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Accounting basis adjustments and deficit reliability: Evidence from southern European countries

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A B S T R A C T

Government accounting (GA) and National accounts (NA) are two reporting systems that, although aiming different purposes, are linked – public administrations' financial information for the latter is provided by the former. Therefore, the alignment between the two systems is an issue for the reliability of the public sector aggregates finally obtained by the National Accounts.

In the EU context, this is a critical issue, inasmuch as these aggregates are the reference for monitoring the fiscal policy underlying the Euro currency. However, while reporting in NA is accrual-based and harmonised under the European System of Regional and National Accounts, the GA each country still has its own reporting system, often mixing cash basis in budgetary reporting with accrual basis in financial reporting, hence requiring accounting basis adjustments when translating data from GA into NA.

Starting by conceptually analysing the accounting basis differences between GA and NA and the adjustments to be made when translating data from the former into the latter, this paper uses evidence from three southern European countries – Portugal, Spain and Italy, representing the southern Continental European accounting perspective, with cash-based budgetary reporting, and where budgetary deficits have been particularly significant in the latest years – to show how diversity and materiality of these adjustments may question the reliability of the budgetary deficits finally reported in NA.

The main findings point to the need for standardised procedures to convert cash-based (GA) into accrual-based (NA) data as a crucial step, preventing accounting manipulation, thus increasing reliability of informative outputs for both micro and macro purposes.

Ajustes de la base contable y la fiabilidad del déficit: evidencia de los países de la Europa del sur

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R E S U M E N

La Contabilidad Pública (CP) y las Cuentas Nacionales (CN) son dos sistemas de información contable que, aunque tienen distintos propósitos, están conectados – la información financiera de las administraciones públicas para el último es derivada del primero. Así, la armonización entre los dos sistemas es una cuestión importante a tener en cuenta en la fiabilidad de los agregados finales obtenidos por las Cuentas Nacionales.

En el contexto de la Unión Europea este es un tema crítico dado que los agregados de las Cuentas Nacionales sirven de referencia para la supervisión de la política presupuestaria ligada al Euro. No obstante, mientras la normativa en las CN es en la base de devengo y está armonizada por el Sistema Europeo de Cuentas Regionales y Nacionales, en la CP cada país tiene aún su propia normativa contable, muchas veces mezclando las base de caja en el informe presupuestario con el devengo en el informe financiero; por tanto, se requieren ajustes contables cuando se traslada la información de la CP a las CN.

En este artículo, se empieza analizando las diferencias conceptuales entre los sistemas contables de la CP y de las CN y los ajustes que se deben hacer cuando se trasladan los datos de la primera a las últimas.

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En la segunda parte del artículo se analiza empíricamente Portugal, España e Italia con el propósito de mostrar como la diversidad y materialidad de estos ajustes pueden cuestionar la fiabilidad de los déficits finalmente reportados en las CN. Estos países, donde los déficits tienen sido particularmente significativos en los últimos años, representan la perspectiva contable de los países del sur de Europa Continental con informe presupuestario en base de caja.

Los principales resultados apuntan la necesidad de crear procedimientos estandarizados para convertir los datos en base de caja (CP) en los en base de devengo (CN) que ayuden a prevenir la manipulación contable y así mejorar la fiabilidad de los outputs informativos para los propósitos micro y macro.

1. Introduction

The relationship between Governmental accounting (GA – microeconomic perspective) and National accounts (NA – macroeconomic perspective) is assumed as a relevant issue to be studied, by authors such as Lüder (2000), Jones (2000a, 2000b, 2003), Montesinos and Vela (2000), Keuning and Tongeren (2004) and Hoek (2005). The main problem is to evaluate whether GA meets the NA requirements, namely regarding data provided by the General Government Sector (GGS). NA rules have been established in the UN System of National Accounts, adapted to the European context through the European System of Regional and National Accounts (ESA).[1]

This relationship is much more relevant and actual because, in spite of GA reforms over the last two decades, introducing accrual basis, two different accounting bases still coexist in GA systems – accrual basis for financial accounting and cash basis for budgetary accounting.[2] On the other hand, regarding NA, all EU members-States must apply ESA rules for all economic sectors, including GGS that supports EU Treaty convergence criteria accomplishment – ESA requires full accrual basis, allowing some flexibility regarding taxes and social contributions.

