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Accrual Accounting in New Zealand and Australia:

Issues and Solutions

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<u>**Accrual Accounting in New Zealand and Australia: Issues and Solutions**</u>

The last two decades have seen a significantly increasing number of governments throughout the world employ accrual accounting methods for both financial reporting and budgeting purposes, although such instances are certainly still the exception rather than the norm in the international public sector. [1] The national governments in New Zealand and Australia in particular are often cited as having adopted accrual accounting more comprehensively than any others. For that reason, much focus has been devoted, both by scholars as well as government bureaucrats, to the implementation of accrual accounting in those two countries and the subsequent results of their reforms. The lessons learned from the experiences of New Zealand and Australia are especially pertinent to policy discussions regarding the use of accrual accounting in the public sector of the United States. Although the U.S. federal government has adopted accrual standards in some contexts,[2] it has not done so to the extent achieved by New Zealand and Australia, and what adoption has occurred in the U.S. has in large part merely supplemented rather than wholly replaced the traditional government accounting methods and indicators.[3] As

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[1] Among the national governments that have adopted accrual accounting methods in some form or another are the United Kingdom, Netherlands, Canada, Iceland, United States, and Sweden. *See* ORGANISATION FOR ECONOMIC COOPERATION AND DEVELOPMENT, ACCRUAL ACCOUNTING AND BUDGETING, PUMA/SBO(2002)10, at 12–15 (2002) [hereinafter OECD ACCRUAL ACCOUNTING REPORT].

[2] More specifically, the U.S. employs accrual methods in producing consolidated financial statements, while it generally does not use accrual accounting for budgeting and appropriating purposes. *See generally* David Burd & Takeshi Fujitani, *FASAB and the Financial Statements of the United States* (Harvard Law School Federal Budget Policy Seminar, Briefing Paper No. 13, 2005), *at* http://lawweb.usc.edu/cslp/conferences/fiscal%20challenges/documents/13-FASAB.pdf.

[3] In fact, that accrual measures have wholly replaced traditional measures for budgeting purposes in New Zealand and Australia is a critical difference from the situation in the U.S.:

> The problem . . . with applying accruals only to financial reporting and not to the budget is that it risks not being taken seriously. The budget is the key management document in the public sector and accountability is based on implementing the budget as approved by the legislature. If the budget is on cash basis, that is going to be the dominant basis on

proposals for further use of accrual measures are considered in the U.S., the experiences of countries such as New Zealand and Australia can be valuable in shaping the policy debate.

After providing a brief explanation of accrual accounting, this paper will describe the history of the adoption of accrual methods by the governments of New Zealand and Australia. It will then discuss two key issues of significance for U.S. policy discussions: the role of accrual accounting in the output-based budgeting process employed in New Zealand and Australia, and the two countries' treatment of mandatory liabilities such as social insurance and pension benefits. Finally, this paper will briefly summarize and review the available relevant literature.

<u>Background</u>

Accrual Accounting

In general, an accrual accounting system recognizes economic events when they occur rather than when money is actually exchanged.[4] Revenues are generally recognized when goods and services are delivered, and expenses are recorded for the time periods in which assets are used and liabilities are incurred in generating revenue.[5] As such, accrual methods are often favored in situations where transactions of goods and services are not necessarily completed within one time period.[6] In the U.S., accrual

> which politicians and senior civil servants work. Financial reporting on a different basis, risks becoming a purely technical accounting exercise in these cases.

OECD ACCRUAL ACCOUNTING REPORT, *supra* note 1, at 2.

[4] *See* GENERAL ACCOUNTING OFFICE, A GLOSSARY OF TERMS USED IN THE FEDERAL BUDGET PROCESS, GAO-05-734SP, at 7 (2005) [hereinafter GAO GLOSSARY].

[5] *See* GENERAL ACCOUNTING OFFICE, ACCRUAL BUDGETING: EXPERIENCE OF OTHER NATIONS AND IMPLICATIONS FOR THE UNITED STATES, GAO/AIMD-00-57, at 31 (2000) [hereinafter GAO ACCRUAL BUDGETING REPORT]. The GAO report evaluates in detail the reforms relating to accrual accounting implemented in New Zealand and Australia, as well as Canada, Iceland, the Netherlands, and the United Kingdom.

[6] *See id.*

accounting is the most common system used by large entities in the private sector; in fact, publicly-traded corporations as well as other entities are required by law to generate financial statements based upon the accrual methods set forth as Generally Accepted Accounting Principles (GAAP).[7]

Unlike accrual accounting, cash-based accounting primarily records the inflow and outflow of cash, regardless of when revenues are earned or liabilities are incurred.[8] As such, future liabilities, for example, are not accounted for until a cash payment is actually made. In the context of government spending, a future liability, such as payment of a retirement pension, is not reflected in the official financial budgets and statements until pension comes due and payment is made.

The U.S. Government Accounting Office (GAO) describes the primary U.S. federal government accounting method as neither accrual- nor cash-based, but rather as obligation-based.[9] This method of budgeting "focuses on the legal obligations entered into during a period regardless of when cash is paid or received [as in cash-based accounting] and regardless of when resources acquired are to be received or consumed [as in accrual accounting]." [10] While this is theoretically different than pure cash-based accounting, there are few practical differences between cash accounting and the U.S. obligation-based system because the U.S. system measures obligations and other

[7] *See* 15 U.S.C. §§ 78(l), (m) (2006); Policy Statement: Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter, Exchange Act Release Nos. 33-8221, 34-47743, IC-26028, FR-70 (April 28, 2003) (re-designating the Financial Accounting Standards Board as the private entity charged with establishing GAAP standards for the U.S. private sector).
[8] *See* GAO GLOSSARY, *supra* note 4, at 27–28.
[9] *See* GAO ACCRUAL BUDGETING REPORT, *supra* note 5, at 32.
[10] *Id.*

transactions on a cash or cash-equivalent basis and because the principle budget indicator—the unified budget deficit/surplus—is essentially a cash-based figure.[11]

Although accrual accounting has been favored by the private sector for several decades, it is only relatively recently that national governments began to seriously consider employing accrual measures for their own financial reporting and budgeting.[12] The motives in turning to accrual accounting vary, but in general, an accrual system is seen as a way of increasing budget transparency, especially in terms of its ability to account for long-term assets and liabilities, and also as a tool for increasing government efficiency through performance-based management.[13] Two of the first countries to turn to accrual accounting for these very reasons are New Zealand and Australia.

