ANNEX D.
BENEFITS OF ACCRUAL ACCOUNTING

Extract from Study No. 14, "Transition to the Accrual Basis of Accounting: Guidance for Governments and Government Entities," IFAC Public Sector Committee, December 2003

1.18 The PSC has commented extensively on the benefits of accrual accounting for governments and individual public sector entities in previous Studies (Studies 5, 6, 8, 9 10 and 11) and Occasional Papers (Papers 1, 3, 5, 6 and 7). In order to provide some context for readers who are not familiar with the PSC's other publications, this section contains a summary of the benefits of reporting on the accrual basis.

1.19 The information contained in reports prepared on an accrual basis is useful both for accountability and decision-making. Financial reports prepared on an accrual basis allow users to:

- assess the accountability for all resources the entity controls and the deployment of those resources;
- assess the performance, financial position and cash flows of the entity; and
- make decisions about providing resources to, or doing business with, the entity.

1.20 At a more detailed level, reporting on an accrual basis:

- shows how a government financed its activities and met its cash requirements;
- allows users to evaluate a government's ongoing ability to finance its activities and to meet its liabilities and commitments;
- shows the financial position of a government and changes in financial position;
- provides a government with the opportunity to demonstrate successful management of its resources; and
- is useful in evaluating a government's performance in terms of its service costs, efficiency and accomplishments.

Financial Position

1.21 Accrual accounting provides information on an entity's overall financial position and current stock of assets and liabilities. Governments need this information to:

- make decisions about the feasibility of financing the services they wish to provide;

- demonstrate accountability to the public for their management of assets and liabilities recognized in the financial statements;
- plan for future funding requirements of asset maintenance and replacement;
- plan for the repayment of, or satisfaction of, existing liabilities; and
- manage their cash position and financing requirements.

1.22 Accrual accounting requires organizations to maintain complete records of assets and liabilities. It facilitates better management of assets, including better maintenance, more appropriate replacement policies, identification and disposal of surplus assets, and better management of risks such as loss due to theft or damage. The identification of assets and the recognition of depreciation help managers to understand the impact of using fixed assets in the delivery of services, and encourage managers to consider alternative ways of managing costs and delivering services.

1.23 Accrual accounting provides a consistent framework for the identification of existing liabilities, and potential or contingent liabilities. The recognition of obligations meeting the definition of a liability and the criteria for recognition:

- compels governments to acknowledge and plan for the payment of all recognized liabilities, not just borrowings;
- provides information on the impact of existing liabilities on future resources;
- means that it is possible to allocate responsibility for the management of all liabilities; and
- provides necessary input for governments to assess whether they can continue to provide current services and the extent to which they can afford new programs and services.

1.24 Accrual accounting highlights the impact of financing decisions on net assets/equity and may lead governments to take a longer term view when making financing decisions than is generally possible when relying on cash or modified cash reports. Information on net assets/equity also means t hat governments may be held accountable for the financial impact of their decisions on both current and future net assets/equity. Changes in an entity's net assets/equity between two reporting dates reflect the increase or decrease in its wealth during the period, under the particular measurement principles adopted and disclosed in the financial statements. Under the accrual basis of accounting, the financial statements will include a Statement of Financial Position which discloses information about assets and liabilities. Where assets and liabilities are not equal, a residual figure for net assets/equity will be reported. Where this figure is positive it can be interpreted as the net resources that may be applied for the provision of goods or services in the future, and therefore the community's investment in the reporting entity. Where the figure is negative, it may be viewed as the amount of future taxation or other revenues which are already committed to paying off debt and other liabilities. Net assets/equity can comprise some or all of the following components:

- contributed capital;
- accumulated surpluses and deficits; and
- reserves (for example revaluation reserve; foreign currency translation reserve).

Financial Performance

1.25 Accrual accounting provides information on revenues and expenses, including the impact of transactions where cash has not yet been received or paid. Accurate information on revenues is essential for assessing the impact of taxation and other revenues on the government's fiscal position, and in assessing the need for borrowing in the long term. Information on revenues helps both users and governments themselves to assess whether current revenues are sufficient to cover the costs of current programs and services.

1.26 Governments need information about expenses in order to assess their revenue requirements, the sustainability of existing programs, and the likely cost of proposed activities and services. Accrual accounting provides governments with information on the full costs of their activities so that they can:

- consider the cost consequences of particular policy objectives and the cost of alternative mechanisms for meeting these objectives;
- decide whether to fund the production of services within government sub-entities, or whether to purchase goods and services directly from non-government organizations;
- decide whether user fees should cover the costs associated with a service; and
- allocate responsibility for managing particular costs.

1.27 Accrual accounting can provide financial information on whether sub-entities are delivering specified services, and delivering them within agreed budgets. The same information, at a more detailed level, can also be used within sub-entities for the management of activity and program costs.

1.28 Accrual accounting allows an individual entity to:

- record the total costs, including depreciation of physical assets and amortization of intangible assets, of carrying out specific activities;
- recognize all employee-related costs and to compare the cost of various types of employment or remuneration options;
- assess the most efficient way of producing their goods and services and of managing the resources over which they have been delegated authority;
- determine the appropriateness of cost-recovery policies; and
- monitor actual costs against budgeted costs.

Cash Flows

1.29 Accrual accounting provides comprehensive information on current cash flows and certain projected cash flows, including the cash flows associated with debtors and creditors. It can therefore lead to better cash management and may assist in the preparation of more accurate cash budgets.