

Seven years since the implementation of accrual accounting in public sector from Romania

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Abstract: Worldwide, the public sector is taken over by important changes. Among the managerial, organisational changes, there are the ones made in the field of public accounting. Romania, as a European Union member state made no exception.

In this article I presented the evolution of public accounting in Romania since the events of 1989 and until now, a period marked by the introduction of accrual accounting in all the fields of public administration. This method was considered the most accurate in presenting the state's patrimonial and financial situation and, implicitly, that of the state institutions, especially in this moment of global economic crisis.

The present study is based on published scientific articles on the subject, accounting papers, national and international accounting regulations as well as my own experience and aims to show if the implementation of accrual accounting can be considered a success and if it is useful for the Romanian public sector.

Key-Words: cash accounting, accrual accounting, public sector, NPM, cash budget, accrual budget

1 Introduction

In recent years, the attention of many researchers focused on the general performances of the public sector (given the recent changes that have occurred in this field) and, particularly, the accounting field reform.

The International Federation of Accountants-Public Sector Committee has identified four basic methods: cash accounting, modified cash accounting, modified accrual accounting, accrual accounting (Jovanic, 2013)

The key difference between cash accounting and accrual accounting consists of the moment when an event is recorded (Davis, 2010). Cash accounting, recognises transactions and events only when cash is received or paid while accrual accounting recognises transactions and events when they occur, regardless of when cash is paid or received (□tefănescu and □urlea, 2011). Rowles (2004) considers that "accrual accounting provides information about the financial performance and position of public resources that cash accounting cannot".

Mohammadi S. et al (2012) believes that transactions are recognized when the income or expenditure can be tolerated. Cash accounting focuses on cash receipt and payment (surplus or deficit of cash) while accrual accounting focuses on revenue and expenditure (profit or loss). Hence, the

net income reported by each reporting basis is not equal.

Accrual accounting is a component of the concept called New Public Management (NPM). This concept, was developed by Christopher Hood in 1990 and refers to the structural, organisational and managerial changes which have occurred in the public activity. Thus, the New Public Management was designed to replace the traditional bureaucratic public administration (Stewart and Walsh, 1992) with a new results-based management, directly involving public accountability (Coy and Pratt, 1998). The boundaries between the public and the private sectors tend to blur so that the two can find the same practices to achieve a good management.

Pina et al. (2012) are of the opinion that the implementation of NPM reforms is influenced by the organizational culture of the respective countries, the historical and legal context.

In the Anglo-Saxon countries, accrual accounting dominates the public sector while in European countries, this process is ongoing. Janovic (2013) considers that in many countries of Central and Eastern Europe, this process is deficient.

In most countries, the accrual basis reporting model was adopted following a political decision,

to meet certain conditions for joining the EU, as is the case of Romania.

In fact, the European Union recommends the introduction of accrual accounting to all the countries wishing to apply for membership bringing with it essential advantages, such as (www.ec.europa.eu):

- a complete image of assets and liabilities,
- multi-annual financial statement presentation,
- analytical presentation of accounting records,
- increased efficiency of management and decision-making due to better information,
- more efficient audits due to clear and consistent records,
- tighter political control through a better understanding of the financial impact of policies,
- minimized risk of error in payments to beneficiary,
- provides international comparability, especially between EU Member States.

More than ever, accrual accounting has proven useful in this time of crisis. Like most organisations, the public institutions are facing financial problems. Accrual accounting, in these circumstances, provides more comprehensive financial information than cash accounting, particularly on debt.

