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Accrual Accounting and Budgeting: Why and How?

Austrian Reform Experiences

In December 2007 and December 2009, Austria's federal parliament approved a far reaching comprehensive budget reform package. The introduction of

- + a legally binding medium-term expenditure framework,
- + a long-term fiscal projection,
- + a more transparent budget structure,
- + accrual accounting and budgeting as well as
- + performance budgeting (including gender budgeting)

marks a decisive change not only in steering the budget, but even more in the Austrian administrative and political culture. Both legislative decisions were taken unanimously. The first budget which fully implements the reform – the annual federal budget for 2013 – was approved by the Austrian parliament in November 2012.

Graph 1

This article focuses on accrual accounting and budgeting: Why did Austria decide to switch to accruals, how were accruals implemented and which are the first and preliminary practical reform experiences? At first the reform process is described: How did Austria manage to create a broad political consensus on the budget reform?

How to create momentum for reform

Up to the mid 1990's budget formulation in Austria was very traditional, cash-based, highly legalistic and input oriented. Numerous detailed and legally binding line item appropriations prevented the flexible use of resources to a large extent. This led to growing dissatisfaction within the federal administration, as the weaknesses of this system became more and more obvious: There was no binding medium-term perspective for budgeting, which created planning problems both for the Ministry of Finance (MoF) and the line ministries. The focus of budgeting prevailed on inputs and neglected to performance results. As cash-based cameralistics characterized public accounting and budgeting, important financial information was lacking. Therefore, the budget administration within MoF started to develop reform

ideas to counter those problems. It successfully lobbied for political support and managed to get political approval for reform.

Before designing the reform, Austria started an in depth analysis of fiscal rules in various countries to create a comprehensive steering model for the Austrian federal budget. Austria gathered most information via the OECD-network of Senior Budget Officials. As to accruals Austria learned a lot from Swiss experience. Thus, international budget experience, both successes and failures, exerted high influence on Austria's reform.

From the start of the reform initiative it was obvious that it would take a number of years to develop and implement the respective changes. Therefore, it seemed crucial to ensure that the reform would not depend on the then existing political constellation, but would survive under different governments. Thus, the reform process had to integrate all political parties represented in parliament. A general political consensus should keep the reform out of political day to day quarrels and label it as a modernization project that would be supported by all relevant political forces.

For that purpose, an adequate forum was needed: An informal parliamentary reform committee was established in autumn 2004. All political parties with representation in parliament and several experts were integrated. The committee acted as a platform of discussion between Ministry of Finance (MoF) and party representatives. MoF presented its ideas for the reform design and later on detailed drafts for legislative texts. The representatives of political parties discussed these suggestions and provided feed-back to the administration. Finally the MoF-approach was accepted with only minor changes.

The reform process created a win-win-situation for MoF and political parties: On the one hand, MoF could accomplish its reform; on the other, political parties made sure that issues of particular relevance for them – such as the role and the rights of parliament in the budget process – were designed according to their needs. This referred especially to budget reporting requirements of the administration (in most cases of the MoF) to parliament and the creation of a parliamentary budget office that would support the budget committee with technical budget expertise. Moreover it was attractive for parliament that the reform design included detailed and regular performance information in future annual budget bills. Therefore, the portfolio of parliament was enriched substantially. All in all the informal parliamentary committee created a common reform spirit and established a reform-axis between MoF and parliament.

Another important stakeholder of the reform process was the Court of Audit (CoA). MoF viewed itself and the CoA as „friends of the taxpayers“ and made sure that the CoA was integrated in the informal parliamentary committee from the start and had the opportunity to add its perspective. As in the case of parliament, CoA got additional levers and could broaden its portfolio: The introduction of performance budgeting needed an institution to evaluate ex post, whether and to what extent the outcomes and outputs were fulfilled. This proved to be an important task for the CoA. As far as accruals are concerned, CoA is responsible for important legal acts and for the annual financial statement. Thus, CoA enriched its tasks and consequently expressed support for reform (for instance for the implementation of accruals) in public and towards parliament, which was important to strengthen political acceptance of the reform.

