The limits of accrual accounting applied to public accounts: A French view

The French system of public accounts continues to function at its current state with little doubt. The gap between information provided on the one hand, and users' vague expectations on the other however, is insistent and continues to widen. At its current state, the public accounts system is not only costly but is also starting to prove inadequate in addressing the challenges of the future. This article aims to determine the extent to which this system could be enhanced – and at what cost – or whether the development of a new system built on different principles should be considered.

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Introduction

The information system for public finance is primarily based on public accounts, which outline an array of information on the public finance situation. However, criticism and discontent remain, and this can limit the use of these accounts by decision makers, as well as in the public debate as a whole. Despite major improvements as a result of reforms undertaken over the past several years, this situation persists. The question that therefore emerges at this juncture is how can we determine the right path forward to close the insistent gap between information provided on the one hand, and users' expectations on the other: these expectations do, however, remain relatively vague, making this choice more challenging. We have probably reached certain limits of the current set-up, and while its continued implementation is not in doubt, it is costly and will not be adequate to address all of the questions. It is therefore vital to understand the intrinsic limits of this system, and this article will aim to determine the extent to which it can be enhanced – and at what cost – or whether we should consider the development of a new system built on different principles.

Public accounts are established using various systems: budget accounting, accrual accounting and the system of national accounts. The question of the limits should therefore be addressed differently depending on the system.

With respect to budget accounting, the question is integral to the requirements related to both the form and content of budgets, so any potential progress should thus be closely linked to considerations on the nature of budgets themselves. However, this question cannot be raised intrinsically, unless we believe that a reference budget model exists; this paper does not intend to deal with this extensive question.

When it comes to the system of national accounts, the question of the limits should be set against the general model's structure, which also includes issues related to calculating gross domestic product (GDP), households and corporations, and additionally involves the need for an approach incorporating concepts that can apply to all economic stakeholders. This requires separate deliberation and is not the issue at hand in this paper.

Accrual accounting standards are deemed to be based on general and universal principles that can be applied to all entities. However, they can also take on board the main features of the entities they apply to, through developing specific interpretations and adaptations where necessary. They play a crucial role in the general set-up by enabling users to go beyond the limits of budget accounting and providing extensive data that are used directly or indirectly in national accounts. So the question of the limits is first and foremost an issue of the limits of accrual accounting as applied to its "natural" recipients, before considering the limits of their transposition to public sector entities.

Features and limits of accrual accounting

"*Comptabilité générale*" – or general accounting principles – is the term broadly used in France to embody the notion of "financial accounting" used in English-speaking countries. This type of accounting is based on accruals, as opposed to the cash basis. By purposefully taking a very general approach with the ensuing questionable approximations and associations, we can describe this accounting method as being designed to provide data for third parties on an entity's financial position and results that are useful or necessary for said parties in assessing the outcome of transactions that they conduct or may conduct with the entity. It is also a management and control tool for "managers". This accounting approach relies on general and universal principles, but was developed to assess the financial position of private and commercial companies, and some of the key features of this accounting model are a result of this prior context.

Accounting, reporting entity, scope for net assets and capital

Accounting is a system for recording and producing information with precise technical features that provide specific quality to this information. It is therefore important to briefly outline these features with a view to better understanding them. This system uses the double-entry bookkeeping principle to recognise past events that affect the entity's financial position. These events are classified into consistent categories and measured in monetary terms, applying rules that then enable users to add them by category and calculate the balances between the various totals. These recorded figures are subsequently rounded out by inventory operations, thereby ensuring that all significant events that took place during the period in question are included.

Two prerequisites are essential to achieve the goals set out for accrual accounting requirements, and these will help determine their framework and some of their limits: it is crucial to define the nature of the reporting entity, and to determine the type of events that must be recognised in the financial statements.

Determining the reporting entity

The accounting process must apply to a clearly identified entity, which is sufficiently independent in its decision making and responsible for the commitments it undertakes to ensure that consideration of its financial position is relevant. The accounts for an entity that is controlled by another entity that can consequently impose its own policies may not be significant. Consolidated accounts are therefore deemed to provide superior information in these circumstances, even if individual accounts are still relevant to some extent. In this respect, it is important to note the close connection between an entity's degree of independence and responsibility and the relevance of its accounts. These two aspects are meaningful to being accountable for an activity and for its allocated resources.