However, a large number of authors consider that the adoption of accrual accounting in the public sector, in most cases, is accompanied by problems of organizational, financial and human resources nature that hinder the process (Eriotis *et al.*, 2011)

2 Before 2006...

The first accounting field to be regulated in Romania was that of public accounting in 1865 and has its roots in the Financial Regulation adopted in 1860. Thirty years later, in 1895, through the new public accounting law, it extended to all the fields of public administration. Changes to it were made in 1903, 1904, 1906, 1908, 1910, 1911, 1922, 1923, 1925 but the most important one took place on the 31st of July 1929 when a new Public Accountancy Act was adopted (Demetrescu, 1972). It contained the following innovations: the mandatory introduction of double entry accounting, the mandatory introduction of the 12 months fiscal year instead of 18 months, the mandatory introduction of the preventive financial control, the establishing of the four phases of budget execution: induction,

liquidation, ordering, payment, the mandatory inventory of public assets.

In communist period (1948-1989), the financial statements drawn up according to cash accounting principles were not a tool available to the management team but had more of a statistical role.

After 1989, and by 2002, our country's public accounting was deaf to the global trends in the field. Public administration used the same system based on cash accounting, which was based on a legal framework available since 1984 and which had undergone little change (Deaconu *et al.*, 2011).

The Accounting Law adopted in 1991 refers to the public institutions that have the obligation „to organize and manage financial accounting”.

In December 1999, the European Council in Helsinki decided that Romania, along with other five countries (Bulgaria, Latvia, Lithuania, Malta and Slovakia), would start accession negotiations with the EU.

Romania responded to this challenge and began a series of reforms that included:

- Harmonization of the chart of accounts and financial statements of the public institutions with those of commercial companies;
- Harmonization of the accounting system of public institutions with the international regulations (IPSAS);
- Modification of budget classification in order to assess the performance in using public money (budget programs) according to ESA 95;
- The introduction of mandatory leading of management accounting in order to track the costs associated with the programs foreseen in the budget.

At the end of the year 2002, the Ministry of Finance takes the step towards accrual accounting:

- approves the methodological norms regarding the restructuring of budgetary accounting by "supplementing cash flow accounting with liabilities accounting" (Order 1746). These norms, achieved with the help of the British experts have been experimentally applied on 13 public institutions in the first half of 2003 (alongside to the existing regulations at the time).
- approves the four phases of the budgetary execution of expenditure (induction, liquidation, ordering, payment) that are undergone by all

public institutions, irrespective of who they answer too and their manner of financing, with mandatory compliance to procedures (Order 1792).

The novelty regarding the registration of fixed assets in accounting. In 2003 depreciation and revaluation are introduced to reflect the real value of goods (by adopting Ordinance 81 and the Order 1487/2003).

„The public institution, regardless of the source of expenditure funding and subordination, will inventories and revalue the tangible fixed assets and tangible fixed assets in progress, under patrimony on 30th September 2003 and revaluation results will be included in the balance sheet issued on 31st December 2003. Revaluation of tangible fixed assets and tangible fixed assets in progress, under the patrimony of public institutions, aims to bring them at the current cost or updated input value, in correlation with the utility of these goods and their market value.”

Until now, fixed assets are recorded in the accounts under symbolic values (Table no. 1). This situation determines an undervaluation of public state patrimony.

Table no.1. Comparative situation regarding the revaluation of fixed assets

Name of asset	Year of entry as heritage	Book value	Revaluated value 2003
Building A	1972	922,39	5.340.843,42
Building B	1982	1312,23	5.064.429,34

For the revaluation of assets, the book value of the fixed asset was taken into consideration as heritage at the entry date, correlated with an updated coefficient available on December 31, 2002 (Order 1487 of 2003 on revaluation and depreciation of fixed assets).

By applying this method, the book value at the moment of entry in updated accounting and, implicitly, updated depreciation were determined (Dascălu *et al.*, 2006) for the period of time between the entry date of the fixed asset and revaluation date. The revaluation difference is determined by comparing the updated value and the input one.

In 2008, the Ministry of Finance Order 1487 is revoked and Order 3471 is adopted. “Through the revaluation of tangible fixed assets existing in the patrimony of public institutions, the update of the value of these patrimony elements in the annual

financial statements of the year in which the revaluation took place is achieved.

