

From Cash To Accruals In Portuguese Local Government Accounting: What Has Truly Changed

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(recebido em 19 de Maio de 2008, aceite em 7 de Novembro de 2008)

Sponsored by:

FCT Fundação para a Ciência e a Tecnologia

MINISTÉRIO DA CIÊNCIA E DO ENSINO SUPERIOR

Portugal

(POCTI/CPO/58391/2004)

Abstract. As many countries, Portugal has been reforming governmental accounting since the beginning of the 1990s. The system in force results from the first law-based governmental accounting general plan passed in 1997, which was adapted to Local Government in 1999. Using double-entry, the Portuguese Local Government accounting framework currently combines cash-based budgetary accounting with accrual-based financial and cost accountings, providing information for both accountability and decision-making. While recognising considerable innovations, this paper presents some difficulties implementing the reforms, whereas highlighting some limitations still remaining in the Portuguese new local governmental accounting system. It also discusses why, together with other reasons, those shortcomings make budgetary cash-based information still to be given more importance, namely by internal users.

Keywords: local government accounting; cash basis; accrual basis; content analysis

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1 Introduction

The recent reform of governmental accounting in Portugal has been clearly and comprehensively of normative character. Starting at the beginning of the 1990s, with a set of very important new regulations (labelled as the State Financial Management Reform), it reached the utmost point with the 1997 first *Plano Oficial de Contabilidade Pública* [POCP – Official Public Accounting Plan⁴], which became the basic accounting framework for the whole Portuguese Public Administration⁵, including Local Government, which the *Plano Oficial de Contabilidade das Autarquias Locais* [POCAL – Official Accounting Plan for Local Government] was passed for in 1999.

In spite of major innovations brought in by the new local government accounting system, several implementing problems have arisen, namely related to understanding and applying the accrual concept. Moreover, although within the current system, financial and cost accountings are accruals-based, budgetary accounting continues using a modified cash basis (while recognising expenditures future commitments) and the whole system functioning is ruled by budgetary transactions, meaning that budgeting still strongly determines the development of the accounting and reporting system. Consequently, while the Balance Sheet and Operating Statement are now acknowledged as important reporting statements, budgetary information still has a seminal importance within the accounts and management report, raising questions of whether those statements are in fact useful within the municipalities' financial report, which continues aiming mainly at demonstrating accountability to the legislative and executive power.

Notwithstanding, it is undeniable that the recent Portuguese local government accounting reform has increased the quantity and quality of accounting information available for supporting decision-making.

This paper starts addressing the reforms happened in Portuguese local government accounting, particularly focusing on the information required to be reported by the new system, both in cash and accruals bases. It also discusses some implementation problems, calling attention to limitations still existent. The

⁴ This is a law-based general accounting plan as others existing in France, Belgium and Spain. In Portugal it is the fundamental set of instructions for governmental accounting practices and it contains: a standard decimalised Chart of Accounts, instructions relating to the presentation of uniform published financial and budgetary statements, and standard definitions of items and their valuation methods.

⁵ The POCP, as the basic framework reference for the whole Portuguese Public Administration, has been the basis for several official accounting plans that have been approved for autonomous sub-sectors: Education, Health, Social Security and Local Government. It was the first attempt for standardisation within governmental accounting in Portugal. Therefore, while the Local Government accounting system in Portugal has been what could be said as typical of the Continental Europe, it has recently undergone a radical transformation, as a consequence of a top-down embraceable reform process of the whole governmental accounting.

empirical survey aims at showing the prevalence of cash-based budgetary information over accrual-based financial information, combining the results of some ongoing studies on the reforms implementation (Carvalho *et al.*, 2006, 2007a, 2008); Fernandes *et al.*, 2005), with content analysis of both the official records of Local Executives meetings approving the annual accounts, and Management Reports, referring to 2006, and comparing to 2005 and 2004.

Overall, the results suggest that, although the recent Portuguese local government accounting reform has closely followed the business accounting model⁶, there are considerable differences. A major one concerns the fact that budgetary cash-based information still is the most important, more frequently used by the internal users and embraces the major part of the information reported in practice in both municipalities' accounts and management reports; financial accrual-based information is therefore secondary.

2 Portuguese local government accounting

Local Government accounting has evolved towards managing local governments' activities in a more economic, efficient and effective way, demanding for an accurate and complete information about each entity's patrimony composition (which assets and liabilities and for which value). Additionally it has also been important to know how that patrimony can contribute for the development of local communities.

The main purpose of the new system is to create conditions for the consistent integration of three accounting subsystems – budgetary, “patrimonial”⁷ and cost accounting – in a modern accounting system, which becomes a fundamental instrument to support Local Government management. Since it is compulsory for all municipalities and parishes as well as similar entities⁸, conditions for municipal consolidated accounts are created, though specific rules have not been defined yet (Carvalho *et al.*, 2006b). Effectively, POCAL does not define rules for the consolidation of accounts, but nevertheless, since the publication of the new Local

⁶ This comprises full accruals financial and cost accountings, supported by a set of GAAP in order to show a true and fair view of companies' financial situation and economic annual result. It presents Balance Sheet, Operating Statement and Notes as general-purpose financial reporting statements.

