



## The HM 'Treasure's Island': The Application of Accruals-based Accounting Standards in the UK Government

Yuri Biondi

To cite this article: Yuri Biondi (2016): The HM 'Treasure's Island': The Application of Accruals-based Accounting Standards in the UK Government, Accounting in Europe, DOI: 10.1080/17449480.2016.1142096

To link to this article: <http://dx.doi.org/10.1080/17449480.2016.1142096>



Published online: 16 Feb 2016.



Submit your article to this journal [↗](#)



Article views: 14



View related articles [↗](#)



View Crossmark data [↗](#)

# The HM ‘Treasure’s Island’: The Application of Accruals-based Accounting Standards in the UK Government

YURI BIONDI 

*ESCP Europe (Labex ReFi), Paris, France*

**ABSTRACT** Since the 1990s, UK has been progressively adopting a governmental accounting reform purporting to interpret and mimic accounting standards and practices from the private sector. Since 2009, the UK set of accounting standards applicable to the whole of governmental entities is based upon the HM Treasury’s official interpretation of the international accounting standards initially designed for commercial enterprises, the latter standards having extensively inspired the International Public Sector Accounting Standards. This article analyses some representational concerns raised by its application of a balance sheet accounting approach to the public administration, pointing to consolidation perimeter, current value measurement of assets and liabilities and the case of public–private partnerships. This theoretical analysis develops relevant implications for representation and control of public spending and borrowing in UK and in general.

**Keywords:** public accountability, accruals and cash basis accounting, non-business accounting and economics, governmental accounting theory and standards, UK, nature and role of non-business entity, IPSAS, IFRS

*JEL Classification:* D73, E62, H61, M40

## 1. Introduction

### *1.1. UK Leadership in ‘New Public Management’ in Governmental Accounting and Finances*

In the aftermath of the global financial crisis and its impact on the management of sovereign debts in Europe, the European Union decided to harmonise public sector accounting in Europe. In March 2013, the European Commission (2013) initiated a relevant project aiming at creating harmonised ‘European Public Sector Accounting Standards’ (EPSAS) and implementing them in the Member States (Biondi et al., 2014). A similar process was already achieved for private sector accounting standards between 1995 and 2002, leading to the adoption and implementation of International Financial Reporting Standards (IFRS) issued by the

---

*Correspondence Address:* Yuri Biondi, Cnrs – ESCP Europe, 79 avenue de la République, Paris 75011, France. E-mail: yuri.biondi@gmail.com

International Accounting Standards Board (IASB). With a view to developing EPSAS, the European Commission Report (2013, p. 8) presented the international public sector accounting standards (IPSAS) issued by the IPSAS Board under the auspices of the International Federation of Accountants (IFAC) as an 'indisputable reference' (Bellanca & Vandernoot, 2014; Grossi & Soverchia, 2011).

In this context, the case study of the UK accounting system may provide input for the overall debate at the European level. According to the survey carried out on behalf of the European Commission, the UK has the most IPSAS-compliant public sector accounting system (Ernst & Young, 2012). Indeed, the British system and IPSAS share a common background based on the adaptation of the IFRS to the public sector (mimicking private sector accounting); and both apply a balance sheet approach which gives priority to definition, recognition and measurement of accruals-based assets and liabilities. This article argues that a balance sheet approach is inconsistent with financial, economic, organisational and institutional features that are specific to the public sector. These specificities involve specific accounting needs that a balance sheet approach is unable to satisfy. This approach may also lead to an inappropriate and misleading accounting representation when applied to the public sector. The UK case study provides paradigmatic illustrations of this misrepresentation.

The EPSAS project is consistent with a general transformation of the management of public administration and public finance which have been submitted to major reforms since the 1980s, in Europe and abroad. This has been quite a general movement, led by some international institutions (Sudcliffe, 2003) as well as by the UK and some former British colonies such as Australia and New Zealand. Other European countries followed.

Concerning the UK, the reform of governmental accounting standards started in the 1990s pursuing a distinctive convergence towards the set of accounting standards originally issued for business enterprises. Between 2001 and 2002 and between 2008 and 2009, UK GAAPs issued by the UK Accounting Standards Board (ASB) were taken as the basis for public sector accounting; since 2009–2010, they have been replaced by the international accounting standards (IFRS) issued by the 'International Accounting Standards Board' (IASB), an independent London-based private accounting standard-setting body whose standards have largely inspired the International 'Accounting Standards for the Public Sector' (IPSAS) issued by the IPSAS Board (IPSASB). IPSASB is an independent accounting standard-setting board whose structures and processes are facilitated by the 'International Federation of Accountants' (IFAC). In 2012, the IPSASB website stated that 'a key part of the IPSASB's strategy is to converge the IPSASs with the International Financial Reporting Standards (IFRSs) issued by the IASB'.<sup>1</sup> In fact, the strategy of the IPSASB has been evolving in recent times; however, all the existing IPSASs were undeniably primarily drawn from the IFRSs, with very limited amendments as regards the specific issues and needs of the public sector. In accordance with the IFRSs, the IPSAS adopt a balance sheet accounting approach and introduce fair value measurements in public sector accounting.

The UK accounting reform introduced accruals-based accounting, which implied a reallocation of total spending from current to capital accounts. Moreover, it involved the introduction of financial and accounting practices previously unknown to the public sector and which were not conceived for its specific needs. In particular, it was based upon an ownership view of government accounts, taking a balance sheet accounting approach that points to net liability as 'the difference between what the government owned [assets] and what it owed [liabilities] at the end of the financial year' (in National Audit Office's (NAO) words). It is notable that the accounting Manual prepared by HM Treasury (2010a) does not provide a comprehensive set of accounting standards, but it aims at interpreting the IFRS, which should then be mastered by public accountants and their auditors. Further issues of loopholes and manipulation occur, as acknowledged by HM Treasury (2010a, §1.20; see also HM Treasury, 2011a, §1.17),

which states that ‘sometimes departments’ or public bodies’ consultants offer them suggestions for ways round the spending control framework’.

The UK reform is in line with a more general transformation of the public service and the relationship between public and private sectors, which is not yet fully understood and foreseeable in its consequences and implications (Erturk, Froud, Sukhdev, Leaver, & Williams, 2012; Lapsley, Brunsson, & Miller, 1998; Mack & Ryan, 2006; Mayston, 1993). This general transformation has led, and not just in the UK, to financial and accounting reforms marked by a definite preference for the private sector and its accounting tools, as well as frequent recourse to private actors for financing, producing and even auditing public administration (Broadbent & Laughlin, 2003; Ellwood, 2002, 2003; Humphrey, Miller, & Scapens, 1993).

The most famous case is surely that of public–private partnerships (PPPs) (House of Lords, 2010; National Audit Office [NAO], 2011a). Following the privatisation and financialisation policies run by Margaret Thatcher’s government (1979–1990), first a Tory government (led by John Major, as from 1992) and later a Labour government (led by Tony Blair, as from 1997) launched the ‘Private Finance Initiative’ (PFI) and the PPP policies, respectively, in order to encourage recourse to private actors to finance, realise and manage public services and infrastructures. Since the 1990s, these UK policies have attracted attention and fostered imitation all around the world, although they have been harshly questioned and criticised in their originating country, especially on account of cost overrun and ineffectiveness (Biondi, 2011; House of Lords, 2010; Seddon, 2008).<sup>2</sup>

For all these reasons, the UK case study can help us get a better understanding of the implications and consequences of business-style accounting reforms for the operations carried out by public administrations and even for public administration itself. In particular, this article develops a theoretical analysis of financial accounting and the representation of public administration activity it conveys, especially Whole of Government Accounts (WGA). Our analysis points to representational issues raised by the adoption and adaptation of IFRS which were initially designed and issued for the private sector. In particular, it addresses conceptual and practical concerns with a balance sheet approach that requires taxpayers to recover value changes in the government’s net worth. Empirically, this theoretical analysis mainly focuses on the way the accounting Manual issued and yearly updated by HM Treasury interprets the IFRS and makes them applicable to government accounts in the UK. It further considers the application of this Manual to the WGA in order to illustrate the representational issues that are raised by its application. It points especially to the 2010 edition of the Manual and the related 2009–2010 WGA (HM Treasury, 2011b), which were the first consolidated statements published by the UK government. Therefore, other aspects of the UK accounting reform, including accrual-based budgeting and the previous accrual-based accounting system (called resource-based accounting or RAB) lay outside the scope of our analysis; nevertheless, some remarks may be carefully extended to them as well as to other business-style accounting systems that are transferred into public administration. In particular, accrual-based budgeting and reporting may be undermined and become misleading for decision-makers if they are grounded in an implied representation of accounting that is based upon an inconsistent accounting model of reference. Our theoretical analysis purports to point to some major inconsistencies in the case of the currently adopted accrual-based representation of accounting adopted by the UK government, such as illustrated by Whole of Government Accounts.