The revaluation of tangible fixed assets is carried out with the purpose of determining their fair value at the balance sheet date, taking into account inflation, utility of these goods, the condition they are in and their market value, when the carrying amount differs materially from fair value.”

Since January 2006, within the context of undertaken commitments for joining the European Union, by implementing Order 1917, all public institution from Romania have to prepare financial statements under the accrual accounting rules and lead double entry bookkeeping (until this time a fairly number of public institutions, respectively rural town halls, had led single entry bookkeeping).

Financial statements prepared under accrual accounting conditions include: statement of financial position (balance sheet), financial performance statement (profit and loss), statement of changes in net assets / equity, cash flow statement, accounting policies and notes to the financial statements, account budget execution.

Budgeting is a process that converts information into a decision. Budgets are used as a planning tool for the future and describe what the institution wants to obtain (Hoek, 2005).

According to other authors, the budget is a binding forecast document that compares revenue and expenses for the period referred to (Dascălu *et al.*, 2006). The budget is a key tool in public management.

Worldwide, there are budgets prepared under cash accounting conditions and others under accrual accounting conditions. As the introduction of accrual accounting in the public sector has been a subject of worldwide debate so has the budgeting system (cash or accrual) been the subject of research.

The difference between the two models is given by when the transactions occur (Marti, 2004). An accrual budget will estimate income and expenditure for a given period of time in order to determine the profit that is to be achieved. A cash budget will relate only to the items received or paid in order to determine whether there is sufficient cash.

Internationally, New Zealand, Australia, Sweden prepare financial statements under both cash and accrual budget conditions, other countries making efforts in this regard.

In Romania, the budget is prepared under cash accounting conditions and is used to control receipts and payments. In these conditions, the

budget should ensure the comparison between the revenues collected and the expenses made

The budget is of great importance both at institutional level and at national level, both financially (by attracting and directing resources needed for the activity) and economically (through the use of the intervention mechanisms in the economy).

Champoux (2006) states that by applying accrual accounting only for financial reports, these risk not being taken seriously and a purely technical action.

Alecu (2010) considers that in Romania the transition to an accrual budget is imposed, reminding as advantages the fact that it offers more complete information about the financial situation of the Government, provides better management control, improves efficiency, performance and asset and liabilities management.

Ștefănescu et al. (2010), propose the full adoption of accrual accounting in the context in which it "provides greater transparency, relevance, more reliable information."

3 After 7 years...

Seven years have passed since the adoption of accrual accounting but can this process be considered a success?

To answer this question I started from the essential conditions that must be met for the process to be considered a success.

Wynne (2004) lists the following conditions for the implementation of accrual accounting to be considered a success:

- consultation and acceptance;

Before the formal introduction of accrual accounting in January 2006, it was used to complement cash accounting (Order 1746) and some entities had experimentally implemented this method. Pitulice (2013) considers that there was no public information regarding the success of this experiment which led the public sector accountants to believe this change as a rule imposed by the accounting-standard setters (Tudor *et al.*, 2008).

- participation of accountancy and the joint development of accounting standards;

As far as the accounting profession is concerned, it "must have the capacity and be prepared to be interested in and involved with the public sector" (Hepworth, 2003).

The Body of Experts and Licensed Accountants of Romania (CECCAR) has taken steps in this regard publishing in 2005 the

International Accounting Standards for the Public Sector and in 2009 the Handbook of International Public Sector Accounting. However, CECCAR was not involved in the implementation of accrual accounting in the public sector (Pitulice, 2013).

- support of the government auditor;

"Successful implementation of accrual accounting depends heavily upon the understanding of, and willingness to support, the system by the external auditor of central government" (Hepworth, 2003).

In Romania, the external audit is performed by the Court of Auditors.