Another important stakeholder for budget reform is the public. Thus, MoF tried to persuade the public into the merits of the planned reform. A main target group were scientists. MoF presented reform ideas to specialists for public management and accounting, got feed-back and integrated hints that fitted into the general framework. The aim was clear: The scientific community should contribute to the reform and foster a positive public climate towards the reform efforts. Professors were not hired as consultants, but MoF tried to involve them on an informal basis to ensure effective communication between the scientific community and the administration.

Budget reform is generally seen as a very technical issue and cannot be communicated to the media easily. Therefore, MoF identified aspects of the reform that were supposedly attractive to journalists. These efforts focused on a simple question: How would citizens encounter the reform? What would change for them? Consequently the merits of good performance information were an important part of that exercise. Another one was additional information on the financial situation of the country derived from accrual accounting and budgeting. MoF organized special meetings for journalists to present the reform ideas and to generate a positive reaction in the media. These efforts succeeded at least to a certain extent: When at some point the reform process was at severe risk to grind to a halt, some newspapers published articles in favour of the reform and helped to put pressure on sceptics within parliament and administration.

Last but not least, it was important to bring civil servants on board. Administrative reforms can only survive if they are respected or – even better – endorsed by those who do the day to day public service. Otherwise even reforms with a strong legal basis risk to be paralyzed in practice. Thus, MoF regularly informed civil servants in all ministries on the design, main elements and details of the reform. The basic assumption was that civil servants could benefit from the reform, especially from performance information: This could contribute to a positive public recognition of the public service as a whole as well as of respective ministries and their staff. Citizens and taxpayers would be in a position to realize the merits of public services. This could positively influence the traditionally sceptical attitude towards civil servants in the Austrian public.

To create ownership within the Austrian federal administration, the reform had to emerge from the civil servants who had to be the experts for change. Thus, MoF decided to rely on the huge expertise and experience of its administrative staff to design the reform. The basic assumption was: Budget people know best how to effectively change fiscal rules. The reform driver was the Directorate-General of Budget and Public Finance. While a small number of young high potentials were hired to support the Director General in steering the reform process, the whole staff of the Directorate-General was on duty to help to design and implement the reform. Therefore, there was no split between those, who would do the routine budget work and others that would construct the future. The reform was derived from budgetary practice, from the experience of those, who, in many cases for decades, were used to steer budgets, thus, knowing deficiencies and ways to overcome them. This approach motivated civil servants to support the reform and to participate in constructing the new budget world, which was a key success-factor given the technical challenges of the reform process.

Another important aspect with special regard to civil servants was to keep the involvement of consultants to a minimum. In the last decade consultants had been frequently used in the Austrian federal administration and the predominant echo of the administrative staff was very sceptical. Civil servants had the impression that consultants would benefit from the experience and ideas of the administrative staff and would sell that to the government and earn lots of money. Moreover the hiring of consultants was understood as a clear political message to the administrative staff that civil servants were perceived as not being able to cope with the challenges ahead. This created a strong reservation among administrative staff towards consultants. Their involvement would have reduced the acceptance of the reform

considerably. Thus, consultants were – to a very limited extent – hired in just two task areas: Special accruals items and IT-implementation of the reform. Civil servants did the whole design of the reform model and almost all technical development of the numerous reform elements. Finally – it came as no surprise - this was much cheaper than the extensive use of consultants would have been.

To sum up: The Austrian MoF was aware of the fact that it needed broad support from different stakeholders to pass the budget reform. Therefore it developed a communication strategy precisely addressing relevant stakeholders and their interests. Win-win-situations should be created for everyone. Finally this strategy paid off: In December 2009 the new budget law was passed unanimously. All stakeholders got certain advantages and could claim victory in one or the other reform aspect. Broad ownership was successfully built.

How to make the reform irreversible

The aim of the Austrian budget reform was to create a comprehensive package that would not only improve budgeting, but also serve as an effective steering system for the whole federal administration and for political decision making. Therefore, it would not have been sufficient to just change one or a few elements of fiscal rules: Austria needed a complete relaunch of its budget system. The budget of the future, based on a medium-term expenditure framework with legally binding expenditure ceilings, on a transparent and flexible budget structure and on accrual accounting and budgeting, should evolve as an integrated steering instrument for financial and personal resources AND outcomes and outputs.