New Zealand

The adoption of accrual accounting in New Zealand took place amid broad economic reforms that, in the span of only a few years, transformed the country's economy from being one of the most centrally controlled in the non-communist world to being very open.[14] Those reforms began in the mid-1980s with the widespread privatization and corporatization of government-owned commercial entities as well as a

[11] The unified budget deficit is, roughly, the difference between annual cash receipts and cash outlays. *See id*; *see also* GAO GLOSSARY, *supra* note 4, at 43–44, 99.
[12] International Federation of Accountants, *Perspectives on Accrual Accounting* 1 (Occasional Paper No. 3, 1996) [hereinafter IFAC Perspectives] ("From time immemorial, accounting for governments and government agencies has been on a cash basis. No change was contemplated until the early 1980s when it was considered appropriate that government business enterprises should move closer to commercial accounting principles practiced in the private sector either on a full accrual or a modified accrual basis.").
[13] *See id.* at 1–4; OECD ACCRUAL ACCOUNTING REPORT, *supra* note 1, at 1–2; INTERNATIONAL FEDERATION OF ACCOUNTANTS, TRANSITION TO THE ACCRUAL BASIS OF ACCOUNTING: GUIDANCE FOR GOVERNMENTS AND GOVERNMENT ENTITIES 7–12 (2d ed. 2003) [hereinafter IFAC GUIDANCE FOR GOVERNMENTS].
[14] *See* June Pallot & Ian Ball, *Resource Accounting and Budgeting: The New Zealand Experience*, 74 PUB. ADMIN. 527, 528 (1996). For another more recent recounting of the New Zealand reforms, see Ken Warren & Cheryl Barnes, *The Impact of GAAP on Fiscal Decision Making: A Review of Twelve Years' Experience with Accrual and Output-based Budgets in New Zealand*, 3 OECD J. BUDGETING 7 (2003).

broad deregulation of New Zealand's currency and financial markets.[15] Shortly thereafter, the government sought to increase performance and accountability in its remaining public commercial entities by adopting modern management practices, such as giving stronger personnel authority to chief executives (entity heads) and also implementing performance-based executive evaluations.[16]

Until 1989, New Zealand's budgeting process was based upon a cash accounting system.[17] With the passage of the Public Finance Act of 1989, New Zealand redefined the government's budget process, making it output-based, and also required that all budgeting and reporting at the department level use accrual methods.[18] An output-based budgeting process, generally speaking, emphasizes "the use of output (product) cost information as a managerial tool and more specifically as the basis for a purchaser/provider (quasi-market) model of budgeting."[19] In other words, government agencies and departments are viewed as producing outputs (for instance, maintenance of armed forces, prison management, etc.), which Parliament then purchases, so to speak. As such, the departments must use accrual-based projections and reports so that Parliament can know the full costs of the outputs and compare costs with private suppliers if possible.[20] In addition to requiring department reporting and budgeting based

[15] *See* Pallot & Ball, *supra* note 14, at 528; GAO ACCRUAL ACCOUNTING BUDGETING REPORT, *supra* note 5, at 176–77.
[16] Many of the reforms to the public sector entities were implemented through the State Sector Act of 1988. *See* GAO ACCRUAL ACCOUNTING BUDGETING REPORT, *supra* note 5, at 177.
[17] For a brief discussion of many of the deficiencies in New Zealand's cash-based accounting system, see *id.* at 180–81.
[18] *See id.* at 177.
[19] Marc Robinson, *Accrual Accounting and Australian Fiscal Policy*, 23 FISCAL STUD. 287, 288 (2002); *see generally* Tyrone M. Carlin & James Guthrie, *A Review of Australian and New Zealand Experiences with Accrual Output Based Budgeting* (International Public Management Network Conference Paper, 2000), *at* http://www.inpuma.net/research/papers/sydney/carlinguthrie.html.
[20] *See* Pallot & Ball, *supra* note 14, at 530.

on accrual measures, the Public Finance Act also implemented accrual-based performance assessments.[21]

New Zealand produced its first fully accrual-based combined financial statements in 1992, known as the Crown financial statements.[22] These statements are independently audited and very much resemble the GAAP-compliant reports of large corporations.[23] In 1994, the Fiscal Responsibility Act expanded the accrual system even further and required that the government articulate its fiscal strategy and report progress towards its objectives on an accruals basis.[24] Since that time, accrual accounting has been the principle system both for budgeting in Parliament and also for financial reporting by the Crown, and it has continued to be utilized as a corporate-like performance measure for government entities.

The accrual-based reforms in New Zealand are arguably the most comprehensive that any country has undertaken to date.[25] While it is indisputable that the reforms significantly affected the government management processes in New Zealand, it is difficult to ascertain the true fiscal and economic impact of the reforms. The GAO reports that, in general, most observers seem to agree that the accrual measures have provided better information for purposes of asset management and cost calculations.[26] Additionally, many believe that the accrual measures have produced much greater fiscal

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[21] *See* GAO ACCRUAL ACCOUNTING BUDGETING REPORT, *supra* note 5, at 177. The New Zealand Treasury recently issued an excellent guide explaining in detail the requirements of the Public Finance Act and, more broadly, the budgeting and appropriations process for New Zealand. *See* NEW ZEALAND TREASURY, A GUIDE TO THE PUBLIC FINANCE ACT (2005), *available at* http://www.treasury.govt.nz/pfa/default.asp.
[22] *See* Pallot & Ball, *supra* note 14, at 528. The Crown Financial Statements are issued by the New Zealand Treasury and are available online at http://www.treasury.govt.nz/financialstatements/.
[23] *See* Ruth Richardson, *Opening and Balancing the Books: The New Zealand Experience*, in IFAC Perspectives, *supra* note 11, at 5, 8 (1996).
[24] *See* GAO ACCRUAL ACCOUNTING BUDGETING REPORT, *supra* note 5, at 177; Pallot & Ball, *supra* note 13, at 529.
[25] *Cf*. OECD ACCRUAL ACCOUNTING REPORT, *supra* note 1, at 12–15; *see generally* GAO ACCRUAL ACCOUNTING BUDGETING REPORT, *supra* note 5.
[26] *See* GAO ACCRUAL ACCOUNTING BUDGETING REPORT, *supra* note 5, at 193–194.