"Control and external public audit activity planning shall be performed at two levels, multiannually (3 years) and annually. Multiannual planning shall allow the Court of Accounts to address its duty to audit all entities, the managers of which act as main authorizing officers of the general consolidated budget, at least once every three years." (www.curteadeconturi.ro).

Furthermore, the audit performed by the Court of Accounts centres more on the lawfulness of public spending and less on how the accrual accounting rules are respected.

- comprehensive management training for the managers of public institutions;

Champoux (2006) states that by applying accrual accounting only for financial reports, these risk not being taken seriously and a purely technical action.

Although the decision of implementing accrual accounting in local administration entities is taken by the central body, enforcement is carried out by managers (Pina *et al.*, 2012). Since they are responsible for account management it is necessary to organize training courses.

Furthermore, the adoption of the accounting reform by high-level institutions is associated with the level of education of the accounting department staff (Eriotis *et al.*, 2011)

Wynne (2004) believes that the schedule of such a training program should include:

- an assessment of basic financial concepts underpinning accrual accounting;
- the manner in which accrual accounting allows the introduction of the improved budgetary system and of the financial control system.

At present, in Romania there are companies that have the main object of activity that of organizing training courses in budgetary accounting, but the economic and financial crisis

has led to the point where public institutions can no longer afford to train their employees.

- an appropriate cultural approach;

Besides morality and democracy, ethics is one of the core values that characterises public sector management. Ethics involves “the removal of old mentalities and contributing to the shaping of a conscience to improve our current social existence, to think and act prospectively” (Androniceanu, 2007). From this point of view, Romania is at the beginning of its journey.

- a recognition of the elapsed time needed and that it is part of a reform;

“From the outset, there must be a willingness to recognize that the introduction of accrual accounting and budgeting will take time (Hepworth, 2003).”

National and international experience indicates that the implementation of accounting reforms takes about 8 to 10 years (Wynne, 2004).

In Romania, the introduction of accrual accounting in the public sector was a political decision, a condition for EU membership. Usefulness of its implementation will be proven over time through the recognition of the benefits of accrual accounting listed above.

- an IT capacity;

From this point of view, Romania has sufficient IT resources. Many of the IT resources were purchased through grant programs funded by the European Union. On the other hand, accounting programs do not fully respond to accrual accounting requirements. There are deficiencies in the recording of budgetary and legal commitments because there are not enough programs developed to do so. Most include financial accounting modules and too few modules that are in accordance with the laws on ALOP (induction, liquidation, ordering, payment).

- a willingness to use incentives and penalties.

The Romanian budget system is facing serious financial problems, thus the financial incentives in this sector are nonexistent. Before the global economic crisis, persons from the private sector, who were specialised in the application of accrual accounting, were hired in the budget system. Unfortunately, the financial problems have led to a reduction of wages in the public sector, situation which has determined a loss of motivation of public employees in general and accounting employees in particular which, in turn, has led to a reduction in their performance or has determined them to leave the system.

Romania has made efforts to implement accrual accounting, but this process is not considered a full success. Ștefănescu *et al.* (2010) consider the adoption of accrual accounting as an uncertain process. The argument in this regard is the fact that the development program of public accounting has not been adapted.

Pitulice (2003), considers that public accounting “still pays tribute to some archaic concepts that, from an economic and administrative point of view, are still kept in the legal regulations that govern the public sector”.

For accrual accounting to be useful and successful, the information it provides should improve the decision-making process in the public sector.

4 Conclusion

Following research, as well as personal practice, I believe it is time that the public sector accounting system should undergo a new phase of legislative change. Besides the need of introducing the accrual budget, I consider that improvements could be made as far as the valuation of receivables, liabilities and cash reserves are concerned. In the private sector, the valuation of receivables, liabilities and cash reserves is done monthly while in the public sector it is done quarterly, on the balance sheet date.

Being a long-lasting process, in order for the implementation of accrual accounting to be successful, it is necessary that the public authorities make an effort in the training of accounting personnel on the application of the internal control management system.

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