⁷ This means accounting for all property or patrimony belonging or under control of each entity within the Local Government general regime. As Carvalho *et al.* (2006a) explain, this means that the so-called “public domain assets” (such as infrastructure and heritage) must be listed in the Balance Sheet and depreciated if that is the case; however, since by legal restrictions they cannot be sold or mortgaged to solve liabilities, the accounts under this system are not presented in a financial perspective, following instead a patrimonial perspective, from which the term “patrimonial accounting” is derived.

⁸ Such as metropolitan areas, county assemblies and associations of parishes and municipalities, among others.

Finances Law (Law 2/2007, January 15) the consolidation of accounts is an obligation for all municipalities holding municipalized service units or the total of the capital of municipal business companies (article 46). A change in POCAL is foreseen until 3 December 31, 2008, namely including rules of method for the consolidation.

Budgetary Accounting was the only one in force until the POCAL and it used to be merely a legislative mechanism of controlling public funds and expenditures, not a method of measuring the wealth of a municipality or its performance (Christiaens, 1999). However, now it works differently, once it is integrated with the other two subsystems in the same framework, despite continuing to be essentially cash-based. The two new accounting subsystems provide information on the resources origins, needs and applications. They allow obtaining information in order to define the entities' financial-economic situation and to identify how the several resources lead to a certain result. Accrual accounting has also offered the opportunity for governments to improve their management of assets and liabilities (Singh, 2005).

Another innovative characteristic brought in by this framework was using double-entry bookkeeping method for the whole accounting system. Nonetheless, some freedom has been given to each entity in what concerns the way Cost Accounting is organised.

This new integrated system goes beyond the objectives of the Portuguese traditional governmental accounting, providing information that allows analysing local governments' expenditures according to not only legal criteria, but to economy, efficiency and effectiveness criteria as well, hence increasing objectivity and transparency on the management of public resources (Fernandes and Carvalho, 1999).

Table 1 summarises the information POCAL requires Local Government entities, namely municipalities, to report. The similarities between this and the business accounting framework are many. Yet, there are some statements required to be presented by municipalities (as well as by Public Administration entities in general), but not by companies, which are listed in italics.

TYPE OF INFORMATION (FINANCIAL AND BUDGETARY REPORTING STATEMENTS)	CASH BASIS	ACCRUALS BASIS
Balance Sheet		X
Operating Statement		X
<i>Statements of Budgetary Execution:</i> <i>Investments Multi-Annual Plan</i> <i>Budget</i> <i>Budgetary Execution Statements – Expenditures and Revenues</i> <i>Statement of Annual Execution of the Investments Multi-Annual Plan</i> Cash Flow Statement <i>Treasury Operations Statement</i>	X	
Entity characterisation		
Notes to the Balance Sheet and Results Statement		X
<i>Notes on the budgetary process and respective execution</i>	X	
Management Report	X	X

Table 1– POCAL reporting requirements – cash versus accruals bases

The main difference concerns budgetary information (statements and notes) additionally required to be reported. Another important difference regards the Cash Flow Statement. While in companies it is considered a financial statement, in Local Government accounting it is a budgetary statement⁹.

⁹ The cash flow statement in POCAL summarises payments and receipts of the year, conveying the cash balance for the next administration/year and showing, in what respects particularly to budgetary execution, whether the budget then closing has been managed more or less successfully. It does not allow evaluating the contribution of operating, financing and investing activities (functions) within the entity for creating cash flows. Since it is included in the budgetary accounting subsystem, instead of providing information on the entity's capacity to generate cash flows or equivalents, allowing evaluating the need for external financing, the cash flow statement here compares receipts with payments, merely distinguishing those related to the budget from treasury operations (amounts collected and/or paid by an entity on behalf of third parties, which cannot be considered as part of the entity's budgetary revenues and expenditures, although they imply cash flows).

The Management Report, both for business and governmental accounting, summarises the main management activities of the year and consequences on the accounts. Within the Local Government reporting structure, it is supposed to add budgetary ratios and information on the evolution of the budget execution and final situation, to accrual-based information, namely analysing the entities' annual economic and financial position¹⁰.

