

## CASH ACCOUNTING STANDARDIZATION IN THE PUBLIC SECTOR

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*ABSTRACT: An important component of public institutions' accounting is represented by cash accounting. At the same time, the normalization, harmonization and convergence of accounting are the chronological stages generated by globalization.*

*The paper "Cash Accounting Standardization in the Public Sector" approaches aspects regarding the role of the budget within public institutions' accounting, the management of public financial resources, the cohabitation need between cash accounting and accrual accounting, the provisions of international accounting referential regarding the financial reporting specific for cash accounting, as well as the positioning of the Romanian public sector in relation to these provisions.*

*Key words: cash accounting, public sector, standardization, public budget, international accounting referential*

*JEL codes: M41*

### **Introduction**

Globalization is perceived as a worldwide connection of the differences between entities in all the aspects of the economic and social life (Bolos, 2006, 20).

Each nation has its own legal system, where legal provisions regulate the financial statements prepared by the public sector. It includes national governments, regional administrations (state, province, territory), local administrations (i.e., towns) and associated governmental entities (councils, commissions).

The international referential specific for this sector may help national bodies in developing new accounting principles or in revising existing ones in order to significantly improve financial reporting.

National regulators are given the right to set accounting standards and guidelines for the financial reporting in their jurisdiction, encouraging the expansion of accrual accounting and the adequate implementation of accounting policies. An accounting standard is a rule or a set of rules that regulate acknowledgement and valuation in accounting, and prepare and present accounting information in financial statements (Ristea, 2006).

The accurate reflection of the economic-financial reality and of its social, human and institutional consequences are defining attributes of accounting, and the most formidable accounting experts are working for its improvements.

By being concerned with standards, with convergence, with the accounting reflection of reality, accountants are actually concerned with economy, with institutions and with people (Dragan, 2009) IPSAS are based on professional reasoning, achieved by turning to principles, which may lead to multiple solutions for a given problem.

Among the components of public accounting, Accounting Law no. 82/1991 and the Law of public finances no. 500/2002 stipulate "the accounting of the budgetary revenues and expenditures that will reflect the encashment of revenues and the payment of expenditures associated to the budgetary year".

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This segment of public accounting is the exponent of cash accounting, which needs to be adapted to the growing complexity of the financial operations conducted by public institutions, and implicitly, it is a contribution to the adequate development of the economic information in scope, content and nippiness.

### **Literature review**

The starting premises is the fact the theoretical, scientific and practical limits of accounting are endless, both in terms of covering economic phenomena and how they are systematized, processed and presented, so that you can't pretend you know everything about it (Drăgan, 2009).

The inventory of the current concerns of the scientific research regarding financial accounting reveals the sustained interest to optimize the budget-accounting report, to improve parameters of the financial-accounting information and financial communication at global level.

Therefore, since 2002, Matheson A. has noted that extending commitments in the area of budgeting is controversial, and later was believed (Bolos, 2006) that the future belongs to disconnecting the budget from public accounting, or that it's more feasible to report by using accrual accounting and by preparing the budget on the basis of cash (Schick, 2007). In Schick's view, accrual budgeting shifts budgeting from cash flows to earned revenues and involved debts. This will align budgeting and financial reporting, because both will be established on the same accounting basis. It is rather about one of the potential combinations between cash/accrual budget and cash/accrual accounting, because it is believed that in accrual budgeting the accounting principles will become decision rules in budgeting. A decision rule is information that dictates how decisions are made or the types of decisions.

At the same time, cash or accrual accounting are considered two extremes of accounting and financial reporting, between which there are numerous combinations: modified cash accounting, modified accrual accounting (Hoek, 2003).

In this context it's important to remember the budget refers to allotting financial resources for various alternative uses, while financial-accounting reports describe in retrospect the results of the financial transactions' organization in terms of financial positions, financial performances and cash flows.

At the same time, an analysis, even brief, of recent publications brings into discussion the globalization phenomenon, which is related to the processes described above. Lately, we have been hearing about harmonization, conformity and accounting convergence. At international level there are concerns to reform public accounting, which are mainly aimed at making a transition from the cash model to the accrual model, the precision of the information transmitted to users, etc. There are also concerns about changing the optics regarding the budget, which maintains its position as an axis around which accounting is outlined (Schick, 2007).

