

# The functions of governmental accounting in Europe

Rowan Jones\*

R.JONES@bham.ac.uk

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## Introduction

This paper rests on the propositions of Zweigert and Kötz (1998), which they offered in the context of comparative law but are being used here in the context of comparative governmental accounting:

The basic methodological principle of all comparative law is that of *functionality*. From this basic principle stem all the other rules which determine the choice of laws to compare, the scope of the undertaking, the creation of a system of comparative law, and so on. Incomparables cannot usefully be compared, and in law the only things which are comparable are those which fulfil the same function. This proposition may seem self-evident, but many of its applications, though familiar to the experienced comparatist, are not obvious to the beginner. The proposition rests

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\* Professor of Public Sector Accounting Birmingham Business School – University of Birmingham; Chair and co-founder of Comparative International Governmental Accounting Research network. Research interests are in governmental accounting at local, regional and national level, and in accounting for charities and the myriad quangoes and like-organisations. He has written accounting history and is actively involved with comparative international government accounting research (CIGAR)

on what every comparatist learns, namely that the legal system of every society faces essentially the same problems, and solves these problems by quite different means though very often with similar results. The question to which any comparative study is devoted must be posed in purely functional terms; the problem must be stated without any reference to the concepts of one's own legal system (Zweigert and Kötz, 1998, p34).

### **They develop these propositions further:**

...when the process of comparison begins, each of the solutions must be freed from the context of its own system and, before evaluation can take place, set in the context of all the solutions from the other jurisdictions under investigation. Here too we must follow the principle of functionality: the solutions we find in the different jurisdictions must be cut loose from their conceptual context and stripped of their national doctrinal overtones so that they may be seen purely in the light of their function, as an attempt to satisfy a particular legal need (Zweigert and Kötz, 1998, pp43-44).

This paper takes it that these propositions can be applied to governmental accounting. It has three sections. The first section offers a synthesis of the *generic functions* of governmental accounting in some historical context. The second section is a review of the factors external to each country that have influenced, and might influence, change in the *functional requirements* of PF&A in governmental accounting in Europe. The final section provides summary remarks.

## **Generic functions of governmental accounting**

Governmental accounting in Europe is diverse between countries and within countries. This diversity ranges from fundamental differences in recording systems to different measurement rules and disclosure requirements.

The only significant comparison of accounting and budgeting systems available is Lüder and Jones (2003). This book describes, for the core government services, governmental accounting and budgeting in each of nine countries, at national and local levels (and state or regional levels, when applicable), in their current and prospective forms. The nine countries addressed were Finland, France, Germany, Italy, Netherlands, Spain, Sweden, Switzerland and the UK. The overall focus of the book

was on accrual accounting and budgeting reforms, and a cross-country study was included to provide an understanding of the implemented, ongoing and intended accrual-based reforms.

The international language of accounting is English, in the sense that developments in accounting that are taken to have global relevance have first of all been expressed in English. However, much of the theory and practice of accounting in each European country is expressed in the language of that country, with minimal overlap between each country. This diversity is much more than a matter of mere vocabulary: at bottom, there are often polarised ways of thinking about accounting systems, with what can be termed an Anglo-American view of accounting at one extreme and a continental European view at the other.

This polarisation has been clearest in business accounting but the European Union's adoption of International Accounting Standards with effect from 2005 represents a major step towards the dominance of Anglo-American (often, in continental Europe, referred to as Anglo-Saxon) accounting. It is also reflected in governmental accounting, although there are significant differences between governmental accounting in the US and governmental accounting in the UK. In European governmental accounting, there is often the UK at one extreme, countries such as France and Germany at the other, with hybrid systems in between; a pervasive explanation for this spectrum is the extent to which governmental accounting is expressed through the law (with the UK having minimal such expression).

It is necessary to be clear about the nature and amount of diversity across Europe in the theory and practice of governmental accounting. However, the proposition here is that the governmental accounting system of every country faces essentially the same problems but sometimes solves these problems by quite different means, though very often with similar results. Thus, we can express the problems and solutions in purely functional terms, without reference to the concepts of a particular accounting system.

### **Bookkeeping and internal financial control**

Records of transactions are the fundamentals of accounting systems. There is polarisation of views of whether these records should be expressed in a uniform way across a set of organisations (the most basic elements of a 'chart of accounts') or whether they should be left to each organisation to determine. Even in the latter case, at some level there is demand for some kind of uniform classification of the results of these transactions. The difference of opinion hinges on belief in the extent

to which any accounting system can provide meaningfully uniform categories (of cost, for example). In extremis, a ‘chart of accounts’ believes that uniform records produce uniform categories; the polar view is that the economics of different organisations are different and no amount of uniformity in record-keeping can change that. In practice, there are very strong demands for some degree of uniformity – especially from politicians and non-financial managers – that have to be satisfied, regardless of whether the underlying records are expressed in a uniform way.