The rest of the article is organised as follows. The first section provides a summary of the accounting system for the government accounts in the UK, its recent evolution and current practice. It shows the centrality of HM Treasury not only in financial and accounting policies, but also in their respective regulations. The second section introduces a frame of reference and analysis that defines which specificities characterise public administration activity in relation to the specific needs and purposes of government activity. This activity mainly consists of

collective missions of general interest. Its specificities should therefore be considered in the light of a suitable accounting model of reference. This suitable model further combines cash basis accounting with an income statement approach, while excluding the recourse to a balance sheet accounting approach that has proved inconsistent with those specificities. The [Appendix](#) provides a numerical example of the application of this model that remains compatible with multi-period budgetary accounting. The third section applies this model to show some representational issues raised by the accounting system currently adopted by HM Treasury. Behind this system lies an inconsistent representation that is based upon a balance sheet accounting approach. Illustrative examples concern consolidation perimeter,<sup>3</sup> current value measurement of assets and liabilities, and accounting policy for PPPs.

In conclusion, the article raises theoretical and practical issues concerning representations of accounting and government control in the UK. All together, these issues show the limits and cast doubts on the experience of the government in developing new public financial management (NPFM) in the UK. These limits and doubts are relevant for the overall debate on NPFM and the EPSAS, in Europe and abroad.

## 2. Government Accounting and Finances in the UK: An Overview

### 2.1. Accounting for the Whole of Government in the UK

The UK Treasury, called *Her Majesty's Treasury*, dominates the budgetary process as well as the accounting for investments, revenues, expenses and cash flows of the UK government (Jones, 2003). The Prime Minister is in charge of the Treasury from a political viewpoint, while the 'Chancellor of the Exchequer' manages it from the administrative viewpoint. HM Treasury's economic functions and responsibilities include the administration of central government finances, but also monetary and financial policies that are operationally delegated to the UK Central Bank (Bank of England).

Since the 1940s, the government's annual budget has followed a macroeconomic and macro-budgetary logic. It refers to macroeconomic measurements of national accounting, more than to the microeconomic and micro-budgetary measurements based upon financial accounting. Specific attention is given to public spending and its financing, which requires a focus on cash basis in this context. Nevertheless, some items and measurements are nowadays reconciled with their assessment on an accruals basis, especially through a summary of consolidated accounts ([Table 1](#)) and the accruals-based budget introduced by the reform of 2000.

HM Treasury is central to public accounting and finances in the UK, not only for its administration of public finances, but also for its regulation of public finances and accounting. Concerning accounting regulation, the Treasury holds the power to issue, year by year, the budgetary and accounting rules to be applied by all the entities that are to be consolidated in government accounts. In this regulatory task, it is supported by a consultative committee called 'Financial Reporting Advisory Board'. Concerning accruals-based accounting, the Treasury has issued a set of accounting rules called 'Financial Reporting Manual', every year since 2005. It was previously called 'Resource Accounting Manual'. Since 2009–2010, this set of accounting rules has been based upon an adaptation and interpretation of the IFRS initially issued for commercial enterprises.

On this basis, HM Treasury (2010b, 5.2.11, pp. 4–7) requires every entity to reconcile all accounting elements included in the year budget (on a cash basis) with the corresponding element in resource accounts (on an accruals basis). This involves a double system of accounting. Cash basis accounting is still in place and follows three main Laws: 'Exchequer and Audit Departments Act' of 1866, 'Exchequer and Audit Department Act' of 1921, and 'Government Resources and Accounts Act' of 2000. The latest law added the preparation of budgets and financial statements

**Table 1.** Reconciliation in WGA 2009–2010 between public debt (net liabilities) and deficit (net deficit for the year) as determined, respectively, by national accounts and financial accounting (WGA) systems

	£bn
High-level reconciliation of public sector net debt	
Net liabilities (WGA)	1212
Net public service pensions liability	(1132)
Provisions	(102)
PFI contracts	(23)
Unamortised premium or discount on gilts	(16)
Tangible and intangible fixed assets	759
Payables and receivables	40
Investments	16
Other	6
<b>Public sector net debt (National Accounts)</b>	<b>760</b>
High-level reconciliation of current deficit	
<b>Net deficit for the year (WGA)</b>	<b>165</b>
Public service pensions	(52)
Impairment of assets	(25)
Capital grants	(16)
Depreciation of assets	(6)
Provisions	28
Military expenditure not capitalised	5
Other	8
<b>Current deficit (National Accounts)</b>	<b>107</b>

Source: HM Treasury (2011b, p. 26). See HM Treasury (2012, p. 22) for WGA 2010–2011. Contains public sector information licensed under the Open Government Licence v3.0.

on an accruals basis, but as far as central government is concerned, it did not lead to any revolution in the public accounting system that has been in place since the mid-nineteenth century.

## 2.2. *The Introduction of Accruals-Based Accounting*

Accruals-based accounting was not intended to replace cash-based accounting, which is still central to the annual budget and is based both on capital and current spending. The introduction of accruals-based accounting (called resource accounting) has complemented this budget through consolidated accounts and accrual-based budgeting (called resource budget). The decision that first introduced accruals dates back to the early 1990s. A consultation paper was published in 1994 (open to comment until 31 January 1995) to explain the reasons for this choice, paving the way for the new accruals-based budgeting. Law proposals were presented by the government in July 1995. Accordingly, accrual-based accounting was prepared and submitted to the Parliament in the fiscal year 1999–2000, coupled with a tri-annual accrual-based budget in 2000. Consolidated accruals-based accounts were introduced only later and published for the first time in 2003–2004. The new mode of accounting was utilised for the first time to prepare the tri-annual budgets for 2001/2002–2003/2004, published in July 2000.

## 3. A Theoretical Accounting Model of Reference for Public Administration

### 3.1. *Questioning Only ‘One’ Accrual Basis of Accounting*

UK accounting reform has adopted a balance sheet approach that was originally designed for business entities, which raises well-known representational and organisational issues

(Ellwood, 2002, 2003; Ellwood & Newberry, 2006, 2007; Heald & Georgiou, 2009). Concerning recent public sector accounting reforms, the choice of this approach is often justified as being a suitable transition from a cash basis to an accrual-basis accounting model (Iuliana, 2010; Lande & Rocher, 2011; Parry & Wynne, 2009). The latter is then deemed to be synonymous with a balance sheet accounting approach.

Theoretically, this transplantation of the balance sheet approach into the accounting reform could perhaps be taken for granted if there were only one model of commercial accounting (and accrual-basis). However, Biondi (2008, 2012) reviewed the relevant literature and accounted for three main views that feature in generally accepted models of commercial accounting:

- A static view (ownership), focusing on the net worth of the enterprise entity and its valuation at a specific moment in time;
- A financial view (cash flow), focusing on financial inflows and outflows of the enterprise entity and representing resources available at a particular time to meet the needs or purposes of the enterprise;
- A dynamic view (becoming concern), focusing on resource inflows and outflows of the enterprise and representing resources mobilised (and utilised) by activities of the enterprise during a particular period.

The *static* view focuses on evaluating the net worth of an enterprise. Net worth is determined by valuing the batch of assets (understood as properties and rights) held by the enterprise, minus the batch of liabilities (understood as claims and obligations). This representation is static because it refers to an arbitrary moment in time. An accruals basis is here associated with estimates and valuations of current values (fair values) at that moment. In contrast, the *financial* view follows ‘cash flows’ (monetary or financial) arising from the activities of the enterprise. It identifies a set of financial sources and a set of acquired funds which are capable of sustaining and developing the activities of the enterprise. Finally, the *dynamic* view is an extension of the previous one: it starts from the monetary and financial flows and imputes them according to the resources utilised during the period, in order to match the costs of these resources against the corresponding revenues. This matching of costs against revenues characterises the accruals basis of accounting here.

This classification points to a different understanding of timing (intergenerational equity): while a static approach focuses on the current value of an imagined future at an arbitrary moment in time, a dynamic approach refers to the accrual of actual expenditures related to the ongoing productive process of the enterprise entity through time and space. Intergenerational equity is a fundamental decision to be taken by public sector management and policy-makers. Concerning this decision, a dynamic approach seems capable to assist and inform them in understanding the implications of this decision through time and cohorts of constituencies (Barton, 2009; Colquhoun, 2011; Pallot, 1991; Robinson, 1998a).

