

**Written evidence from Dr Laurence Ferry¹, and Dr Danny Chow², Durham University
(IGA 04)**

Public Administration and Constitutional Affairs Committee inquiry into Government accounts

We welcome this opportunity to submit written evidence to the Public Administration and Constitutional Affairs Committee Inquiry into Government Accounts. This reply draws on recent published academic work and senior level personal experience of both central government and local government accounting practices.

The main focus of our response is that progress has been made and continues to be made with government accounting, but the culture has to further change to embrace the full benefits of accrual accounting. This undoubtedly has to involve financial literacy becoming a norm for politicians and civil servants alike rather than an add-on, a specific skill, a nice to have or even a tick box to promotion. For this to happen involves a more rigorous continuation of building institutional capacity and capability, and further recognition on the importance of accounting for good governance.

The International Federation of Accountants (IFAC) and Chartered Institute of Public Finance and Accountancy (CIPFA) have issued a number of standards and reports which explain the importance of accrual accounting in the public sector, and such financial reporting is considered critical to an international framework for public governance (IFAC / CIPFA, 2014).

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The limitations with previous systems of accounting and accountability in UK central government were well reported, and one of the primary reasons for the move to accrual accounting and Resource Accounting and Budgeting (Likierman, 1998a, 1998b, 2001, 2003).

The move from cash to accrual based accounting has arguably helped to improve the quality of standards in government accounting practices in countries including the UK that have made the transition (Aggestam et al., 2014; Chow, Humphrey and Moll, 2007; Chow et al., 2015). This is because there is a more comprehensive coverage of transactions in the financial statements themselves that potentially can provide more useful information. For example, under accrual accounting the revenue and expenditure statement will include items previously hidden from view and thereby help with better government performance measurement and facilitate scrutiny. Items here include depreciation of fixed assets and accrued civil service pensions, which are both significant government costs that represent the expense consumed in providing the public services and not captured by cash accounting. The cost of programmes and cost centres may have therefore been understated, and not fairly presented. Likewise cash receipts and payments are more detailed in the cash-flow statement and so solvency can be better ascertained. In addition, accrual accounting enables a balance sheet to be reported that includes assets and liabilities. As a result there is potentially better information for both asset management and debt management.

Having said this, the issue of political buy-in (or lack thereof) is an issue if such advanced accounts are to be useful. The overwhelming focus of politicians and civil servants in the UK central government remains on the budgeting process for contesting allocations (Aggestam et al., 2014; Chow et al., 2015; Ferry and Eckersley, 2011, 2012, 2015). The vocal and visible contest over budget allocations in central and local government relations provide an ongoing testimony to this situation, although reporting of performance to supplement conformance has become an ever more important issue as part of accountability and transparency arrangements (Ahrens and Ferry, 2015; Ferry, Eckersley and Zakaria, 2015; Ferry and Murphy, 2015) and likewise for the NHS (Ferry and Scarparo, 2015; Gebreiter and Ferry, in press). What is missing for central government, however, is the shift to a longer-term decision-making focus, afforded by improved visibilities on future costs and liabilities that could be linked with some reformed version of public service agreements. The misalignment of shorter-term political incentives and the centrality of annual resource allocation contests remain the biggest stumbling blocks to greater use of accruals and Whole of Government Accounts in the UK

government's decision process, and in some ways to accountability that goes beyond mere financial conformance.

As part of nurturing this political buy-in, parliamentary scrutiny needs to foster general financial literacy amongst all politicians, rather than an (over) reliance on specialist members and/or committees of Parliament (Chow et al., 2015). Whilst important work is carried out by the Public Accounts Committee with groundwork from the National Audit Office (NAO), this at the end of the day comes after major decisions are taken and the responsibility for scrutiny rests on a relatively small group of individuals. With greater financial literacy the scrutiny of government business can become a more everyday activity embedded into the culture of parliamentary work.

In addition, the financial literacy of the civil service also has to be developed and maintained. Important institutional capacity and capability building has been done but often financial literacy can be perceived as an accounting-centric function for compliance, reporting and auditing purposes as part of a 'conformance' culture rather than an enabler of a 'performance' culture. There is a cultural mind-set here that whilst improving still needs more work, and is something that is important across all levels of government and across public services more generally (Ferry, Coombs and Eckersley, 2017).

Furthermore, an area worth further consideration is Integrated Reporting. The International Integrated Reporting Council (IIRC) and CIPFA have established a Public Sector Pioneer Network to consider how Integrated Reporting can be adopted in the public sector to look at the connectivity of the information they publish, and how that can maintain or improve outcomes with the same or less resources on a more sustainable basis. An important part of this is to therefore move beyond the short term political cycle and focus more long term. It also recognises that financial data can only tell part of the story in creating value, and so addresses broader forms of capital and means of narrative reporting.

We do not have sight of the use of management accounts in the everyday running of government and so do not comment, except to say that this is an area that would benefit from more research.

Variations in constitutional boundaries between countries make it more difficult to benchmark the UK. In particular the boundary of the public services is categorised differently between countries and often on the politics of the moment within a country. However, there are determined reformers aiming to keep the UK at the vanguard of public sector accounting reforms, and this determination helps to sustain the momentum for improving financial reporting and scrutiny.

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