Because of this difference in the accounting bases, several adjustments must be made when converting data from GA into NA, since the former are mostly cash-based, coming from budgetary reporting.

Subsequently, this paper starts by identifying, from the conceptual point of view, the major differences between GA and NA (namely concerning the recognition criteria – cash versus accrual basis), highlighting the main adjustments to be made when translating data from the former into the latter. The main purpose is to analyse the diversity and materiality of those adjustments, showing how they can question the reliability of final NA data (e.g. the deficit figures) reported by EU member-States to monitoring the Maastricht criteria these countries are obliged to accomplish with.

The paper relies on empirical evidence from three countries – Portugal, Spain and Italy, representative of the southern Continental European governmental accounting perspective, all using cash-based budgetary reporting, also embodying similar cultures and economic developments models, nowadays facing comparable difficulties in accomplishing with the EU convergence criteria.[3] Data from Excessive Deficit Procedure (EDP) Notifications of October 2010 and October 2013, covering years 2006 to 2012 and Central Government, were used.

Analysing accounting basis differences between GA and NA and being one of the first attempts to quantify those differences, this study makes an important contribution both theoretically and for practice, calling attention to the need for further alignment between both reporting systems, in order to avoid adjustments management and reassuring Government Financial Statistics reliability.

The paper follows divided into three main sections. Section 1 discusses the relationship and differences between GA and NA. Section 2 addresses the main adjustments when translating data from one reporting system into the other. Section 3 analyses adjustments diversity and materiality, illustrating with data from the above-mentioned EU member-States. At last, some conclusions and final comments are presented.

2. The relationship between governmental accounting and national accounts

GA is aimed at running and reporting on one Government's budget, for purposes of financial management and accountability. It has evolved as Governments (broadly seen as including all governmental entities) have done, and as additional governmental information have revealed necessary within new contexts (Jones & Pendlebury, 2010).

In the last decades, under the *New Public Management* trends, new information requirements have been made to GA, which has therefore experienced considerable reform processes worldwide, which main common feature has been the introduction of accrual basis with a progressive approach to business accounting, particularly in what concerns financial accounting subsystems, thus moving to approach GA and NA, since the latter is already accrual-based (Benito, Brusca, & Montesinos, 2007; Brusca & Condor, 2002; Vela Bargues, 1996).

Nowadays, GA in general comprises two different subsystems: (i) budgetary accounting and reporting; and (ii) financial accounting and reporting. Budgetary subsystems support budgetary decisions regarding countries fiscal options, in a straight line with policy making, and report on budgetary achievements. Financial subsystems are related to governmental entities' reporting in order to evaluate their performance and financial position.

Many international studies have shown that most countries that have adopted accrual basis in their GA, have not introduced it comprehensively, namely embracing budgetary systems, i.e. budget preparation and reporting of budgetary performance still remains

[1] The most recent version of the UN System of National Accounts was approved in 2008, implying a subsequent revision of the ESA. ESA2010 based on SNA2008 will be in practice in European countries from September 2014.

[2] In fact, budgetary reporting is cash based. However regarding the budgetary execution, countries like Portugal and Italy use commitments recognition. So, when referring to the budgetary system as a whole, modified cash basis is mentioned, in spite of cash-based budgetary reporting.

[3] In Portugal, Spain and Italy, reliability of Government Financial Statistics gathered by the National Accounts are perhaps even more important than in other countries. In the period considered for analysis, these countries were not fulfilling with the convergence criteria within the EU and/or were at the edge of default, as it came to happen: Portugal is under external financial support since 2011 and Spain and Italy are struggling with serious economic conditions (high levels of public debt and deficits) that have led to austerity policies as those implemented in Portugal under the agreement with the creditors.