From an institutional viewpoint, the static approach is oriented towards ownership, purporting to measure the value of net holdings and the management of the ‘treasure’ held by the government as owner.<sup>4</sup> On the contrary, the dynamic approach is oriented towards the deployment and evolution of the ongoing entity over time. In this context, the accounting literature defines the entity as a ‘going concern’, while Biondi (2005) reformulates it as a ‘becoming concern’, in order to stress its evolutionary dimension, which includes and overcomes revolving activities which roll over and are then identically renewed over time. Table 2 contrasts these distinctive accounting models of reference.

These models of reference have important implications for the accounting representation of the business entity. Each model distinctively defines, recognises and measures the main accounting elements (assets and liabilities, revenues and expenses). Table 3 summarises differences between the static and the dynamic accounting view in this respect.

How can these models be adapted before transplantation so that they fit the specificities of the economic process of government? The current regulatory debate often ignores the need for this accounting choice, supposedly for two main reasons. On the one hand, following Barton (2009, p. 223), it does not make a distinction between the recording method of

accrual accounting (whereby all transactions and relevant events are recorded as at dates of incurrence) and particular models of accrual accounting (which depend upon the nature and roles of the accounting entity and the basis of income and net asset measurement).

On the other hand, some participants in this debate *choose to* ignore these specificities by adopting a normative ‘paradigm of government by market’, as stressed by Barton (2009, p. 223), quoting Self (1993):

After reviewing the reforms in the UK, New Zealand and some other nations, Self (1993, cover page) noted that: ‘economic or public choice theories have contributed powerfully to a new paradigm of “government by the market” – meaning not only that public responsibilities should be reduced and public policies adjusted to the pressure of economic markets, but also that the government itself should be remodelled and reformed according to market concepts of competition and efficiency’.

In this context, the variety of accrual accounting models for business entities makes the reference to ‘the one’ accrual basis void and misleading. No such thing as ‘the one’ accrual basis exists. This myth cannot and does not respond to the necessity of choosing a model of reference.

Following the ‘true and fair view’ ideal already favoured for the private sector (Barton, 2009),<sup>5</sup> this fundamental accounting choice should be based upon some distinctive features that characterise the specific economic process of government and its accounting needs. Drawing upon Pallott (1992), Barton (2009, 2011) and Monsen (2012, 2014) among others, we can point to three main features of government: (i) the driving purpose to redistribute collected resources through direct transfers and non-lucrative provision of goods and services; (ii) the mission to protect and manage the commons in the general interest, including the interest of remote future generations; and (iii) the special function and use of borrowing, in view of serving this purpose and this mission. These features summarise the driving economic purpose and scope of government intervention in a Republican economic order. Accordingly, governmental accounting must control and represent ongoing public administration activity, its cost and its funding according to the specific representational needs that are raised by these features.

These features make the ongoing economic process of government specific, and different from that of a business activity. The first feature (point (i) above) refers to the overarching purpose of

**Table 2.** Accounting models of reference under an accruals basis of accounting (commercial accounting)

	Static view	Dynamic view
Representation	Ownership	Becoming concern
Approach	Balance Sheet	Income Statement
Method	Stock Method	Flow Method
Purpose	Valuation	Accountability and Control
Focus	Wealth, Net Worth	Inflows and Outflows, Revenues and Expenses

**Table 3.** Accrual-based representation of the business entity (commercial accounting)

	Static view	Dynamic view
Orientation	Wealth	Net result
Focus	Net worth	Resources mobilised (and utilised)
Basis of reference	Properties and claims	Matching of costs and revenues
Timing	Moment in time; changes between moments	Time period
Recovery of ...	Values conferred	Costs absorbed

redistribution through government activity. This purpose is not pursued by commercial activities that have a market basis and a profit orientation. From an accounting viewpoint, redistribution implies that the activity generates expenditures that must be financed and covered over time by the successive cohorts of constituencies that are committed to the entity’s activity, pointing to the intergenerational equity concept discussed above. This expenditure-sharing process is central to government activity over time. Expenditures are mainly transfers to beneficiaries (direct redistribution) or delivery of products and services for free or on non-commercial basis (indirect redistribution). Recovering revenues is mainly carried out through taxes (collected through ‘hard’ redistribution) and refinanced debt (issued as a means of ‘soft’ redistribution). Public borrowing indeed accomplishes ‘soft’ redistribution, as opposed to and complementary with ‘hard’ redistribution generated by taxation on private actors’ income and wealth. Tax collection is considered ‘hard’ because it transfers income and wealth from taxpayers to beneficiaries. Debt refinancing is considered ‘soft’ because it does not definitely transfer wealth, which formally still belongs to the debt holders, although it shifts the use of the wealth involved to the government, who can then employ it for accomplishing its redistribution purpose against the payment of interest charges to debt holders.

This illustration of the basic economic process of government leads to its two other features. First (point (ii) above), this process is not expected to generate a surplus or maintain financial capital (either nominal or real). In this context, government resources and related holdings may be understood as ‘commons’ to be managed and protected in the general interest. Second (point (iii) above), this process makes a specific use of borrowing that enables government to fund its activities by systematically issuing and refinancing debt over time. Public debt is then continuously rolled over time through successive cohorts of fund-providers that go on subscribing it for interest payments. This enables government to acquire financial funds against interest charges, while capital instalments are sterilised by continued refinancing.<sup>6</sup> Both features justify the net liability (negative net assets) that usually appears when governments are accounted for on an accrual basis. This net liability is generated by the management of the debt for redistribution purposes, when financial capital maintenance is not required or expected.

*3.2. A Critique of the Balance Sheet Accounting Approach Applied to Public Administration*

This section argues that a balance sheet accounting approach is inconsistent with the specific organisational purposes and special legal powers, as well as accountability issues inherently related to the unique government environment (GASB, 2006). Already Holder (1980), Robinson (1998a), Stanton and Stanton (1998) and Barton (2009, 2011) provide critiques of the accounting and economic view implied by a static accounting approach, arguing that the use of the economic concepts of value are inadequate and unreliable for public administration. Non-cash assets and non-borrowed liabilities in particular are at issue in so far as their economic value measurements and re-measurements include computational revenues and expenditures that

may never materialise, which blurs the meaning and usefulness of accounting and reporting. Furthermore, the management of fair value measurements of refinanced public debt may further undermine redistribution purposes. Therefore, a static accounting view may result in a representation that does not properly reflect the financial sustainability of the reporting public administration entity nor its economic position. In particular, McCrae and Aiken (2000) develop a ‘flow of obligations’ perspective of accounting for public administration. This perspective refers to a flow (or matching) concept of service provision rather than to a ‘stock’ (or ‘valuation’) concept (see Biondi, 2008, 2012, for further details).

Balance sheet accounting involves a peculiar conception of government according to which it is expected to manage its resources, revenues and various activities so as to generate some financial performance. Governmental economy will then be assessed in terms of financial return and the government held accountable for this financial performance. The balance sheet accounting approach involves a peculiar representation of ownership that depicts public resources as a wealth of commodities, a sort of treasure that the government is called to hold as owner. This treasure differs from a stock of (net) assets in that the focus is implicitly laid on maintaining and accruing its financial value. However, the government’s activity is not that of a Kingdom. As a constitutional monarchy, the UK separates the property of the Queen and of the Royal family from the collective resources managed by the UK government and public administration in the general interest, on behalf of its citizenship. Indeed, in terms of accounting, the task of the government and public administration has nothing to do with the management of the Royal Treasure, although the UK Treasury is still called ‘Her Majesty’s Treasury’ (*HM Treasury*). Government activity is not expected or required to maintain and accrue the financial value of collected resources. Therefore, balance sheet accounting is inconsistent with a conception of government activity which purports to redistribute those resources through direct transfers and non-lucrative provision of public goods and services (point (i) above). In particular, balance sheet accounting is inconsistent with the idea that government activity primarily involves protecting and managing resources that are shared (commons), with a view to pursuing missions of general interest (including the interest of (remote) future generations).

Balance sheet accounting misrepresents the specific government economic process whereby current spending (expenses in the income statement) and capital spending (invested assets in the balance sheet) are ‘covered’ (that is, paid *and* financed) by taxation *and* public borrowing (point (iii) above). For a better understanding of this misrepresentation, we can take the example of a building acquired by the government through taxes paid by its taxpayers. The taxpayers do not expect to pay a rent for its utilisation, since they have already contributed to its acquisition through taxation. Furthermore, they do not expect to recover the ongoing changes in its current value through their future taxes: only the actual costs of maintenance and obsolescence are accountable as expenses in the government income statement. This statement may then match expenditures of the period to recovering revenues of the period, providing an expenditure-sharing representation of the period on an accrual basis.