MoF assumed that such far reaching changes could not be managed in one single step. Consequently two major stages were envisaged: The first step would be implemented in 2009 and the second step, which would add the most ambitious parts of the reform (including accrual accounting and budgeting), as of 2013. Prior to the second step intensive training for civil servants and pilot projects to test the new budget world were organized. The far reaching changes in budgeting had to be well prepared and the risk of practical failure substantially reduced.

Being aware of a common attitude in administrations to bring reform intentions to a halt, it was crucial to burn all bridges and to make sure that the reform process was completely implemented without losing momentum. But how to realize that when lots of detailed legal regulations were necessary to make change really happen? Design and decisions on those regulations would take lots of time and effort. The reform process would absorb an enormous amount of energy within the administration and political decision making. This energy had to be protected against all attitudes to fail. A huge frustration potential and a considerable stranded investment of taxpayers' money had to be avoided.

The solution was inspired by soccer: A through ball and then a successful scoring. As the Austrian legal tradition is based on a rather detailed constitution in which even the basic legislation for the budget is enshrined, MoF planned to change the constitution in a way that would make fundamental change unavoidable. The core elements of the whole reform were to be rooted in the constitution already at a time when the details for the second reform step were not yet designed. If this attempt succeeded, the danger of stranded investments and lots of frustration would be successfully banned.

Backed strongly by the minister of finance and after intense discussions with stakeholders mentioned above, MoF presented two draft reform bills: The amendment of the constitution and a detailed reform bill for the first reform stage (see graph 1). In december 2007 parliament passed both reform bills unanimously. This was a decisive victory, because the reform process now was irreversible. Unanimous amendment of the constitution was a very strong signal to the public and administration that this change was to stay under any political constellation after future elections. Therefore, the message for all stakeholders, especially for the administration, was clear: better adapt in time.

The change of the constitution focused on the principles for budgeting. The traditional Austrian budget principles of economicalness, thriftiness and usefulness were transformed in the four following principles that would apply as of 2013: Outcome-orientation, efficiency, transparency and true and fair view. Those four principles could not be put into practice by sticking to the traditional budget system. For instance: True and fair view was not compatible with a budgeting system solely relying on cash. Outcome-orientation was not in line with lack of performance budgeting.

After unanimous parliamentary decision on the first reform package in 2007 the Austrian MoF could focus on working out the details for the second reform step starting in 2013. From 2008 until summer 2009 a complete new budget law was constructed which enshrined detailed legal provisions for all reform elements including accrual accounting and budgeting. This was accompanied by numerous discussions on all the reform aspects with relevant stakeholders such as chancellery, line ministries, CoA, informal parliamentary committee and scientific community. Within MoF a very close cooperation between the budget department and the IT-department made sure that the technical design of the reform would be appropriate.

After intensive negotiations between all political parties represented in parliament a consensus was reached and the reform passed parliament by unanimous decision on 11 December 2009. Based on this new budget law additional regulations were released to implement technical details of the reform. This applied especially to accrual accounting and budgeting concerning detailed provisions for accounting procedures, the opening balance sheet and the annual financial statement.

Why accruals?

Cash is important, but solely cash is not sufficient. Important information is not provided on a cash-only basis.

Some examples:

Sale of assets: If a government disposes of real estate or other assets a cash budget shows the respective revenue. The fact that the assets are no longer available is not transparent. Thus, cash-only produces a fiscal illusion: Incoming revenue seems to improve the budget balance while the loss of assets is blanked out. Accruals would avoid such a fiscal illusion, as the balance sheet would show the loss of assets.

Order now, pay later: If a government orders in year n and pays in year $n+1$ or even later, a cash budget would show the budget burden in year $n+1$ or later. This creates a fiscal illusion in year n , as the liability is not visible when the decision to order is taken. Therefore, timely transparency concerning the existing budget burden is not effected.

Doubtful receivables are not shown in a cash perspective. The respective budgetary risk is not transparent and cannot be taken into account when assessing the financial state of the respective country.

Finally: Cash does not provide an answer, if a country is poorer or richer than a year ago. Accruals do.

Cash provides key information on liquidity. To steer public finances this is of course indispensable - but not sufficient. The perspective of resources (operating statement) and the comparison of assets and liabilities (balance sheet) add crucial information. Off balance sheet contingent liabilities have to be taken into account as well (for instance: guarantees). Thus, to provide true and fair view, all these instruments need to be combined to ensure full information concerning a country's financial state. In other words: Accruals do not imply to abdicate cash but provide additional perspectives. Consequently it would be a fundamental misunderstanding to assume an inevitable choice: Either cash or accruals.