discipline, especially in as much as legislators and other government officials can more easily ascertain the fiscal sustainability (or lack thereof) of government programs.[27]

Indeed, since implementing the reforms, New Zealand has in fact demonstrated strong fiscal restraint. In terms of budgeting, New Zealand has more or less tolerated increases to core budgets of each department at only a constant nominal level.[28] Remarkably, New Zealand's gross financial liabilities has decreased from 65% of GDP in 1993 to 23% in 2005, while the OECD as a whole has increased from 66% to 76% in the same time period.[29] The country has also reported budget surpluses in nearly every year since the early 1990s.[30] As a result, New Zealand's net debt has decreased significantly, from approximately 52% of GDP in 1992 to near 10% in 2005.[31] During the same time, New Zealand has enjoyed, for the most part, moderate to strong economic growth, averaging around 3.3% annual growth in real GDP over the last decade.[32] To what extent any economic success can be attributed to New Zealand's major reforms and, more specifically, to its use of accrual accounting, is highly unclear.

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[27] *See id.* at 195 ("Some officials noted that adopting accrual-based budgeting was also valuable in ensuring fiscal discipline and improving the ability to maintain surpluses.").
[28] *See id.*
[29] *See* OECD Economic Outlook No. 78, Annex Table 32 (2005), *available at* http://www.oecd.org/document/61/0,2340,en_2649_201185_2483901_1_1_1_1,00.html.
[30] *See id.* at Annex Table 27.
[31] *See* NEW ZEALAND TREASURY, A GUIDE TO THE PUBLIC FINANCE ACT 33 (2005), *available at* http://www.treasury.govt.nz/pfa/default.asp.
[32] *See* OECD Economic Outlook No. 78, *supra* note 28, at Annex Table 1.

Figure 1: New Zealand Real GDP Growth[33]

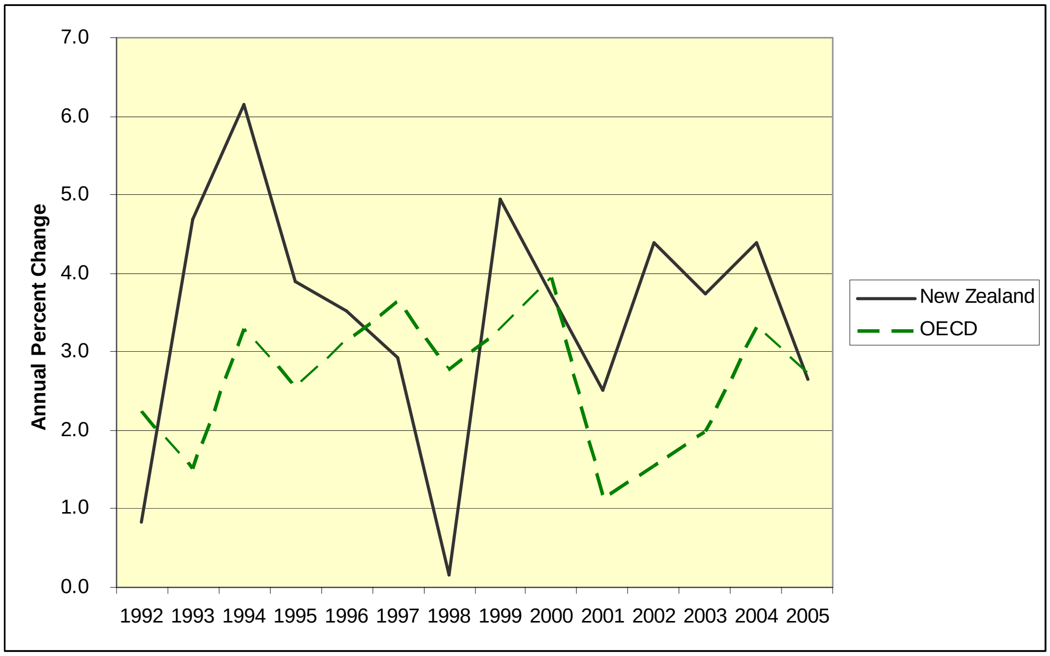
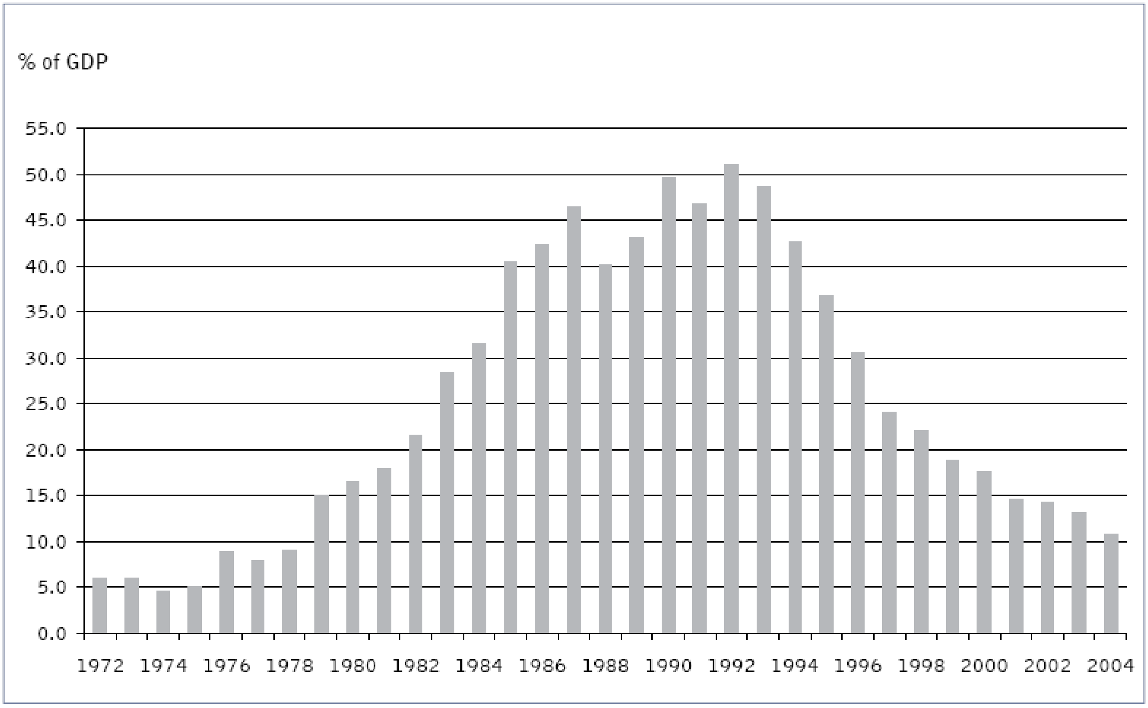