In sum, the government activity that the accounting system controls and represents does not purport to maintain any invested capital (net worth), but to recover consummated resources and incurred expenditures. The government does not and should not increase its wealth by asking taxpayers to pay several times for its invested costs, since its economic activity is expected to be non-lucrative. Government assets are ‘commons’, which are not intended to generate a financial performance, or to be appropriated by creditors in case of financial distress (point (ii) above). Government assets are expected to be utilised with a view to accomplish general interest missions and activities.<sup>7</sup> Creditors cannot presently seize ‘Big Ben’ or Tower Bridge, can they? Should they?

The way the UK government is actually run is not an exception to this general understanding: its accruals-based accounts show a material, persistent and increasing negative balance between total assets and liabilities (net liability). This negative balance and its increasing path prove that the whole of current expenses (including interest charges) are not covered by taxation alone (fiscal revenues of the period of reference).<sup>8</sup> Issuance and refinancing of public debt are then essential to fund total expenditures. From a macroeconomic perspective, this structural unbalance enables governments to borrow financial savings accumulated by private actors (debt holders) in order to organise wealth redistribution at the collective level (Biondi, 2012, 2013).<sup>9</sup> This spatial redistribution consists in collecting private financial savings through public borrowing, in order to spend them during the period for the purpose of performing general interest activities. This specific economic function and use of public borrowing is another fundamental feature (point (iii) above) that distinguishes a governmental entity from a business entity. It should be noticed that this persistently negative net liability which characterises modern governmental activity has never prevented governments from being funded through financial markets, confirming that the going concern assumption and credit risk are differently assessed by investors in governmental securities.

### *3.3. A Suitable Accounting Model for Public Administration*

To be sure, accounting representation does not determine the amount of tax revenues that shall cover the expenditures of the period. In the UK and generally abroad, this amount is voted by the Parliament, while debt issuance and refinancing are administered by the Treasury. However, accounting representation defines the very expenditures that have to be covered (i.e. paid and financed). Every accounting model of reference determines a distinctive expenditure basis for this representation. This basis may have a decisive impact on understanding and decision-making by both the Parliament and the Treasury. Moreover, it can also be employed to establish regulatory recommendations, requirements and covenants, in the way that, in the public sector, accounting not only provides an information tool, but also plays the role of a control device and of a regulatory instrument.

Altogether, these impacts provide relevant implications for accounting control, and define suitable objectives for the accounting model of reference. In particular, this accounting model should control for and be robust against the following types of behaviour:

- (a) managing expenditures (revenues) by passing (extracting) them through (from) other entities and stakeholders, for instance by reducing the quantity and quality of government activity, or increasing contributions paid by beneficiaries other than taxes;
- (b) hiding expenditures (and obligations) by putting them out of the accounting consolidation perimeter and scope, or recording revenues from transactions with formally unconsolidated but substantially related parties;
- (c) adding imaginary expenditures and revenues (both current and future) to manipulate the accounting representation and undermine accountability and control.

The most characteristic purpose of expenditure-sharing (point (a) above) requires a specific definition of the expenditure that has been covered. This definition should exclude the application of a static representation, which does not fit with the ‘true and fair view’ of the underlying economic activity, since it focuses on net worth and related changes in value, which do not represent the incurred expenditure that is allowed to be covered over time. Expenditure-sharing further implies a combination of financial and economic representations, that is, the combined recourse to budgetary accounting and dynamic accrual accounting (the dynamic view). Both

are flow-based accounting representations. Their combination is suitable for obtaining the ‘true and fair’ representation of public administration. While budgetary accounting can represent the resources that are made available to different projects and programmes (cash outflows, under a financial view), dynamic accrual accounting can represent the resources absorbed by the activities of the public administration as a whole (costs absorbed, under a dynamic view). Accounting for financial and economic flows is then combined to recognise and measure the resources that have been acquired (contributions) and consumed (expenditures). This consumption must be covered (by taxation and debt refinancing) to ensure the continuity and fairness of the government economic process over time.

In this context, the received critique of a matching process related to a flow accounting approach is misleading. This critique considers that the matching process is fundamentally flawed by arbitrariness and extensive subjective judgements. Two responses apply here. From a practical viewpoint, current value measurements that are applied under the alternative stock approach are by no means less arbitrary and subjective. From a theoretical viewpoint, the indeterminacy involved in the matching process refers to managerial and political decision-making on the recovery of absorbed resources. The accounting representation is not expected to replace this decision-making, but to assist and inform it in a meaningful, consistent and reliable way. It is up to policy-makers to decide how and when to cover public spending through taxation and debt refinancing over time and through successive cohorts of constituencies.

Therefore, following Monsen (2012, 2014), we can argue for a comprehensive flow accounting approach that makes cash basis and accrual basis accounting compatible with each other for the sake of public administration accounting, accountability and control. Accordingly, a governmental accounting system can represent the collective action of the government by combining budgetary accounting with a modified dynamic accounting approach. This combined accounting model may better respond to the concern expressed by HM Treasury’s Manual (2011a, §1.17) over the spending control framework.

Unlike the Manual, though, this model abandons the inconsistent notion of net worth accrued to government. Reference to net worth is especially inconsistent with the above point (c), since net worth includes a reassessment of assets and liabilities in relation to current values of reference that are external to the entity process and that may never materialise through this process. To avoid this inconsistency, government accounts may instead refer to past, current and future financial and economic flows, while the balance sheet is prepared and understood as a *statement of funds* that account for suspended flows to be matched to future periods. The Appendix provides a numerical example of this combined model of reference. The following section applies this model to assess the government’s accounting system currently adopted and applied in the UK.

#### **4. A Theoretical Analysis of the Accruals-Based Accounting System for Government in the UK**

This section will show how preference for balance sheet accounting characterises the Financial Accounting Manual issued and yearly updated by HM Treasury (2010b) to help interpret the IFRS with a view to applying them to public administration in the UK (the Manual, thereafter). However, the Manual does not provide any conceptual framework addressing the specific representational needs of governmental accounting. It broadly refers to generally accepted accounting practices driven by: UK accounting requirements under the Companies Act; the IFRS; the statement of recommended practice (SORP) for accounting by charities; and the body of academic and professional accumulated knowledge (HM Treasury, 2011b, 2.1.1). The Manual only mentions ‘parliamentary accountability’ (HM Treasury, 2011b, 2.3) and ‘regularity’ as additional accounting principles specific to public administration (HM Treasury, 2011b, 2.1.2), and does not justify

the accounting convention of revaluation and current value measurements that are required (HM Treasury, 2011b, 2.1.4). While both HM Treasury and IPSAS Board (IPSASB) maintain an overall alignment strategy with the IFRS, HM Treasury's standardisation strategy is not in line with the IPSASB's recent decision to develop a conceptual framework that 'is not an IFRS convergence project' and does not purport 'to interpret the application of the IASB framework to the public sector' (IPSASB, 2010, p. 4). In fact, IPSASB's conceptual framework 'does not establish authoritative requirements for financial reporting by public sector entities that adopt IPSASs, nor does it override the requirements of IPSASs or RPGs' (IPSASB, 2013, §1.2).

Our theoretical analysis shall show how the accounting representation driven by HM Treasury's approach adopts a static ownership view purporting to evaluate the current value of assets to cover the nominal or current value of outstanding liabilities (including borrowing). This peculiar view of ownership is likely to jeopardise the accomplishment of the government's 'general interest generating activities', transforming the public resources of the UK into a 'Treasure's Island' held by a HM Treasury that has been turned into a Leviathan or super-owner.

In sum, HM Treasury's accounting approach actually undermines both the accountability of the government, and the very logic of the 'res publica' in its double meaning of general interest and commons. The rest of this section will apply a dualistic perspective that contrasts static and dynamic views, in order to normatively analyse some of the representational issues raised by the application of the Manual. Illustrative issues concern consolidation perimeter and scope, recognition and measurement of assets and liabilities, discounting (including those in connection with provisions and contingencies) and PPPs.

#### 4.2. *Accounting Boundaries*

According to HM Treasury (2010b, 4.2.3), the main criterion for inclusion in consolidation perimeter and scope differs from the IFRS and follows the budget perimeter. However, according to the 'Certificate and Report of the Comptroller and Auditor General to the House of Commons on the Whole of Government Accounts 2009–10' (NAO, 2011b, p. 3), HM Treasury (2010b) deviated from this accounting requirement by defining the accounting boundary for 2009–2010 WGA by reference to those bodies classified as being in the public sector by the Office for National Statistics (note 1.21.1 to 2009–2010 WGA), implying the exclusion of Network Rail. This shows a problematic disconnection between aggregates from national accounting (on which macroeconomic control of stability and sustainability is based upon) on the one hand and budgetary and accounting aggregates on which microeconomic control of public administration is based upon on the other hand, both in the UK and abroad. Moreover, the NAO (2011b, p. 3) claims that this accounting rule was not even consistently applied, especially because publicly owned banks and other bodies, such as the Bank of England, were excluded from the consolidation perimeter.<sup>10</sup> Although it is impossible to quantify the effect of these omissions through public information, the NAO further argues that a significant impact may be expected on governmental accounts. To illustrate the potential impact (pointing to point (a) above):

- Network Rail which had gross assets of £41.7 billion and gross liabilities of £35.7 billion;
- publicly owned banks which had gross assets of £2862.1 billion and gross liabilities of £2720.9 billion; and
- other bodies, such as the Bank of England, which had estimated gross assets of £263.3 billion and gross liabilities of £250.1 billion.

