To accrue or not to accrue: UK governmental accounting practice and military history from 1815 to the present

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Abstract
Despite acknowledgment of the benefits of accrual accounting and the introduction of accrual accounts on several occasions, the UK government relied heavily on cash basis accounting until the turn of the 21st century. This paper provides context and background for the limited use of accruals in UK accounting history by drawing on historical examples from the Ministry of Defense and its precursor, the UK War Office.

Keywords: accounting history; UK government; cash versus accrual accounting

1. Introduction

In the 1990s, the UK government set out to adopt a commercial accruals basis for both its budgeting and accounting. The impetus for the initiative was a Green Paper published by the Treasury in 1994, *Better Accounting for the Taxpayer's Money: Resource Accounting and Budgeting in Government*. Referring to the Treasury report, the Comptroller and Auditor General wrote in 1995, 'The Government's proposals represent the most important reform of central government accounting and budgeting arrangements since Gladstone's reforms of the mid-19th century' (Her Majesty's Government 1995).

Prior to the change of direction, government departments functioned on a cash basis. As pointed out by the Comptroller, although cash basis accounting dovetails nicely with cash appropriations by parliament, it is 'not necessarily the most informative way of presenting financial information.' Under cash accounting, for example, it is difficult to match revenues with expenditures, especially when dealing with capital costs. The Comptroller continued, 'The introduction of accruals-based accounting should bring benefits for departmental management and, most likely, better accountability to Parliament' (Her Majesty's Government 1995).

Given the avowed benefits of accrual accounting, why did it take the central government so long to adopt its underlying framework? In this paper, we take an historical approach to help explain the bias against accrual accounting, in the process illuminating three major Acts of Parliament that addressed government accounting: the Exchequer and Audit Act of 1866, the Exchequer and Audit Department Act of 1921, and the National Audit Office Act of 1983.

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Even though there had been periods of limited use of accruals in the UK public sector (Wright 1977; Likierman and Vass 1984; Stewart, 1984;Thain and Wright 1992;Heald 1995), a bias against accrual accounting persisted based on the idea that cash transfers are concretely verifiable transactions. Cash was seen as the most robust basis for accounting. On this basis, the 1866 Act saw accruals as unacceptable and quite deliberately made cash the sole basis for appropriations by the state and the accountability of the government to the legislature for appropriations. The 1921 Act adopted a similar position, when the Treasury took specific actions to exclude reference to accruals from the Act even though a major experiment using accrual accounting was underway at the time in the Army and the legislature had intended to expand the experiment to include the entire government (House of Commons 1918). Finally, accruals also did not feature in the construction of the 1983 Act.

In this paper, we provide context and background for the dictates of the three acts of parliament and the limited use of accruals in UK accounting history by drawing on examples from the Ministry of Defense (MoD) and its precursor, the UK War Office. These examples are appropriate for a number of reasons. First, defense is one of the few government spending areas that existed continuously over the roughly 200 years covered by this study. Also, accounting reform is likely to have its largest impact on departments with large asset bases, such as the MoD (Her Majesty's Government 1995). Furthermore, in times of war, the temporary national priority on defence and war economy contributed to permanently define the characteristics of the British government (Burk 1982).

2. The 1866 act and antecedent developments

During the mid 1850s, significant doubts existed about the UK government's capacity to use its military power to effectively and efficiently defend the country's colonial interests with integrity given results of the Crimean War (1854-1856) and the Indian Mutiny (1857). In the interest of economy, the government had, in the years of peace after Waterloo (1815), drawn down the Army's logistics organization. It was replaced by Treasury-managed contracts with private suppliers. The contracts called for service deliveries in the event of war. In addition, army commissions, appointments to commands, were purchased on an open, unregulated market accessible to untried and inadequate commanders.

2.1. The Crimean War (1815-1856)

It is perhaps unsurprising that, untested, such contractors failed when put to the test—with 21,000 reported dead in the Crimean War from a deployed army totaling 30,000. Disease, cold and malnutrition generated the majority of the losses, the consequence of poorly administered and corruptly delivered support. Other losses in combat were attributable to leaders inadequate to the task of conceptualizing what was required of them and their men in war. The failure of command wasted men in fruitless bloody action, despite brave efforts exemplified by the infamous 'Charge of the Light Brigade'. No matter how brave, the ill-trained, inexperienced officers leading the army had a lethal incapacity to conceptualise their approach to the fighting. They were in command as a result of purchasing their commissions on the open market or being given them on the basis of patronage unconnected to their efficiency as soldiers (House of Commons 1856).