Determining the nature and scope of events

The definition of what is referred to as the financial position – or net assets – dictates the type of events that are recorded. In practical terms, this range of events involves lists that define the scope of events to be booked: simply referring to a general list of rights and obligations is insufficient. If we look at implementation of accounting standards and actual practices, we can see that the concept of net assets or the notion of financial position depend partly on the purpose assigned to the reporting documents produced, as well as on the nature of the entities in question. All rights and obligations are not necessarily included in the financial position as defined from an accounting standpoint, and only those that meet the overall definitions of assets and liabilities feature in the accounts: these definitions are thus set up to meet the objectives of reporting "accounting" financial information.

These features are important and they set the accrual accounting process apart from the production of financial information based on collecting statistics or varied pieces of information.

Private sector accrual accounting and the concept of private sector entity

Two models for corporate accounting

Practically, these principles and rules apply to private sector entities through two main models: 1) a reporting-based model that is designed for investors or potential investors and focuses on assessing the financial performance of shareholders' investments; and 2) a model based on recording and measuring a company's guarantees to third parties, where the company's responsibility is limited to the amount of its equity. The first reporting-focused model is recommended under international financial reporting standards (IFRS) and this approach is based on general principles consistent with the way international financial markets and investors operate. The second model reflects a more legal and national view of companies. There are few differences between the two models, but those are important. They primarily derive from

differences in time frames, as well as measurement bases. The IFRS model strives to recognise all events that could have an impact on the financial position – even where this effect is remote or uncertain – and uses valuation methods that focus on measuring these impacts. Meanwhile, the national model focuses on events with more direct and certain effects, drawing on more "legal" pronouncements. Two examples clearly illustrate this difference. First, international financial reporting standards recommend accounting for income tax relating to a given period on the basis of an estimate of what the company should pay by applying the tax rate to income for the period, even if part of this payment is deferred and contingent on future developments in the company: this method involves developing assumptions on these future developments. Conversely, the national model recommends booking these taxes based on whether they fall due during the fiscal year. A second example of these differences is the way lease contracts are accounted for: international accounting standards hold that they create debt for the lessee in most cases, while national standards in France consider that the lessee's commitment is not a long-term liability in general, and take a narrower view of this concept.

Similar features and limits of these models

However, a company as defined in these models is always seen as having a legal personality tasked with utilising capital provided by partners with the aim of generating profit, or at least maintaining capital. The financial position – or net assets – that defines the scope of elements that are accounted for is dictated at the outset by this capital, which offers a clear, but only partial, view of the company. Rights and obligations embodied by assets and liabilities depend on the legal, economic and social environment that the company operates in, while the effects of this context – as well as the impacts of the company's actions on its environment – are not outlined in the financial statements, or if they are, then it is only partly and indirectly.

This is the case for the entire range of company's externalities, yet these factors can have a central role when assessing the company's financial position and any changes therein. It is difficult to measure their effects, particularly as they can vary depending on the business sector, the company size and a number of other factors. Those include very general aspects such as the quality of infrastructure, the general level of staff qualifications, legal security and the quality of institutions, the state of the environment and applicable regulation, as well as other properties that characterise the economic context of the company's operations. They can also involve more specific aspects that only affect certain companies that work in more regulated sectors. Companies themselves also generate a footprint, with both positive and negative effects. All these various aspects have direct, indirect or potential consequences on a company's financial position, yet none of these is explicitly reflected in the financial statements. This situation not only results from the difficulties involved in measuring the effects of these externalities, it is first and foremost the result of the choice of accounting's primary objective, i.e. prepare the financial statements for a legal entity – operating in a given context – that is founded by ownership contributions with the aim to enhance this capital by conducting commercial economic operations and managing the rights and obligations related to this activity.

This reference to capital is vital in developing the key categories on the balance sheet, i.e. assets, liabilities and equity. Regardless of whether the goal is to assess financial profitability or the degree of guarantees for third parties, the primary aim is to outline and measure any changes in capital over successive accounting periods. Assets equate with productive capital, in that it is the double entry to invested capital booked in equity, while liabilities equate to third parties' rights on capital. The accounting model assumes full consistency between these two visions of capital.

The accounting model therefore does not apply to the company as a whole, but rather to a certain vision of the company in a given environment, whose effects cannot all be taken into account.

Balance sheet and capital

The balance sheet is the preferred tool for measuring capital as it lies behind the creation of the legal person "corporate entity" as a reporting entity. It recognises the initial capital, then measures how capital evolves through changes in equity over successive accounting periods. Thus, equity is not just the difference between assets and liabilities, but first and foremost it is the position of invested capital as at the end of the accounting period.