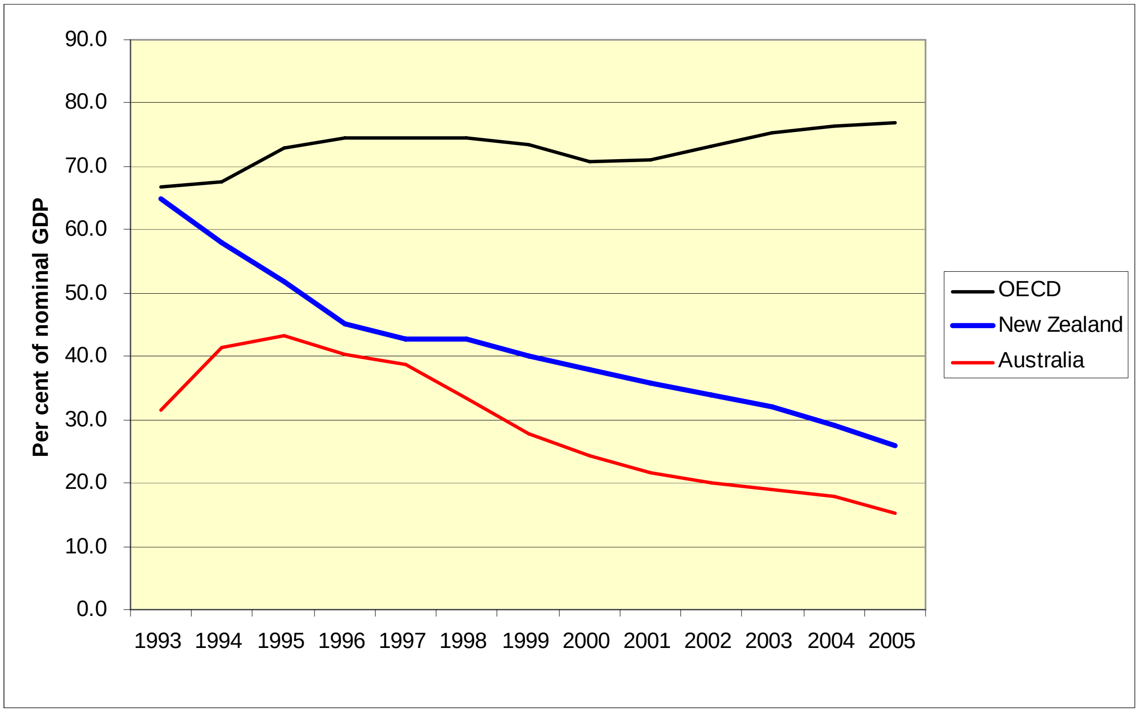
Figure 2: New Zealand Net Public Debt[34]



[33] *Id.*

[34] NEW ZEALAND TREASURY, A GUIDE TO THE PUBLIC FINANCE ACT 33 (2005), *available at* http://www.treasury.govt.nz/pfa/default.asp.

Figure 3: General Government Gross Financial Liabilities[35]



Australia

As was the case with New Zealand, Australia's adoption of accrual accounting for the public sector occurred during a period of broad economic reforms, though Australia's reforms were perhaps more modest than those of New Zealand. Although Australia's economic growth had been more consistent than New Zealand's, pressure arose by the early 1990s to increase government efficiency and improve fiscal performance.[36] Comprehensive reforms to those ends were implemented through two initiatives: the Financial Management Improvement Program and the Program Management and Budgeting.[37] Additionally, the Financial Management and Accountability Act of 1997

[35] *See* OECD Economic Outlook No. 78, *supra* note 29, at Annex Table 32.
[36] *See* GAO ACCRUAL ACCOUNTING BUDGETING REPORT, *supra* note 5, at 117; James Guthrie, *Application of Accrual Accounting in the Australian Public Sector—Rhetoric or Reality?*, 14 FIN. ACCOUNTABILITY & MGMT. 1, 7 (1998). In general, Guthrie's article provides an excellent, though slightly outdated, overview of the accrual accounting reforms in Australia.
[37] *See* GAO ACCRUAL ACCOUNTING BUDGETING REPORT, *supra* note 5, at 117, n. 5.

introduced a government management system with emphasis on performance assessments not unlike those implemented in New Zealand.[38] As a result of these reforms, government agencies were required to begin budgeting, reporting, and accounting on an accrual basis.[39] For the 1999-2000 budget, Australia produced comprehensive accrual-based financial statements and had fully implemented accrual output budgeting.[40] Since then, Australia has continued to expand its accrual-based accounting and budgeting.

Like New Zealand, Australia has demonstrated strengthened fiscal discipline in recent years. Australia has produced a budget surplus in every year for close to a decade, and it has succeeded in reducing its net debt from a high of 25% of GDP in the mid 1990s to near debt elimination.[41] Its gross financial liabilities have decreased from a high of 43% of GDP in 1995 to 15% in 2005, the second lowest percentage in the OECD.[42] At the same time, Australia has enjoyed economic growth in real GDP averaging 3.6% annually over the past decade.[43] Again, it is unclear to what extent accrual accounting reforms are responsible for the fiscal discipline and economic growth.