Some of the existing systems of recording transactions are forms of single-entry bookkeeping; others are double-entry. In the Anglo-American context, single-entry systems would be seen as archaic, belonging to the nineteenth century, at the latest. Probably few systems are wholly comprehensive, integrated recording systems: the use of subsidiary systems being pervasive. In addition, it is common practice to keep sets of transactions (pools of resources) assigned to a particular purpose completely separate from other pools. This is known in the US as fund accounting (although that phrase has also come to be used as shorthand for ‘state and local government accounting’) but is simply a technical response to the instinct we all have to designate money for specific purposes. This thinking is also common in business accounting but the financial reporting imperative in Anglo-American accounting is now seen to be the provision of one set of consolidated financial statements providing measures of revenues, expenses, assets, liabilities and cash flows for each organisation as a whole.

The enduring focus of accounting in government has been on internal financial control: the proper recording of transactions. Closely associated with this has been control of spending against the budget.

## **Budgeting**

Budgets are requests for money: at bottom, for taxation. In their definitive form, they are requests by the executive of a sovereign government for the authority from the legislature to raise taxes. In the context of local governments, they may be seen as requests by officers for the authority of the politicians to raise taxes; or the requests may be directly from the local government to the electorate.

As such, budgets may not be seen as the product of accounting systems at all but, once they have been approved, it is the chief financial officer’s role to monitor actual spending against the budget: to provide a crucial form of, internal or external, financial control. The form and content of the budget can significantly influence the extent of the financial control that is possible. Moreover, the requirement that is

usually imposed on local governments to balance their budget (even if the measurement rules are often vague) adds to the influence of the budget on accounting.

In Europe in particular, from the nineteenth century on, the budget has been used to impose central financial control on all aspects of governments. Using modern terminology, the management accounting system and, to a considerable extent, the management control system was structured around budgeting. Rules were developed, many of which are still in use, to provide control. Budgets that provide money for only a year, after which time they lapse, is one such (sometimes known as ‘annuality’). Another is the rule that budgets are provided gross, so that any income earned by a budget-holder must be surrendered to the central coffers (the ‘gross budget principle’). The requirement that budgets balance (that budgeted spending is financed by taxation) was also common. This emphasis on central financial control was also associated, notwithstanding the fact that government budgets during the late nineteenth century began growing at unprecedented rates, with the idea that public money had to be spent on the cheapest that money could buy, especially for routine, recurrent spending.

The form that budgets physically take varies across organizations, countries and over time, as does the form of all financial statements. But traditionally there are common features of budgets. Since the 1940s, these features have been challenged, particularly by the techniques of programme budgeting and zero-base budgeting. As comprehensive alternatives they failed to be accepted but there are elements of each that continue to have relevance and be used.

The traditional starting-point of a budget is the organizational structure: more specifically, identification of those officers within the government who are held accountable for spending money against budgets. This feature of budgets applies whether budgets are held at a high level of aggregation or whether there is significant devolution of budgets: the organizational structure locates the budgets.

Within each of the budgets thus identified, there are other common elements. Budgets are usually listings of what is to be bought with the money being requested: they are lists of inputs. These may be very broadly specified and may, *in extremis*, be a single amount. They may also, and were more typically, specified in much detail. There might be one amount for the whole of the costs of employees; but this might also be broken down into very detailed items, such as overtime pay for wage earners. But again, whatever the level of specification, budgets are usually lists of inputs (sometimes, following US terminology, known as ‘line-items’).

Budgets tend also to focus on one year, the coming fiscal year. The form of this annual request embodies another common feature of budgets: the request for the coming year is justified in terms of the marginal changes from the previous year’s

budget (commonly called ‘incrementalism’). The essence of this feature of budgeting is not that budgets must always increase but that budgets are justified by marginal changes from previous years – which may, in principle, be decrements.

Summing up these common features, their traditional form is of line-item, incremental budgets that reflect the organizational structure. In being expressed in money terms, they are natural ways of requesting money. They are also very good at providing a crucial sort of financial control that financial officers demand, in that the budgets specifically identify who is spending money and what they are buying with it. This demand is not only in the interest of the financial officers themselves but is on behalf of the public, whose money is being spent. It is common for budgets to be enacted as law, in part to emphasise the importance of this kind of control.

But, of course, there is much more to governments – even to their financial operations – than lists of what is to be bought. The quality and quantity of services provided used largely to be the province of judgements by spending departments (of service professionals) and politicians, with financial officer intervention whenever overall budgetary control and other matters of probity were implicated. However, two comprehensive budgeting methods were developed and experimented with in the second half of the twentieth century that attempted to integrate, *within the budgetary process itself*, judgements about services provided, including measurements thereof.

Programme budgeting was the first and the most ambitious. It challenges traditional budgeting by focussing on long-term planning, arguing that governments must take a view longer than one year, when requesting money. It also argues that, rather than using the organizational structure as the framework of the budget, governments should establish their long-term and short-term objectives, analyse different possible ways of achieving those objectives and provide cost-benefit calculations to determine the best policies (programming). From these data, the coming year’s budget requests follow.

Programme budgets are designed to ‘cut across departmental boundaries’ (being built on programme rather than organizational structures) but traditional budgets are still needed to identify who was spending money. Thus, two budgets are needed.

