

Accrual Accounting and Performance of the Public Sector

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Abstract – The improvement and the measurement of performance in public sector have preoccupied governments for at least half a century. Over the past two decades, public sector performance has taken on special urgency as more and more countries have faced recessions, increase of more and better public services demands, and higher taxes paid by the citizens. Accompanying these pressures have been demands for a better accounting system. The paper explains the reform process in the public sector in order to improve its performance, the measurement of performance in public sector and differences between public and private sector. The paper contributes to a better understanding of performance measurement and public sector accounting and opens a new perspective in the Romanian public sector.

Keywords: Performance measurement, public sector, accrual-based accounting and management accounting

I. INTRODUCTION

Accounting plays an important role in public sector affairs. The past two decades have witnessed an increased progression towards improved financial management and harmonized accounting and budgetary procedures across all levels of public sector. Put together, economic constrains, greater demand for improvement in the financial accountability of public sector bodies, efficient use of public sector resources and more assessment of the public sector performance have placed existing government mechanisms for financial planning, budgeting and control under review [6, 7].

In addition, more emphasis is being placed on the economic cost and the consequences of public sector activities [8]. The need for such a review and consequent reform is justifiable in view of the important role of accounting in the public sector.

Traditionally, public sector had operated on a cash-based accounting system. The main objective of the public accounting system was to control cash spending in accordance with parliamentary limits customarily set by the budget [12].

Under cash-based accounting, receipts are recorded when received in cash and payments are recorded when cash is disbursed. Thus, cash-based financial statements show sources of cash receipts, the allocation of cash expenditure and provide a comparison of actual against budgeted expenditures [4]. Capital assets are treated as ordinary expenditure having the entire cost charged against the year of purchase. The existence of a considerable investment in unrecognized cost at the end of any fiscal period should be an important factor in decision relating to budgets and appropriations [2].

Over time, major changes in public accounting sector have evolved to a series of innovations directed toward improving the economy, enhancing the efficiency and effectiveness of public activities and then, providing better accountability for public sector. All over the world, public sector has undergone radical changes in their accounting systems, which were often directed toward replacing the traditional cash-based accounting with accrual – based accounting as practiced in the private sector [13]. The adoption of the private sector accounting techniques within public sector accounting is expecting to enhance the efficient allocation of resources through the provision of relevant, reliable, comparable and understandable information about finances and programs and activities costs. This advantage is capitalized on by the fact that accrual-based accounting could be able to enhance public sector accounting by providing useful information, which would play a major role in measuring project costs and benefits, asset valuation, management control, and to maximize the resources utilization efficiency.

In order to achieve the desired outcomes, the public sector needs to produce outputs (goods and services) which are specified in terms of quantity, quality, cost, time and purpose (as a means to allocate resources and measure performance) [6, 7, 9, 10, 12].

Public sector reform in accounting system has been initiated for many years in different countries around the world. Despite the relative advantage of

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publications favoring the adoption of accrual-based accounting in the public sector, the system has not been without criticism.

According to Mellet, 1997, the major changes of accrual relative to cash-based accounting are “adjusting revenue income and expenditure cash flows for changes in working capital, and operating a system of depreciation accounting” [12]. However, Guthrie, 1998 points out that the only difference between the two bases of accounting is the timing of the recording of transactions, but the timing of recording economic transactions is vital for management decision-making and accountability.

The 1980s have witnessed a growing interest in public sector accounting. However, its theoretical framework is still undeveloped. In the absence of conceptual framework for public sector accounting, the results of managerial activities aimed at public sector delivery are reported under a framework designed for and developed in a profit-oriented environment. A common framework for public and private sector does not necessarily result in the same accounting practices because of the variation of the actual practices being operated and the interpretation of concepts between the two sectors.

Romania adopted the accrual accounting system starting with the budgetary year 2006 in order to disclose the economic and financial results for the measurement of revenues and costs, which help in the decision-making process, it serves the basic financial needs for programming and appraisal of performance.

II. PERFORMANCE EVALUATION IN THE PUBLIC SECTOR

Over the past two decades, the cost of public sector, generally, has grown dramatically. It is widely believed that the inefficiency of public sector institutions has contributed, at least in part, to this cost increase. Therefore, an extensive body of literature has addressed the issue of performance efficiency and its measurement in public sector.

The Romanian government, as many other governments around the world, has been trying to provide its citizens with the best possible services despite the limited resources available on hand. Reforms have been proposed and designed to improve the performance of the financing, human and physical infrastructure bases of the public programs while assuring effective co-ordination with the substantial delivery and technological capacity of the private sector.