The financial accounting challenges faced by the public sector are highlighted by professor N. Feleagă also, who especially underlines the use of two instruments to satisfy the reporting needs of various categories of users, namely the budget and accounting. "These two instruments induce a series of challenges: the advantages, limits and ways to involve the budget in the management of public organizations; to what extent is accrual accounting superior to cash accounting in the public sector? To what extent does the use of IPSAS standards contribute to higher valences in public accounting?"

The considerable contribution to the quality and uniformity of financial reporting at global level by facilitating the convergence of national and international standards belongs to the International Federation of Accountants (IFAC), which elaborates relevant and applicable accounting standards for the public sector through the International Public Sector Accounting Standards Board (IPSASB) (IFAC, 2009).

It is known that until now the International Public Sector Accounting Standards Board has developed and approved 26 standards for public accrual accounting and a standard for cash accounting (IFAC, Handbook of international public sector accounting pronouncements, 2009).

The end goal of the International Public Sector Accounting Standards is to standardize the accounting treatment of information obtained by running streams of receipts and payments, but also the accounting treatment of the operations that affect public property. Public accounting is currently going through a reform: transition from cash accounting to accrual accounting and, in the end, the unitary accounting treatment of information by implementing IPSAS (Boloş, 2006).

We believe that since IPSASB issued cash accounting standard, this type of accounting has (still) got something to say on the stage of the public sector accounting. An additional argument is that most European Union countries are asking for an end to the continuous change of the international accounting standards (therefore, the public sector is also included) because no accounting system is perfect and all are infinitely variable (Ristea, 2006)

### **Methodology research**

Methodology means the scientific theory of methods for collecting and processing data, as well as the principles and norms used to conduct scientific knowledge in accounting.

In relation with accounting objectives and its particularities in the public sector, it's important to highlight the scientific value of literature and the practical valences of the legal norms, but also the favourable position of public finances and general accounting.

By relating to the subject of the paper, the used research method is a cognitive approach of the perception phenomenon of internationalizing the public sector accounting, a systematic investigation approach of reality regarding this accounting segment.

We used literature, the national legal framework and the provisions of the International Public Sector Accounting Standards as a methodological, theoretical-scientific base for the paper. By relating to the temporal criterion, we used the cross research method, which implies analyzing [economic] phenomena at a given moment.

### **Budget – a premise of cash accounting**

The instrument used primarily to develop and coordinate activities run in public institutions is represented by planning with the help of the budget.

Cumulative, the budget is a document which provides and approves public revenues and expenditures annually; a legal act (an annual document of forecasts and authorizations); a system of financial flows related to constituting public financial resources and their allotment; a government's instrument of financial policy for taxation and public expenditure (Mosteanu, 2008).

Objectives related to the accurate and opportune reflection of obtaining budgetary revenues and making budgetary expenses, of administrating material and financial means, as well as providing information through the budget regarding revenues, the level, structure and dynamic of expenditures, justify the extremely important role of the budgetary information in public institutions.

The budget is used to minimize the action of internal or external disturbing factors and to maintain control over the functional parameters of public institutions at different periods in time.

The budget is the instrument that materializes the projections of the receipts and payments flows and exercises control over the results of the company's monetary resources execution and over how these resources are allotted and used to cover public expenses. Through the budget is possible to highlight imbalances that may occur between resources and uses and therefore favourable premises are created to identify the selection methods of the adequate financing means in order to establish a balanced relationship between revenues and expenditures, with positive repercussions over the satisfaction of human needs (Cenar, 2007).

The indissoluble link between budget and accounting has been highlighted in literature for more than half a century, the “budgetary accounting” phrase having been used all this time. The following references illustrate this fact:

- the public institution is an “economic unit with a public administrative feature, being concerned with obtaining revenues and making the necessary expenditure to maintain that administration”. The accounting of public institutions is primarily aiming to supervise the approved budgetary execution through various management bodies, acknowledged as legitimate and competent. For these reasons, this type of accounting is also known as budgetary accounting. “The characteristic of this type of accounting is that we won’t find an income statement in its system of calculations because it doesn’t have a lucrative purpose. However, it will have a provision document known as budget and which refers to the revenues and expenditures of that [public, s.n.] administration” (Dumitrescu, 1947).

“The budget should be a source of information for those interested, so that harmoniously combined with the accounting science, it will lead to shaping opinions about the state and financial performance of a community”, and therefore of a public entity also.