After early failure of comprehensive programme budgeting systems, the focus on long-term planning eventually reappeared in the guise of strategic planning, in which the use of the martial adjective betrays its provenance. Two of the reasons for the success of the idea of strategic planning are that it tends to be applied in organizational contexts that are much smaller than those of a sovereign government, which was the original setting for programme budgeting, and it is not encumbered by the web of a programme structure. As such, it retains the instinct to want to take a long-term view but allows much greater flexibility.

During the late 1960s, the other comprehensive budgeting alternative appeared. Zero-base budgeting had been developed in the private sector, for use in those parts of a business in which the causal relationships between their budgets and sales revenues are difficult to establish, such as head-office costs of marketing, legal and accounting services. It was less ambitious than programme budgeting in eschewing the long-term planning focus and in being based on the organizational structure. Its name suggests that the particular feature of traditional budgeting that it challenges is incrementalism: budgets, instead of using the previous year's budget as the base, must be developed from zero. This necessitated explicit treatment of the quality and quantity of services to be provided and in fact chose to emphasise the measurement of them. In this, zero-base budgeting and programme budgeting share the same kind of thinking.

Traditional line-item, incremental budgets based on organizational structures usually survived the challenges of programme and zero-based budgeting but have increasingly been supplemented with explicit measurement of the quantity of services provided. The results are neither programme budgets nor zero-base budgets but they share their fundamental premise.

### **Budgetary accounting**

Traditional line-item, incremental budgets based on organizational structures provide the (often legal) authority to spend. A continuing fundamental objective of governmental accounting systems is to demonstrate that spending was within the budget. This function is often called budgetary accounting. In Anglo-American accounting, budgetary accounting tends to be a less formal function and one that does not necessarily affect the basis of accounting. But in some continental European systems, budgetary accounting is very formal and often dominates all other aspects, reflecting or being reflected by the central role of law in such accounting. In those systems that either are part of or are influenced by German theory and practice, such systems are embodied in the term 'cameralistic accounting'.

In many systems of budgetary accounting, there are usually two measures of 'spending'. The first records 'commitments' to spend (in the US, these are known as encumbrances). In some systems, all spending (even of the routine recurring spending on salaries, for example) has first of all to be recorded as a commitment. The second measure of 'spending' is the associated settlement, typically the payment of cash (or near cash, recognising accounts payable, for example). There are also systems of budgetary accounting that only present commitments (and not the

associated settlement) in the comparisons of budgets to actuals.

Such budgetary accounting ignores many economic events, including consumption of economic resources, and offers only partial measures of assets and liabilities.

### **Accrual accounting**

The meaning of the term ‘accrual accounting’ (in the UK, sometimes called accruals accounting) can vary considerably, in theory and practice. The term ‘business accounting’ is often used, and often unhelpfully, to refer to the same thing. In its fullest sense, what is being referred to is the comprehensive and continuous recording of all revenues, expenses, assets, liabilities and cash flows of the organisation. In this sense, what is meant affects the recording of transactions, the periodic internal financial statements and the published financial statements. A prerequisite of accrual accounting systems is a comprehensive record of assets owned (which usually does not exist in extant accounting systems) and of liabilities incurred (which probably does, except that contingent liabilities are usually not recorded).

What is meant by ‘comprehensive’ is still controversial. The traditional basis of all accounting was historical cost. In business accounting practice, there are many ways now in which historical costs are changed to some form of current value (increasingly referred to as ‘fair value’); however, a comprehensive system of current value accounting, while it has been experimented with in the past, is not part of extant practice. In governmental accounting, in some of the new systems that have adopted accrual accounting, a wider use of current value accounting has been adopted, even if stopping short of being wholly comprehensive.

The terminological problems mean that it is not straightforward to relate the history of accrual accounting in government. Anglo-American state and local governmental accounting has been replete with accrual adjustments for more than a century; on the other hand, the practice of each organisation producing one set of audited consolidated financial statements on a full accrual basis is a product of the past three decades at most. The biggest change – measured by the size of the difference between cash-based accounting and some form of accrual base, as well as by the influence that it has had around the world – came when some national governments introduced accrual accounting, from the early 1990s on.

Significant discussion of accrual accounting focuses explicitly only on the published financial statements, with the other implications being at best implicit. In governmental accounting systems, the prevalence of records of commitments, for example, raises important questions about when a liability has been incurred and

therefore when an accounting system should best reflect incurrence of the liability. Some of the settings of such questions can be unique to governmental accounting and have therefore not been answered by business accounting.

Because a comprehensive system of accounting necessarily includes records of cash flows, in principle a full accrual accounting system only adds to any existing cash or cash-based accounting system and takes nothing away.

There are two ways that an accrual accounting has been added to a budgetary accounting system: as a separate system or as an integrated system, often depending on the available software. With a separate accrual accounting system, the bookkeeping in the budgetary accounting often remains single-entry and without data transfer from the accrual accounting system. In such a case, a single transaction can generate three entries (two in the accrual accounting and one in the budgetary accounting). There can also be separate systems in which there is data transfer from the accrual accounting system; as there can be separate systems in which there is no data transfer.