The military failures were reported as they occurred. The telegraph, newly invented at the time, enabled *The Times* correspondent William Howard Russell to report the problems of the army within 24 hours. A series of subsequent public enquiries on the conduct of the War Office, the Army, Treasury and the Admiralty made such failures in administrative control even more publicly evident (Her Majesty's Government 1855, House of Commons 1856).

2.2. The Indian Mutiny (1857)

Outsourcing was evident on an even greater scale in India, where the whole colonial government was contracted out to an equity-financed private enterprise, the East India Company (Anderson et al. 1983), which was demonstrably corrupt. The grand 'Nabob' houses scattered over England today attest to the rapacious extent of this corruption. A nabob was a salaried senior government official employed by the East India company. Nabobs evidently had licence to make their own as well as their shareholders' fortunes. Although deep-rooted, murderous antipathy existed between the Hindu, Muslim and Sikh segments of the Indian population of the time, the groups had sufficient animosity towards the government imposed by the East India Company to join together in an armed resistance. An imperial British army had to be sent to restore UK rule. It was clear to the government that a populous country such as India could only be governed by consent. This required government to be seen as fair and honest. The UK set out to establish the basis for such government, constructed on the ideas of the Northcote-Trevelayn Report (Her Majesty's Government 1968). It was applied swiftly to the reform of the Indian and more slowly to the Home Civil Services.

2.3. The Exchequer and Audit Act of 1866

The 1866 Act instituted reforms in response to the perception that government system had failed badly during the Crimean War and the Indian Mutiny. It followed the implementation of the Northcote-Trevelayn reforms of the British civil service as proposed originally in 1853 and was based on the work of the Parliamentary Select Committee on Public Monies (Her Majesty's Government 1968). Evidence from Committee records during the 1850s suggests that while the executive branch of government was accountable to parliament for public spending by law (*de jure*), actual oversight by the legislature (*de facto*)was deemed insufficient.

The 1789 Act of Settlement had established an annual spending cycle, since no finance acts had constitutional currency beyond one year. This ensured annual parliamentary action was needed to re-legislate the finance requirements of government. However, in practice, unexpended funds or resources could be carried forward year-to-year in bank accounts, stocks or property for disposal. Adjusting debits or credits could be delayed or brought forward as and when the government saw fit. The variations so permitted by auditing and accounting practice limited the value of legislative oversight.

Insufficient oversight was the focus of the Committee on Public Monies'
deliberations from 1854-1857. For example, in 1854 the Treasury maintained that any system should 'be based on confidence in the government and let the controlling and responsible department of state [i.e. the Treasury] have full freedom of action' (House of Commons 1858). But the Comptroller General of the Exchequer who acted for the legislature disagreed, stating, 'I utterly reject this principle. I deny such confidence in the Executive Government is, has, or ought to be recognised in any free state. I deny that it has ever been from the earliest times a principle adopted in the British constitution. On the contrary it is constitutional jealousy and not confidence, upon which our institutions are founded and on which the safety of the liberties of England depend'(House of Commons 1858).

The legislative view prevailed in the 1866 Act.It was a rather tardy response to a number of public financial scandals, including the Crimean War and Indian Mutiny cases already discussed. According to the legislature, executive slackness had allowed the scandals to occur in public affairs, contrary to the wishes of parliament. The Act marked the legislature's determination to constrain government, and it established the adherence to the legal requirement of annual accounting. Thus, the act set out to make annuality a reality *de facto* as well as *de jure*. It set limits on the role accruals and other commercial credit generating practices could play in public sector finance, accounting and auditing. It specified precisely what accounts were and were not to be used. Accruals were explicitly banned, and cash transactions were to be the sole basis for accounting. These actions were seen to ensure control over public funds, guaranteeing that propriety in spending would be of the highest order.

