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Accrual Budgeting—State of Play

Introduction

The Commonwealth delivered its first accrual Budget in May 1999. This Research Note outlines the nature of accrual budgeting and its role in broader public sector management reform. It also identifies some issues revolving around financial management skills and accountability.

What is accrual budgeting?

Under accrual budgeting, an agency is funded for an agreed price for its outputs, including non-cash items such as depreciation. Thus the amount an agency is appropriated in any one year may exceed its cash expenditure. Any unspent amount is accumulated for use in future years (e.g. to replace buildings and equipment).[1]

The Government points to the following benefits:

- the identification of the full costs of the goods and services agencies provide, and the resources agencies administer, on behalf of the Commonwealth, and
- the provision of the full information necessary to manage the financial position of agencies, including: information on assets and liabilities; income earned or expenses incurred during the financial year but not resulting in a cash transaction in that year; cash inflows and outflows; and consistent and streamlined reporting arrangements.[2]

How does accrual budgeting fit with other public sector management reforms?

Accrual budgeting was introduced in conjunction with the outcome–output framework and the devolution of financial management responsibilities to agencies. These changes are intended to provide agencies with the flexibility and the responsibility to meet the Government's objectives. Other reforms have also transformed public sector management (see box for an outline of the new framework).

What new demands does accrual budgeting place on Commonwealth non-commercial agencies?

The costs of implementing accrual budgeting vary from agency to agency.

Along with other elements of the new public sector management framework, accrual budgeting requires strong financial management skills from public sector managers.

In the words of the Auditor-General, 'Perhaps the biggest challenge for public service managers and accountants is to understand and then to use accrual-based information, including financial reporting data, for better program management.'[3]

The financial responsibilities of managers have been specified more clearly to include areas such as:

- measuring and ensuring effectiveness and efficiency, and
- using quantitative and qualitative performance information for planning, controlling, budgeting and reporting.

How are agencies meeting these demands?

Agencies' responses to these changes have been the subject of comment by the Australian National Audit Office (ANAO) and the Vertigan Report.[4]

In July 1999, the ANAO reported its findings from a study of seven agencies. It noted that line management and finance areas were generally not well prepared for the new financial management framework. General observations included the following:

- the financial responsibilities of managers were narrowly defined, leading to the provision of a limited suite of information,
- little evidence was found of managers using available financial information, including accrual-based data, for daily

The new public sector management framework

- emphasis on meeting performance objectives—for agencies via the outcome–output framework, and for employees via performance agreements
- accrual budgeting, accrual accounting, costing of outputs and capital use charges
- devolution of responsibility to agencies
- increased opportunities for outside organisations and individuals to provide services to, and on behalf of, the Commonwealth
- more flexible employment practices, and
- increased use of information technology and telecommunications (e.g. online services).

operations, strategic planning or performance management,

- finance areas were not generally well prepared for their new role of assisting managers to analyse and interpret financial information, and
- more training was required to assist managers to understand how to use accrual-based information to support the cost-effective achievement of outcomes.

In his *Review of Budget Estimates Production Arrangements,* Dr Michael Vertigan (former Secretary of the Departments of Treasury and Finance in Victoria and Tasmania) noted that the 1999–2000 budget was 'a very considerable achievement' that would 'position Australia at the forefront of public sector budget and financial management internationally.'[5]

However, he also noted a range of outstanding issues that limited the usefulness of budget-related information. These included the level of expertise in accrual accounting, the level of resources devoted to the budgeting function, and the level of support and guidance available to agencies.[6]

Dr Vertigan noted also that the full benefit of the new framework would take some time to realise. He emphasised the importance of establishing the integrity of accrual-based information before using it to make judgements about performance.[7]

Does accrual budgeting compromise accountability?

The Auditor-General has defined accountability as '… the process whereby public sector agencies and the individuals within them are responsible for their decisions and actions and submit themselves to appropriate external scrutiny.'[8]

A question has been raised as to whether accrual budgeting diminishes the capacity of external bodies to exercise such scrutiny (e.g. via the Senate Estimates process).

In a submission to the Joint Committee of Public Accounts and Audit (JCPAA), Mr Maurie Kennedy (former Senior Executive in the Department of Finance and Administration) argued that appropriation by high-level outcomes may have a systemic potential to permit payment for executive actions that could be hidden from Parliament.[9]

This concern prompted the JCPAA to recommend that the Department of Finance and Administration review the accrual budget format to ensure that the change to accrual accounting does not diminish the ability of Parliament to scrutinise appropriations.

On the other hand, the Government points to strong accountability through arrangements such as annual reporting requirements and access to information on the full costs of government services. For example, agencies are required to report in their annual reports against performance indicators specified in Portfolio Budget Statements.

At this early stage, it is difficult to determine the degree of transparency provided by accrual budgeting and accounting. However, it is possible that, as the JCPAA observed, a clearer view of government activities will be achieved at the cost of a 'reduced ability to identify and influence spending on the processes of government.'[10]

Conclusion

By itself, the implementation of accrual budgeting would represent a substantial challenge for agencies. In conjunction with other public sector management reforms, this challenge is intensified, highlighting the need for strong financial management skills.

Accountability is a key component of Australian democracy. The consequences of accrual budgeting for the quality of accountability are not yet clear. However, the significance of this issue means that continuing attention is essential.

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1. Department of the Parliamentary Library, *Budget Features, 1999–2000*, p. i.
2. Department of Finance and Administration web site (www.dofa.gov.au)
3. Auditor-General, *Whole of Government Financial Reporting (or putting on a happy face)* (information paper), 1996.
4. M. Vertigan, Review of Budget Estimates Production Arrangements, http://www.dofa.gov.au/pubs/vertiganreport/ July 1999.
5. ibid., p. 2.
6. ibid., p. 5.
7. ibid., p. 4.
8. Auditor-General, 'Whither accountability—the wisdom of Solomon' (speech delivered 13 September 1999), p. 16.
9. M. Kennedy, Submission to the JCPAA inquiry into the *Financial Management and Accountability Act 1997* and the *Commonwealth Authorities and Companies Act 1997*, 1999.
10. JCPAA, *Review of the Financial Management and Accountability Act 1997 and the Commonwealth Authorities and Companies Act 1997*, 1999, p. 34.

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