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Richard Laughlin

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Non-theme articles

Debate: Accrual accounting: information for accountability or decision usefulness?

Richard Laughlin

Andreas Bergmann's article on 'The influence of the nature of government accounting and reporting in decision-making' (see pp. 15–20 in this edition of *Public Money & Management*) raises an important set of issues. The increased accountability that comes from the contents of general purpose financial statements (GPFs) constructed on an accrual, as distinct from cash, basis, has, as Bergmann points out, been 'well documented'. Yet, as he also makes clear, the claimed decision usefulness of the information from GPFs is less well developed. This concern is very topical and of considerable importance to the International Public Sector Accounting Standards Board (IPSASB) and its conceptual framework project—part I of which was published recently as an exposure draft (IPSASB, 2010). Of course, Bergmann is clearly well aware of these debates and concerns given that he is currently chair of IPSASB.

This article first explores Bergmann's claim that the contents of GPFs *should be*, as distinct from *can be*, used for decision-making purposes. The concern that I address here is to clarify what information GPFs can actually supply and, therefore, how decision useful they should be allowed to be because of this. Second, this analysis is used to trace the implications for IPSASB's conceptual framework project, particularly related to the objective(s) of general purpose financial reports (GPFs), of which GPFs are a central part. This can be referred to as the 'one or two objectives' problem (see Laughlin, 2008), namely should the objectives of GPFs be accountability *and* decision usefulness or just one of these?

What is accrual accounting?

It is important to be clear what is meant by GPFs produced on an accrual as distinct from cash basis. In a literal sense accrual accounting is simply saying that instead of recording

transactions when received and paid in cash, the accrued receipts and payments, to be received and paid in cash at a later date, can and should be included. However, when Bergmann and others talk about accrual accounting, they are talking about much more than this. This is why in the UK the changes have been referred to as resource accounting and budgeting (RAB) (Likierman, 2003), rather than simply accrual accounting. The key to RAB/accrual accounting is that the accounting records for receipts of cash and accruals go beyond a simple debit (to cash or debtors) to a classification and recording (credit entry) as either income or liabilities. Likewise, cash and accrued payments go beyond a simple credit (to cash or creditors) to a classification and recording (debit entry) as either expenses or assets. This reclassification of the known (cash or accrual) into income, expenses, liabilities and assets unquestionably provides extra information but information that is fraught with definitional issues, judgement and uncertainty. The classic accounting problem in this reclassification is deciding when payments (cash or creditor) can be called assets and when they are expenses. This classification problem is the hunting ground for all manner of financial scandals—Worldcom being a classic example—which is why accounting regulators have invested enormous energy into defining the characteristics of assets and expenses as tightly as possible. Yet judgement in specific cases is always needed. Similar points apply to income and liabilities.

The reason for this slight diversion is because it provides the context for judging the nature of the information that is contained in GPFs and, therefore, whether it is possible to use this information for decision-making purposes.

GPFs in decision-making

Now we come to the heart of Bergmann's arguments and the heart of my concerns. Clearly you can use the information in GPFs for decision-making—for instance, Switzerland's reliance on the 'self-financing of investment ratio' to judge the fiscal responsibility of government organizations is demonstration of this. Yet the calculation of this ratio—cash flow over net investment—is fraught with problems and judgement. Cash flow includes taxes or grants to cover what we refer to as 'expenses and assets'. To use this as a meaningful

numerator would require presumably deducting an adjudged (estimated?) expense amount from this cash flow measure. Likewise, the denominator is likely to be made up of all manner of previous asset purchases, from different time periods and no doubt depreciated in different ways. To then use this ratio to say that a figure of not less than 60% or 80%, or whatever, demonstrates that the government department in question is acting responsibly in terms of self-financing of investment is going beyond what is possible or appropriate.

The generic point is that this ratio, like all ratios, may be used but they are all of limited usefulness because of the nature of the data that is used in their construction. At very best, all information supplied by ratios can be seen as necessary but certainly not sufficient for whatever the decision focus might be. At worst, they can supply inaccurate messages which, if relied on, may quite possibly lead to wrong decision-making. Put simply and directly, health warnings need to be added to the use of any ratios drawn from the information contained in GPFs. The problem with Bergmann's article and his celebration of the decision useful relevance of the information contained in GPFs is that none of these health warnings seem to have been recognized.

Implications for IPSASB's conceptual framework

This analysis has major ramifications for the conceptual framework concerns of IPSASB. As indicated above, the exposure draft (IPSASB, 2010) has tried to maintain that the objectives of GPFs are two—accountability *and* decision usefulness and the survey Bergmann mentions in his article suggests this might still be the preferred option. If this is the final outcome then at least, as an aside, it is better than the International Accounting Standards Board (IASB) who, in attempts at their conceptual framework (IASB, 2010), have only one objective—decision usefulness—which, with their exclusive concentration on GPFs, will, in my view, be difficult, if not impossible, to achieve except for a small group of (primary) users who, even then, may not be satisfied with the information supplied. The trouble for IPSASB to continue to try to pursue two objectives is, as I made clear in an earlier article (Laughlin, 2008), that GPFs, which includes GPFs, can, at best, only partially satisfy accountability and their use in decision-making can be misleading. GPFs are, by their very nature, 'general purpose' and have been geared

for and have the potential to satisfy some aspects of accountability. Information for decision-making to be *useful* needs to be once-off and specific, designed for a particular decision for a specific user at a specific moment in time. Accountability reports will be *relevant* to users' decisions—on the grounds that an account of what organizations have been doing and have achieved, which is the essence of accountability, cannot be anything other than relevant to users—but they can never be fully decision-useful in the above sense.

Hopefully IPSASB will recognize that satisfying accountability is the only objective that is possible to be achieved through GPFs. They do, however, need to be rather clearer than present about what accountability constitutes but, fortunately, there is considerable academic literature to aid this understanding. Once clarified, they would then need to move quickly to clarifying the other reports that build on, but extend, the GPFs. Maybe then accountability can be satisfied in full through GPFs. IPSASB can, if they so choose, then move into trying to satisfy the design of directly decision-useful information as a second objective but this will always involve specific reports for specific purposes for specific users.

Bergmann raises an important set of issues. Hopefully this brief article has clarified these important issues enough to engender responses not only by him, but by others as well. Given the deliberations of IPSASB at the moment on the objectives of GPFs, there can be no better time for this debate to occur.

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Richard Laughlin is Emeritus Professor of Accounting, King's College London, University of London, UK.