The 1866 Act is best understood in relationship to other reforms, including the Northcote-Trevalyn system of personnel management, in the nineteenth century. The prime design feature of their systems was robustness against impropriety. The Act set stringent standards of administrative control and integrity. A key feature was the separation of powers. This was to be achieved by separating the specification of a requirement for goods or services from any decision on the contractual means to satisfy it or the cash to finance it. The three functions were deliberately separated. All spending decisions had to be taken by a committee drawn from at least the three hierarchically and culturally distinct parts of the bureaucracy that evolved. (The feature continues to this day: in the current MoD, there is a commitments staff for specification of requirements, a procurement staff that specifies how the requirement will be met, and a finance staff that controls payments to providers.)

3. The 1921 act and antecedent developments

The centralized system of bureaucratic accountability put into place by the 1866 Act made public sector performance difficult to monitor. No record was required of the detailed allocation of cash to purposes, only to means. This raised the potential for government to be unaccountably inefficient or ineffective. The resource cost of operations by the state is often dependent on assets acquired and expensed entirely in earlier periods on a cash basis. Also, without accruals, inter-departmental services appeared to be provided for free, distorting the real cost of departmental operations.

3.1. The Second Boer War (1899-1902)

During the colonial Boer War of 1899-1902, the system broke down completely (Her Majesty's Government 1904). It proved impractical to centralize resource acquisition and allocation in a fluid guerrilla war. Peacetime propriety-enhancing constraints on local initiative limited army officers' opportunities to learn in peace the resource allocation and financial control tasks delegated to them due to the exigencies of the war. The army in this colonial war, conducted at a distance from Whitehall, was inefficient and ineffective at local acquisition, management and husbandry of resources required to sustain combat in South Africa. The consequence was excessive expense and waste.

The Esher Report of 1904 into the causes of this waste (Her Majesty's Government1904) emphasized the need for devolved responsibility and authority in peace as a means to train for war. These were seen as pre-requisites to training in the achievement of both the value for money and the propriety required for the successful conduct of war. The Report recommended a decentralized organizational structure for the army and the extensive use of accountable decentralized resource management in peace, neatly demonstrating the strong link then perceived as essential between organizational behavior and accounting change. For example, it was argued, 'When money is doled out in compartments and no discretion as to allocation is permitted, savings are not likely to accrue. In the case, however, in which some measure of financial responsibility has been accorded to officers, marked regard for economy has been manifested' (Her

Majesty's Government 1904). And argued more strongly, 'While the present system of financial control is futile in peace, it is ruinous in war. Officers unaccustomed to bear any financial responsibility, and ruled by excessively complex regulations, cannot at once improvise a system for the control of expenditure in the field, when the restraints are suddenly removed. The result, as in South Africa, is the waste of millions' (House of Commons 1904).

3.2. The First World War (1914-1918)

The theme of lack of value for money in defence spending continued into the First World War. This is made clear by the evidence given to the Select Committee on National Expenditure in 1918 (House of Commons 1918). The system conceived by the 1866 Act to ensure propriety proved singularly ineffective ensuring that funds were also efficiently and effectively used. For example, assertions in the records include, 'I do not think Estimates as furnished in the past to parliament are worth the paper they are written on from the point of view of parliamentary control' (Mr. S. Dannreuther, CB Acccounting Officer of the Ministry of Munitions, House of Commons 1918) and 'You cannot get any real control of expenditure by cash issues or cash payments excluding such factors as liabilities, consumption from stock and things of that sort' (Sir Hcarles Harris, K.C.B., Assistant Financial Secretary to the War office, House of Commons 1918).

3.3. After the First World War

In response to recommendations of the Committee on National Expenditure, the army instituted a devolved system of management accounts and budgets where accounts were linked to defined army outputs as well as inputs (Hilton and Cowton 1996). The cash-based system was designed to free the service provider to deal with delegated tasks constrained by a budget alone. To provide accountability, managers were to be held rigorously to *ex poste* accounts regarding value for money.

In 1919, the system went even further by introducing accrual accounts. The intention was to economise on staff by eliminating bureaucratic controls over every line item. Budgetary control over operationally coherent blocks of expenditure was to be substituted. Line item control was left to the executive authority of an accountable line manager. The system provided extensive information on performance, that is, the levels of efficiency and effectiveness of public spending.