However, all standards systems provide for other uses for accrual accounting, either implicitly or explicitly. In addition to the fact that information related to the composition of capital not only interests shareholders or other investors, accounting in the sense of a financial reporting system can provide other information that is useful to a range of users. However, even if consideration of other needs reduces the relevance of the measurement of capital from an investor's standpoint, this approach is still retained. This is explicitly outlined in international accounting standards, and the same also naturally applies to the national model due to its legal, fiscal and prudential dimensions, meaning that the capital measurement goal is a guarantee of the rights of shareholders and third parties. While the rules for measuring these net assets differ partly from one model to the other as a result of different priorities in measuring rights, these differences do not jeopardise the pre-eminence of financial information over equity.

Moving beyond the balance sheet or beyond accrual accounting

Recent changes in the concept of a company – seeking to extend its scope of responsibility to social and environmental aspects with a view to taking on board certain externalities, and not merely be limited to its legal definition of a company with share capital – obviously raise a central problem in view of this general-purpose priority. However, efforts to provide information on these aspects have not so far entailed an in-depth change of the presentation of the balance sheet: any change would be tantamount to seeking to internalise these externalities. Solutions put forward all involve providing additional information in the notes to the financial statements. A reason for this caution is the resolve to preserve the model's consistency with its initial assumptions. Certain aspects can only be internalised following a change in the context – for example the creation of taxes on pollution. Internationalisation cannot take place in the absence of external constraints that create new rights or new obligations, otherwise the concept of the company that sits at the heart of the accrual accounting model would be jeopardised. Nevertheless, this change, however limited it may be, has an effect on the extent and the very nature of private sector accrual accounting.

The notes to the financial statements were initially intended as a way to comment on the balance sheet by setting out more detailed information – although implicitly contained in the balance sheet – and explaining the underlying assumptions used for some measurements or providing additional details on specific points that do not feature on the balance sheet, such as contingent items. The scope for this additional information is clearly set out in the conceptual framework where it exists, or in the general principles. All commitments therefore do not feature in the notes, but rather only those equating to contingent liabilities.

The current trend is to take the process much further and add into the notes any information that cannot be included in the balance sheet from an investor's point of view or even from broader viewpoints that are not really delineated. This change fosters the risk of a breakdown of the accrual accounting model, which could lead to the preparation of two (or more) so-called true and fair views. From a technical standpoint, this clearly reflects a major difference in nature between two approaches:

- Setting up the balance sheet based first on the identification and recognition of elements that make up partners' and third parties' rights to net assets, and that are deemed to be sufficiently consistent to be added together within each of the two columns assets and liabilities, then on subtracting the total of assets from that of liabilities. This process assumes that identification and recognition are consistent in substance and as regards time frame.

- The preparation of the notes to the financial statements, setting out lists of diverse data which cannot usually be added together to provide meaningful information and therefore cannot be used to produce relevant synthetic indicators such as subtotals that may show on the face of the financial statements.

Thus the question here is whether these two approaches can be included in the "accounting reporting" category. International accounting standards went the route of shifting from IAS (International Accounting Standards) to IFRS (International Financial Reporting Standards) without further elaborating on the effects of this development. The French term used for reporting is "*compte rendu*", which literally means giving an account, and which further heightens the ambiguity: should this term be understood as referring to accounting in the technical sense or rather as literally describing events that took place over the period? This change was further pursued by introducing a distinction between "basic" or "primary" financial statements (balance sheet, income statement/surplus or deficit statement, cashflow statement, statement of changes in equity) and the notes to the financial statements.

There has been no analysis of the effects of this change on the nature of accounting itself. Providing financial information in the notes is not an accounting process in itself in theory, and offers more of a descriptive or statistical approach, which can also involve projections. The accounting process is the recording of events that are actual, backed up by supporting evidence; this process is based on a key difference between these actual events, with monetary value, that will have future consequences, and future events that are very likely at the end of the reporting period that will have as predictable and important future effects as actual events. Actual events are featured in the financial statements, while future events cannot be.

We can understand that standard-setting bodies, when setting a clear framework for financial reporting, are not only concerned about the type of tools to use, but also about the relevance for users. As such, all parties agree that forward-looking information is extremely interesting for users, while the legitimacy of standard-setting bodies is built on the benefits of accounting techniques that cannot take this information on board. A piece of information may be useful, but this is not sufficient for it to be considered an accounting item. This question of defining the scope and nature of accounting cannot be left unclear: beyond the issue of standard-setters' authority, "accounting" financial statements potentially have specific legal consequences that are different in nature from that of mere financial information. It is also crucial to ensure comparability of accounts between various entities and thus guarantee the "conceptual purity" of accounting information.

