for the society about the actual debt</li> </ul>
<i>After the modification of the cash accounting model</i>	
<p>Additionally:</p> <ul style="list-style-type: none"> <li>– control of assets and liabilities of the budget, making possible debt management</li> <li>– available information on the commitment of funds for budget expenditures of a given year and the forthcoming years</li> </ul>	<p>Still:</p> <ul style="list-style-type: none"> <li>– the scope of information does not provide a basis for rational management of all resources</li> <li>– lack of data on costs prevents the evaluation of the activities</li> </ul>

Source: Zysnarska, 2010, p. 39.

## 2. New Public Management as a main reason for the development of the accrual accounting

The development of market economy, and first of all the decentralization of government authority associated with the transfer of some public functions to local self-management authorities and the changing philosophy of the budget sector management, have increased the information requirements posed to accounting. In addition to the traditional control of legality and compliance of activities with the budgetary plan, the need of managing units belonging to this sector in accordance with the "3-E" principle (economy, effectiveness, efficiency) was recognized and stressed (Isaac-Henry, Painter, Barnes, 1993, p. 6). The budget sector accounting faced new challenges of measuring and monitoring the performance of budgetary units, taking into account the control of the effective, efficient and responsible spending of public funds.

New goals of accounting in the budget sector, commonly used in accounting for the private sector, were associated with (Śnieżek, 2003, p. 69):

- 1) a clear identification of objectives and results of a unit's operations,
- 2) the introduction of the principles of their measurement,
- 3) comparing results with established objectives.

The consequence of the new way of managing public resources, defined as the New Public Management (NPM), has also been the emergence of managerism in this sector. According to C. Hood the changes caused by the New Public Management, were the following (Hood, 1995, p. 95):

- clear definition of the public sector entities and the introduction of the principles of delegation and autonomy,
- the introduction of more competitiveness in the public sector and between the public and the private sector thanks to lowering costs,
- raising the quality of management in the public sector units, to the level present in the private sector,
- cost-effective allocation of resources,
- managing with more responsibility, including clear definition of the new "responsibility", based on the rejection of the traditional bureaucratic system and on more emphasis on the implementation of tasks in a way allowing for the measurement of performance results and / or their benchmarking with certain standards,
- systematic monitoring of results.

I. Lapsley and J. Pallot (Lapsley, Pallot, 2000, p. 216) characterized the NPM in a concise form as "highly reasonable actions, in which choices results from objective and factual analysis of the valuation of different alternatives; the management of an organization is based on managing resources (material and human ones), performance control in order to induce units to work in the interest of the organization, and the objectives are the key dimension needed to measure the performance results of the individual units, subsidiaries, and the entire organization".

However, the prerequisites for the NPM were not always possible to apply in the public sector in its entirety. For example, „The Efficiency Unit”, set up in the Great Britain by the government of M. Thatcher in the framework of introducing the managerism principle to the public administration has focused – according to its critics – on the savings in expenses rather than on implementing tools to improve operating efficiency (Isaac-Henry, Painter, Barnes, 1993, s. 9). Nevertheless, it was important to observe the principle of "value for money" wherever it was possible to reduce the cost of services rendered. Consideration of the "3-E" principle in the units operations was intended to

change the way of managing public organizations, and thus to increase their efficiency, which in their case depends more on organizational and managerial factors, than on market forces.

It should be noted, however, that this is not the only cause of the evolution of accounting systems. The implementation of the system on an accrual basis was also induced by other factors. Results of research conducted under the direction of K. Lueder on so-called the Contingency Model (Buschor, Schedler, 1994, p. 1) have shown that often the catalysts for the change in accounting systems are problems, both economic and political ones, faced by state governments, such as: high fiscal deficits, growing public debt, low or even negative GDP growth, high unemployment, and a fall in government acceptance in public opinion polls.

In addition to endogenous factors, the change in the accounting system is also affected by the requirements of external institutions or international organizations to which the country aspires to membership.

Reforms of the accounting system can also be stimulated by financial scandals and the fact that the government authorities make use of various accounting and reporting systems (this is so-called fragmentation of the government's accounting system). The fragmentation of the accounting system makes it impossible to obtain a full, accurate picture of the financial situation of the entire government.

As a result of research by K. Lueder it was pointed out that, especially in countries applying for membership in the European Union, as well as in France, Spain and the UK, the driver of the reforms was the willingness to show a given country as a modern and progressive state and the need to ensure the reputation of the sector public versus the private sector. The propensity to undertake reforms is seen as an advantage in the competition among countries. The more countries take the reform, the more pressure will be felt by others.

Among the factors affecting the change in the accounting system, some authors also enumerate requirements posed by aid institutions, auditors, and to a lesser extent by the capital market. Such aid institutions as the World Bank and the International Monetary Fund are able to impose certain requirements with regard to accounting for those countries which are interested in obtaining a financial support. Lueder studies have shown, however, that the requirements of aid institutions are not a stimulator of accounting systems reforms in the countries benefiting from this aid (Lueder, Jones, 2003, p. 46).

In consequence of the factors mentioned above, the implementation of accounting systems, based on full or modified accrual basis, has taken place in the public sector. (The modified accrual accounting model does not show a gradual depreciation of non-financial fixed assets because the value of the acquisition of such assets fully charges a financial result of a year).

It is understood that the essence of accrual accounting in general – irrespective of its sector – are basic standards (practices) of accounting, refined over the centuries, arising from the same and generally accepted principles:

- accrual principle,
- going concern principle,
- matching principle,
- prudence principle.