The consolidation of the Bank of England (and the Bank of England Asset Purchase Facility Fund) was planned in 2009–2010 and completed in 2010–2011 WGA (HM Treasury, 2011b,

Annexe 5; NAO, 2011b, §65, p. 37). This resulted in offsetting a material share of government gilts currently held by the Bank of England, without any loss to the private sector, with a ‘reduction of £183.8 billion to government financing and borrowing’ (HM Treasury, 2011b, p. 23). This had a material impact on the outstanding debt burden, alleviating the need for austerity policies.

#### 4.3. *The Asset Side of the Balance Sheet*

Concerning the asset side of the balance sheet, the Manual has introduced asset revaluations to current (fair) value for current, non-current and inventory assets since its very beginning (HM Treasury, 2010b, §2.1.4). Consistently, even the option given in IAS 40 to adopt the cost model for investment properties is withdrawn (6.2.80). This is a significant departure from the IFRS, which allows historical cost measurement for most classes of assets.

The adoption of the revaluation approach may involve inappropriate reference to and over-dependency on market values for non-marketable special assets. In particular, the Manual requires capitalising the value of artistic and cultural assets (heritage assets), as if they were available to be sold or liquidated. In fact, since WGA 2010–2011, the HM Treasury (2012) has added an exception to the accounting framework applicable to the WGA, allowing the holding entities to exclude recognition or disclosure of heritage assets. The latter can now be valued at either cost or current market value (HM Treasury, 2012: par 1.30–1.32, pp. 23–24).

With absent active markets for reference, this adoption of a revaluation approach may further imply recourse to discounting. In the latter case, measurements become subject to volatility from reference discount rates (generally fixed by the Treasury itself: HM Treasury, 2011b, 6.2.60; 9.2.7 (d); 10.2.13; 12.3.14 (a)), as well as volatility of other estimated variables. This volatility further adds well-known problems with pro-cyclicality of current (fair) value accounting measurements.

In particular, recognition and measurement for non-current assets require applying the revaluation approach according to the IAS 16. The historical cost approach is explicitly excluded, even as complementary information (HM Treasury, 2011b, 6.2.7), except for assets with short lives or immaterial values (HM Treasury, 2011b, 6.2.8 (h)). As a consequence, taxpayers are required to maintain the current values of the government’s investments, although their ongoing value changes may never become actual charges to be paid. In particular, taxpayers should recover every revaluation loss exceeding previously recognised gains (HM Treasury, 2011b, 6.2.6). The Manual further requires capitalisation of the value of the road network (HM Treasury, 2011b, 6.2.12/13/14), implying an inconsistent compensation between computed depreciation charge based on estimated current value, and actual charges for annual maintenance (HM Treasury, 2011b, 6.2.15); net loss of road network value must then be passed to ‘net operating cost’ of the period (HM Treasury, 2011b, 6.2.16).

#### 4.4. *The Liability Side of the Balance Sheet*

Concerning the liability side of the balance sheet, some precautions are taken regarding public borrowing. For instance, loans are accounted for at their nominal value and submitted to impairment (HM Treasury, 2011b, 9.2.7 (c)), while full fair value measurement for financial instruments (i.e. ‘the designation of financial assets and liabilities as at fair value through profit and loss’) is conditional to a special authorisation granted by relevant supervisory authorities (HM Treasury, 2011b, 9.2.8). This accounting policy for loans fits a liquidation accounting approach that matches current value of assets against nominal value of outstanding liabilities at a certain moment in time. However, the Manual does not clarify whether financial liabilities that are

quoted in an active market, such as government gilts and bills, are recognised and measured at current (fair) value or nominal value.

Civil servants' pension liabilities (HM Treasury, 2011b, 12.2.5) are evaluated at their fair value. This value features on the balance sheet and its change over time must pass through into the income statement. Following IAS 19, the impact of discounted value changes on expected future obligations (and dedicated assets) concerns only *defined benefit plans*.<sup>11</sup> The reference discount rate is fixed here by the Treasury, on the advice of the 'Government Actuary's Department'. In March 2010, pensions actually paid during the fiscal year totalled 26.9 £bn, while the reduction of the reference discount rate involved an accounting loss on capital account of 286.8 £bn, coupled with an accounting loss in income account of 58.9 £bn (HM Treasury, 2011b, p. 21). Concerning this critical representational issue, the House of Commons' Committee of Public Accounts (2012, pp. 3 and 6) argues that 'it is difficult for users to interpret underlying trends in long term liabilities, such as pensions and nuclear decommissioning, because of inconsistency and, more importantly, volatility in the discount rates used'.

Moreover, some contingent liabilities are also disclosed at their fair value (HC Public Accounts Committee, 2012, 9.2.7 (e); 10.2.13); their measurement is then submitted to estimation and volatility of discount rates and other estimated variables of reference. On the contrary, future commitments related to normal or remote affairs are not accounted for (HC Public Accounts Committee, 2012, 10.2.15; 10.2.17), although they may imply charges and risks that are material to the economy and finances of the UK government. This last choice does not meet the precautionary purpose envisioned by the HC Public Accounts Committee (2012, p. 3).

According to our theoretical frame of analysis (section 2), better representation and control may be obtained by excluding discounting from accounting measurements, recognising expiring and future charges at their likely nominal values, regularly and timely updated, and kept in line with long-term budget planning. Contingencies and other conditional amounts may be recognised in a special section of the balance sheet, excluded by net financial position. This solution may be relevant for civil servants' pension liabilities (Biondi & Sierra, 2015). Their recognition as liability is questionable and was rejected by other Member States such as Finland and France (Biondi et al., 2014). Moreover, their measurement at current values involves subjectivity, uncertainties and volatilities that undermine the meaning and intelligibility of overall financial statements and budgets, if included. On this matter, HM Treasury (2003, pp. 17–23) provides an illustrative explanation of how national accounts, accruals-based balance sheet and comprehensive projections incorporate past and future assets and liabilities.

#### 4.5. Governmental Net Worth as Main Purpose of WGA

NAO (2011b, p. 13) states that 'consolidating the assets, liabilities, income and spending of these bodies gives, for the first time and in one place, an audited accounts-based view of what the UK public sector owns and owes, and what it earns and spends' (Table 4).

Our analysis of adopted accounting treatments shows that HM Treasury has preferred a static ownership view which requires taxpayers to recover changes in the financial value of governmental net worth. This implies representing the negative balance between assets and liabilities (consisting of 1211.8 £bn in March 2010) 'as if' it would be covered by future fiscal revenues. It is currently compensated in the balance sheet by the 'Taxpayers' equity' composed of three funds, respectively, called *general reserve*, *revaluation reserve* and other reserves (HM Treasury, 2011b, p. 73). In particular, the revaluation reserve (+218.6 MLD £ to March 2010) compensates the general reserve, 'as if' the government could (or should) dispose of its net worth to cover the net liability. This representation undermines the meaning and usefulness of this balance for purposes of public deficit and debt control and accountability.

**Table 4.** Summary of the WGA 2009–2010 provided by the NAO (2011b, p. 14)

	Description	Examples	Value in WGA 2009–2010 (£bn)
Assets	Resources controlled by government from which future benefits can be generated	Gold reserves, student loans, the national road network, military equipment	1207.5
Liabilities	Obligations on government arising from past transactions or events	Deficit on the public sector pension schemes, gilt-edged stock, future cost of decommissioning existing nuclear facilities	(2419.3)
Net liability	The difference between what the government owned and what it owed at the end of the financial year		(1211.8)
Revenue	Income received from government activities	Taxation, rental from local government housing, funding received from the EU	582.0
Expenditure	The cost of running government and providing public services	Benefits payments, staff costs, grants, depreciation, contributions to the EU	(665.7)
Net financing cost	Costs recognised in relation to the funding of government activities	Investment revenue, interest paid on gilts, interest on pension scheme liabilities	(80.5)
Net loss on the sale of assets			(0.3)
Net deficit of the year	The shortfall between operating revenue and expenses (including finance costs) during the year		(164.5)

Source: NAO analysis of WGA 2009–2010.