An important feature of many ‘new public management’ reforms initiated over the past two decades is the preoccupation with public sector performance measurement despite the many facets and permutations of such reforms observed in international, comparative studies [14].

Performance measures in public services have a long history, but have been developed and increasingly emphasized recently.

Performance measurement can be very difficult in the public sector in general. Having multiple objectives and providing several homogeneous types of services to a wide range of recipients, measuring performance based on the value of outputs may be extremely difficult, because such measurement as that in monetary terms is not available in these organizations. This fact is very important for the management control systems and maintains that measuring the revenue collected from clients could facilitate both measurement and the amount of services.

Cost and performance criteria

In the nationalized industries and in other public trading organizations the concepts, criteria and systems of performance measurement and evaluation are closely similar to the practice of the private sector. In essence there are geared to the measurement of profit or profit contribution assessed at several levels: overall, by segment or division, by site or unit, and by product or service produced and marketed [5].

In the field of public services, there is no single, tangible, easily quantifiable operational objective to take the place of operating profit, and so more complex concepts and measures of objectives and performance review are needed. These include economy, efficiency, effectiveness and value for money.

- Economy defines the minimal cost of inputs to an activity, whether achieved by purchasing cheaply or by closely restricting the consumption of resources.
- Efficiency defines the relationship achieved between the outputs of a service or activity (such as the number of examined students) and the volume or value of inputs consumed (e.g. teaching time, books, space and heating) in generating those outputs.
- Effectiveness relates to the degree of success or failure attained in meeting objectives.

Increasing the value for money from public expenditure may require a change of attitudes of cultural behavior among the management in public sector, while the traditional approach was to emphasize the quality of professional service, within available funding.

Measuring the resources put into public sector organizations is easier than measuring how effectively those resources are used. However, the measures of cost used in public services decision-making, control and performance review are not different in concept or definition from those normally used in business management accounting, even if the feasibility of producing certain types of cost information may be different. Only a few public services are organized on a “factory production line” basis.

The costing situation approximates to process costing, batch costing, or costing of customized contract units of output (e.g. hospitals have a unique treatment need which is customized as long as

resources permit). Thus data collection for the monitoring and cost control of public services can be complex and expensive. Simplified, cost concepts and measures can be subdivided between those especially relevant for planning and decision-making, and those continuously relevant for routine output costing, budgeting and formal performance review systems. The first subdivision, the cost concept is relevant both in the public and in the private sector. The second subdivision, cost concepts and measures for use in routine costing, budgeting and performance measurement, comparability between public services and trading organizations, public or private, is much weaker. Whereas most trading organizations produce or distribute a largely standardized product or service, a high proportion of public services are labor-intensive with the input/output requirements tailored to the individual needs of beneficiaries (e.g. hospital patients, university students). Therefore, the commercial accounting techniques such as "standard costing" have a much more limited range of application in the public sector. However, standard costing may become increasingly important for measuring and controlling intermediate outputs of public services.

Many performance measures have been criticized for undermining the overall quality of service in pursuit of narrow targets, while private firms have increasingly adopted a 'balanced scorecard' approach, involving a range of measures that include finance, business processes, customers and innovation. Whilst originally developed in the private sector, there are indications that this model is beginning to diffuse to public sector organizations [1]. However, the public sector is different from the private sector, especially regarding the purpose, scope and method of performance measurement.

Balanced Scorecard for the public sectors

The Balanced Scorecard has risen to the performance measurement challenge of the private sector and is equally well-equipped to facilitate a rapid and dramatic transition of 21st century public organizations.

a) The top of the Balanced Scorecard is represented by the mission - In the Balanced Scorecard model addressed to the profit organizations, all of the measures appearing on the Scorecard should lead to improved bottom line performance. Improving shareholder value is the end game for profit seeking enterprises and they are accountable to their financial stakeholders to do just that. This is not happening in public sector.

Public organizations are accountable for the efficient allocation. They exist to serve a higher purpose, for example, reducing the incidence of HIV, teaching the pupils, or increasing public safety. To include such lofty objectives on Balanced Scorecard could be hesitant because of the missing of the total control over the mission, it can't influence the outcomes. In the same context, the mission can't be

achieved overnight, and in fact may see only periodic movement. This is precisely why the other perspectives of the Balanced Scorecard are so vital. Monitoring performance, and learning from the results, in the customer, internal process, employee learning and growth, and financial perspectives provide with the short to medium term information required to get closer to achievement of the mission.

b) Strategy Remains at the Core of the Balanced Scorecard - Strategy remains at the core of the Scorecard system. Public organizations often have a difficult time cultivating a clear and concise strategy. Strategy regards those broad priorities planned to pursue in order to achieve the mission. Once developed a strategy the Balanced Scorecard serves as the device for effective translation and implementation.

c) The Customer Perspective is important - A clear distinction between private and public sector Balanced Scorecards is drawn as a result of placing mission at the top of the framework. Flowing from the mission is a view of the organization's customers, not financial stakeholders. Achieving a mission does not equate with fiscal responsibility and stewardship; instead, the organization must determine who it aims to serve and what how their requirements can best be met.