3 Reform main advantages and some problems still remaining

Local Government accounting reform process brought dramatic changes to the previous system:

From one single accounting information addressee (the State), there are now several intended (external) receivers – State, Supreme Audit Office, suppliers, financiers, customers, service users, taxpayers, etc. Furthermore, it is now acknowledged that accounting information is also very useful and thus has to be prepared for internal users/uses, namely chief financial officers and executive and deliberative committees for the purpose of control and decision-making;

From merely cash and budgetary perspectives, it is currently offered information on the entity's economic, financial and patrimonial situation, as well as on the cost of services provided, using accrual-based accounting;

While previously the information disclosed on the entity's fixed assets was purely historical – they were recorded only by the acquisition price (in a cash perspective, only when they were paid) – under the new system, although the historical cost convention is used, it is possible to have a “up to dated” historical cost, namely via depreciation to get the net book value. Also revaluation might be legally authorised. Moreover, some public domain assets in the initial balance sheet might be capitalised using current cost, inasmuch as the market price and the net replacement cost are allowed to be used;

Apart from only budgetary principles, nowadays patrimonial/financial and cost accounting have to be prepared according to the general accepted accounting principles (GAAP), in order to show a true and fair view of the assets, liabilities, economic-financial situation and net results of each reporting entity;

¹⁰ According to POCAL, this information is about: annual economic situation – analysis of the management evolution, mainly with respect to investments, functioning conditions, and costs and revenues; summary of financial situation – financial ratios in order to facilitate the analysis of balance sheets and operating statements; evolution of both short and long-term debts and receivables; justified proposals for the application of the annual economic net result; and relevant facts that occurred after the closing of the economic period.

Single-entry bookkeeping method was replaced by double-entry, including in budgetary accounting; the latter is recognised as a better technique to assure the system transparency and integrity.

In summary, many features of business accounting were brought into Local Government accounting, implying advantages (namely in what respects the quantity and quality of the information provided) but also resulting in some drawbacks, particularly taking into account specificities of the Local Administration context¹¹. Although a few of these have been considered in the new accounting system, there seems to be lack of further conceptual explanations, which have brought some misunderstanding while applying the new rules and reading the information reported in the light of the new context (Carvalho *et al.*, 2006c).

As in other countries (Lapsley and Pallot, 2000; Christensen, 2002; Pallot, 2005; Singh, 2005), there have been factors creating implementation barriers to the reforms, namely lack of governmental accounting expertise and problems relating to assets recognition.

For example, while total assets have been enlarged to include public domain assets (infrastructures and heritage) typical of governmental entities (Barton, 1999; Byrne, 2002; Heinrich, 2002), no additional clarification has been provided, neither on the distinction between assets of private and public domain nor on the difference between financial and “*patrimonial*” perspectives¹². Since the practical interest of the latter has not been explained as well, many within governmental entities have problems in understanding the time and costs involved in inventorying and valuating non-operational items – namely buildings and others included in the historical and cultural heritage – for which it has been difficult to apply and establish objective criteria such as those used in business accounting (Guthrie, 1998).

Another issue concerns the hierarchy of accounting principles – although governmental accounting in Portugal must now comprise with GAAP, the legality principle prevails, which means that in situations where GAAP conflict with general administrative law, they might not be accomplished. Governmental accounts must continue, above all, informing whether the resources were obtained and used according to legal and contractual requirements, including financial limits

¹¹ Although the particular context and activities of governmental entities might not require a specific conceptual framework for governmental accounting, it is generally acknowledged that governmental entities’ reality is very different from companies, affecting the way accounting is interpreted, namely requiring specific adaptations of some general concepts (Vela Bargues, 1992), which has not been done in Portuguese governmental accounting.

¹² Actually, in Portuguese governmental accounting, financial accounting is intentionally designated “*patrimonial accounting*”, precisely to emphasise the idea, different than business accounting, that total assets must include all items owned by the entity or under its control, even though it has not been emphasised that, for those of public domain, there are legal constraints preventing them to be sold or mortgaged.

established within the budget approved. Therefore, within municipalities' accounts, the principle of economic substance prevailing over legal form cannot be generally accepted, although it might be admitted in a few rare exceptions, as for financial leasing contracts. Still, there is lack of further explanations whether this principle can be applied in other circumstances, such as for assets under temporary concession, very frequent in the governmental context. Also the prudence principle is less important than in business accounting, because within the governmental context there are no equity holders to be protected or dividends to be distributed. Yet, according to the new rules, legal reserves have to be compulsorily created and displayed as equity in the Balance Sheet, adjustments in current assets are allowed, and a certain degree of general prudence might be said to exist in the accounts, since the historical cost convention is the general rule and fixed assets revaluation is allowed only by legal authorisation. On the other hand, even in cases where current cost might be allowed, the lowest value must be chosen.

In what concerns the accrual basis application, there is no clarification on what to do when, due to the process of collecting taxes, there is no possibility of assessing fiscal revenues to be accrued.