#### 4.6. The Accounting Treatment of PPP

Governmental accruals-based accounting policies for PPPs have mimicked business accounting practices to keep these operations off balance sheet through recourse to special-purpose vehicles and shell entities, operating leases and other sophisticated legal–financial arrangements, undermining the overarching governance mechanisms for those partnerships. These practices have been criticised even for the business sector, in Europe and abroad (Biondi et al., 2011). In particular, these governmental accounting policies have evaded not only macroeconomic statistical control on both incurred deficit and debt, but also microeconomic accounting control that is required by law on public debt and spending. Since the very beginning of these policies, the National Audit Office Report (1996, §3.30–§3.31, pp. 25–26) has expressed concerns about this accountability loss, claiming for mandatory information to the Parliament on ‘the future financial obligations that such projects are likely to represent and which may be substantial’.

This problem was recently acknowledged by the House of Commons’ Committee on Public Accounts (2012; Conclusions and Recommendations, point 2, p. 5, and p. 8):

The WGA illustrates how individual spending commitments can accumulate to create significant liabilities for government over time. In particular, PFI deals had created future obligations of £131.5 billion at 31 March 2010, which was four times the value of the

assets secured through these deals. This shows that, when considering the affordability of investment in infrastructure projects, Treasury and individual government bodies must take into account the comprehensive and total cost of all such commitments as well as the value for money of individual transactions.<sup>12</sup>

To November 2011, 712 partnerships (at 31 March 2011, consolidated accounts reported 706 contracts) have been signed by the UK government (more exactly, by its entities) with a nominal investment value of 54.3 £bn. Among them, only 69.7% (or 82.4% of total value) were on the balance sheet of the UK government, that is, 42.4 £bn. According to Biondi (2011), this share was 19.3% by October 2007, showing an improvement on this major issue raised by UK's accounting reform (Heald, 2010). However, the whole of the future obligations incurred by these contracts, which appear to meet the definition of a liability from functional and conceptual viewpoints (see also the definition contained in the conceptual framework of the IASB at that time, at par. §4.46), consists of 242.5 £bn at the same date, of which 199.7 £bn concerns contracts that are on the balance sheet. In March 2011, the WGA (2011) [WGA (2010)] only recognised a net accounting value of 35 £bn [30.9 £bn], associated to a liability of borrowed financial capitals of 32 £bn [28.1 £bn], implying a positive net balance (see, respectively, HM Treasury, 2011b, 2012). This occurs because the accounting method is applied on the capital element of the contract, that is, the accounting basis for capitalising assets and liabilities (HM Treasury, 2011b, 2012, 6.2.56 to 6.2.58), while the interest and service elements are excluded (HM Treasury, 2011b, 2012, 6.2.62). However, the whole future disbursement, including the latter elements, is relevant to public sector control and accountability. The liability that is currently recognised on the balance sheet is defined through discounting and it is limited to the capital element. This representation is consistent with a static approach that focuses on the net worth of the government at a certain period of time. This is also consistent with the IFRS, especially after the IFRIC recommendation no. 12 of 2008. However, from a dynamic accounting view, the flow of payments over time constitutes the accounting focus. Accordingly, special sources of funds can be added on the liability side to show the outstanding future obligations that are involved by the service element (which corresponds to either an executory contract or a non-borrowed financial obligation), and also by the interest element. Practically, this inclusion is particularly relevant because Biondi (2011) finds empirical evidence of material premia – that is, higher interest charges – paid by PPP contracts over long-term governmental borrowing rates in the UK.

At present, these future obligations related to PPP contracts are only disclosed in the Notes, where the consolidated report shows their discounted value at 145 £bn for WGA (2011) and 131.5 £bn for WGA (2010). In conclusion, the liability amount recognised on the balance sheet excludes one-third of the contracts signed by November 2011. Moreover, this liability remains materially less than the discounted value of included contracts (more than four times less), which, in turn, is almost one half of the cumulated nominal value of the future obligations. This eventually means that the liability recognised in the balance sheet for all these contracts is more than eight times less than the nominal value of future obligations that must be honoured over time.<sup>13</sup> In this context, the reports by the House of Lords (2010) and the NAO (2011a) raise concerns about evasion of internal control raised by PPPs.

## 5. Conclusive Remarks

In the UK and abroad, reforms of government accounting and finances have often taken for granted the need (or wish) to mimic practices and standards belonging to the private sector. These reforms have raised important expectations about the efficiency and effectiveness of

the public service and administration. These expectations are nowadays coupled with increased attention to public deficit and debt in a context affected by the global financial crisis that started in 2007 and claims for austerity policies at national and EU levels.

This article has developed a theoretical analysis of the accounting system developed and applied to the WGA by HM Treasury in the UK. It throws light on representational issues raised by the adoption and adaptation of IFRS that are originally designed and issued for the private sector. In particular, our analysis addressed conceptual and practical concerns with a balance sheet accounting approach and its static ownership view, requiring taxpayers to recover value changes in the government's net worth. Illustrative examples concerned the consolidation perimeter and scope, current value measurement of assets and liabilities, and some doubtful accounting practices in PPP. From an international perspective, the UK case study shows the limits of and casts doubts on the leading experience of the UK government in developing new public financial management (NPFM) in the UK and abroad.

Formulating hypotheses to explain the reasons behind these peculiar accounting choices goes beyond the purpose and scope of this article. One reason might be disclosure avoidance on some sensitive matters, both in relation to users (the Parliament, but also financial investors) and to European authorities, with the risk of undermining internal control and of misleading the overall accounting representation of public administration in the UK. Another reason might be to provide government support through implicit government grants to private actors such as auditing firms, providers of public service and infrastructure and financiers. A further reason might be to reassure users on the viability of public borrowing through a liquidation assessment of its net worth, although this assessment is inconsistent with longstanding public borrowing practices and with the current assessment of investors on this practice, which is based upon continuous refinancing over time.

Further research may develop a comparative analysis of these representational issues in the European context, in order to assess the position of UK relative to other Member States in general and in the context of the EPSAS project that is under development. From this perspective, the case study of the UK's accounting system may have implications and provide input for the overall debate at the European level. According to the survey performed on behalf of the European Commission, public sector accounting in the UK is the most compliant with the IPSAS (Ernst and Young, 2012). According to our analysis, the balance sheet approach that is adopted by UK public sector accounting and the IPSAS is inconsistent with economic, organisational and institutional features that are specific to the public sector. It may therefore involve an inappropriate and misleading accounting representation. This result is especially significant in the European context which applies financial ratios based on accounting data to control and regulate public spending and borrowing by its Member States.

### Acknowledgements

Yuri Biondi is Tenured Senior Research Fellow of the Cnrs and research director at the Financial Regulation Research Lab (Labex ReFI). He wishes to thank Jane Broadbent, Sheila Ellwood, and Richard Laughlin for comments, while Dr Sumita Shah (ICAEW) and Prof. Rowan Jones (Birmingham University) early provided suggestions and references. He further acknowledges fruitful discussions at conference presentations: Mari Kobayashi (Waseda University), Tadashi Sekikawa (JICPA, former IPSAS Board Member), Kenji Izawa (Ernst & Young, current IPSAS Board Member), and the participants of the seminar organized by the Public Sector Research Institute of Waseda University, Tokyo, on 13 November 2012; Ileana Steccolini (Bocconi University), Enrico Guarini (Milano University), Maria Francesca Sicilia (Bergamo University), and the participants of the XVIII IRSPM (International Research Society of

Public Management) Meeting, Prague, 10–12 April 2013; David Heald (Aberdeen University), Pam Stapleton (Manchester University), Andy Wynne, and the participants of 14th CIGAR (Comparative International Governmental Accounting Research) Conference, Birmingham, 2–3 September 2013, Usual disclaimer applies.

## Disclosure Statement

No potential conflict of interest was reported by the author.

## Notes

<sup>1</sup><http://www.ifac.org/public-sector/about-ipsasb> (accessed on 8 May 2012).

<sup>2</sup>One case of reference is that of ‘Balmoral High School’ in Ireland (‘PFI school’, 2007). Signed in 2000 for a nominal investment of £17.7m, this partnership started in January 2002 and ended in August 2008 due to falling enrolments. Although the school shut down, the government continues to pay an annual charge of £1.3m and will do so until 2025–2026 under the terms of the contract. This partnership was kept off balance sheet under the official interpretation of UK GAAP, but is now on balance sheet under the official interpretation of IFRS (applied since 2009).

<sup>3</sup>By consolidation perimeter, we mean both the boundary and the coverage, or scope of consolidation.

<sup>4</sup>This representational background justifies the title of our article, since the current accounting model depicts UK Treasury as the owner of UK Island.

<sup>5</sup>We refer to the concept of ‘true and fair view’ in its general sense, pointing to faithful representation consistent with facts, events, and users’ needs.

<sup>6</sup>The [appendix](#) provides a numerical illustration of this case. Government may issue debt also to cover payments, including interest charges, over time.