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[38] *See id.*
[39] *See id.* at 117–118.
[40] *See id.* at 118–119. The Treasury Annual Reports, which include Australia's financial statements, can be found online at http://www.treasury.gov.au; national budgets can be found at http://www.budget.gov.au/index.htm.
[41] *See* Australian Government, *2005-06 Budget Overview* 7, *available at* http://www.budget.gov.au/2005-06/overview/html/index.htm.
[42] *See* OECD Economic Outlook No. 78, *supra* note 29, at Annex Table 32.
[43] *See id.* at Annex Table 1.

Figure 4: Australia Real GDP Growth[44]

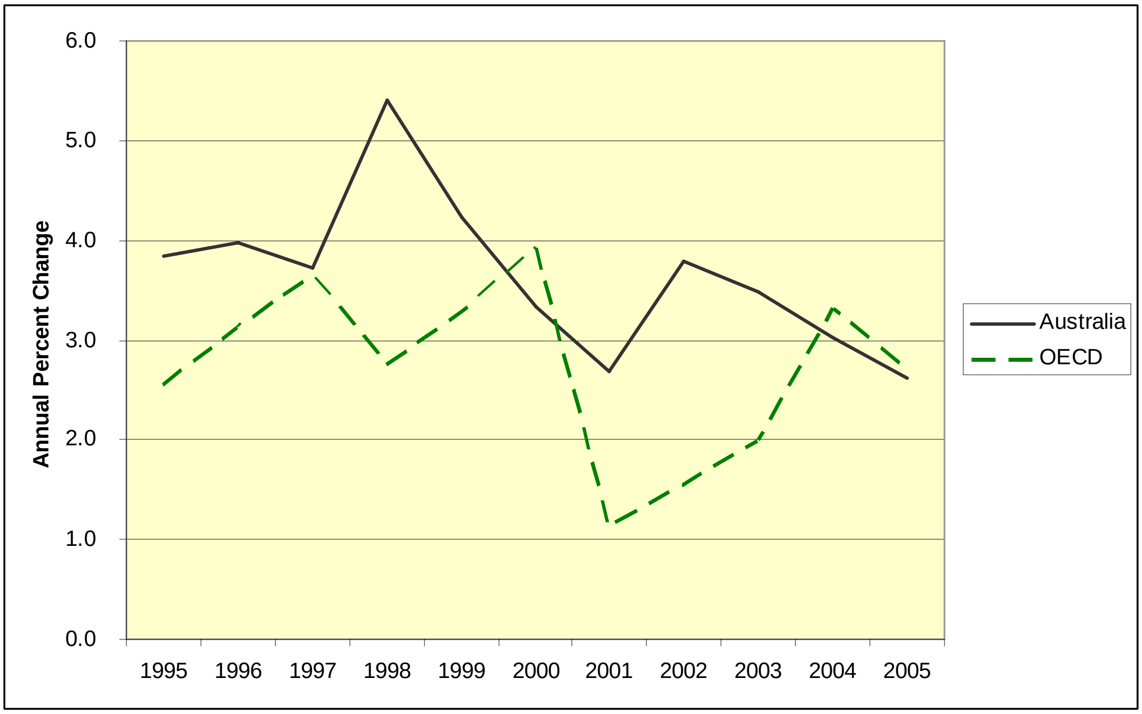
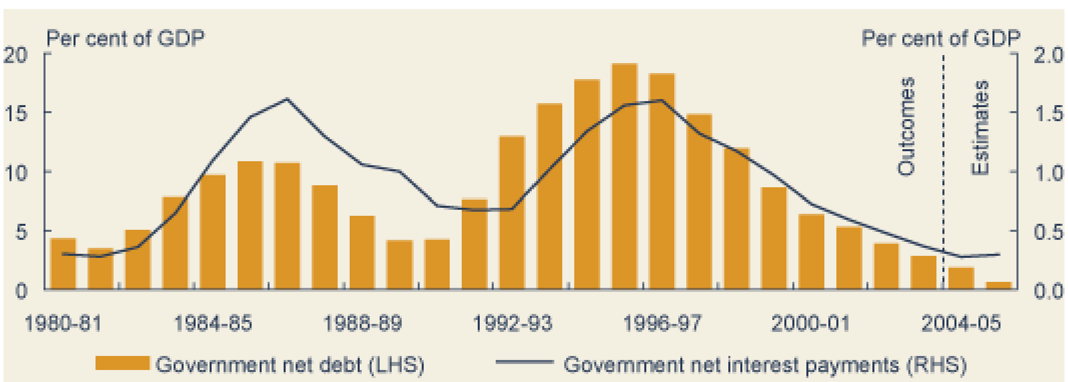


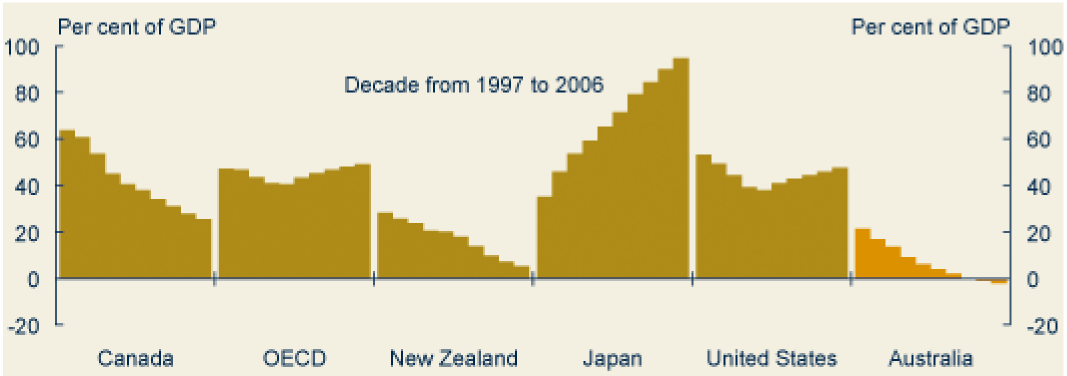
Figure 5: Australia Net Public Debt[45]



[44] *Id.*

[45] Australian Government, *2005-06 Budget Overview* 7, *available at* http://www.budget.gov.au/2005-06/overview/html/index.htm.