Our intention is not to discuss further the potential consequences of this emerging dichotomy for the future of corporate accounting, but rather to seek to consider how these problems can affect public accounts based on accrual accounting. However, the effects of this change also depend on the scope of application of the accrual accounting model from the private sector. These two questions must be tackled simultaneously: is the accrual accounting model relevant to address public sector entities? And how should we approach the issue of the relationship between primary financial statements and information in the notes to the financial statements for public sector entities?

Specific features of public accounts in light of the accrual accounting model and its developments

When applying accrual accounting principles and rules to the public sector, it is key to bear in mind that this accounting approach was developed to establish the financial statements of private sector commercial entities if we are to avoid transposing purposeless provisions. The legitimacy and scope of direct transposition of corporate accounting standards should therefore be considered in light of previous developments, and this raises several questions:

- Why apply accrual accounting standards?
- How should reporting entities be defined in the public sector?
- How should we define the scope for the accounting patrimonial position that equates to “capital”, both at individual entity level and for groups or combinations of entities?
- How should the question of externalities be addressed?
- How can we address the question of moving beyond the balance sheet or accrual accounting in the public sector?

The nature of the choice of accrual accounting based on private sector accrual accounting

If we are to gain greater insight into this aspect, it is important to first consider the meaning behind the reference to accrual private sector accounting: is this choice based on purely technical considerations or is it guided by an ideological goal?

We cannot find a clear answer by looking at debates on the various reforms that have brought traditional public sector accounting closer in line with private sector accounting. Some advocates of these reforms were clearly keen to take the first option, while others sought to take the approach further and believed that the private sector accounting model would encourage sound public finance management, in addition to its ability to provide useful information for management and control. Additionally, these attempts at convergence date back some time and have taken several different forms, making motivations particularly difficult to decipher. We will therefore not seek to look back nor attribute any type of ulterior motives to such reforms, but rather we will merely strive to define the main features of these two points of view, while bearing in mind that they have never been promoted nor even expressed from a purely conceptual standpoint.

The technical approach

Adopting accrual accounting principles from a technical standpoint may be defined as an attempt to move beyond cash accounting – or budget accounting – by recording transactions with third parties based on the consideration of rights and obligations, including those that are neither approved nor provided for in the budget. This recognition process uses the double-entry bookkeeping method and adopts a stable nomenclature to book all events that affect the net financial position, as implicitly defined in a restricted approach. This extension looks fairly logical and is difficult to oppose, although its legal scope is open to discussion. Recognising tangible assets, expenses to be paid, the correct measurement for receivables, provisions for risks and impairment of assets – to mention just a few basic examples – seem to make for obvious progress in providing insight into the public finance situation and in potentially improving management tools. Similarly, using consistent categories makes for time-bound comparisons, which are more difficult to establish if we take on board the restrictions of purely budgetary nomenclatures, as these must keep up with changes in public policy organisation. These developments are now widely recognised as vital and acted as the driving force behind accounting reforms wherever they were implemented, which is the case in most OECD countries.

However, we can see that this – undisputable and significant – progress addresses aspects that are not merely specific to the public sector. Assets and liabilities thus recognised are key components that largely make up the “technical” resources used by public sector entities to drive the policies entrusted to them. It is critical to both understand and monitor these aspects, and accounting practices reliably support these two processes. However, applying accrual accounting from a merely technical standpoint reaches certain limits. It involves accounting for specific patrimonial items of public sector entities in a similar way as assets and liabilities created and operating in a market environment. Thus, taxes are recognised as receivables from taxpayers with recognition criteria similar to contractual receivables, while the power to levy future

taxation is not recognised as an asset. Similarly, commitments related to citizens' rights to protection against certain social risks are usually only recognised when the related expenses are incurred in the reporting period, since the future commitment to guarantee social benefits in the long term cannot be recognised as a liability. The public domain is perceived only through the taxes and royalties received from its usage.