Accruals provide relevant fiscal informations and thus enhance transparency. This is an important contribution to steer public finances according to fiscal sustainability. Of course success is not guaranteed, but improved fiscal transparency makes it harder for stakeholders to ignore future budget challenges. Thus, accruals enhance accountability.

Implementation of accruals

As of 2013 Austria's federal annual budget consists of two perspectives, both subject to decision in Parliament: A cash flow statement and an operating statement. Thus, the budget provides the perspective of liquidity as well as the perspective of resources.

The main differences between the two statements are:

- + Periodicity: The operating statement contains positions, for which the payments will take place in later periods, while the cash flow statement includes payments which are in due to costs or receipts deriving from former periods. This is for instance relevant in the case of installments or deferred payments.
- + The operating statement includes positions, which are not cash relevant as depreciation, provisions, value adjustments.
- + The cash statement deviates from the operating statement for instance concerning liquidity for investment, shares and grants.

An opening balance sheet as of 1 January 2013 will be finalized in fall 2013. Annually the Court of Audit will update the balance sheet as a crucial part of the annual financial statement, which inter alia will additionally contain contingent liabilities. The annual financial statement will be subject to approval in Parliament.

An important aspect of the new system is to integrate budget and cost accounting in order to make the latter relevant for steering purposes. Prior to 2013 cost accounting was existing on the Austrian federal government level but lacked consistency with the cash only-perspective of the then existing budget world. Thus, cost accounting had very limited practical relevance, whereas the reform of 2013 boosts the importance of cost accounting. Accounting standards are set by the MoF with the consent of CoA.

The introduction of accrual accounting and budgeting certainly represents a decisive cultural change in dealing with public finances. Therefore, several challenges emerge on the way from a cash-only budget world to accruals.

First of all: The design of accruals need to be based on a reasonable balance of relevance and accurateness. Too much complexity would create unnecessary bureaucracy which endangered acceptance and thus, success. The Austrian accrual approach is consistent with most IPSAS standards, but some deviations occur. If the respective standard is perceived to have very limited impact on steering public finances or bears the danger of too much complexity or bureaucracy Austria does not apply it. Accounting and budgeting rules were designed in a „digestible“ manner by focusing on those issues, which seemed to be really relevant for adequately steering public finances. „Nice to have“ elements which perceived to be more of academic than practical merit usually were not implemented.

A typical example for the „pragmatic“ accruals approach in Austria are valuation rules: Usually the valuation would rely on acquisition costs. In the context of the opening balance sheet, however, it turns out that for a considerable number of assets, for instance real estate, acquisition costs are not known. Therefore, the valuation rules for the opening balance sheet allow several options to substitute the unknown acquisition costs. These might be maintenance costs in case of buildings. In case of lots average local selling prices deriving from official statistics can be used. Valuation of cultural heritage is a special issue. Assets are included in the balance sheet, if reliable data is available. If not, assets are just listed in the annex of the opening balance sheet without valuation.

The Austrian accrual system is designed in a way that the public administration itself is able to do the valuation. Costly external specialists are to be avoided. This requires a substantial upgrade in the capabilities of administrative staff.

Most people in the Austrian administration were used to deal only with cash. The implementation of accruals was prepared by a huge training effort. Ministry of Finance developed a variety of training tools, for instance an e-learning program and special training courses focusing on accruals. In the few years between parliamentary approval of the new budget law (December 2009) and coming into effect of accrual accounting and budgeting thousands of civil servants were instructed by a „snowball-system“: Ministry of Finance trained key staff from all ministries, who then coached additional staff within the respective ministries. In other words: The instruction was done by the administration itself, which created two positive effects: Key staff had to be very familiar with accruals to successfully coach others. And civil servants were trained by the likes of them, which increased acceptance within staff. Thus, accruals were rooted within administration.

