

## A STUDY ON THE IMPROVEMENT MEASURES OF THE ELEMENTS IN MILITARY ACCOUNTING STATEMENT ON THE ACCRUAL BASIS OF ACCOUNTING

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**Abstract:** *It is vital to the reform on the governmental accounting policy in China that is to introduce the accrual basis of accounting step by step, and stage by stage. In addition, to introduce the accrual basis into military accounting by a “progressive” means is the next step of the reform activity in this filed. And this will have a great effect on the recognitions of the elements concerning the military accounting statements on the current cash basis. This paper precisely sets forth the characteristics of defining issue of the accrual basis. Meanwhile, the author also analyzes both the methods of how to introducing this basis in order to modify the current military accounting system, as well as the proposals to perfect and improve the elements in the military accounting statements.*

**Keywords:** *accrual basis, military accounting, accounting statement elements*

The elements of accounting statement constitute the financial statements. They are also plays a critical role among all the elementary items of the financial statements. Thus, reasonably introducing the accrual basis into military accounting system must greatly affect on the current accounting procedures which are based on the cash basis. And the first-run of the reform on the current system is the modification and improvement of the statement elements and its recognitions.

### 1. THE BACKGROUND OF THE SELECTION OF THE ACCRUAL BASIS

To introduce the accrual basis into present military accounting system, is due to the comparison between the two accounting bases – accrual basis and cash basis. As the result, the former one is much better than the latter one. And this necessary selection is also determined by the changing military accounting environment.

**1.1 The difference between the cash and the accrual basis.** Accounting basis, also called Basic Accounting Report or Basis of Accounting, is an effect on the decision about when to settle the transaction for the purpose of editing the accounting report. It consists of both cash and accrual bases.

But actually, these two bases are only the two poles of the entire system. There are still many diversifications between them.

These diversifications can be divided into two aspects mainly. One is the modification of the cash basis, or we call it the modified cash basis; on the other side is the modification of the accrual basis, that is to say, the modified accrual basis.

The cash basis, or cash basis of accounting, means to settle down the accounting transactions only after the cash revenue and expense. It is an accounting result which is primarily to measure the balance between the revenue and expense of the cash during a certain period made by the accounting subject. It is generally considered as having the merits of simple, brief and concrete feedback of the cash flow. However, it is not able to record some big accounting activities that have really happened but left nothing with cash in and out. The accrual basis, or accrual basis of accounting, considers rather the aspect on financial effects during the procedure of the financial transactions than the condition concerning that whether the cash has already received or paid. The subject of the measurement of accrual basis is a kind of gap or financial achievement between the economic profit and consumption in a certain period. The criterion to judge whether it indeed happened is that the transaction has actually occurred. Comparing to the cash basis, this accounting basis is superior to both range and depth of reporting the military accounting data, as well as the military financial management and decision-making.

These advantages are mainly manifested in four aspects: The first one is to totally report the fulfillment of accountability. The second aspect is to provide a report about the information of the comprehensive financial operation process, result and its efficiency. And the third advantage of the accrual basis is to serve on settling down a long-term decision. The last one is to improve the quality and efficiency of operation in every working unit and department.

**1.2 The main reasons on introducing the accrual accounting into current military financial system.** The main function of current military budget accounting is to enhance the macroeconomic management and budget management service of the military finance. That is to say, the accounting basis must be consistent with the budget, which is the main reason leading to the current cash basis application in the military budgeting. However, this kind of accounting focuses on the receipt and payment of funds rather than enough attention on accounting for large stock of assets.

As we mentioned previously, the accrual accounting is quite superior to the cash basis. On the accrual basis, the military accounting statement of the property distribution and performance will be more actual, comprehensive and credible. That will be an essential for the accountant to assess the military accountability and do the decision making. Therefore, according to the above all, the accrual basis could be introduced into the military accounting system and become one leading role of it. However, we should be clear about the current situation that the financial management, the capabilities of accountants and the entire accounting information system still need an improvement. Actually, the western countries have spent decades of years through the establishment of the accrual basis to its application in the real governmental accounting.

And in a sense, under the circumstances that the reform of government accounting in China has just started, as well as the military financial information system of PLA and its related regulations are not perfect. It would be imprudent and aggressive that we try to introduce the accrual basis and use it as the basis for the military accounting report in a large scale. And it is difficult to achieve the expectation. The author believes that the reform of military accounting system should begin with a modified cash basis.

Then, we can gradually introduce a modified accrual basis into the reformed system later and the accrual basis at last when the condition is perfect. Therefore, the "progressive" way of introducing accrual basis is the further direction of the reform of military accounting.