Ideological option

The ideological option, while not casting any doubt over previous justifications, should immediately raise the question of capital equivalent: what should be valued or maintained, and why? However, interestingly, even the staunchest defenders of this approach do not openly raise this question. Some seem to feel that there is no deep-rooted difference between a company's net assets, which equate to its equity, and net assets from the recognition of public sector entities' assets and liabilities. They fail to realise, or profess not to realise, that defining the financial position merely as the difference between assets and liabilities restricts the process to a circular reasoning. A private sector's financial position equates to its equity, which exists and is defined before showing on the balance sheet. For non-commercial public sector entities that were not set up with an initial funding allocation recognised at one point in time, this "capital" only exists in the form of net assets built up over time. This is also the opening net assets/equity in the opening balance sheet when applying accrual accounting for the first time. However, there is no indication that these net assets/equity equate to the rights or guarantees from shareholders or third parties. This very notion of shareholders is indeed obviously meaningless for government entities. As for third parties, the guarantees that they may seek out lie in entities' political stability more than in their net assets/equity, all the more that the impact of the incomplete nature of net assets/equity would seemingly contradict this stability. Therefore, net assets are merely net assets. What they are made of depend on the capacity to identify and recognise all assets and liabilities, without drawing on a reference to an initial scope defined by invested capital. The ideological take thus appears to be a stance rather than a real justification, as it does not offer answers to these questions: we have therefore defined this approach as ideological, rather than conceptual.

Efforts made both in France and elsewhere so far to transpose standards that apply to companies have in practice thus been restricted to the technical option; however, justifications have sometimes accompanied these moves, pointing to the possibility of later developments offering an operational basis to the goals pursued by proponents of the ideological approach. Yet these goals remain fairly vague and this confusion fuels the misunderstanding that has surrounded the introduction of accrual accounting standards for the financial reporting of public sector entities since the outset.

Nature of public sector reporting entities

Accrual accounting as a technique can be applied to all sorts of entities. The scope and usefulness of financial statements that it produces will, however, depend on the features of the entities that it applies to. Accounting principles and standards do not directly define the type of entities they apply to, but rather are based on the prior assumption that these entities are independent: they particularly have to control their assets and liabilities, as this is the primary requirement for these to be recorded to the balance sheet.

The question of companies' autonomy was raised when groups began to emerge, bringing together a number of entities with legal personalities in a grouping with no legal personality. The group is usually "borne" in a legal sense by an entity that holds investments in the companies controlled, thereby affording this "entity" control of these companies. Consolidated accounts are accounts of the controlling entity, "extended" to the accounts of the companies it controls. This means that the value of the investments featuring on the controlling entity's balance sheet is replaced with the corresponding assets and liabilities of the controlled entities. This process raises a number of technical questions, although they will not be addressed here as this aspect does not have any bearing on our discussion. We would merely note that the question of the absence of autonomy – which remains relative – of a set of entities tied together by

control relationships has been recognised as a limitation of accounting principles: recommendations that accounts be established for that set of entities and borne by the controlling entity have helped move beyond this.

Some public sector entities may encounter this type of situation. For example, the government controls private sector companies through investments in those companies. It may also control public establishments, although there is no share capital in those types of entities. In this case, the principles of consolidation can – and should – apply, with any necessary adaptations. However, these scenarios do not cover all relationship configurations between public sector entities, raising the question of their autonomy when considered on an individual basis.

Public sector entities are therefore involved in groups that make up other entities, with or without a legal personality, while control relationships cannot be established within the group. This is particularly true of the local authorities sector. Such situations occur in the private sector, though less frequently, and the methodology of combined financial statements was developed to address these scenarios, applying and adapting consolidation techniques. Here again, this approach can apply to the public sector with likely significant adaptations, although this does not jeopardise the actual principles of the methodology.

Yet, there is another reason to consider the concept of the autonomy of public sector entities. All of these entities are subject to a sovereignty principle – though to varying degrees – and we can see aspects or delegations of sovereignty in some of them, although none embody this fully. The government, even in its broadest definition, which incidentally is not the definition used in its accounts, is not "the sovereign", i.e. the entity that decides on the rights and obligations that it recognises and the public policies that operationalise those rights and obligations. Public sector entities are merely executing bodies of the sovereign power. In this respect, their autonomy is limited both in terms of the resources they have to conduct their action and of the obligations they must fulfil. These limits may be ignored when it comes to recognising public sector entities' non-specific assets and liabilities (real estate, receivables, debt, etc.), but they are a of critical importance when it comes to addressing specific rights and obligations for public action (right to levy taxes, nature of the public domain, obligation to provide or maintain public goods or services, etc.).

The question of capital

While bringing together and classifying "technical" or non-specific resources and commitments used by a non-commercial public sector entities in a statement identifying assets and liabilities can provide a measure of net assets, this figure is not a concept with the same properties as capital or equity for a private sector company. Additionally, the fact that these net assets are structurally or even massively negative for large public sector entities, such as governments, indicates that either they are incomplete or that the way public sector entities operate is not based on their net assets being maintained or properly measured, or on whether third parties consider this figure of key importance (otherwise, how could the "dollar privilege" existence alongside the United States' massive negative net assets be explained?). One of the major difficulties, which partly explains why these data are not extensively used, also comes from the fact that no one knows to what extent these attempted explanations, which are not exclusive, are justified. The limitation of the technical reference lies in the difficulty of tackling the question of the range of events to recognise.