Although a literal interpretation of the term ‘accrual accounting’ does not necessarily require each organisation to produce one set of consolidated financial statements, that is what is usually meant by it. Since all but the smallest governmental entities are complex, the imperative for consolidation confronts a wide variety of organizations that are creations of governments but are not wholly governmental (nor wholly private sector organizations), among which is a group of organizations, otherwise difficult to describe: quasi-autonomous non-governmental organizations. This complexity also includes voluntary bodies that may formally be part of the public sector or that are part of the private sector but receive substantial support from public money. Moreover, the increasing focus on ‘regions’ – regionalisation – within the EU produces even more complex entities.

The basic dilemma, in deciding which entities should be included in this consolidation and which not, is between adopting the criterion of ‘ownership’, which might produce a legal determination, or the criterion of ‘control’, which might produce an economic one; in practice a more radical approach might be to use the extent to which an entity is financed by taxation – however it is owned and controlled – to make the judgements about consolidation.

### **Accrual budgeting**

In principle, the case for accrual budgeting follows from an accrual accounting system. Since budget-to-actual comparisons are fundamental, whether formally or informally, if the actuals are accrual-based then so must the budget be. However,

accrual budgeting as a term and as a practice is neither well known nor well understood. In business accounting, although the term is not used, the practice is familiar: that part of budgeting that produces estimated income statements and balance sheets. Transferring this practice to government budgeting, in which the budgets have traditionally been for cash or near-cash, requires a significant change in the way that budget-holders think about ‘spending’. To take one example, under a full accrual basis, this ‘spending’ would include a charge for depreciation of depreciable assets; many budget-holders would need persuading that this was part of their spending.

In practice, accrual accounting has often been introduced as an accounting system separate from the budgetary accounting, which remains on a commitment basis and cash or near-cash basis. The pragmatic attraction of this is that the wealth of additional data provided in the accrual accounts is just that: additional data. These data do not necessarily change the way that a government functions, not least because the budgets still occupy most people’s attention when concerned with financial matters. The introduction of accrual budgets is an enormous change, which goes to the heart of the way that governments manage their finances. Indeed, it is not too much to state that it can go to the heart of constitutional relationships between a legislature and an executive.

The argument for whether an accrual basis would be better for budgetary accounting is significantly complicated by the current practice of recording commitments, which in some cases could be close in time to the associated accruals and in other cases could be more prudent (and possibly therefore better) than those accruals.

## **Output measures**

The traditional role of accounting in government was limited to matters of financial probity and the minimisation of spending; matters relating to the quantity and quality of services provided were left to service professionals and politicians. But during and since the second half of the twentieth century there has been a stream of initiatives, which shared the same fundamental premise: that – given scarce resources – explicit measurement of the quantity, if not the quality, of services provided, linked to measurement of resources consumed, produces better services. These initiatives often did not emanate from accountants, although accountants were sometimes instrumental in the experimentation. From the point of view of accounting technique and practical implementation, the Anglo-American initiatives came in

three forms chronologically: until the 1970s, they focused primarily on budgeting; subsequently, auditing was the medium; and from the 1990s onwards, accrual accounting has dominated.

The emphasis of public sector auditing has been, and still is, on probity (also referred to as regularity), more specifically with whether spending has been proper and whether the spending has conformed to the budget. Often explicit, though sometimes implicit, in this kind of audit is a certification of financial statements. In the UK and the US, the trend has been away from auditors being a part of financial control systems towards their being apart from, and attesters of, the systems themselves. It is still common in continental Europe, however, for auditors to be a part of the systems.

In order to audit the propriety of spending, judgements have to be made about the quality and quantity of services provided but, since these elements were not always measured, their part in auditing was tacit. This changed in the early 1970s with the formalisation of the idea that, in addition to the regularity of spending and the certification of financial statements, government auditors must take a view on the quality and quantity of services provided in the light of resources consumed. Subsequently, the phrases economy, efficiency and effectiveness auditing, value for money auditing and performance auditing became commonplace. However, very often the choice was made not to require auditors to offer opinions on the performance of governments, but rather to require them to offer opinions on whether governments have installed suitable systems for allowing the governments themselves to judge their performance. In this way, audit stimulated an explosion of performance measurement, soon followed by explicit treatment of quality issues – although the governments themselves often developed the measures.

Accrual accounting includes measures of costs of service provided. It is a natural step then to require these costs to be compared with measures of quantity and quality of output to produce measures of performance. As the adoption of accrual accounting has increased so have requirements to publish such measures and, at least by implication, to use these measures in the management of organisations. The associated audit requirements may have been the stimulus, and may continue to be; yet there are settings in which we have also witnessed higher-level governments requiring lower-level governments to use specific performance measures using specific bases.

In the management of organisations, the stream of initiatives that continually requires more relevant measures of cost of service provided have included, for instance, activity-based costing, balanced scorecard and strategy-based performance measurement systems. In a governmental setting, these initiatives often have an implicit, sometimes explicit, emphasis on cost reduction.