On the other hand, in some issues, the approximation of the new system to business accounting seems to be somehow exaggerated, not considering Public Administration practical reality. This is rather evident in the financial reports forms and contents. Municipalities' annual accounts embrace fundamental budgetary statements to report on the budget execution. Recently, financial statements have been added, similar to those presented in companies' annual accounts – Balance Sheet, Operating Statement and Notes – assuming accrual-based accounting and matching concept (direct correlation between costs and revenues). Although these are easy to apply in companies where normally revenues (mainly from sales) depend on costs incurred, on production itself and on assets profitability, they are not straightforward in governmental entities where, instead, the costs to be incurred depend on revenues (mainly from taxes and grants). While in companies it is easy both measuring costs and calculating results per products or services, in governmental entities this is not the case. Therefore, in governmental entities, performance measurement, namely implying efficiency assessment, is difficult to carry on (Carvalho *et al.*, 2006d) because there is not a straightforward performance indicator as the net income in companies. Revenues are many times measured in more social than economic or monetary terms. Consequently, if it makes sense in private business companies to prepare Operating Statements comparing costs and revenues (operational, financial and extraordinary), it is questionable in governmental accounting where, however, calculating costs per functions, products, services, activities, departments, etc. is yet important, both in forecasted and actual numbers.

Since the users/users' needs in governmental entities are different than in companies, they imply different purpose, form and content of the accounting

information. The main objective of business companies' financial statements is to provide information on the company financial situation and its changes, as well on the economic performance, to a large number of essentially external users (suppliers, investors, creditors, taxation authorities...), for the purposes of accountability and, above all, decision-making. These purposes are also admitted for Local Government accounting in Portugal: along with providing information for controlling purposes¹³, municipalities' accounts must also allow evaluating decisions namely concerning resources allocation. However, accountability on the use of public resources tends to prevail.

Moreover, in Portugal, municipalities' accounting information main receivers/users are different than those in the business sector. In practice, some as taxation authorities, suppliers and citizens are generally acknowledged as not interested in governmental entities financial and budgetary reporting. Financiers are considered interested, mainly when deciding on providing loans or not. Nonetheless, the major users in practice are, along with internal managers, deliberative committees, the (external) Supreme Audit Office and the National Institute of Statistics for National Accounts (Jorge, 2003). Most of these tend to privilege budgetary cash-based information, hence conditioning the importance it is given in governmental entities' financial and budgetary reporting. Subsequently, accrual-based financial statements might not be as important within Portuguese Local Administration accounts as they are in the business context.

In conclusion, we believe it is important to consider specificities of Local Government accounting practice as distinctive factors from business accounting practice. If, on the one hand, some of those have been taken into account in the recent reform process, on the other hand, the Portuguese Local Government accounting new system is sometimes exaggeratedly close to business accounting, raising usefulness problems.

Since there is still no adaptation of the business accounting conceptual framework to governmental accounting, some information reported is yet rather subjective, resulting from judgements of those responsible for the accounting section within municipalities. This jeopardises reliability and comparability, supposed to be fundamental features of accounting information also in governmental entities.

¹³ In Portuguese municipalities, the main internal users of financial reporting are local executive and deliberative committees for the purposes of internal control, as well as the Supreme Audit Office as an oversight body of external control.

4 Empirical Survey

This paper addresses a new topic, given that the predominance of cash-based budgetary information in governmental accounting in Portugal has not been approached neither in the existent Portuguese literature nor internationally. Concerning the latter, although there are already some studies involving Portuguese governmental accounting (e.g. Montesinos Julve *et al.*, 1995, 1996; Pina Martínez, 1997; Fernandes and Carvalho, 2001; Hepworth, 2001; Ballaguer Coll *et al.*, 2001; Brusca Aljarde and Condor, 2002; Brusca Aljarde and Benito López, 2002; and Jorge, 2001, 2003, 2004), these essentially have addressed Portugal within the issue of governmental accounting international harmonisation.

It is also original regarding gathering qualitative information from a thorough analysis of municipalities' official records and management reports.

4.1. Research context and methodology

Local Government in Portugal embraces every entity whose activities and decision power are separated from Central Administration (both in Continental Portugal and in the autonomous regions of Madeira and Azores). Their services aim at satisfying interests of a certain geographic territory, since they are a consequence of a process of administrative territorial decentralisation. The main entities forming part of the Portuguese Local Administration are municipalities and parishes. Although there are only 308 municipalities, while there are around 4,300 parishes, the former are the most important considering the services provided (Bravo and Vasconcelos e Sá, 2000).

The Constitution establishes that the entities belonging to Local Administration have their own finances and property – *financial autonomy*. Furthermore, the services they provide have *budgetary independence* (Carvalho *et al.*, 1999)¹⁴.

The discussion in this paper is firstly supported by findings in other studies, some still in progress, which have been based on information reported in the annual accounts directly asked to each municipality and submitted to The Court of Accounts. It is additionally substantiated by evidence gathered from qualitative content analysis¹⁵ (Weber, 1990; Krippendorf, 2004) of official records of Local

¹⁴ In general terms, financial autonomy is the attribution of financial powers to under-State entities. Accordingly, municipalities may have autonomy in one or more of the following areas: property, budget, cash and borrowing. Their budgets are also independent from the State's Budget, although they receive grants as revenues from Central Government.