The notion of capital for the entity

From a microeconomic standpoint and for some public sector entity categories, there can be an equivalence or some (limited) similarities with private sector companies as regards the idea of capital. For example, this is the case for public establishments that are created via a funding allocation to equity. This looks more difficult though to apply to the largest public sector entities as they bear some features of sovereignty. Because accountants cannot recognise sovereignty in the financial statements, those features

can only appear in these entities' financial statements in a diminished form that does not reflect those entities' sovereign power, even though those features make for a decisive aspect of the resources those entities use and of the responsibilities they carry. Their financial statements are therefore automatically incomplete and net assets cannot be interpreted as a corresponding entry to the capital that would equate to the sovereign rights reflecting sovereign power. Endeavouring to record this aspect would be all the more meaningless that, while sovereign power is admittedly clearly identified in the Constitution, the actual features of sovereignty are subject to debate and remain very difficult to define.

Problem considered from a macroeconomic standpoint

The situation for public finances is also a macroeconomic question. Numerous major indicators are defined at the macro level based on an aggregation of public accounts drawn up for national accounting purposes. Considering whether this matter can be dictated by accrual accounting standards or not is becoming increasingly important, particularly as national accounting is not accounting in the full sense of the term, but rather a compilation of statistical and accounting data set in an accounting framework. National accountants prefer accounting data, and particularly accrual accounting information where it exists for the reasons outlined above, i.e. these data are deemed to be more comprehensive and more reliable than other data. We can, therefore, raise the question as to whether the calculation of these indicators could – or should – be obtained directly via a "consolidation" of public sector entities' financial statements that would replace the aggregation of accounts carried out under national accounting processes.

However, there is a key difference between consolidation and aggregation. For example, we can aggregate companies' accounts to obtain statistics and thereby come to an amount that represents the "capital" of the group of companies, but this remains a statistical aggregate that has no accounting meaning, as the group of companies is neither a company nor a reporting entity. The aggregate obtained is therefore not capital as such. The situation for public sector entities is even more complex. An aggregation of public accounts does not equate to a public sector entity's financial statements, and even less so to the sovereign's accounts, yet aggregation (or even consolidation) of public sector entities' liabilities does equate to public debt. Even though this debt is not the debt of a reporting entity in the strictest sense of the word, it is still more than just a sum of liabilities. This debt is also subject to hefty political commitments, mainly on a supranational level. It is information on public finance provided through the accounting process, which also guarantees its reliability, but from which its relevance does not flow, because the aggregation of accounting data over a different scope than that of a reporting entity is not covered by the accounting framework. The fact that this aggregation uses consolidation techniques to cancel out debt that, for example, public sector entities' hold on other public sector entities does not change this conclusion. The result of this process is not the debt of a reporting entity. As a consequence, its use in financial analyses should be justified in its own right and cannot result from properties of accounting principles that relate the debt of an entity to its assets or equity.

The question of externalities

Accounting's inability to account for the effects of sovereignty also explains the difficulty in determining public sector entities' positions on externalities. The question is admittedly irrelevant when we take a purely microeconomic view of entities that merely operate public action from a technical standpoint. However, if we expect accrual accounting to provide summary data on the public finance situation broadly speaking, then we cannot overlook the issue of externalities and their consequences, unless we restrict consideration to highly fundamental but also extremely limited aspects, such as the financial debt. Unlike companies, especially how they are pictured in the current accounting model, public authorities' remit is to organise the environment for the economic activity in general as well as for their own activity, at least to a certain degree. They can therefore decide to internalise certain externalities. The decisions or lack of decisions on this aspect have consequences for the public finance situation both now and in the future. However, this is the responsibility of the sovereign as a political body, which partly delegates implementation to public

organisations. Applying accrual accounting standards only at the level of these organisations is tantamount to putting them on an equal footing with companies in terms of externalities, while overlooking the importance of their role in the exercise of sovereignty.