The analysis of the budgetary reform may (Bolos, 2006) use the APFD standards (The Association of Public Financial Directors) as reference points, which consist of presenting the budget as a financial plan (a consolidated statement of the operations and activities financed by the budget, where explanations of the revenues and expenditures projections are presented), as an operations guide (it explains by comparison the present financial statement with the past financial statement and the relationship between current and capital expenses), as a mean of communication (coherent and exponent of the key policies and strategies, supported by tax data) and as a public policy (which explains and argues the changes and implementation method of public policies).

### **General guiding marks regarding the internationalization of the public sector accounting**

Although there are factors that support the dissociation of IPSAS from IFRS (the financial mechanism of functioning of public institutions, the nature of the expenses financed from the budget, the origin sources of the revenues, the purpose of the conducted activity, etc, Bolos. 2006, 304). The IPSAS issued by the International Public Sector Accounting Standards Board (IPSASB) “converge with the IFRS issued by IASB by adapting them to the context of the public sector” (preface by IPASA, handbook, p. 190). Furthermore, “the general framework for preparing and presenting financial statements” of the International Accounting Standards Board is a relevant reference for the IPSAS users.

Therefore, we may consider IPSAS as a set of accounting standards with global vocation. For the national norms, the standards may be of interest in the following instances (Ristea, 2006): a direct adoption as national norms, a documentary source for the development of national regulations, a reference basis for the harmonization between national and international, adopting them as standards for preparing and presenting financial statements.

The purpose of the international regulators is to harmonize as much as possible the accounting standards and procedures applied in various countries:

- based on principles, which largely involve professional reasoning;
- leading to transparent and comparable financial statements.

Serving the general public interest, developing financial reporting standards of high quality, facilitating the convergence of national and international standards are only a few of IPSASB’s objectives.

Financial reporting in the public sector is based on the unitary accounting treatment of the information in the public sector, aimed at providing the necessary information to support decisions and to justify how public financial resources are used.

### **IPSAS provisions for cash accounting**

In our opinion, the starting premise is the fact cash accounting will play another important role on the scene of the public sector accounting. There are many arguments that justify the role of information regarding cash inflows, cash payments and the entity's cash balances, including:

- Making decision factors accountable
- Providing the necessary data to assess the entity's capacity to generate the needed cash in the future
- Facilitating the possibility of getting to know the sources and uses of the cash
- Increasing comparability with the financial statements associated to previous periods, as well as with the financial statements of other entities that adopt cash accounting
- Understanding the opportunity and safety of the cash inputs and outputs

The general purpose financial statements are the ones that fulfil the conditions of the users that are not in the position to ask for reports drawn-up to respond to their specific need of information.

The international referential mentions the following categories of users: taxpayers, subscribers to various services, members of the legislature, creditors, suppliers, mass-media and employees.

Cash accounting is an accounting basis that acknowledges transactions and events only when the entity receives or pays in cash or in cash equivalents.

An important aspect for public entities is cash control, namely the possibility to use cash to achieve their objectives or to benefit in another way from it, the access of other parties to that benefit being excluded or regulated.

According to IPSAS, the components of the general purpose financial statements for cash accounting (IPSAS Handbook, vol. II, p. 966) are the following:

- Cash receipts and payments statement
- Accounting policies and explanatory notes
- Comparing budget values with real values

It must be mentioned that the **cash receipts and payments statement** acknowledges all cash receipts, cash payments and cash balances controlled by the entity and it identifies separately the payments made by third parties on behalf of the entity.

The values presented for the reporting period refer to:

- Total receipts with the associated sub classifications, using a classification criterion appropriate for the entity's operations;
- Total payments with the associated sub classifications, using a classification criterion appropriate for the entity's operations;
- Cash balances, opening balances and closing balances.

Goals like transparency and accountability of financial reporting are dependent on the presentation of information regarding the entity's cash balances, the generating cash source (from taxes, fines, contributions, loans, etc.) and its use (for the operating costs, the acquisition of fixed assets, debt removal, etc.).

According to IPSAS, professional reasoning is the one that intervenes in solving the issue of the total cash receipts and payments sub classifications.

In case the debts settlement of an entity or the acquisition of goods and services on its behalf is done in a reporting period by a third party, the payments done by third parties that are not a part of the economic entity belonging to the reporting entity will be presented in a distinct column, separate from the payments done by third parties that are part of the economic entity belonging to the reporting entity.

In such a case, payments may be done on the basis of a subsidy or of a different succour or may take the shape of a reimbursable loan. Although the reimbursed value is not cash (there are no cash receipts and no control over an account), it is required to have a separate report for the sources

and uses of the third parties that are not a part of the economic entity belonging to the reporting entity.