¹⁵ Content analysis is a standard methodology in social sciences on the subject of communication content and can be applied in quantitative and qualitative ways. Quantitatively it starts with word counts,

Executives meetings concerning the annual accounts approval, as well as of Management Reports. The information particularly used in this study is gathered from the official records accompanying the annual accounts and Management Report of 2006 and embraced all 308 Portuguese municipalities.

The analysis of official records aims at verifying which topics have been especially addressed, while the analysis of Management Reports allows seeing which additional information is reported, namely ratios. We particularly look for topics of discussion relating to cash *versus* accrual-based information, namely those presented in Table 2.

	OFFICIAL RECORDS	MANAGEMENT REPORTS
BUDGETARY CASH-BASED INFORMATION	Degree of expenditure execution (GEOD)	All budgetary ratios listed
	Degree of revenue execution (GEOR)	
	Degree of Multi-Annual Investment Plan execution (GEPPI)	
	Functional expenditure execution (EF)	
	Budgetary modifications (MO)	
	Level of indebtedness (GE)	
	Undertaken commitments not yet paid (CANP)	
ECONOMIC AND PATRIMONIAL ACCRUAL-BASED INFORMATION	Balance Sheet (BAL)	All financial and patrimonial ratios listed
	Liabilities (PASS)	
	Public Domain Assets (Act-BDP)	
	Accruals and Deferrals (AD)	
	Costs structure (EC)	
	Revenues structure (EP)	
	Annual Net Result (RL)	
Proposal for annual net result destination (PDR)		

Table 2 – Topics analysed within the Official Records and Management Reports

In what concerns Management Reports, we could not a priori specify which type of information to be gathered, since each municipality is free to decide on which ratios to consider. The law does not typify but merely provides very broad guidance.

space measurements, time counts, etc. Qualitatively it can involve any kind of analysis where communication content (speech, written text, interviews...) is categorized and classified by having contents of communication available as readable texts; they are taken as input and counted for word frequencies. From the frequency list, a list of categories might be generated allowing controlling the distribution of categories over the text.

While methods in quantitative content analysis, in this way, transform observations of founds categories into quantitative statistical analysis, the qualitative content analysis focuses on the intentional meaning of communication content.

4.2. Previous empirical evidence

Evidence from ongoing research has shown that cash-based budgetary information prevails within both municipalities' annual financial and budgetary reports and accounting main objectives in practice.

Since 2004¹⁶, Carvalho *et al* (2006a, 2007a, 2008) have analysed several crucial parameters of information and practices within the new Local Government accounting system in order to: a) assessing the degree of conformity between practices and standards, and b) studying the relationship between the new system general objectives and the information disclosed so as to assess the level of interest of municipalities in fulfilling those objectives.

The general objectives of the new accounting system were summarised from legal establishments as:

Demonstrating appropriate budgetary situation;

Showing a true and fair view of the financial position and economic results; and

Supporting performance management (decision-making).

As to practices and information that, in general, the new system is required to offer, five categories were considered (each one comprising several parameters): management accounting, information on long-term investment projects, accrual basis, cash basis, and information on accounting policies (valuation criteria, derogated policies, etc.).

Between 2004 and 2006 different levels of implementation of POCAL were observed, since some reports were more complete and reliable than others, proving that some municipalities are further than others implementing the new system. However, it must be emphasised that, in spite of the gaps still observed in the different years of analysis, we have seen significant improvements in the accomplishing of the demanded rules and requirements related to the new accounting system.

In what concerns 2006, the main conclusions may be summarised as follows:

The average level of total compliance, corresponding to the global implementation level of the new Local Government accounting system in the country, was 69%. The analysis of partial conformity according to the categories above has revealed that the compliance was higher for cash basis information and practices (88%), followed by accrual basis (78%), and accounting policies (43%) respectively. There was no compliance with practices and information concerning Management Accounting.

In what concerns the practices and information offered to fulfil the main objectives of the new system, the study has revealed a clear preference by the great majority of the entities for complying with parameters related to 'Demonstrating

¹⁶ In 2004 municipalities from Madeira (11) and Azores (19) were not analysed, so the sample totalized 278 entities.

Appropriate Budgetary Situation'; the second objective to be favoured concerns 'Showing a true and fair view of the financial position and economic results' and the less preferred is 'Supporting Performance Management' (the majority of municipalities comply with less than 42%). Therefore, priority continues to be given to the objectives of account for legal and budgetary conformity, since the greater part of municipalities fulfil more than 72% of the main requirements related to the objective of demonstrating appropriate budgetary situation, despite the new system have gone beyond that to embrace other financial, patrimonial, economic and management purposes.

Carvalho *et al.* (2007b, 2008) have analysed the financial (including budgetary) reporting practices in order to demonstrate whether: a) they conform to standards, and b) there is diversity amongst municipalities, trying to determine whether the information provided by the municipalities' accounts is comparable. The study also assessed the effect of entities' size (large, medium or small, considering the number of inhabitants) on both these issues.