Example of income tax or tax on profits

Difficulties encountered practically in all countries in accounting for income tax – or rather interpreting the meaning of this accounting – provide a sound illustration of these aspects. The traditional method, still actual in budget accounting, involves recognising a tax due in the same period as the period in which it is collected. Beyond the fact that this is cash accounting, which by definition does not follow the principles of accrual accounting,this method also bears specific drawbacks. As a hefty proportion of this tax is collected in advance, it is impossible to assume that the amounts received are definitively revenue. In this latter example, cash accounting is not a way of measuring revenue generated after the event, as it is for transactions such as sales, but rather it may lead to overestimating revenue for the period.

Methods developed to record this tax in accordance with accrual accounting standards have been – and still remain – subject to intensive discussions between experts that are largely unheard of in broader circles. If we assume that the right to levy tax could not be booked as an asset, then there are very few options for recognising this tax other than cash accounting. Applying accrual accounting principles leads to recognise a receivable in the accounts of the beneficiary public sector entity as soon as the authorisation to tax has been granted and the taxable base has existed. Impairment on receivables may be booked subsequently on statistical bases upon initial recognition, or during inventory operations, to take into account the recoverability risk.

These rules that are set out in the standards, are difficult to apply for a variety of reasons: the need for a reliable estimate of the taxable basis and the existence of tax deferral mechanisms related to future events such as tax credits, which may be repayable or simply deducted, make the calculation of receivables highly uncertain. The necessary assumptions must include information on taxpayers' current and future behaviour, which is usually unavailable. This is why a diminished approach is often taken, such as using the reference to the tax payable for the year rather than to the tax due. This involves drawing on documents that set out the tax commitments (such as roles or declarations from taxpayers) and leads to a critical lag in accounting. The effects of this lag, which generally involves recognising the tax payable in one year during the following year, can be viewed in several ways. If we assume that accounts recording these taxes are the financial statements of the entity responsible for the technical aspects of tax collection, then this lag raises no specific problems. Accounts outline the result of the entity's action, operating in the environment that applies to it. However, if we assume that accounts that feature these amounts are the financial statements of the entity responsible for implementing public policy by using taxes to finance expenditures incurred, then the lag is more problematic and makes the result difficult to interpret. If we look at sustainability or at the sovereign, then the relevant information is the measurement of the capacity to raise taxes. In this case and in many others, accrual accounting can only offer diminished information, albeit useful.

Using the notes to the financial statements to host specific items

The notes to the financial statements, as currently defined in the strictest sense of the word, complete the balance sheet by providing for information on contingent items, in addition to certain technical explanations on balance sheet elements. Contingent items generally represent a very small portion of the company's transactions. They do not feature on the balance sheet as they have no bearing on the financial position, except for some confirmed external events that entail the recognition of provisions in the case of contingent liabilities. We may thus wonder whether some specific items that cannot be recognised in the balance sheet should be included in this category. The usefulness of this approach therefore hinges on whether it

can be applied to items that are specific to public sector entities. The effects on the structure of the financial statements as well as some legal and operational effects must then be assessed.

Of course, the same type of operations exist in the public sector with the same accounting approaches, and the question here is whether specific items are covered by these definitions. Exhaustive research into the nature of these items would be required to provide a robust answer, but this research would require the list of these items to be clearly delineated, which is remote. However, it is possible to provide a general idea by looking at some illustrative examples.

Commitments related to fundamental rights recognised in constitutional texts and implemented through public policies are obvious candidates for being labelled contingent liabilities. Commitments such as those to pay benefits in cash to beneficiaries when they meet certain criteria could be included in this category.

Under current standards, a liability only exists where the beneficiaries are identified and fulfil all of the conditions required to receive the benefit. These conditions include annual checks, so liabilities are generally considered limited to accruals, i.e. the amount of annual benefits due but that have not been paid before the end of the period. There is still some debate as to what should be considered a yearly criterion and there are some disputed cases that are difficult to assess, but overall, current rules lead to recognise few liabilities for these commitments.