The government's management of the expenses of its departments and of other entities through a centralized treasury function or through a sole account commitment determine payments on behalf of the departments or entities after proper authorization and after receiving documentation from them. Although they don't control cash and they benefit from the payments, departments and entities report in a separate column the value of the central payments made by the central entity on their behalf, the sources and uses of the amount spent with the associated subdivisions.

Presenting the **comparison between budgetary value and real values** is "required" by the public feature of the budget and may be done through an additional financial statement or through a column of the budget in the cash receipts and payments statement, but the latter is possible only when financial statements and the budget are prepared on a comparable base.

The standard doesn't exclude the possibility of **additional statements** for general purpose financial statements, such as:

- Reporting cash receipts and payments and cash balances for major financing categories;
- Additional information about sources and loans, the nature and type of cash payments;
- Presenting the comparison between real and budgetary values.

The **notes to financial statements** are designed to present information regarding the basis of preparation of financial statements and of specific accounting policies selected and applied in certain transactions and other events, such as providing additional information, needed for the accurate presentation of the entity's receipts, payments and cash balances.

The requirements regarding the intelligibility, relevance and credibility features of the information are maintained. Comparability is not ignored either, being necessary to present numerical information for the previous period also.

The notes to financial statements have also the privilege of presenting, together with a commentary, the nature and value of the significant cash balances that are not available for use, which are subjected to external restrictions, as well as the unused loan facilities that may be available for future operating activities and for reimbursing capital commitments.

Narrative information may be relevant for the current period, in terms of identifying the taken measures to resolve the uncertainties observed in the last report.

The notes to financial statements may include information that is not acknowledged by cash accounting, such as:

- receivables, debts, loans, non-monetary assets, revenues and expenditure from liabilities;
- contingent liabilities and debts;
- performance indicators and achieving the objectives of providing public services.

The occurrence of an error regarding the cash balance reported in financial statements determines the necessity to present in the notes the nature of the error, the adjustment value and the fact comparative information were retreated or this wasn't possible. The previous period attributed to the error generates the adjusting of the cash balance in order to correct it and to explain the error in the notes.

### **The presentation of budgetary information in financial statements**

A very important aspect for public institutions is the presentation of budgetary information in financial statements.

Therefore, according to IPSAS, within cash accounting, an entity that publishes its approved budget must present a comparison of the budgetary values for which it is publicly responsible and for which it is officially accountable with the real values. There are two methods for this situation, namely an additional financial statement (when financial statements and the budget are not prepared on the same basis of comparison) or additional columns of the budget to the cash receipts and payments statement (for the other case).

Thus, the presented data refer to:

- the comparison between initial and final values
- real values based on comparison
- explaining the significant differences between the budget for which the entity is

officially responsible and the real values, either in explanatory notes or in a report issued previously, correlated with or at the same time with the financial statements.

The similarity between initial and final values shows the monitoring of the budgetary execution during the reporting period and the gradual revision of the budget.

Literature review highlights the possibility of several combinations within the budget – accounting couple, namely cash or accrual accounting corroborated with the budget established on cash or accrual bases, having pros and cons for each option.

IPSAS mentions that, although rare, the entities may adopt cash accounting for their financial statements and accrual accounting for their budget (including information about the commitment to spend funds in the future) and for financial statements.

It should be mentioned that it's not necessary to present comparative information regarding the previous period.

In terms of regularity, general purpose financial statements must be submitted at least annually. A different period caused by exceptional causes entails the necessity to present the reasons for which a different period was used, as well as the possibility that comparative values might not be comparable.

According to the opportunity criterion, the publishing of financial statements must be done within six months from the reporting day; however, it is strongly encouraged to submit a report every three months.

The approval for publication of financial statements is important for users because the events prior to this date are not reflected in the statements.

The accounting information must be disseminated before losing its ability to influence decisions. It serves as a basis in developing forecasts and in making decisions by the users.

In our opinion, in terms of national realities, it's about drawing-up receipts and payments statements on each source of funding.

### **Positioning the public sector in our country in relation to IPSAS provisions for cash accounting**

The preparation of financial statements by public institutions aims to obtain and provide useful information to underlie decisions and to justify how public financial resources are used. The usefulness of the information is proved by its content: the nature of the resources and how they are attracted, the allotments conducted in accordance with the approved budget, the use of resources, how cash needs were secured, the ability to cover debts and commitments, etc.