This does, of course, not mean that all civil servants gladly supported the switch to accruals. There were (and still are) lots of complaints concerning the workload associated with the introduction of accruals. Therefore, it is a permanent task of senior staff to communicate, why accruals make sense in practical administrative life. This reflects another important challenge when introducing a reform in general and accruals in particular: Commitment of political and senior administrative level is key. In the Austrian case this is particularly true for the Ministry of Finance, who is the driver seat of the reform and for the Court of Audit. But it would not be sufficient to just rely on these two institutions. All relevant stakeholders have to be primarily convinced or – if inevitable – overruled.

A decisive prerequisite of successful implementation of accruals is an adequate IT-support. The new accounting and budgeting system needs sophisticated technical preparation which cannot be done accordingly without a very close cooperation of administrative units responsible for accounting, budgeting and IT. Intensive and structured communication between these specialists is necessary to make sure that everyone understands one and the same and that technical needs are underpinned by adequate IT-solutions in time.

Of course a key aspect of accounting standards is comparability, which leads to the importance of common standards across countries. As mentioned before Austria uses IPSAS

as a general orientation but deviates if that seems to be appropriate. One important deviation are future budget burdens stemming from pensions. Austria transparently includes them in the annex of the opening balance sheet and subsequently in the annex of the annual financial statement, but does not integrate them into the balance sheet itself.

Currently Austria fully applies 19 of 32 IPSAS-standards (green in graph 2), 7 are not relevant for Austria (grey in graph 2) and 6 are not fully applied (red in graph 2).

Graph 2

Why use IPSAS? The answer is simple: Because IPSAS is there and has standards to offer, which can be regarded as helpful in most respects.

It would be highly desirable to foster fiscal transparency within the EU by implementing common standards for accrual accounting and budgeting. Thus, the EPSAS-project should be promoted quickly and on a very broad basis. As it makes sense to use reasonable standards, which already exist, EPSAS should consider IPSAS-standards and only deviate, where there are good reasons to do so. This approach would be helpful to quickly progress towards implementation.

A common standard setting procedure is needed which is adequately rooted in good governance. Such a procedure (and standard setting body) obviously is a key issue to be clarified in due time.

Last but not least reform needs resources. The external costs of the whole federal budget reform in Austria (not just accruals but the other reform elements as well, which were mentioned at the beginning of this article) add up to 30 million euros (predominantly IT). This figure does not comprise internal costs, particularly expenses for the working time of public staff dealing with reform issues.

Preliminary reform experiences

The federal budget 2013 is the first annual budget based on accrual accounting and budgeting in Austria. The opening balance sheet has not been published yet (it will be finalized until fall 2013). Thus, practical experience in living the new system is still very

preliminary. Nevertheless interim lessons can be drawn from the preparation of the budget 2013 as well as from the first months of budget execution.

The new operating statement discloses important informations on investment, which were not transparent in the old cash-only budget. Consequently, the operating statement would show a substantially lower budget burden for 2013 than the cash flow statement. This is of course not true, where current public investments are reimbursed by the budget in later periods (predominantly railway infrastructure). In this case the operating statement shows the full budget burden, while the cash flow statement only reflects the expenses in the current fiscal year. In all issues the operating statement provided valuable financial information that could not be derived from a cash flow statement. As the huge interest of media and other decision makers in the upcoming opening balance sheet indicates, the balance sheet will attract lots of attention and curb discussion on public financial issues.

Accrual budgeting (based on accrual accounting) obviously manages to provide substantially enhanced transparency on public finances. The awareness of this advantage of accruals was recently curbed by a financial scandal in an Austrian province, where the regional government speculated with public money on the financial markets. The (at least preliminary) losses were not shown in the regional budget based on cash. When the speculation was detected, a huge public outcry followed immediately. Media quickly communicated that this could not so easily have been hidden, if accruals were in place. Up to this moment only one out of nine regions in Austria had decided to join the federal budget reform. The financial scandal triggered a switch to accruals not only in the concerned region (as a result the regional parliament decided to switch to accruals and other elements of the federal budget reform) but in some other regions as well. Under these circumstances a new important task emerges: Make sure that accounting standards are the same or at least easily comparable on each level of government. The quick implementation of EPSAS would be of practical help in that respect.

It will, of course, take some time until all stakeholders make full use of the new informations and levers, which are provided by accruals. Political and financial culture does not change decisively within a few weeks or month. But first experience of the budget reform shows that the tanker is moving and indicates that accrual accounting and budgeting is indeed key to provide true and fair view in the world of public finances. Thus, accruals are a decisive prerequisite of steering public budgets according to fiscal sustainability.