The information and practices of the new accounting system were grouped in three categories, considering the three subsystems integrated in the POCAL (each one comprising several parameters, with a few parameters comprised in more than one subsystem): budgetary accounting, financial/patrimonial accounting and management accounting. A concentration index was computed for practices and information of budgetary and financial/patrimonial accounting, the two subsystems presenting higher conformity. The main conclusions were:

In 2006 the average level of total compliance with the new system practices and information was of 69% being unchanged compared to the average level of implementation observed for POCAL in 2005. Despite no changes in this level, there have been clear improvements, as the most part of the municipalities increasingly accomplish with more parameters, reaching the considered maximum of 20.

There seems to be some dependence between size and compliance with the total parameters analysed, but the results are not conclusive regarding the direction of the effect.

The highest average partial conformity level for the whole sample in 2006 continues relating to the Budgetary Accounting subsystem (84%), followed by 78% for Financial Accounting and 55% for Management Reporting.

There is no association between municipalities' size and compliance with practices of both Budgetary and Management Accounting when separately analysed. However, size seems somehow to affect compliance with the Financial Accounting subsystem.

The diversity of practices and information is lower for those concerning Budgetary Accounting, regardless municipalities' size. On the other hand, it is higher within the Financial Accounting subsystem, which diversity seems to be somehow affected by size.

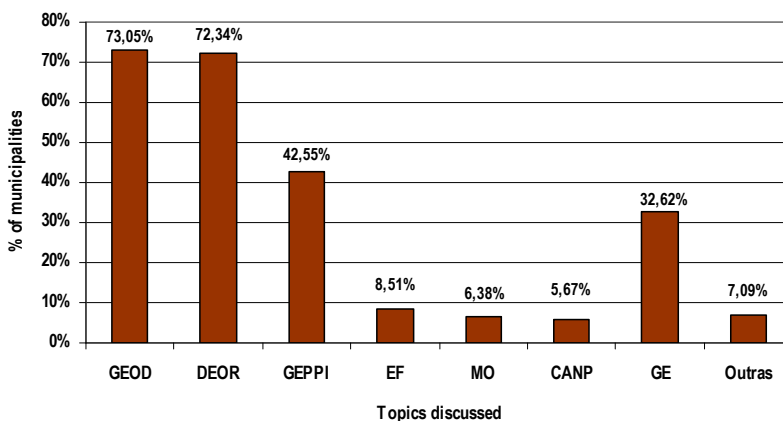
In summary, the studies evidence that Budgetary Accounting is the one municipalities seems to concern more to comply with, which means that budgetary cash-based information is still the priority, as it is the one for which there was more uniformity of practices amongst Portuguese municipalities at 2006.

4.3. Complementary results

Analysis of meetings Official Records

Concerning budgetary cash-based information, Graphic 1 shows the more discussed topics in the official records of meetings approving the annual accounts of 2006.

Graphic 1 – Budgetary Cash-Based Information



It can be observed that discussions related to the degree of Execution of the Expenditures and Revenues budgets, and the Multi-Annual Investments Plan were discussed by more than 40% of the municipalities, reaching more than 70% in what concerns the first topics.

The level of indebtedness is also one of the more discussed aspects in the Local Executive meetings. Nevertheless, in spite of the importance given to the level of indebtedness, the discussions do not show any concern about the undertaken commitments and not yet paid, as this item is only referred by 5% of the minutes.

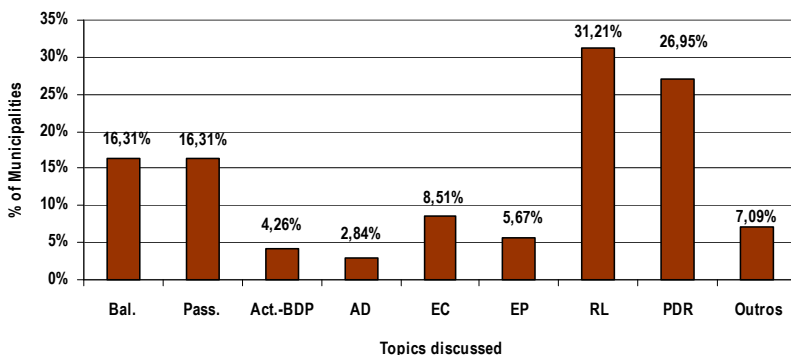
Furthermore, issues related to budget changes observed along the year, are only discussed in a very short percentage of municipalities (about 6%).

Compared to the analysis performed to the minutes of 2005, we must highlight that there is a significant increase regarding discussing these topics. Effectively, in 2005 only about 20% of the municipalities discussed these issues.

Considering a more embraceable period, from 2004 to 2006, it might be said that there were no significant changes in what concerns the topics that remain to be more discussed (given more attention) in the meetings: budgetary (revenue and expenditure) and Multi-Annual Investments Plan execution statements.

Compared with the budgetary situation, the topics on economic and patrimonial accrual-based information show much lower levels of analysis and discussion during the meetings, as displayed in Graphic 2.