<sup>7</sup>We can then define them as ‘general interest generating activities’ by analogy with the ‘cash generating activities’ introduced by the IFRS for the private sector.

<sup>8</sup>This net balance should remain consistently positive if the whole of current expenses (including interest charges) are covered by taxation (current fiscal revenues). It should reverse to parity if taxation eventually pays for all the expenses, comprising current and capital spending. See [Appendix](#) for a numerical illustration.

<sup>9</sup>For the sake of simplicity, we will leave aside here the macroeconomic and theoretical connection of public borrowing (and debt issuance) with money creation. Readers can compare with HM Treasury (2011b, 3.4, p. 12).

<sup>10</sup>The NAO (2011b) listed the significant bodies excluded in Figure 12 (p. 35). Further difficulties and uncertainties were stressed regarding the elimination of intra-government transactions and balances; see NAO (2011b, pp. 38–41).

<sup>11</sup>In this way, the ongoing actual contributions flowing in and out these funds disappear from the accounting representation (NAO, 2011b, 12.2.4 (b)).

<sup>12</sup>For further information, see HC Public Accounts Committee (2011), Oral Evidence, Q39, Q42 and Q48 (pp. 7–8).

<sup>13</sup>Biondi et al. (2011) have a similar analysis of leases. Please note that the time misalignment in available data (November 2011 for partnership contracts and March 2011 for consolidated accounts) only allows a rough calculation, which is nevertheless sufficient to show the magnitude of the problem.

## ORCID

Yuri Biondi  <http://orcid.org/0000-0002-5545-5550>

## References

- Barton, A. (2009). The use and abuse of accounting in the public sector financial management reform. *Abacus*, 45(2), 221–248.
- Barton, A. (2011). Why governments should use the government finance statistics accounting system. *Abacus*, 47(4), 411–445.
- Bellanca, S., & Vandernoot, J. (2014). International Public Sector Accounting Standards (IPSAS) implementation in the European Union (EU) member states. *Journal of Modern Accounting and Auditing*, 10(3), 257–269.
- Biondi, Y. (2005, August). *The firm as an entity: Management, organization, accounting* (Working Paper No. 46). Universitàdegli Studi di Brescia. doi:10.2139/ssrn.774764

- Biondi, Y. (2008). De Charybde de la comptabilité de caisse en Scylla de la comptabilité patrimoniale. *Revue de la régulation*, 3/4 (2nd semester). Retrieved from <http://regulation.revues.org/5003>
- Biondi, Y. (2011). Cost of capital, discounting, and relational contracting: Endogenous optimal return and duration for joint investment projects. *Applied Economics*, 43(30), 4847–4864.
- Biondi, Y. (2012). Should business and non-business accounting be different? A comparative perspective applied to the new French central government accounting standards. *International Journal of Public Administration*, 35(9), 603–619. Retrieved from <http://ssrn.com/abstract = 1414751>
- Biondi, Y. (2013, June 27–29). *Governmental accounting and austerity policies: Accounting representations of public debt and deficit in Europe and abroad*. Accounting, economics and law research network conference, SASE annual meeting, University of Milano. Retrieved from <http://ssrn.com/abstract = 2245028>
- Biondi, Y. (main author), Bloomfield, R. J., Glover, J. C., Jamal, K., Ohlson, J. A., Penman, S. H., . . . Wilks, T. J. (2011). A perspective on the joint IASB/FASB exposure draft on accounting for leases. *Accounting Horizons*, 25(4), 861–871. Retrieved from <http://ssrn.com/abstract = 1768083>
- Biondi, Y. (Ed.). (2014, December). Harmonising European Public Sector Accounting Standards (EPSAS): Issues and perspectives for Europe's economy and society. *Accounting, Economics and Law: A Convivium*, 4(3). doi:10.1515/acl-2014-0015
- Biondi, Y., & Sierra, M. (2015, May 7–8). *Accounting for pension flows and funds: A case study for accounting, economics and public finances*. EGPA XII Permanent Study Group Public Sector Financial Management Workshop, Zurich-Winterthur (Switzerland). doi:10.2139/ssrn.2606547
- Broadbent, J., & Laughlin, R. (Eds.). (2003). Public–private partnerships. *Accounting, Auditing & Accountability Journal*, special issue, 16(3).
- Colquhoun, P. (2011). Intergenerational equity in municipal accounting: New Zealand in the early 20th century. *Accounting History Review*, 21(2), 143–161. doi:10.1080/21552851.2011.581838
- Ellwood, S., & Newberry, S. (2006). A bridge too far: A common conceptual framework for commercial and public benefit entities. *Accounting and Business Research*, 36(1), 19–32.
- Ellwood, S., & Newberry, S. (2007). Public sector accrual accounting: Institutionalising neo-liberal principles? *Accounting, Auditing & Accountability Journal*, 20(4), 549–573.
- Ellwood, S. M. (2002). The financial reporting (r)evolution in the UK public sector. *Journal of Public Budgeting, Accounting and Financial Management*, 14(4), 565–594.
- Ellwood, S. M. (2003). Bridging the GAAP across the UK public sector. *Accounting and Business Research*, 33(2), 105–121.
- Ernst & Young. (2012, December 19). *Overview and comparison of public accounting and auditing practices in the 27 EU Member States prepared for Eurostat final report*. Retrieved from <http://ec.europa.eu/eurostat/documents/1015035/4261806/study-on-public-accounting-and-auditing-2012.pdf/5ad43e2b-2ba7-4b05-afab-d690fc2ad9dd>
- Erturk, I., Froud, J., Sukhdev, J., Leaver, A., & Williams, K. (2012). Accounting for national success and failure: Rethinking the UK case. *Accounting Forum*, 36, 5–17.
- European Commission. (2013, March 6). *Towards implementing harmonised public sector accounting standards in Member States. The suitability of IPSAS for the Member States* (Report from the Commission to the Council and the European Parliament, SWD(2013) 57, COM(2013) 114). Brussels. Retrieved from <http://ec.europa.eu/eurostat/about/opportunities/consultations/epsas>
- Governmental Accounting Standards Board. (2006, March). *Why governmental accounting and financial reporting is – and should be – different* (White Paper). Norwalk, CT: Governmental Accounting Standards Board. Retrieved from [http://www.gasb.org/white\\_paper\\_full.pdf](http://www.gasb.org/white_paper_full.pdf)
- Grossi, G., & Soverchia, M. (2011). European commission adoption of IPSAS to reform financial reporting. *Abacus*, 47(4), 525–552.
- HC Public Accounts Committee. (2012, February 7). *Whole of government accounts 2009–10, sixty-seventh report of session 2010–12, report, together with formal minutes, oral and written evidence*. HC 1696. London: The Stationery Office Limited.
- Heald, D. (2010). *The accounting treatment of private finance initiative projects*. Supplementary written evidence p. EV78-EV80, House of Commons, Treasury Committee, pre-budget report 2009, fourth report of session 2009–10. Published by the House of Commons, HC 180. London: The Stationery Office Limited.
- Heald, D., & Georgiou, G. (2009). Whole of government accounts developments in the UK: Conceptual, technical and timetable issues. *Public Money & Management*, 29(4), 219–227.
- HM Treasury. (2003). *Long-term public finance report: Fiscal sustainability with an ageing population*. London.
- HM Treasury. (2010a). *Consolidated budgeting guidance 2010–11*. Retrieved from <http://www.hm-treasury.gov.uk/>
- HM Treasury. (2010b). *Financial reporting manual 2010–11*. Retrieved from <http://www.hm-treasury.gov.uk/>
- HM Treasury. (2011a). *Consolidated budgeting guidance 2011–12*. Retrieved from <http://www.hm-treasury.gov.uk/>
- HM Treasury. (2011b). *Whole of government accounts – year ended 31 March 2010*. Retrieved from <http://www.hm-treasury.gov.uk/>