Yet, it is often possible to reliably estimate the amount of commitments that equate to rights "acquired" by beneficiaries at the end of the accounting period, assuming that current programmes will continue. There is therefore a potential obligation resulting from past events. To label this obligation a contingent liability, it should be determined whether its existence will only be confirmed by the occurrence or non-occurrence of one or more future uncertain events that are not wholly within the control of the entity. This is where the main difficulty lies: everything hinges on the choice of the reporting entity in question, and how it operates. In most cases, entities responsible for paying out benefits operate under the "*répartition*" principle and within the confines of budgetary authorisations. The limits to paying out future benefits closely relate to the existence of future revenue and/or future authorisations provided for in budgets for the following years. Events that will effectively trigger the obligation to pay benefits are therefore not under the control of the entity in the working framework so far. We could therefore consider that this is a potential obligation, but the question is "of whom"? When a company issues a guarantee, it decides to take the commitment of its own accord, yet in the example of a mandatory pension "*répartition*" system, the retirement fund responsible for paying out pensions did not set up the system or take the related commitments. However, the fund applies rules set by the sovereign and is a component of the public authorities system. In this respect, while it is true that events that dictate future pay-outs – for example, the amount of contributions or that of benefits – are not under the control of the entity in question in the strictest sense of the word, it also holds true that these events depend on decisions taken within a larger group that includes (and controls) the entity. Setting such "commitments" on a par with potential obligations is therefore a matter of form rather than one of substance. It actually depends on how one would consider the "substantive" nature of an entity. The downside of this approach, though, is that in complying with standards set for the private sector, it sustains an ambiguity on the scope of accountability of the entities whose financial statements are being prepared.

Lastly and most importantly, if we take on board this approach, then this raises the problem of it being applied in a more general way and in particular its extension to contingent assets. If commitments to pay benefits in the future are to be considered contingent liabilities, why not view future revenues as contingent assets? We can see why including these amounts in the notes to the financial statements actually leads to the same type of difficulties as the extension of the scope of financial reporting for companies. Considering that specific elements as contingent elements would drive to include estimates of future revenues and expenses in the notes to the financial statements. This involves considerable amounts that cannot be added discreetly on the pretext of a formal analogy.

Herein lies the problem that is raised for companies: is the extension of the scope of financing reporting – wished for by all stakeholders – an accounting issue, or a matter that goes beyond accounting? However, the debate takes place in a different context, as we saw that "traditional" accrual accounting standards that focus on the balance sheet are less relevant for public sector entities than for companies due to the difficulty of giving a full meaning to the concept of equity.

Conclusion

The development of reporting on public finances with the aim of closing the gap between expectations and actual data is a prerequisite for this information to be more broadly used in the public debate, and hence for the public debate to be conducted under better auspices. This programme could be elaborated along two approaches:

1. The relevance of applying an accounting model drawn from the private sector should be assessed against entities' specific features. Scope for interpreting results and providing an operating dimension to the concept of equity are the criteria for assessing its degree of relevance. In any case, this involves restricting the approach on items to be booked to the balance sheet to non-specific items (except for certain exceptions that should be justified). Data from these financial statements can naturally be used in other systems, but following rules that no longer pertain to accrual accounting standards and to those who use them in their capacity as standard-setters, preparers or auditors. Specific consideration should be made of the option of using the notes to the financial statements to set out information that lies outside these limits, in conjunction with the active discussions on the same issue in the private sector. These debates involve the status of accounting and that of the actors involved, rather than the definition of the accounting model, which remains fundamentally the same and safeguards its properties. The notes to the financial statements, or a second set of notes if we wish to maintain the traditional notes in accordance with the current accounting principles, would then be considered an extra-accounting document from a technical standpoint. However, the contents of this specific set of notes should still comply with recommendations or rules set out by standard-setters and should be elaborated by accountants within their remits. Finally, the status of this document should relate to certification requirements and diligence. This approach would offer useful information on the situation for public finances, without jeopardising the accounting tool, and would avoid misinterpretations that would hamper the notes' use.
2. Reconsider the accounting model while striving to maintain the principle of primary information set out in the balance sheet. This involves redefining the concepts of asset and liability by fully taking on board the specificities of public sector entities. This approach does not jeopardise previous achievements, but recognises their limited scope and completes the set-up outlined in the previous point by developing an accounting model that addresses these specific aspects. This model would not apply to individual entities, which would continue to apply the current standards. It would rather be developed at a broader categories level that would still need to be defined. This would ensure that debates on standards take place at the correct level, avoiding formal interpretations beyond their substantive validity, with the risk of confusing users or preparers. This involves better setting out the accounting consequences of the specific aspects involved in public management. We noted that the existence of negative net assets/equity, for the most specific entities, could be attributed to two reasons that are not mutually exclusive i.e. an incomplete balance sheet or its inability to describe the way these entities operate. In fact, this boils down to the same reason: the balance sheet as prepared in accordance with the current standards, which themselves derive from the transposition of private sector accounting standards, does not include elements that are used in the way these entities operate. Public action does not use capital, whether financial or productive, or at least not in the majority of cases. We would therefore advocate the development of a balance

sheet that would record the operating resources used and the ensuing responsibilities. This would also require consideration of the scope, nature and identification of the entities that should be included.