According to the legal framework (Order of the Ministry of Public Finance no. 1917/2005 Methodological standards regarding the organization and accounting guidance of the public entities), the financial statements of public institutions include the following: balance sheet, the profit and loss statement, statement of changes in net assets/equity, cash flow statements, financial statements annexes: accounting policies and notes to the financial statements, budget execution account.

Without going into details, it should be mentioned that the first four components are build with the support of accrual accounting.

However, the revenue column of the budget execution account includes information regarding: initial budgetary provisions; final budgetary provisions; noticed receivables; receipts; receivables for encashment. The expenses column includes: initial and final budgetary credits, budgetary commitments, legal commitments, payments, legal commitments for pay, actual expenses. All this information is presented separately, for each financing source.

The presence of budgetary information is obvious, especially for initial and final budgetary provisions and receipts; and a part of the expenses that include budgetary credits, legal commitments and payments are subordinated to cash accounting. We also shouldn't neglect the interference of accrual accounting through the other mentioned elements.

Thus, the budget execution account enriches the information about how the budgetary provisions were applied and complied with and confirms the materialization of the reforming intention to ensure the complementarity of cash accounting with accrual accounting. The gateway to the accounting truth depends on the fairness in informing the factors that show interest towards the accounting product and towards the absence of distortions in the image of reality.

Cash accounting is just one point on which a part of the financial statements is resting upon; it must blend perfectly with accrual accounting in order to provide an accurate image of public institutions to all users of financial-accounting information.

### **Conclusions**

Given the multitude of complex processes that have a variable dynamic and which have infiltrated all the areas of social life, no one can speak of a universally accepted understanding of globalization. Therefore, accounting is in an inconvenient position, namely that of answering to the changing needs of society and of reflecting the economic, legal, cultural, social or political conditions in which it functions.

Therefore, in the current context, phrases like Europeanization, internationalization, accounting convergence have found a wide range of use and we thought it was appropriate to approach how they were perceived and implemented in public institutions.

Public institutions have placed the emphasis on supplementing cash accounting with accrual accounting, and more, because public institutions' accounting gravitates around the budget.

Starting from the previous viewpoints, we may summarize the following:

→ the accounting convergence process manifests in the entire accounting environment in Romania, including public institutions;

→ according to national norms, the budget is a public document, regardless of the hierarchical position of the public institution. This justifies the distinct component of financial statements – the budget execution account. The status of financial policy instruments in the area of taxation and public expenses justifies the main position held in the hierarchy of accounting information by the budget report and the budget execution;

→ the early stage of the debates surrounding IPSAS (including the one regarding cash accounting) among accounting professionals and in public institutions;

→ the existence in literature of different opinions regarding the combination budget/accrual accounting;

→ the budget execution account may be considered the exponent of cash accounting, the other components of financial statements, stipulated by IPSAS 1 (balance sheet / statements of financial position; the profit and loss account / statement of financial performance; cash flow statement; statement of changes in net assets/equity), being the result of the use of accrual accounting;

→ the opportunity to achieve a combination of the two accounting bases into a “third annual account” – annexes / accounting policies and notes to the financial statements. We can't neglect the factors that left a mark over current and future performances of the public institution, the potential restructuring and reorganization, the estimation of revenues and the financing opportunities, potential sources of replacing financing, etc.;

→ IPSAS require turning to principles and professional reasoning. As a result, it's essential to activate the role of accounting professionals through contributions in disseminating information regarding the structure and real state of the patrimony and of the results, ensuring material integrity and efficient management of economic values, exercise supervision, ensuring information about the



financial position and performance; the activity analysis, etc. The valences of accounting as art of communication rediscover the complexity of those who use, process and deliver economic information, but also their ability to make public and lay down on the coordinates of convergence the economic interests in the context of the restrictions made on the allotted resources.

It is certain that all the steps taken by theoreticians, practitioners and the legal environment must have the same strategic aim: to improve financial management in public institutions. This requires a balanced budget, sustainable over time, capable to ensure quality public services for the benefit of the citizens, as well as increased financial solvability of public institutions so that the optimum and balanced financing of sustainable development is ensured, with its three sides, namely economic, social and environmental.

In order to become a perfected instrument of financial communication, financial reporting (including cash accounting) must meet the requirements of all the users on the financial information market, taking into account the increased internationalization of economies.

In the end, we may conclude there is no invincible assertion regarding the budgeting basis corroborated with the ideal accounting basis used in financial reporting.

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