Graphic 2 – Economic and Patrimonial Accrual-Based Information



Graphic 2 shows, in global terms, as in 2004 and 2005, a very lower percentage of municipalities that discuss these aspects, relegating them to second plan in face of the budgetary information. This fact confirms that in the meetings, the budgetary issues are still more important.

Concerning the economical and patrimonial topics, the most discussed are related to the net result and to its application proposal, which is no surprise, since this discussion is a legal requirement. It must be noticed that the level of indebtedness is also discussed in patrimonial terms, namely via liabilities (16,31%) as it was in budgetary terms (32,62%). In spite of its significantly inferior percentage shown here, the information starts to be used and discussed in two perspectives.

Analysis of Management Reports

Given that there are no typified ratios required to be used, the only analysis useful for this study was separating budgetary from economic and patrimonial ratios, additionally considering brackets for the number of ratios presented by the municipalities of the sample.

Table 3 compares the situations for the years 2004 to 2006 concerning the numbers of ratios presented by municipalities in the defined intervals.

Brackets of Ratios	Number of Ratios		
	2004	2005	2006
0	86	69	51
1-10	59	73	108
11-20	67	75	92
21-30	35	47	19
More than 30	31	44	38
Total of municipalities	278	308	308

Table 3 – Average of ratios

Accordingly, in the three analysed years, there is still a significant number of entities, which did not present ratios – 31% in 2004; 22% in 2005 and 17% in 2006, in spite of these numbers having decreased yearly. On the other hand, the number of municipalities presenting the highest number of ratios (more than 30) has been more or less constant in the three years of analysis (11% – 2004; 14% – 2005 and 12% – 2006).

The interval of ratios in which we could find the highest number of municipalities was the one between 10 to 20 ratios for 2004 and 2005 (approximately 24%). Nevertheless, this situation has changed in 2006, where 35% of municipalities have presented between 1 to 10 ratios.

In relation to the type of ratios presented in the Management Reports, Table 4 shows that in 2006 a total of 1.232 different indicators were used and, within these, 65,9% (784 ratios) were budgetary indicators, while only 33,5 % (433 indicators) were economical and/or patrimonial. 0,5% are context ratios.

Ratios	Number of ratios		
	2004	2005	2006
Budgetary	333	660	784
Economical and/or patrimonial	131	338	433
Others	0	6	15
Total of ratios	464	1.002	1.232

Table 4 – Type of ratios

If we compare the situation in 2006 to the years 2005 and 2004, it can be observed that:

There is a significant increase in the number of indicators presented. In effect, from 2004 to 2005 there was an increase in the total number of indicators from 116%; from 2005 to 2006 the increase was 23%;

The importance of the budgetary indicators continues to be much higher than the economical and/or patrimonial indicators (72% in 2004; 66% in 2005 and 64% in 2006).

These results validate those of other works referred to within this paper (e.g. Carvalho *et al.*, 2005, 2006a, 2007a, 2007b, 2008; Fernandes *et al.*, 2005; Jorge, 2003), which show that, in spite of the new local government accounting system having as innovative aspect the obligation for municipalities to disclose the patrimonial and economical information, they go on giving more relevance to disclose budgeting information.

5 Why cash-based information yet prevails

In our perspective, several reasons might justify the above-shown prevailing practical importance, i.e. perceived usefulness, of budgetary cash-based information over financial and economic information:

It seems to reflect a conscientious choice by the report preparers, considering that:

Since many public domain assets are not yet reported, the information included in the Balance Sheet is not complete, eventually reducing the importance of this statement for reporting on the municipalities' patrimony;

Those statements have been recognised as still having little interest to municipalities' management in practice, being of difficult reading for the main internal users of municipalities' accounting information, namely the executive and

deliberative committees, notwithstanding the presentation of some economic and financial indicators that might help that understanding.

The main users of municipalities accounting information are the executive and the deliberative committees (politicians) – who discuss and approve both the budget and the accounts. For them, the politically relevant information concerns the budget and budgetary execution, which are criticised, commented, analysed, and approved or disapproved.

Furthermore, since within the Portuguese Local Government accounting system the only forecasted statements (to be legally approved and published) are budgetary and cash-based, only budgetary cash-based information reported allows comparing budgeted with actual numbers. Time-series comparisons are also possible to be made. Since there is no requirement to prepare and approve forecasted financial accrual-based information (e.g. forecasted Balance Sheet and Operating Statement), the only possible comparisons here are time-series (Jorge, 2003).

Portuguese municipalities are required to use the accrual accounting principle in financial (patrimonial) and cost accounting, meaning that this must be followed both in the Balance Sheet and in the Operating Statement. In 2003 only 78% of the entities were reporting deferred revenues and only 51% were reporting costs accruals in the Balance Sheet (Carvalho *et al.*, 2005). In 2006, these percentages increased to 91% and 72% respectively. Despite the clear improvement, there are a significant number of municipalities still not applying the accruals principle properly, in particular in what concerns earmarked investment grants that must be considered deferred revenues, as well as regarding holiday subsidies (personnel expenses) that must be accrued costs.