Figure 6: Worldwide Comparison of Net Debt[46]



<u>Key Issues for Discussion in U.S. Policy</u>

Accrual Accounting and Output Budgeting

As was mentioned above, a major impetus for the adoption of accrual measures in both Australia and New Zealand was the desire to implement output-based budgeting as a means to increase government efficiency. There are a number of reasons to believe that the use of such a budget, at least in the form adopted by Australia and New Zealand, is somewhat unlikely in the U.S. federal government. With an accrual, output-based budget, the legislature makes appropriations based upon the aggregate accrual cost of each output.[47] The legislature specifically avoids specifying how much is to be spent on the individual expense-generating elements of each output.[48] For example, the legislature might approve "purchasing" an output of effective prison management from an agency at a cost previously determined on an accrual basis (or sometimes determined as compared with private sector providers, which is generally also derived under accrual standards). But the legislature would not specify how much money would go to salaries, to building costs, to education programs, etc. In other words, the legislature, after purchasing the

[46] *Id.*
[47] *See* Pallot & Ball, *supra* note 14, at 529–530.
[48] *See id.*

product from the agency, so to speak, allows the agency manager the ability to produce the outcome as efficiently as possible in whatever way he or she sees fit, although the legislature can and does make good use of management performance evaluation.

Such a hands-off approach to bureaucracy management seems somewhat inconsistent with the U.S. appropriations process, at least as a matter of current practice and culture, where the norm is detailed, line-item budgeting. But even if Congress were willing to subject itself to such a substantial change in its role in appropriations and agency oversight, it is not entirely clear that such a system would be constitutional under the Appropriations Clause[49] and the Nondelegation Doctrine. Further, the additional influence of the President complicates the budget process in ways that a Parliamentary system avoids, making the possibility of an American output-based budgeting system seem even more uncertain.[50]

Because adoption of an output-based budget in the U.S. is somewhat unlikely, one of the primary reasons to fully adopt accrual accounting becomes moot.[51] Indeed, this very point was made by the GAO in its 2000 report to Congress on accrual accounting, in which it essentially recommended against implementing a full accrual system similar to that of New Zealand and Australia.[52] Rather, the GAO, as well as other observers, suggested that management efficiency and performance evaluations can be effectively

[49] U.S. CONST. art. I., § 9, cl. 7.
[50] The GAO, among others, has pointed to this difference and the complications it presents in terms of adopting an accrual, output-based budget in the U.S. *See* GAO ACCRUAL BUDGETING REPORT, *supra* note 5, at 12–13.
[51] *See, e.g.*, Carlin & Guthrie, *supra* note 19, at 3 ("Most often, accrual budgeting is not highlighted as an end in itself, but rather, as a means of shifting the emphasis of the budgetary process away from cash inputs, towards outputs and outcomes, in the hope that this will result in greater management efficiencies, and hence, better outcomes for Governments and the communities they service.").
[52] The GAO recommended only a "selective application of accrual budgeting." GAO ACCRUAL BUDGETING REPORT, *supra* note 5, at 13. More specifically, GAO admitted that accrual measures might be helpful in the budgeting process, but only as a supplement to the current obligation-based measures. *See id.* at 13–17, 104–110.

implemented in ways that stop far short of requiring accrual-based and output-based budgeting.[53]

Accrual Accounting and Future Liabilities

In addition to employing accrual measures for an output-based budgeting system, another motivation to fully adopt accrual accounting in New Zealand and Australia was the desire that the budget figures considered by legislators and the public would more accurately reflect many of the future liabilities ignored under cash budgeting.[54] Indeed, one event that prompted reform in New Zealand was the redemption of government guarantees by a variety of industrial actors in the 1970s and 1980s; the cash-based budget of the time never accounted for these future liabilities, and so the total cost was inflicted on the budget in the year that the guarantees were redeemed.[55]

To some extent, New Zealand and Australia have succeeded in using accrual accounting for such future liabilities, which has made the overall financial statements more accurate in terms of the actual financial position of the government. Both New Zealand and Australia, for example, use actuarial and accrual methods to account for future liabilities incurred under government employee pensions and various types of government-sponsored insurance, and New Zealand also accrually accounts for most government loans.[56] Neither, however, have adopted accrual methods to officially budget for future social insurance (i.e., old-age pension) liabilities, and instead use

[53] *See id.* at 16 ("Congressional oversight could also be enhanced by better matching of the cost of resources consumed with the performance achieved in a manner that does not forfeit budgetary controls.); *see also id.* at 108–10; Jack Diamond, *Performance Budgeting—Is Accrual Accounting Required?* (IMF Working Paper, WP/02/240, 2002), *available at* http://www.imf.org/external/pubs/ft/wp/2002/wp02240.pdf.
[54] *See* GAO ACCRUAL BUDGETING REPORT, *supra* note 5, at 21–22.
[55] *See id.* at 180-81.
[56] *See id.* at 124–26 (Australia), 185–87 (New Zealand).

traditional cash- or obligation-based measures to fund such programs.[57] One explanation given for this exclusion is that social insurance commitments do not qualify as a liability under the GAAP standards of each country.[58] Because the government can adjust or cancel the benefit at any time, the actual event of future payment and the estimated amount of payment are too uncertain to be included as a liability in the financial statements.[59]

The GAO has stated that it assumes the U.S., even should it adopt full accrual budgeting, would similarly exclude future Social Security obligations as liabilities in the financial statements because of U.S. GAAP standards.[60] As such, it recommended that Congress study other methods for incorporating social insurance commitments into the budget.[61] To the extent, then, that a motivation for adopting accrual methods in the U.S. federal budget is the desire to more accurately account for future mandatory liabilities in present financial statements, one must recognize the difficulties in including social insurance as an accrued liability.[62]