## **Factors influencing change in the functional requirements**

In a continuing context in which, in management theory and practice, ‘change’ is judged to be axiomatic, accounting systems cannot be immune. However, of all the elements of management, accounting can be especially resistant to change. The traditional focus on the proper recording of transactions and on control of spending against the budget does not change. During exuberant periods of the economic cycle this focus can be under-emphasised but it can never be forgotten. Within governmental accounting, the tradition has been especially strong and is the main reason why accounting theory and practice in many organisations has been essentially unchanged for decades, if not centuries. Sophisticated accounting systems are not necessarily required to maintain the traditional focus; even a double-entry system, which many would take to be a given, is not a requirement.

On the other hand, there are many more aspects to a governmental accounting system that now can be provided but which traditionally have not been, without (in principle anyway) reducing the traditional focus: economically-relevant measures of cost of service provided, with clear segregation of capital and current costs; comprehensive measures of indebtedness and of assets employed; thus, facilitating substantially widened measures of government performance. It will presumably become harder and harder to resist calls for change, including to resist calls (in non-English languages) for adoption of double-entry bookkeeping.

Thus far, the clearest triggers for change to an accrual basis have been identified as financial distress and fraud. Financial distress is usually taken to mean that the size of government has become too high to be borne by lenders or by taxpayers. Financial distress and fraud are not necessarily a function of accounting, although accounting is usually implicated either directly or indirectly. When accounting systems do change, they will often be associated with wider changes in management, even though any cause-and-effect relationships are not well understood.

The site of the most extraordinary transformation in governmental accounting, in theory and – in some countries – in practice, is that of continental Europe, since the 1990s especially. Previously, cash-based budgetary accounting systems developed for the purpose of control by the centre of each government, hide-bound in law and administered by civil servants, were the norm and were largely unquestioned. Now, every such system is being questioned, often using Anglo-American models, and in significant cases radical changes are being made. It follows also that the new and proposed member states of the EU will be the most likely setting for radically new governmental accounting systems.

## **International Public Sector Accounting Standards Board (IPSASB)**

IPSASB has now published, and is continually extending, a unique set of measurement and disclosure policies (that is not exhaustive and that explicitly allows choices) for financial reporting on an accrual basis, for use by the governmental organisations of the world. They are based on historical cost but allow use of current values. These will potentially lead to two kinds of change: the first is towards accrual accounting in each government; the second is towards a standardised accrual accounting across governments.

IPSAS, notwithstanding their name, are narrower than *accounting* standards: they are standards of *financial reporting*. They are recognisably part of the tradition effectively begun in the US in 1959 and adopted in the UK in 1970, in which a codified set of accrual-based measurement and disclosure policies is published widely, after due process, by a non-profit, non-governmental and non-political body with the self-proclaimed responsibility to make the rules but without the power to enforce them. The rules are predicated on user-dominance but, in their development, users have remained passive. The production of these standards has not been accompanied by any imperative for governments to adopt them; the power of IPSASB is only one of persuasion. The Board does want a government, when applying its standards, to apply them as a whole rather than partially adopting those standards, or parts of standards, that it prefers. However, it similarly lacks the power to enforce even this. The typical, though not unfailing, mechanism in business accounting for compliance is through the audit of financial statements but in governmental accounting audit requirements have not yet developed to include full compliance with IPSAS.

IPSAS are a product of the accounting profession. More specifically, they are a product of what was a committee and is now a board of the International Federation of Accountants (IFAC), which is the representative organisation of the world's professional accounting bodies and has administrative headquarters in New York City. Since IFAC's member bodies come from more than a hundred different countries, it is to be expected that it represents many different social, political, economic and legal contexts. However, in its own words it is 'non-profit, non-governmental, non-political', with a mission for 'the worldwide development and enhancement of an accountancy profession with harmonized standards, able to provide services of consistently high quality in the public interest'. There is a similar body that represents the accounting profession in Europe, with overlapping membership to that of IFAC, called the European Federation of Accountants (FEE), which has a public sector committee, and which supports IPSAS. The same is to be expected of the individual professional accounting bodies that are members of IFAC and FEE.

In other words, IFAC is promulgating between nations the ostensible values on which the accounting profession was built from the middle of the nineteenth century onwards in the UK and subsequently in the US. For example, while accounting professionals are certainly concerned as individuals to make profit, their (national) representative bodies are not (usually by legal and tax definitions). Also, the dominant accounting professionals were not employed by governments and did not have employment contracts with their clients. Even when they did have employment contracts with their clients (including with governments), they had an appeal beyond them to 'the public interest'. And, in any case, the accountant's accounting judgements were ostensibly apolitical, in the traditional sense of not being overtly influenced by government, either by its politicians or its civil servants. It is self-evidently true that substantial numbers of people in most countries, during most of the period since the mid-nineteenth century, have not shared these values – ostensibly or otherwise.

