



# Accruals accounting in the public sector: A road not always taken

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## ABSTRACT

The move from cash to accruals accounting by many governments is viewed as an aspect of an ongoing New Public Management agenda designed to achieve a more business-like and performance-focused public sector. Proponents argue that accruals accounting provides more appropriate information for decision makers and ultimately leads to a more efficient and effective public sector. The transition from cash to accruals accounting for UK central government departments was announced in the early 1990s and was embedded within approximately ten years. At that time there were clear indications that analogous changes, following a similar timeline, would occur in the Republic of Ireland (RoI). In reality, the changes were significantly less extensive. Utilising document analysis and interviews with key actors, this paper considers why a functioning accruals system was established in the UK whereas in the RoI the change to accruals accounting was a 'road not taken'.

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## 1. Introduction

Over the last 25 years, numerous changes, which collectively are categorised as New Public Management (NPM), have been introduced at different paces and in different ways in public sectors across the world, including the United Kingdom (UK) and Republic of Ireland (RoI). These changes often include a move from a cash-based to an accruals-based accounting system in the belief that this will provide more appropriate information for decision makers and lead to better decision making. In the early 1990s, the UK and RoI governments provided clear indications of their desire to introduce accruals accounting in central government in the near future. However, while accruals accounting was embedded in the management accounting and financial reporting systems of UK central government departments by 2003, change in the RoI has been minimal.

Given the apparent initial desire to introduce accruals accounting in central government in both the UK and

RoI, this paper examines the impact of its adoption in the UK and explores the reasons why significant accruals-accounting principles were not ultimately embedded into the RoI's central government. In terms of the format of the paper, the next section discusses the linkages between NPM, accruals accounting and new institutional theory in order to provide a theoretical and contextual backdrop for the reported empirical research. This is followed by an analysis of recent changes in government accounting systems in both the UK and RoI. After outlining the research method, the next section reports the results of semi-structured interviews with key actors in the public administrations in both jurisdictions. In the final sections the results are discussed and conclusions drawn.

## 2. NPM, accruals accounting and institutional theory

### 2.1. Variability of adoption

NPM is a collective term used to classify broadly similar public sector reforms that have been introduced in many Organisation for Economic Co-operation and Development (OECD) countries since the late 1970s. These reforms

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include the adoption of private sector managerial techniques, the development of market mechanisms and the break-up of government into smaller quasi-autonomous units. Research indicates that some countries have implemented NPM-style changes at a quicker pace and more enthusiastically than others, with Hood (1995) identifying high- (Australia, New Zealand and the UK), medium- (Austria, Italy and the RoI) and low-intensity adopters (Greece, Japan and Spain). He argues that, while right-wing political orientation, poor economic performance or government size do not necessarily mean increased use of NPM techniques, the existence of both motive (for example, potential savings from implementation) and opportunity (for example, limited constitutional checks on central government) may be important determinants. Pollitt and Bouckaert (2004), who contend that reforms are easier to push through in a centralised state that operates a majoritarian, rather than consensual, approach to government, argue that the cultural climate of a country has a major influence on the success of public sector reform programmes. With respect to culture, Hofstede (2001) suggests that the UK has a much greater individualistic orientation than the RoI. While Hofstede's work is not without criticism (Harrison and McKinnon, 2007), it possibly indicates a more accepting environment for NPM ideas in the UK than in the RoI.

In the field of accountancy, many, although by no means all, governments that have embraced NPM ideas have also adopted accruals accounting. Indeed, it is argued that without accruals accounting some of the NPM changes would be weakened (Likierman, 2003). Since the late 1980s there has been a significant movement towards accruals-oriented public sector accounting, most notably in countries such as Australia and New Zealand, with proponents claiming that it provides new and, arguably, better information. It is asserted that in a cash-based system, there is an inbuilt bias against rational capital investment and that the information provided through accruals accounting enables better-informed decisions on the balance between current and capital expenditure, taking into account the opportunity cost of capital and its consumption over time.

However, an increasing body of literature has criticised the adoption of accruals accounting by public sector organisations on both theoretical and practical grounds. Guthrie (1998) argues that, in the context of the public sector, accruals accounting is inferior and unsuitable because: profit is not a goal and cannot consequently be a relevant measure of performance; financial structure and solvency are not relevant in the public realm; accruals accounting does not measure outcomes; and accruals accounting provides a narrow idea of performance, focusing on cost of services and efficiency. In addition, Hepworth (2002) urges caution to governments contemplating the change to accruals accounting, arguing that accruals accounting will not solve underlying financial control problems; indeed it will make them worse because it arguably leaves greater scope for judgement (however this, given the political dimension of public sector budgeting, may be attractive to politicians as it offers more flexibility for window dressing). Cash-based accounting has the virtues of simplicity, understandability and objectivity, qualities which should

not be underestimated, particularly as in many government departments there are few, if any, skilled accountants and preparing and understanding the related information requires a degree of training (Pina et al., 2009). Regardless of the warnings against the unthinking adoption of private sector practices, in particular accruals accounting, it is argued that there is pressure on the public sector to reform and to demonstrate efficiency and effectiveness, with the implementation of accruals-accounting systems often being viewed as having a prominent role in this process (Pallo, 1992). As NPM advocates mimicry of private sector practices and emphasises quantification and performance measurement, it has had a profound effect on public sector accounting practices, with the need for accruals accounting being seen as 'self-evident' (Lapsley et al., 2009), perceived as progress (Guthrie et al., 2005) and viewed as fashionable (Hepworth, 2002).

## 2.2. Institutional theory

NPM literature typically suggests that functional or rational reasons (to improve efficiency and effectiveness) are the primary motivations for change. However, in contrast, institutional theory stresses that other factors related to both internal and external organisational expectations and values can play a part (Meyer and Rowan, 1977). As this includes the influence of the social and cultural aspects of an organisation's environment, it broadens the range of aspects which should be considered when assessing organisational change. Institutional theory seeks to explain the isomorphism of organisations, a key aspect of which is that organisations may adopt certain characteristics in order to appear legitimate, when, in fact, there are no technical economic efficiency gains from doing so.

Meyer and Rowan (1977) suggest that reforms are sometimes only introduced to satisfy external rules or expectations (for reasons of 'external legitimation') in order to portray an organisation as appropriate, rational and modern, and thereby seeking to avoid critical attention and questions from its social environment. Moreover, research indicates that institutional pressures for governments to adopt generally accepted accounting principles, and thus accruals accounting, may stem from normative pressures from professional (accounting) associations (DiMaggio and Powell, 1983; Pina et al., 2009). However, Carpenter and Feroz (2001), whilst acknowledging this tendency which may encourage the adoption of accruals accounting, warn that such a course of action is an expensive one, involving many actors across government who must be educated and persuaded that the changes are necessary. They also suggest that where self-interest maximising actors only have limited influence over the choice of accounting practices (for example, in the public sector where statutes dictate accounting methods), bureaucrats may not independently have the political influence or power to change existing practices. In such situations this may lead to 'organisational imprinting', where organisations retain practices not by rational design but because they are accepted 'as the way things are done'.

Logic refers to broad cultural beliefs and rules that structure cognition and fundamentally shape decision

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