Literature

Much attention has been given to the experiences of New Zealand and Australia with accrual accounting, and the literature produced on the subject over the last two decades is extensive. One recent review of the general literature on accrual accounting in

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[57] *See id.* at 126 (Australia), 187 (New Zealand).
[58] *See* GAO ACCRUAL BUDGETING REPORT, *supra* note 5, at 78.
[59] *See id.*
[60] *See id.* at 15–16.
[61] *See id.* For the case for adopting accrual accounting in the Social Security context, see Howell E. Jackson, *Accounting for Social Security and its Reform*, 41 HARV. J. LEG. 59 (2004). *But see* Robert L. Clark, *Liabilities, Debts, Revenues, and Expenditures: Accounting for the Actuarial Balance of Social Security*, 41 HARV. J. LEG. 161 (2004); Peter A. Diamond & Peter R. Orszag, *Accrual Accounting for Social Security*, 41 HARV. J. LEG. 173 (2004); Kent Smetters, *The Inadequacies of Accrual Accounting for Social Security*, 41 HARV. J. LEG. 215 (2004).
[62] *See also* OECD ACCRUAL ACCOUNTING REPORT, *supra* note 1, at 5–6.

the public sector has identified four main areas of study.[63] One broad area deals with the general question of whether or not accrual accounting is desirable in the public sector.[64] Another area sees adoption of accrual accounting as inevitable, and so focuses on examining why adoption occurs.[65] The third area examines how accrual accounting can be best implemented.[66] Finally, a fourth topic of the literature asks whether accrual accounting as it has been implemented thus far has actually been beneficial.[67] The same four topic areas might more or less describe the literature specific to the New Zealand and Australian experiences, although, for obvious reasons, recent literature no longer includes the topic of whether or not accrual accounting should be adopted in those two countries (category 1).

Perhaps the greatest portion of the literature deals with category 4: examining the impact of accrual accounting in New Zealand and Australia. For the most part, scholars have written positively of the reforms as a whole but have scrutinized the details of the reforms in practice. For example, June Pallot, writing on New Zealand particularly, argues that the reforms have, in fact, increased "efficiency, accountability, and priority-setting;" [68] but she also identifies inadequately addressed problems, such as the lack of accountability for outcomes and the difficulty in striking "an appropriate balance between managerial freedom and parliamentary control or the short term pursuit of efficiency and

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[63] *See* Tyrone M. Carlin, *Accrual Accounting & Financial Reporting in the Public Sector: Reframing the Debate* 1–2 (Macquarie Graduate School of Management, Working Papers in Management, 2003-22, 2003).
[64] *See id.* at 1.
[65] *See id.*
[66] *See id.*
[67] *See id.* at 2.
[68] *See generally* June Pallot, *A Decade in Review: New Zealand's Experience with Resource Accounting and Budgeting*, 17 FIN. ACCOUNTABILITY & MGMT. 383 (2001). As Pallot points out, much of the literature reviewing the impact of the reforms has been quite positive if only because it has been authored by the Treasury and government officials responsible for the reforms. *See id.* at 398.

long term maintenance of capacity."[69] Allen Schick, who was commissioned by the New Zealand Treasury in 1996 to evaluate that country's reform efforts, similarly found that the reforms resulted in "a State sector [that] is more efficient, productive and responsive."[70] But he also identifies numerous problems either unsolved or created by the reforms, many of which can be understood as a result of the problematic situation in which an output-based budgeting scheme attempts to act as if government agencies are market competitors when in fact, in most instances, there is no competitive market.[71] Finally, perhaps the most comprehensive evaluation to date of New Zealand's reforms is provided by Graham Scott, who also suggests the need for improvement in the broad area of accountability.[72]

Evaluations of Australia's reforms have been somewhat similar, both in viewing the reforms as positive overall and also in identifying specific problems going forward. One of the leading observers of Australia's public sector, Marc Robinson, has written approvingly of the adoption of accrual accounting, but has also argued that it has not resulted in the increased fiscal transparency that had been advertised. In one instance, Robinson specifically addresses the complexity of Australia's "Budget Papers" and other

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[69] *See id.*

[70] ALLEN SCHICK, THE SPIRIT OF REFORM: MANAGING THE NEW ZEALAND STATE SECTOR IN A TIME OF CHANGE (1996), *available at* http://www.ssc.govt.nz/display/document.asp?NavID=82&DocID=2845. Schick followed up on that study with a 2001 paper. *See* Allen Shick, *Reflections on the New Zealand Model* (2001), *available at* http://www.treasury.govt.nz/academiclinkages/schick/paper.asp.

[71] *See* SCHICK, *supra* note 70, at Executive Summary.

[72] Graham Scott, Public Management in New Zealand: Lessons and Challenges (2001), *available at* http://www.nzbr.org.nz/documents/publications/publications-2001/public_management.pdf.

financial reports,[73] and elsewhere he argues that the formulation of Australia's key fiscal indicators could be improved.[74]

Carlin himself has written extensively and somewhat skeptically on the impact of accrual accounting in New Zealand and Australia. For example, he argues, along with James Guthrie, that the adoption of output-based budgeting in New Zealand and Australia has resulted in merely a change of form more than a real change in substance.[75] He also has argued that attention should be paid to the potentially negative effects of accrual accounting in other public sector issues, including outsourcing and competitive tendering.[76] Most recently, Carlin has similarly proposed that evaluation of accrual accounting reforms must be made in the context of their connection to broader reforms in the public sector.[77]

Finally, much of the criticism of the reforms in New Zealand and Australia is common to the more general debate on accrual accounting in the public sector. One particular common criticism is the idea that accrual measures may actually be less transparent than cash-based measures because of the ease with which they may be manipulated and the lack of clarity in the underlying assumptions.[78]