3.4. The Exchequer and Audit Department Act of 1921

Parliament 's wartime National Expenditure Committee opined that to effectively oversee government it needed published accruals and detailed cost accounts (House of Commons 1918), such as those provided in the Army experiment, and parliament intended to expand the Army's practices to the government as a whole. However, the Treasury opposed any further developments (House of Commons 1918; Hilton & Cowton 1996). At the time, public spending was under criticism for control systems that had been relaxed due to the exigencies of war. Therefore, the Treasury was against the accounting reforms that decentralized accountability and relied on accruals. In its view, these undermined its ability to be seen as guarding the public sector's use and disposal of cash (Hilton & Cowton 1996).

In addition, the 1921 Act came at a time when the government was dealing with general public unrest in public service by introducing the Whitely System of industrial relations, which was also a centralizing effort spearheaded by the Treasury. The system gave the Treasury effective control of the personnel management of the whole public service. It entailed a collective bargaining system to set Civil Service pay rates and conditions. This required central Treasury control and a reorganization of the state machine, providing the

Treasury for greater control of the Controller and Auditor General (C&AG). Tellingly, Sections 1(2), 1(3), 3(1), 3(2), 4(1), and 5(1) give the Treasury the authority to direct not only the form of public accounts but also what the C&AG should audit (House of Commons 1921).

Therefore, with the 1921 Act, the War Office's, and the Parliament's (House of Commons 1918) desire to use parliamentary accountable empowerment and accrual accounting to enhance government efficiency thus came to nothing. All spending and accounting had to be sanctioned by the Treasury. Also, as audit was brought under Treasury direction, it deteriorated from a legislative oversight perspective to a mere formality. The 1921 Act confirmed what had already been occurring, the loss of the parliamentary ascendancy the 1866 Act had intended to establish.

The Act established propriety as the over-arching priority for the C&AG. It stated: 'The C&AG shall satisfy himself that the money expended has been applied to the purpose or purposes for which the grants made by parliament were intended to provide and that the expenditure conforms to the authority which governs it.'(House of Commons 1921).

4. The 1983 act and antecedent developments

A brief attempt was made immediately after the Second World War to introduce modern commercial accounting and auditing into government at the behest of Lord Lever, a member of the post-war socialist government. Lord Lever's family ran a successful UK company, Lever Brothers, and he had been a management accountant and senior manager in the Ministry of Munitions during World War I before becoming a Treasury Minister. However, the Treasury was against the enterprise and severely limited the freedom of action of the Crick Committee, the group constituted to carry the idea forward. Accrual accounts were then removed from consideration in all subsequent proposals for government reform until the White Paper released in 1995 (Her Majesty's Government 1995).

The movement toward modern commercial accounting and auditing was stymied by a several factors. One was the growth of the Welfare State, which increased the workload of both Parliament and the C&AG, limiting their capacity to provide spending oversight. In addition, the state started to use spending power as an economic policy instrument, following ideas introduced by John Maynard Keynes. Focus was directed at the macroeconomic level, and data was gathered to be used to control employment, the balance of payments, and growth. Resultant policies enhanced the Treasury's power and influence through its ability to affect vote-winning macroeconomic demand management. This approach focused on the total volume of spending, leaving relatively unexamined individual items of expenditure and providing for little oversight of service delivery. In response, Parliament commissioned Lord Plowdenin 1961 to study the resulting loss of control over public spending (Her Majesty's Government 1961).Lord Plowden's recommendation was to require economic and policy-oriented forecasts, in a process known as the Public Expenditure Survey, as a basis for critiquing government spending in advance. Plowden's recommendations did not achieve desired results as they encouraged scrutiny of intentions, not accountability of results.

In the 1970s, general opinion still prevailed that public services were ineffectively delivered at unacceptable cost. It was felt that managerialism had a role to play in government. The Eleventh Report of the House of Common's Expenditure Committee (House of Commons 1977) noted that the US's Government Accountability Office (GAO) was characterized by a wider scope than the C&AG since it was charged to audit value for money, not just propriety. The lack of a legal basis for the audit of value for money was seen as a deficiency of the UK system. In response, the Thatcher administration (1979-1990) introduced the Financial Management Initiative (FMI). The FMI set out to decentralize authority, responsibility and accountability. It aimed to empower the providers of government services, but traditional control systems made this difficult and it became evident that new forms of audit and accountability were needed.