The profit organizations are accountable to their capital providers (shareholders) for results, and they monitor this accountability through the results attained in the financial perspective of the Scorecard.

This is not the case in the public sectors. Here the focus is on customers, and serving their needs in order to accomplish the mission. But the question of "who is the customer" is one of the most perplexing issues that public sector Scorecard adopters face. In this sector different groups design the service, pay for the service, and ultimately benefit from the service.

This web of relationships makes determining the customer a difficult challenge. Establishing the real customer in many ways depends on the public organization perspective. In the field of public sector, the legislative body that provides funding is a logical choice, as is the group served.

Including all customers is permissible and possible using the public sector Scorecard framework. Not only is it possible, it's desirable since meeting the mission will most likely entail satisfying disparate customer groups. Each group of customers identified will likely result in different measures appearing in the other three perspectives of the Scorecard. Once public sector managers have made their way through this twisted maze, the job of choosing performance measures in all perspectives becomes much simpler.

d) Financial Perspective - No organization, regardless of its status, can successfully operate and meet customer requirements without financial resources. Financial measures in the public sector Scorecard model can best be seen as either enablers of customer success or constraints within which the group must operate. When services are performed at

least cost, or with great efficiency, the program will likely attract more attention and warrant even greater investment from funders.

e) Internal Processes - Every organization will have documented processes for establishing their goals. The key to Balanced Scorecard success lies in selecting, and measuring, just those processes, which lead to improved outcomes for customers, and ultimately allow the working towards the mission. The process choose to focus on will normally flow directly from the objectives and measures chosen in the Customer perspective. It's not uncommon for the Internal Processes perspective to house the greatest number of objectives and measures on the Balanced Scorecard.

f) The Employee's Learning and Growth - Operating as mission-based organizations, public sector organizations rely heavily on the skills, dedication, and alignment of their staff to achieve their socially important goals. Employees and organizational infrastructure represent the line that weaves through the rest of the Balanced Scorecard. Success in driving process improvements, operating in a fiscally responsible way, and meeting the needs of all customer groups depends in a large extent on the ability of employees and the tools they use in support of the mission [11].

Motivated employees with the right mix of skills and tools operating in an organizational climate designed for sustaining improvements are the key ingredients in driving process improvements, working within financial limitations, and ultimately driving customer and mission success [2].

III. CONCLUSIONS

In the international context, and particularly in Romanian public sector, accrual accounting must be considered not a „magic bullet” for improving the performance of the public sector, but a simply tool for getting better information about the true cost of public sector institutions. It needs to be used effectively and in tandem with a number of other management reforms in order to achieve the desired improvement in decision-making in the public sector. The paper tried to discuss some approaches regarding the performance evaluation in public sector, developing a model of balanced scorecard that fits the public sector.

The drive to complement financial performance measures with broader measures of performance in the private sector has led to the common introduction of a “balanced scorecard” approach.

This approach takes the organization's strategic objectives as the starting point and creates a broad set of measures linked to achieving these objectives in the following four areas: finance, business processes, customers and innovation. Most performance measurement in the public sector already uses a range of indicators, not only financial ones. But little research has yet been conducted into the links

between strategy, performance measures and accounting in the public sector.

The paper tries to provide a better understanding of how performance is managed in the public sector and the link between strategy, performance measures and accounting. In addition, the study aims to encourage the spread of best practice where feasible.

The advantages of adopting a balanced scorecard in the public sector are represented by:

- A strategic performance management system for the whole organization;
- A communications tool to make strategy clear to everyone;
- A way to balance financial and non-financial views of organization performance;
- A journey;
- A system for increasing accountability;
- A commitment to change;
- A way of aligning organization vision with human and capital resources, and with day-to-day operations.

The limits of the paper are that the adapted Balanced Scorecard model to fit the public sector is only a theoretical approach. The model could be extent in numerous case studies, the author reserving this objective to subsequent papers.

The Romanian public sector is at the beginning of the implementation process of the “new public management” reform. The results of the movement from the cash-based accounting to the accrual-based accounting system should be reflected especially in the improvement of the decision-making process, serving the financial needs for performance appraisal. The public sector balanced scorecard approach could be a step forward in the performance management and accounting of the Romanian public organizations.

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