IPSAS are explicitly based on extant International Accounting Standards (IAS; when new ones are issued they are known as International Financial Reporting Standards [IFRS]). IAS were a product of the accounting profession, specifically of the International Accounting Standards Committee (IASC), which had the same membership as that of IFAC but which had administrative headquarters in London. IAS are now produced by the International Accounting Standards Board (IASB), which is a body independent of the accounting profession, legally incorporated in the US but still with its administrative headquarters in London. IAS were originally written for businesses. Although they were and still are described as accounting standards, their coverage is much narrower: they are standards of financial reporting (recognised latterly by the change of name). Their primary focus is on reporting by companies to investors and creditors; indeed, some standards are even more narrowly concerned with the reporting of companies listed on stock exchanges. IPSAS are now being produced that relate to issues not addressed by IAS.

Although IPSAS are rules about financial reporting, implicit in them is the requirement to have accounting systems that are capable of producing reliable accrual-based financial statements. It was possible to produce a credible set of IPSAS for use in the governmental organisations of the world because they refer to highly stylised portrayals of organisations. In contrast, the traditional and enduring role of accounting is in financial control. The 'budgetary accounting' of much of continental Europe is not yet addressed by the financial reporting standards of IPSASB. Also because of the provenance of IPSAS, they do not address accrual budgeting.

The codified sets of accounting practices for published financial statements that emerged in Anglo-American accounting in the second half of the twentieth century were accompanied by what have come to be known as conceptual frameworks,

which are broad statements about the objectives of accounting and the constraints within which those objectives are to be achieved. IPSASB has not yet produced a conceptual framework.

### **European Commission**

The European Commission, for its own affairs, is introducing an accrual accounting system, using IPSAS that have been processed by the Commission, with effect from the financial year 2005; this system is on the historical cost basis. Given the operation of the EC in each of the member states of the EU, as well as the natural incentive to promote this development to all member states, this development can be expected to encourage change towards accrual accounting bases. In this, it is especially important to note that the existing 'budgetary accounting' of the EC, being a continental European budgetary accounting system, has not been changed to an accrual accounting basis. Perhaps the influence of the EC's new system will be most direct in some of the new member states whose basic systems are in more urgent need of reform.

### **EU**

Although the EC is introducing accrual accounting in its own affairs, in the attendant discussion, members and officers of the Commission have stated that, in their opinion, the Commission does not have the power to make accounting policies for the governments of the member states of the EU. The EU does not appear to be a force for standardisation of governmental accounting in the near future.

This opinion has to be taken on its face, and not least because of the failure in 2005 of the EU's proposed constitution. Nevertheless, there might be some benefit in wondering whether this opinion will ever change. For example, given that employers and employees might sometimes want to compare the fiscal conditions of local communities in making their choices about where to work and live, it is easy to make a theoretical case for the standardisation of governmental accounting in Europe as part of the Single Market, always assuming that governmental accounting could be relevantly and reliably related to fiscal conditions. This case might improve if standardisation of local tax regimes increases.

The regionalisation within the EU will continue to stimulate change. The establishment of new regional governmental organisations will provide an obvious focus

for the most innovative accounting systems but perhaps of greater significance are the innovative co-operative arrangements by existing lower-level governments.

### **Lüder and Jones (2003)**

Lüder and Jones (2003) is unique. Its explicit purpose is to facilitate the convergence of European systems of government to an accrual-based system. The book shows in all of the nine countries under study that local governmental accounting is now accrual-based. However, because there is no imperative for these accrual accounting reforms even to be harmonised (much less standardised), they are at different stages of implementation and are being implemented in different ways.

### **National accounting**

‘National accounting’ is a harmonised and standardised system, deriving its theoretical framework from economics and being carried out by statisticians; the resultant statistics are however often derived from accounting data. The global system is called the System of National Accounts and is promulgated by all of the major international bodies concerned. There is a European version of this, known as the European system of national and regional accounts in the Community, which is however fully consistent with the global system. This national and regional accounting, and the concomitant budgeting, is imposed on the member states by the EC using Regulations of the EU. Eurostat collects and reports the resulting statistics, which are used by the EC to monitor the economies of the member states, with powers to impose penalties on the governments of the eurozone in relation to budgeting particularly. Other international agencies, such as the International Monetary Fund, also use national accounting to monitor the national economies of the world, as they do their own system of government finance statistics (whose central focus is on imports and exports).

National accounting is very distinctly different from accounting (in English, obviously confusingly so), even though both systems are in part addressing the same economic activities of government. However, the phenomena that national accounting records, measures and reports on are in essence the same as those of accounting; both use money for their measurements and are accrual-based; national accounting depends, in part, on accounting data; and national accounting partially defines itself in terms of its points of departure from business accounting. These commonalities heighten the contrast between the two different kinds of ‘accounting’.

National accounting uses a 'double-entry' system but this is fundamentally different from that in double-entry bookkeeping. There is a common foundation: a transaction, recorded as an exchange between two parties, in which each party is taken to benefit equally. But whereas double-entry bookkeeping keeps the records of actual transactions of a single entity, national accounting records aggregate estimates of actual transactions between a few, large groups of entities (the sectors of each economy). The common name 'double-entry' reflects a common characteristic, which is that two entries per transaction force various kinds of double-checking, ranging from arithmetical checks to theoretical rationalisations.