4.1. The National Audit Office (NAO) Act of 1983

The 1983 Act was passed in the same year as the FMI. The FMI sought, through executive action, to affect organizational change by devolving authority, empowering public servants to act to achieve greater efficiency and effectiveness (value for money). The Act refocused NAO activity. The NAO was given a clear directive to audit value for money. In addition, oversight of the NAO was switched from the Treasury to Parliament. A parliamentary governing body assured that the NAO would be independent of the executive government.

Nothing was done in the 1983 Act to change the C&AG's duty to sustain propriety (as outlined in the 1923 Act). Rather, an additional charge was delivered to conduct value for money audits. The act stated the controller 'may carry out value for money examinations in any department or other body where he is the appointed auditor. The C&AG has complete discretion to decide whether to carry out value for money examinations and how such examinations should be carried out.'(House of Commons 1983)

5. To the present-day

The 1990-1991 defense appropriation included a scheme to provide incentives for budget holders to effect savings. It allowed the retention within a budget area of a portion of any savings achieved. The savings could be reallocated in the same overall budget area. To assure propriety, the monies could only be reassigned to line items that had already been approved. Subsequently, the Accounting Officer's evidence to the Committee of Public Accounts (House of Commons 1992) reported £2,258 Millions of savings in 1990-91 of which £9.4 Million (or 0.4%) was spent on the scheme. Spending deemed to be irregular by the auditors amounted to £1.2 Million (0.04% of the total). By commercial standards these figures suggest a good cash return to taxpayers at minimal cost, and that 'irregular' spending was immaterial. However, public sector standards of materiality are set with taxpayers' sensitivities in view. A senior accounting officer was called to publicly account for the irregular spending in front of the Committee of Public Accounts.

In response, the MoD chose to abandon the budget savings scheme. A memorandum from 1992 clarified the issues: 'It is a basic principle of government accounting that expenditure must not be incurred without the approval of the Treasury. In practice the Treasury delegates. However, all novel or contentious items are by definition outside the delegated authority of departments and must be referred to Treasury for approval, *regardless of the sums involved*' (Comptroller & Auditor General 1992, emphasis added).

5.1. The 1994 Report, Better accounting for the taxpayer's money: resource accounting and budgeting in government

The 1994 report called for 'resource accounting, whereby from 1999-2000 central government departments [would] produce and publish accruals-based "resource accounts" to supplement their current cash-based accounts; and resource budgeting, under which the public expenditure planning process, and the supply process through which Parliament grants legal authority for much of government spending, might both be changed to an accruals basis sometime early in the next century.' Although not calling for a replacement of cash-basis accounts, the report clearly signaled the importance and provision of accrual accounts. In a subsequent report by the C&AG, published in January 1995, benefits of accruals accounts were delineated, including 1) providing a better picture of the true cost of departmental activities; 2) improving stewardship and accounting for assets and liabilities; 3) better matching of resources to objectives and outputs; and 4) setting consistent accounting and reporting standards within government (House of Commons 1994).

The reforms proposed in 1994 were subsequently implemented with the UK Government's 2001-2002 financial year. In a related press release, the Chief Secretary to the Treasury, Andrew Smith, commented, 'This is a very significant day for Government. From now on, the Government will be using best practice in financial management . . . The implementation of resource accounting and budgeting puts Britain among the world leaders in public service reform' (International Federation of Accountants 2002).

6. Conclusion

Three major acts of Parliament (1866, 1921 & 1983) sustained the cash-basis tradition of UK Government accounts from 1815 to 2000, although the merits of accrual-basis accounts were recognized and argued throughout the period and experiments with accrual accounting were even undertaken. In this paper, we provide an historical perspective, based on the history of the Ministry of Defence and its precursor, the War Office, to help explain the delay in widespread adoption of accrual techniques. We document that military spending and oversight in the Crimean War, the Indian Mutiny, the Second Boer War, The First World War, and the aftermath of the Second World War all contributed significantly to the development of governmental spending policies and the question of whether 'to accrue or not to accrue.'

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