On the other hand, in 2006, 77% of the entities presented a positive Annual Net Result, while 23% have presented a negative income. Yet, no assessment has been made whether that figure meant efficiency or inefficiency. Also the POCAL does not provide any explanations on the interpretation and interest of the economic result – the rules relating to the Annual Net Result seem to have been copied from the business accounting plan, without any concerns about adding explanations. In our understanding, this shows two things: first, how the information comprised within the Operating Statement is still considered secondary for Portuguese municipalities management; and second, how difficult is to interpret the Results Statement “bottom line” in governmental entities¹⁷.

¹⁷ The meaning of the “bottom line” in governmental entities is related with the idea of *capital maintenance*, therefore conveying the extent to which the entity has maintained its capital through operations. In municipalities the capital is maintained at a break-even point, since there are no equity owners requiring dividends to be paid. Therefore, the annual result shows whether the municipality is living within its means (Anthony, 1980).

Although the new system is not yet completely implemented (*e.g.*, for most of the municipalities analysed, the cost accounting subsystem is still being developed, and many public domain assets are not yet valued and reported), the POCAL has implied a remarkable change compared to the previous situation. Nevertheless, while it suggests that financial (patrimonial) accrual-based information must be at least as important as budgetary cash-based information, financial and budgetary reporting in practice continue to give privilege to the latter, since this tends to be the most important to account for the political commitment with budgetary cash-based numbers.

Therefore, while theoretically Local Government accounting framework had changed a lot, since a considerable distance still remains between what municipalities are actually doing while implementing the new accounting system and the intentions initially set forth, some questions may arise concerning whether part of the reforms have passed beyond rhetoric.

Summary and Conclusion

Local government accounting in Portugal has recently suffered considerable reforms. From traditional cash-based budgetary accounting, aiming essentially at showing legal and budgetary accountability to oversight bodies, and regulated by laws in force since the 1930s, it has been undergoing massive changes, especially since the late 1970s. The utmost point in the reform process was the 1999 law-based general accounting plan – POCAL.

The new accounting system requires municipalities to report not only on the budget legal compliance, but also on their economic and financial situation. It integrates budgetary cash-based accounting with financial/patrimonial and cost accrual-based accountings, in a single system, using double-entry bookkeeping method. While each subsystem works independently, they follow records of budgetary transactions, demonstrating how the accounting and reporting system is still closely linked to budgeting in the Portuguese governmental accounting.

Regardless of the undeniable improvements in quality and quantity of municipal accounting brought by the recent changes, some problems still remain (*e.g.* no conceptual framework adapted to governmental accounting; lack of consolidated accounts) determining the usefulness of the reporting statements.

Despite the Balance Sheet and Operating Statement recognised in the regulations as important reporting statements, budgetary cash-based information has yet the central importance within the municipalities' financial reporting in practice. This paper has evidenced that:

Municipalities give preference to compliance with cash-based information and conformity with demonstrating appropriate budgetary situation;

There is higher diversity of practices concerning Financial Accounting than Budgetary Accounting, i.e., Budgetary Accounting practices are more uniform;

Topics preferred to be discussed in meetings approving the annual accounts relate to budgetary cash-based information;

Most of the ratios comprised within Management Reports also relate to cash-based, particularly budgetary, information.

In summary, the new system brought into municipalities' accounting a remarkable development, becoming closer to business accounting. Nevertheless, this framework is still not entirely followed. In particular, while it considers financial (accrual-based) accounting information at least as important as budgetary (cash-based) information, in practice, as this paper highlighted, the latter is the one given more importance and consequently seems to continue to be more useful for the general purposes of accountability and decision making than accrual-based information. Although this non-compliance might be seen as a fault, it might also be considered a demonstration of lack of usefulness by accounts (internal) users, namely regarding the information reported in some financial statements, leading preparers to favour budgetary information.

Therefore, if the model for the budgetary statements seems to be adequate, we believe such does not happen for the financial statements within municipalities' accounts. This triggers a challenge for futures stages of the reform, to address a model for financial reporting for governmental entities' in general, and municipalities in particular, more different from the one prepared for companies, namely recognising the central role that budgetary cash-based information still performs in governmental entities' management in Portugal, as in many Continental European countries (Lüder and Jones, 2003).

On the other hand, the definition of a conceptual framework supporting the preparation of such statements could help users' understanding, increasing the practical use and usefulness of accrual-based economic and financial information. We believe that a conceptual framework for governmental accounting would provide the supplementary reasonableness, fulfilling the existing gaps and contributing for increasing the use in practice of financial statements.

Finally, moving to accruals-based budgets would imply that accrual-based financial statements could be used to demonstrate accountability on the budget execution as well, again increasing their practical importance.

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