Nevertheless accruals have their limits. They do not set priorities and posteriorities for public expenses and revenues. In other words: They cannot answer the question, who should benefit from public money, why and how – and who should pay the bill. Accruals do not indicate, if programs financed by taxpayers meet their intended objectives. Which leads to the conclusion that accruals are an indispensable toolkit to provide fiscal transparency, but accruals alone are not enough. This is why Austria introduced performance budgeting at the same time. Combining accruals and performance budgeting transforms budgets into an integrated steering instrument for resources and results.

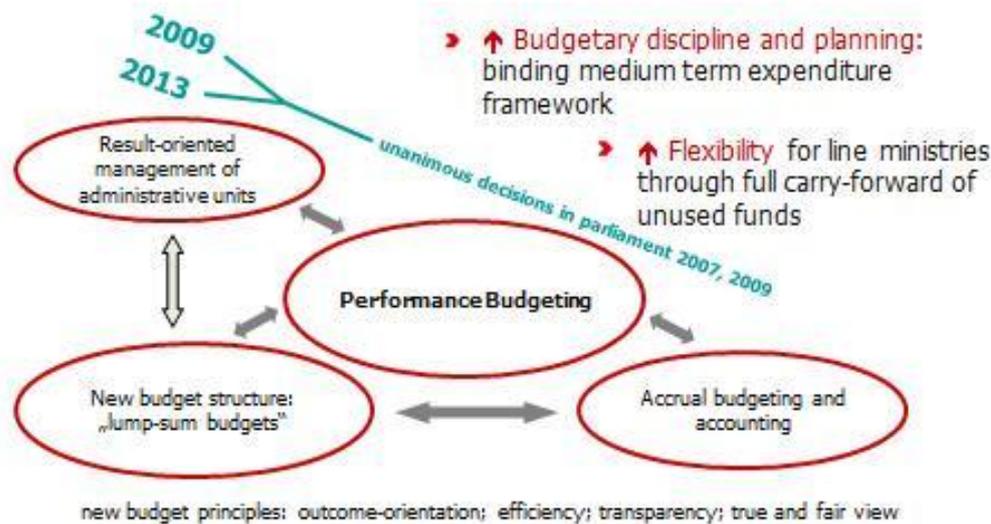
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Austrian budget documents (in German): www.bmf.gv.at/budget

Graph 1:



Graph 2:

List of IPSAS Standards and their application in Austria

Number	Name
IPSAS 1	Presentation of Financial Statements
IPSAS 2	Cash Flow - Statements
IPSAS 3	Accounting Policies, Changes in Accounting Estimates and Errors
IPSAS 4	The Effects of Changes in Foreign Exchange Rates
IPSAS 5	Borrowing Costs
IPSAS 6	Consolidated Financial Statements and Accounting for Controlled Entities
IPSAS 7	Accounting for Investments in Associates
IPSAS 8	Financial reporting of Interests in Joint Ventures
IPSAS 9	Revenue from Exchange Transactions
IPSAS 10	Financial Reporting in Hyperinflationary Economies
IPSAS 11	Construction Contracts
IPSAS 12	Inventories
IPSAS 13	Leases
IPSAS 14	Events after the Reporting Date
IPSAS 15	Financial Instruments: Disclosure and Presentation
IPSAS 16	Investment Property
IPSAS 17	Property, Plant and Equipment
IPSAS 18	Segment Reporting
IPSAS 19	Provisions, Contingent Liabilities, Contingent Assets
IPSAS 20	Related Party Disclosures
IPSAS 21	Impairment of Non-cash-generating Assets
IPSAS 22	Disclosure of Financial Information About the General Government Sector
IPSAS 23	Revenue from non-exchange transactions (Taxes and Transfers)
IPSAS 24	Presentation of Budget Information in Financial Statements
IPSAS 25	Employee Benefits
IPSAS 26	Impairment of Cash-Generating Assets
IPSAS 27	Agriculture
IPSAS 28	Financial Instruments: Presentation
IPSAS 29	Financial Instruments: Recognition and Measurement
IPSAS 30	Financial Instruments: Disclosure
IPSAS 31	Intangible Assets
IPSAS 32	Service Concession Arrangements: Grantor