The first sense in which the double-entry is fundamentally different emanates from the different view of what a 'transaction' is. Double-entry bookkeeping (and accounting practice) is based on each organisation having suitably authorised pieces of paper, each of which is taken to represent an individual transaction. These pieces of paper make the transactions capable of being audited in the narrowest and most traditional sense of that word. National accounting is not, and more crucially is not capable of being, audited in that sense. In recent years, there has been a marked increase in the contexts in which the word 'audit' has been used. In some of the newer senses, national accounting could be audited, for example by auditing the assumptions that underpin a calculation of national income.

The second sense in which the double-entry is different is that double-entry bookkeeping provides the possibility of external verification of a balancing figure: the amount of cash at the bank. Of course, the numbers might still be wrong and they might still not be as relevant as we might wish. But the numbers do then have a meaningful relevance. The double-entry in national accounting obviously cannot provide such a check.

Another way of stating the difference between accounting and national accounting is that the latter focuses on sectors of an economy whereas accounting focuses on an organisation (or an individual). It might be objected that this difference is merely a difference in the level of aggregation and, indeed, there are theoretical and practical cases (of centrally-planned economies) in which this objection would be strong. But in the countries in which the accounting profession began and developed (the UK and US), the difference in focus is crucial. Accountants account for (and auditors audit) specific organisations with which they have an employment or other contract; moreover, there are no requirements for the measurements of one organisation to take account of the measurements of other organisations.

National accounting, by its nature, demands comparable information across each economy. In countries such as the UK and the US, accounting – also by its nature – cannot provide such information. This contradiction is essentially avoided

by using statistical processes. Thereby, national accounting produces relevant data, in worldwide-standardised forms, but using policies that are more vague and more resistant to change, based on policy-making processes that are more esoteric. Accounting produces less relevant information that is very diverse but the information is more reliable and is audited, and is based on policies that emanate from active and open policy-making processes.

National accounting demands increasingly sophisticated, and harmonised across Europe, systems of data collection, storage, classification, reporting – and understanding. In many of the new and proposed member states, the systems may even have in effect to be invented. In addition, there are two ways in which national accounting is a force for change in governmental accounting systems. National accounting is accrual-based, although it uses different accrual bases from those used in any governmental accounting, including IPSAS. However, the use of accrual accounting in governmental accounting systems would significantly improve the reliability of national accounting. One obvious example of this is that a government that adopted accrual accounting would, probably for the first time, generate reliable measures of depreciation of depreciable assets. In the absence of these, under extant budgetary accounting systems, national accounting has to make much less reliable inferences about depreciation. Hence, given the importance of national accounting, improvements in its methods might stimulate accrual-based governmental accounting.

The second possible effect is a more direct version of the first. Some governments have directly made the connection between governmental accounting and the requirements of national accounting, especially in the eurozone, and have required their governmental organisations to provide the necessary data directly, rather than relying on statistical processes. Because of the intrinsic differences between national accounting and governmental accounting, this can produce significant controversy.

### **Banks and credit rating agencies**

For most governmental organisations in Europe, their financial risks have not generally been seen to be borne by their investors and creditors; they may not even be seen to be borne by their local taxpayers but rather by taxpayers in each country as a whole. There has, however, been increasing recognition of the financial risks that are currently borne by investors and creditors, or that might be better borne by them rather than by taxpayers. Those governments that want to see change in the focus on financial risks tend to welcome change in accounting systems towards a full accrual-basis, since the primary focus of the Anglo-American sets of account-

ing rules is on financial reporting to investors and creditors. The corollary is that to those governments who see financial risk in the traditional way it is often not obvious that this focus is of relevance to them.

There are two groups who are explicitly driving this change of focus on financial risks. The first is the banks, represented in this by the Basel Committee on Banking Supervision of the Bank for International Settlements (Basel II), which is directly concerned with greater and more specific disclosure by internationally active banks of their exposure to risk, including in their state and local government products. The second is credit-rating agencies, essentially from the US where state and local government debt secured on specific and risky revenues is a norm. In both cases, the link between greater amounts and greater disclosure of financial risk on the one hand, and financial reporting on the other is obvious but not simple: methodologies for developing risk profiles, within a well-established accrual accounting framework, are not themselves well-established. These risk profiles also become more complex as the governmental organisations themselves become more complex, following from regionalisation for example.

### **International lending agencies**

For decades, international agencies such as the International Monetary Fund and the World Bank have attempted explicitly to influence the accounting systems of governments who are recipients of their loans and grants. This has sometimes meant that innovative budgeting systems were imposed on developing economies before they were generally accepted by governments in the economically more advanced countries. It is to be expected that some form of accrual accounting would currently be required. However, it has also been common for the agencies to be able to require particular forms of accounting only on that part of the recipient's financial affairs that are directly affected by the loans and grants.