Apart from the above, there are also other universal principles that apply to accounting in general, i.e. to both cash and accrual model. These principles include the following: consistency principle, objectivity principle, materiality principle, offsetting principle and realization principle.

Given the nature of the budget sector, the status of the accounting principles should be presented in the following order (according to their importance):

- 1) accrual principle,
- 2) prudence principle,
- 3) going concern principle,
- 4) matching principle.

Comparison of the importance of the fundamental principles of accrual accounting in private and budget sectors is presented in Table 2.

**Table 2. Ranking of principles of accrual accounting**

Private sector	Budget sector
Accrual principle	Accrual principle
Going concern principle	Prudence principle
Matching principle	Going concern principle
Prudence principle	Matching principle

Source: Zysnarska, 2010, p. 46.

The form of the article prevents an exhaustive description of the principles of accrual accounting in the budget sector. Below only some specific aspects of their application in this sector are outlined.

The accrual principle ensures that all economic events that occurred during the period are recognized in the books, regardless of whether the cash balance has changed in connection with them. Compared to the cash model, accrual accounting provides for the recognition in books of all changes in the assets (the full disclosure principle). Finally, in the financial report a complete picture of the unit is presented, including: asset and financial position, financial results for the previous year, changes in net assets and cash flows. In turn, according to the disclosure principle used in accrual accounting, revenues should be accounted for in financial statements when:

- 1) they arise,
- 2) they are realized or realizable.

In principle, the fact of the creation of revenues is determined by the moment of the execution of sale. Revenues, however, are realized when the cash inflow takes place or when a right to receive a specified amount arises.

Enforcement of accrual accounting principles in the budget sector is becoming a problem, if one takes into account the fact that the budget revenues come from many different sources (from exchange transactions, and especially from non-exchange transactions, that is, for example, from taxes and transfers, donations, fines, fees, penalties). It should be noted that – unlike in the private sector – governments possess various resources in kind, often difficult to measure and evaluate. Equally difficult is the measurement and recognition in the books the increase of their value.

The essence of the prudence principle can be described briefly in the following way: “to disclose all the losses, but anticipate no profits”. In other words, according to this principle one should not disclose profits, until they are actually executed (made on cash basis), while losses should be disclosed when they are incurred. This principle is used in order to ensure a current real value of information presented in the financial statements. In the case of the budget sector the prudence principle is applied generally to the receivables of the budget and for the disclosure of the utilization of fixed assets undergoing systematic depreciation.

However, certain difficulties appear with regard to other public resources. The determination of their actual (current) value or the growth of the value, for the reporting is often very difficult and expensive, and in some cases impossible.

Going concern principle is of little significance due to political rather than economic, aspects of the functioning of the units belonging to the budget sector.

Also, applying the matching principle in the budget sector may be questionable. The essence of this principle is the net financial result being the difference between revenues and costs for the period. In the case of units that execute a budget such matching does not exist, because for their settlement a so-called gross principle has been adopted. The matching principle can be used in the budget sector only to assess the efficiency and effectiveness in meeting its public mission by the unit. In terms of results, accrual accounting will be used to determine if the entity has accomplished its goals and to assess inputs related to the goals.

In conclusion, it should be noted that the accrual accounting model should provide different stakeholders with comprehensive information about assets, liabilities, revenues, costs, financial results and net assets of an entity. However, they should possess knowledge about the specific conditions of the functioning of this sector.

### 3. Using the tools of managerial accounting

Compared to the private sector, in government units the establishment of links between inputs and results of operations may be difficult and often impracticable. It depends on both technical factors, arising from the nature of the tasks performed, and on political ones. Therefore, a basic measure of the legality of their activities and control of the execution of financial planning is still mainly a comparison of actual expenditure with the approved budget. Of course, there are attempts aimed at increasing the efficiency and effectiveness of operations through the implementation of the management methods used in the private sector such as task-based budgeting, ABC (Activity-Based Costing), balanced scorecard. Often, however, these actions are not preceded by any calculations based on a relationship between costs and benefits, which makes that these methods are not pursued in the longer term.

In the Polish government budget sector the implementation of the budget in a task-oriented layout was started in 2006. It has been assumed that for the first time in 2013 the state budget will be elaborated in parallel in two forms: the traditional and the task-based ones. For the year 2015 the elaboration of a report on the evaluation of the impact of a task-based budgeting in the public finance system is planned.

In addition, it should be noted that the specific environment of the public sector and in particular limited use of economic calculations caused the development of the internal audit function.

The internal audit function is located in an organizational structure of a unit, and it is aimed at an independent evaluation of its internal control system. It allows for and objective verification and reporting on the operation of internal control as an activity conducive to the proper, economic, efficient and effective (the "3-E" principle) use of resources of an organization (Gut, 2006, p. 105).

Starting from the seventies of last century, the audit system of the government reporting put particular emphasis on the need to verify if the financial transactions of governmental bodies (state and local government) are legitimate and economically beneficial, as well as effective.

**Conclusion.** In conclusion it should be noted that in the budget sectors in different countries most commonly there are dual accounting systems: in parallel with the traditional cash accounting systems, the systems based on the accrual principle are

present. Each of them is applicable in a particular area of the budget sector: the cash system is closely connected with the exercise of the state budget or a local government budget, and the accrual system, taking into account specific features of the budget sector, is connected with other areas of operations of units belonging to this sector.

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