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[73] *See* Marc Robinson, *Accrual Accounting and the Public Sector* (Discussion Paper No. 86, Technical Report, School of Economics and Finance, Queensland University of Technology, 2000), *available at* http://eprints.qut.edu.au/archive/00000569/.
[74] *See* Marc Robinson, *Accrual Accounting and Australian Fiscal Policy*. 23 FISCAL STUD. 287 (2002).
[75] *See* Tyrone M. Carlin & James Guthrie, *A Review of Australian and New Zealand Experiences with Accrual Output Based Budgeting* (International Public Management Network Conference Paper, 2000), *at* http://www.inpuma.net/research/papers/sydney/carlinguthrie.html.
[76] *See* Tyrone M. Carlin, *Accrual Accounting & Financial Reporting in the Public Sector: Reframing the Debate* (Macquarie Graduate School of Management, Working Papers in Management, 2003-22, 2003).
[77] *See* Tyrone M. Carlin, *Debating the Impact of Accrual Accounting and Reporting in the Public Sector*, 21 FIN. ACCOUNTABILITY & MGMT. 309 (2005).
[78] *See, e.g.*, Allen Schick, *Reflections on the New Zealand Model*, *supra* note 70, at 9 ("Whatever the limitations of the cash basis, its overriding virtue is that it is grounded on actual rather than assumed transactions. One should not be surprised if accrual budgeting leads to new types of evasions . . .").

The literature regarding implementation (category 3) identifies and examines key potentially problematic issues that arise as governments adopt accrual methods. These include the treatment of assets, the development and maintenance of accounting standards, and the methods of valuation. Much of this literature comes from institutional sources. Foremost among these is the International Federation of Accountants (IFAC), which strongly supports the adoption of accrual methods in the public sector, and which has published a detailed and comprehensive guide to assist governments in transitioning to accrual accounting.[79] Similarly, the OECD report on accrual accounting is heavily focused on the topic of implementation.[80] The Asian Development Bank has published a guide outlining key implementation issues that are specifically of importance for developing countries.[81] At the same time, Allen Schick has argued that the problems of implementation are among the reasons why developing countries should be cautious in considering public management reforms and should not strive to imitate the reforms of New Zealand and Australia.[82]

Perhaps the most under-examined area of study is the second category identified by Carlin: explaining why governments adopt accrual accounting and budgeting. Christine Ryan provides one of the first and only attempts at such an examination, and

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[79] *See generally* IFAC GUIDANCE FOR GOVERNMENTS, *supra* note 13. The IFAC guidance focuses on the transition to use of accrual accounting in financial reporting rather than in budgeting. IFAC has also recently issued an information paper regarding the adoption of accrual accounting in the United States at both the state and federal level. *See* INTERNATIONAL FEDERATION OF ACCOUNTANTS, THE ROAD TO ACCRUAL ACCOUNTING IN THE UNITED STATES OF AMERICA (2006).

[80] *See* OECD ACCRUAL ACCOUNTING REPORT, *supra* note 1, at 3–10.

[81] *See* S. LAKSHMAN ATHUKORALA & BARRY REID, ACCRUAL BUDGETING AND ACCOUNTING IN GOVERNMENT AND ITS RELEVANCE FOR DEVELOPING MEMBER COUNTRIES (Asian Development Bank, 2003), *available at* http://www.adb.org/Documents/Reports/Accrual_Budgeting_Accounting/default.asp. This study also speaks at length specifically about the New Zealand reforms. *See id.* at 40–48. Also of interest, an appendix to the study contains a cost-benefit analysis for the implementation of accrual accounting and budgeting in New Zealand; the result was an estimated 7% internal rate of return over a 20-year period. *See id.* at 76–78.

[82] Allen Schick, *Why Most Developing Countries Should Not Try New Zealand Reforms*, 13 WORLD BANK RES. OBSERVER 123 (1998).

does so in the context of Australia's reforms.[83] She argues that a financial crisis in the late 1970s and early 1980s in Australia led to heavy scrutiny of the public sector, making it particularly receptive to reform proposals aimed at increasing government efficiency and transparency.[84] In that context, accrual methods were successfully promoted by public sector accountants working within the government – at first government Auditors-General and later accountants within the Treasury and Finance Departments.[85] Importantly, in both instances, the government accountants had strong ties to the organized accounting profession.[86] Ryan concludes by calling for further study to explain why governments adopt accrual technologies.[87]

Conclusion

As two of the only countries that have fully implemented accrual accounting and budgeting at the government level, the experiences of New Zealand and Australia can instruct the U.S. and other nations in the advantages and disadvantages of accrual methods in the public sector. Most observers have found that the reforms in New Zealand and Australia have been a success, though most also believe the reforms remain a work in progress. Both countries have demonstrated improved fiscal discipline since adopting accrual methods, although it is very difficult to determine whether the reforms directly caused the new fiscal discipline and whether the reforms have actually improved

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[83] Christine Ryan, *The Introduction of Accrual Reporting Policy in the Australian Public Sector: An Agenda Setting Explanation*, 11 ACCT. AUDITING & ACCOUNTABILITY J. 518 (1998).
[84] *See id*. at 523–26.
[85] *See id.* at 527–34.
[86] *See id.*
[87] *See id.* at 534. Another scholarly examination of the conditions explaining the adoption of accrual accounting in the public sector is that of Björn Brorström, who focuses on Sweden. *See* Björn Brorström, *Accrual Accounting, Politics and Politicians*, 14 FIN. ACCOUNTABILITY & MGMT. 319 (1998). Also, the GAO reports observing a few commonalities among the case study countries in its report on accrual accounting: broadly speaking, the most important commonality among countries adopting accrual methods in financial reporting and budgeting was simply that such methods were adopted in the context of broader public management reform efforts. *See* GAO ACCRUAL BUDGETING REPORT, *supra* note 5, at 46–49.

economic performance. At the same time, both countries continue to face public management problems either unaddressed by the reform efforts or, in some cases, possibly caused by the reforms. In considering possible reform measures for the U.S., it is particularly important to take note of the difficulties in implementing output based budgeting, especially given the apparent incompatibility of such a budgeting scheme with current legislative culture and practice. Finally, neither New Zealand nor Australia have implemented accrual methods in budgeting for social insurance commitments, making their experience limited in its applicability to the debate on Social Security reform in the U.S.

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