### **Constraints**

The emergence of the accounting profession, which formally began in the UK in the second half of the nineteenth century and spread to the US in the twentieth, coincided with the expansion of government services, essentially from defence to all aspects of the welfare state. However, the profession grew by providing services for business. Governments, on the other hand, tended to look to generic administrators

to carry out their functions, including their financial functions: civil servants, public servants, and local government officials. There was one significant exception: in UK local government, the finance officials created their own branch of the nascent accounting profession, in 1885, as an institute that soon became an examining and certifying body, and that currently exists as the Chartered Institute of Public Finance and Accountancy. CIPFA, and bodies like it in the Anglo-American context, have always played a role in reflecting and leading best practice, and perhaps in being more responsive to developments in the private sector than have civil servants for example. It may be that equivalent bodies in continental Europe will, and perhaps should, emerge; the new and proposed member states might be the most likely settings for such bodies. However, until they do their lack may be a significant constraint on change.

The Lüder model (Lüder and Jones, 2003) identifies the variables that explain why some countries, and not others, have moved towards an accrual accounting that reports on net consumption of resources and financial position. The variables include constraints on the adoption of an accrual accounting: lack of accounting education in professional staff; a ‘political and administrative culture’ that is less open and disposed towards public participation; weak competition between executive, legislature and electorate; weak political competition between users (electorate and legislature) and producers (executive) does not enable former to demand better information; and large size of jurisdiction.

In addition, the model identifies the law as a major constraint. Law is not accounting. Law requires precision and, while precision is at the heart of bookkeeping and record-keeping, it is otherwise the antithesis of accounting: accounting uses rules of thumb, which cannot sensibly be reduced to precise rules. Much of the detail in governmental accounting in continental Europe is expressed in the law (in the UK it is not). This has also been true in business accounting but it is even more troublesome in governmental accounting. In the context of business accounting, the role of the law does not extend to the management of each business; but in governmental accounting it does extend to the management of each government. Not the least of the attendant difficulties is that the detailed use of the law as though it were accounting can give unwarranted substance to what otherwise is mostly ritual: the involvement of the legislature in accounting.

## **Summary remarks**

Governmental accounting in Europe is diverse between countries and within countries. This diversity ranges from fundamental differences in recording systems

to different measurement rules and disclosure requirements. Recent research shows that in nine European countries studied local governmental accounting, though not budgeting, is now accrual-based; however, these reforms are at different stages of implementation and are being implemented in different ways. At the same time, many other European countries have not yet reformed their systems.

While it is necessary to be clear about the nature and amount of diversity across Europe, the governmental accounting systems in every country face essentially the same problems but sometimes solve these problems by quite different means, though very often with similar results.

The traditional focus – on the proper recording of transactions and on control of spending against a line-item, incremental budget based on the organizational structure – does not and should not change. During exuberant periods of the economic cycle this focus can be under-emphasised but it can never forgotten.

On the other hand, there is much more information that can now be provided in a governmental accounting system, without reducing the traditional focus: economically-relevant measures of cost of service provided, with clear segregation of capital and current costs; comprehensive measures of indebtedness and of assets employed; thus, facilitating substantially widened measures of government performance. All of these can be provided in budgets as well as the financial statements.

Accrual budgeting and accounting, in its fullest sense, is the comprehensive and continuous recording of all the revenues, expenses, assets, liabilities and cash flows of the organisation: it affects the recording of transactions, the internal financial statements and the published financial statements. Moreover, while the traditional basis of all accounting is historical cost, in the UK system alone there is a wider use of current value accounting.

There are a number of international factors that might continue to influence change in the functional requirements of governmental accounting. IPSAS are now available and are continually updated, for financial reporting on an accrual basis by the governmental organisations of the world. The European Commission, for its own affairs, has introduced an accrual accounting system, using IPSAS, with effect from the financial year 2005. The central importance of accrual-based national accounting and budgeting statistics, especially but not only in relation to the euro, demands increasingly sophisticated systems, harmonised across Europe, of data collection, storage, classification, reporting – and understanding. In many of the new and proposed member states, the systems may even have in effect to be invented. Moreover, accrual-based national accounting stimulates fuller accrual-based governmental accounting. The increasing emphasis, led by the banks and

credit rating agencies but easily understood by politicians, on financial risk in individual government organisations points to the production of one set of consolidated financial statements, with comprehensive measurement and disclosure of liabilities, including contingent liabilities.

Comprehensive, standardised accrual-based accounting systems in state and local governments throughout Europe will emerge only in the distant future but many of their additional elements can be, and are being, developed by individual, and groups of, organisations.

One dominant theme in the sometimes-bewildering changes in governmental accounting and budgeting over the past fifty years, as the size and complexity of the public sector have continued to grow, is the increasing reluctance of those at the centre of each government to bear the financial risks of that government. This has involved increasing recognition of those risks, as well as to formal devolution of some of them, from one level of government down to another, and from one level of government down to other entities. IT and accounting have to a large extent made this possible and will also be central to making overall sense of it.

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