- HM Treasury. (2012). *Whole of government accounts – year ended 31 March 2011*. Retrieved from <http://www.hm-treasury.gov.uk/>
- Holder, W. W. (1980). *A study of selected concepts for government financial accounting and reporting*. Chicago, IL: National Council on Governmental Accounting.
- House of Lords. (2010). *Select Committee on Economic Affairs, 'Private Finance Projects and off-balance sheet debt'*, 1st report of session 2009–10, Two volumes: HL Paper 63–I et HL Paper 63-II, mars 2010. Published by the Authority of the House of Lords. London: The Stationery Office Limited.
- Humphrey, C., Miller, P., & Scapens, R. W. (1993). Accountability and accountable management in the UK public sector. *Accounting, Auditing & Accountability Journal*, 6(3), 7–29.
- International Public Sector Accounting Standards Board. (2010, December). *Conceptual framework for general purpose financial reporting by public sector entities* (Exposure Draft N. 1).
- International Public Sector Accounting Standards Board. (2013, January). *The conceptual framework for general purpose financial reporting by public sector entities*. Final Pronouncement.
- Iuliana, C. (2010). Cash accounting standardization in the public sector. *Annales Universitatis Apulensis: Series Oeconomica*, 12(1), 79–87.
- Jones, R. (2003). United Kingdom. In Lüder, K. & Jones, R. (Eds.), *Reforming governmental accounting and budgeting in Europe* (pp. 941–1017). Frankfurt: Fachverlag Moderne Wirtschaft.
- Lande, E., & Rocher, S. (2011). Prerequisites for applying accrual accounting in the public sector. *Public Money & Management*, 31(3), 219–222.
- Lapsley, I., Brunsson, N., & Miller, P. (Eds.). (1998). Transforming the public sector. *Accounting, Auditing & Accountability Journal*, special issue, 11(3).
- Mack, J., & Ryan, Ch. (2006). Reflections on the theoretical underpinnings of the general-purpose financial reports of Australian government departments. *Accounting, Auditing & Accountability Journal*, 19(4), 592–612.
- Mayston, D. (1993). Principals, agents and the economics of accountability in the new public sector. *Accounting, Auditing & Accountability Journal*, 6(3), 68–96.
- McCrae, M., & Aiken, M. (2000). Accounting for infrastructure service delivery by government: Generational issues. *Financial Accountability and Management*, 16(3), 265–287.
- Monsen, N. (2012). Development of administrative cameralistics: An example. *International Journal of Governmental Financial Management*, 12(1), 22–38.
- Monsen, N. (2014). *Commercial accounting, fund accounting and cameral accounting: Introduction and comparison with a view to use in the governmental sector* (4th ed., Report). NHH Norwegian School of Economics.
- National Audit Office. (2011a, April 28). *Lessons from PFI and other projects*. Report by the Comptroller and Auditor General, HC 920 session 2010–2012, prepared under Section 6 of the National Audit Act 1983 for presentation to the House of Commons in accordance with Section 9 of the Act, released on 15 April 2011. London: The Stationery Office.
- National Audit Office. (2011b). *Certificate and report of the Comptroller and Auditor General: Whole of government accounts 2009–10*. Prepared under Section 11 of the Government Resources and Accounts Act 2000 on 31 October 2011, published by HM Treasury on 29 November 2011 (HC 1601).
- National Audit Office. (1996, April 24). *Resource accounting and budgeting in government: The white paper proposals*. Report by the Comptroller and Auditor General, HC 334 Session 1995–96.
- Pallot, J. (1991). The legitimate concern with fairness: A comment. *Accounting, Organizations and Society*, 16(2), 201–208. doi:10.1016/0361-3682(91)90014-6
- Pallot, J. (1992). Elements of a theoretical framework for public sector accounting. *Accounting, Auditing & Accountability Journal*, 5(1), 38–59. doi:10.1108/09513579210008244
- Parry, M., & Wynne, A. (2009). The cash basis IPSAS: An alternative view. *International Journal of Government Financial Management*, 23, 23–29
- PFI school to cost £7.4m after closure. (2007, March 23). *The Guardian*. Education Guardian. Retrieved from <http://www.guardian.co.uk/education/2007/mar/23/schools.uk4>
- Robinson, M. (1998a). Accruals accounting and the efficiency of the core public sector. *Financial Accountability and Management*, 14(1), 21–37.
- Robinson, M. (1998b). Measuring compliance with the golden rule. *Fiscal Studies*, 19(4), 447–462. doi:10.1111/j.1475-5890.1998.tb00295.x
- Seddon, J. (2008). *Systems thinking in the public sector*. Axminster: Triarchy Press.
- Self, P. (1993). *Government by the market? The politics of public choice*. London: MacMillan.
- Stanton, P., & Stanton, J. (1998). The questionable economics of governmental accounting. *Accounting, Auditing & Accountability Journal*, 11(2), 191–203.
- Sudcliffe, P. (2003). The standards programme of IFAC's public sector committee. *Public Money and Management*, 23, 29–36.

## Appendix

Based on a numerical example, this appendix illustrates the accounting reference model that combines cash basis with accrual basis accounting, according to a dynamic accounting view (as adapted to the public sector). This example is based upon simple assumptions about the economy and finances of the public administration entity that is to be accounted for. For the sake of simplicity, we assume that this entity acquires only one tangible asset which lasts for five years; this acquisition is fully covered by public debt with a debt instalment schedule that fits in with the asset depreciation pattern. This excludes any refinancing of the tangible asset investment over time, if current tax contributions cover depreciation charges. We further assume that operating expenses are constant over time. All refinancing needs are covered by public debt at the same constant interest rate as the original public debt for tangible asset investment purposes (6% per year on outstanding debts). These borrowing lines are incurred but not refinanced, for the sake of simplicity. All payments are performed at the end of the reference period.

Table A1 shows a scenario in which the accounted entity raises contributions from taxation that cover only operating and interest charges. This scenario shows that current surplus (deficit) is negative but stable as long as tax contributions cover for operating expenses and interest charges incurred by public administration. Cumulated deficits should then be refinanced by the issuance of new debts to refinance investment positions (if no new investment is incurred, cumulated debt becomes stable in the stationary pattern that starts here after the fifth period).

**Table A1.** Illustrative example of accrual accounting representation according to a dynamic accounting representation (as adapted to the public sector)

Periods	1	2	3	4	5
<b>INCOME STATEMENT</b>					
Expenses	100.0	100.0	100.0	100.0	100.0
Interest charge	6.0	6.0	6.0	6.0	6.0
Depreciation charge	20.0	20.0	20.0	20.0	20.0
<b>TOTAL Expense</b>	126.0	126.0	126.0	126.0	126.0
Tax Contributions covering:					
Expenses	100.0	100.0	100.0	100.0	100.0
Interest charge	6.0	6.0	6.0	6.0	6.0
Depreciation charge	0.0	0.0	0.0	0.0	0.0
<b>TOTAL Revenue</b>	106.0	106.0	106.0	106.0	106.0
<i>Net Surplus (Deficit)</i>	-20.0	-20.0	-20.0	-20.0	-20.0
Net cash flows from operations	0.0	0.0	0.0	0.0	0.0
Debt instalment	20.0	20.0	20.0	20.0	20.0
Balance	-20.0	-20.0	-20.0	-20.0	-20.0
<b>BALANCE SHEET</b>					
Gross Asset	100.0	100.0	100.0	100.0	100.0
Cumulated Depreciation	20.0	40.0	60.0	80.0	100.0
Net Asset	80.0	60.0	40.0	20.0	0.0
Initial Outstanding Debt	100.0	100.0	100.0	100.0	100.0
Cumulated Amortisation	20.0	40.0	60.0	80.0	100.0
Final Outstanding Debt	80.0	60.0	40.0	20.0	0.0
<i>Cumulated surplus (deficit)</i>	-20.0	-40.0	-60.0	-80.0	-100.0

It is easy to show that this dynamic accounting representation is compatible with cash basis accounting. In particular, the following Table A2 provides a comprehensive cash flow statement

that can be further aligned with multi-period budgetary accounting. It shows how the initial debt position (taken for capital investment purpose) is continuously refinanced by issuance of further debt, maintaining outstanding debt level constant over periods.

**Table A2.** Illustrative example of a cash flow statement compatible with a dynamic accounting representation (as adapted to the public sector)

Periods	1	2	3	4	5
<b>Net operating cash flows (cash from operations)</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Investment cash flows (cash from capital investing)</b>	<b>-120</b>	<b>-20</b>	<b>-20</b>	<b>-20</b>	<b>-20</b>
<i>Of which:</i>					
<i>Funding of asset acquisition</i>	-100	0	0	0	0
<i>Amortisation of debt</i>	-20	-20	-20	-20	-20
<b>Financing cash flows (cash from funding)</b>	<b>+120</b>	<b>+20</b>	<b>+20</b>	<b>+20</b>	<b>+20</b>
<i>Of which:</i>					
<i>Issuance of debt for capital investment purpose</i>	+100				
<i>Refinancing of expiring debt positions</i>	+20	+20	+20	+20	+20
<b>Total debt outstanding</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

This accounting model combines cash basis and accrual basis accounting. It is relevant for and sufficient to accounting, control and accountability of public administration. A balance sheet accounting approach would add re-measurements of balance sheet accounting elements (here, the non-cash asset and the outstanding debt) at their values of reference (such as their market prices) at each period. This would result in adding comprehensive incomes and losses which are non-cash adjustments. These adjustments depend on those value re-measurements, which do not belong to the entity’s economic and financial process, and which may never materialise through this actual working process over time.