## **2. THE ELEMENTS OF MILITARY ACCOUNTING STATEMENTS ON THE ACCRUAL BASIS**

Elements of military accounting statements, also known as the military accounting elements are the basic classification of the objectives of the military accounting based on the economic content. They are also considered as the basic components of military accounting statements. Relying on the current accounting, these elements are divided into four categories. They are assets, liabilities, net assets and the balance. Nevertheless, this classification is based on the cash basis, which is a little bit rough. Especially on the aspect of the incomplete records of the accounting contents and information, there would be a series of confused information transmission when we meet the problems caused by the emerge of the revenue and the expense as well as the omit of the balance.

Consequently, in order to clearly recognize the assets structure of each department and its subordinate relationship, effectively control the expense, accurately record the budget and other funds on practical using, and to feasibly master the expenditure and balance situation, we can divide the elements of military accounting statements as assets, liabilities, net assets, revenue, expense and balance - six categories.

**2.1 The separation of the revenue and expense elements.** Concerning the practical consideration of the capital operation, we take the first step of reform to separate the combined elements in traditional accounting into two items. In the general situation, even though the budget funds are earmarked for the special use, it still sets a limitation on the items of the reimbursement for the expense to a great extent. However, the military expenses are not all from the budget. Furthermore, the practical using of military funds is not entirely depending on the budgetary provisions. Consequently, combining the revenue and expense items together in military accounting actually would not only cut down the categories of the accounting, but also weakened the basic function of the accounting.

Due to the restriction caused by the budget, in the military accounting statements, many items of expense can be only passively merged into some corresponding items as the record of payments. This situation directly challenges the authenticity and the importance of the military accounting information. Also, the information contained in the statements of military accounting is neither effectively nor sufficient for decision-making on the future budget. Despite of that, this kind of accounting system would neither play as an effective role in the military financial management at all. To improve the functions of the military accounting, we shall clarify that the receivable is right, and the payment is responsibility. Both of them happened at the same time, there would be a real accrual basis which is a true record of financial transactions based on the objective facts. And that is the way for us to collect the original data from the occurred transactions, then to provide reliable accounting information with evidences. Hence, the elements as income, expenses and costs should not be mixed. We need to clearly separate them respectively.

**2.2 Correction: expense element modified into cost element.** The existing military accounting expense is defined as costs and losses of every unit, including expenditure in the budget, expenditure out of the budget, and the expenditure on the dues of Party activities. This concept is vague to some extent.

For an economic unit, according to the benefit period its expense can be divided into revenue expenditure and capital expenditure. The revenue expenditure refers to the expenditure happened in the current accounting period, which forms the current consumption, and cannot bring about any increase of the potential service. Thus, we should recognize it as expense. On the other hand, the capital expenditure refers to the expenditure that happened during or more than one year of the accounting period, which has formed a potential service already. It should be recognized as assets. On the accrual basis, cost is a more accurate reflection index of the current cost.

The cost element is that the reduction in economic profits during the accounting period. It is reported as the decrease of the net assets from the outflow, loss or liability of the total assets. Then, the record of cost can report to the accountants the value of the economic resources which are consumed and changed into the military productions.

Therefore, expanding the range of the cost element in military accounting will be able to include the cost that is originally incapable to record on the cash basis into a specific type of military output, so as to provide a more comprehensive, and more accurate information on the whole military output.

However, please note this: the expenses should be confirmed when they are going to happen and can be measured. If the increase in assets or the decrease in liabilities is related to the decline of the future economic profits, which can be measured reliably, it shall be record as the cost in the financial statements.

According to the economic connotations, these costs can be mainly divided into eight items: personnel cost, the cost of using the physical assets (such as depreciation expense), rent, leasing cost, the fee on routine maintenance and operation, interest, the expense related to the financial assets, and other losses.

**2.3 Adding the balance element.** On the accrual basis, how to find the performance or efficiency of the military operation in a certain accounting period is measured on the ratio of revenue and expense.

Then, the measuring result of the ratio will be reported by the establishment of an element called "balance". The relationship among the three elements is represented by a dynamic accounting equation: "Revenue - Cost = Balance".

The setting of the "balance" is in order to evaluate the military operation performance. However, due to the non-profitable characteristic of the Army, profits or benefits produced by some military operations may not be accurately assessed by money in many cases.

Because of that, this result of ratio is just a reference aiming at measuring the military economic profit. And for a comprehensive assessment of this part, we still have to depend on the disclosure of all types of non financial information in the notes of the accounting statements and the related statistical data.

### 3. THE IMPROVEMENT OF THE ACCOUNTING ELEMENT ON THE ACCRUAL BASIS

It is premised on the clear classification of the elements in the military accounting statements that there should be a necessary modification and improvement on the current traditional elements.

It will create a practical accounting system based on the internal principles of the accrual basis, in order to report and supervise the use of the resources and to record more systematical, creditable and accurate information about the accountabilities.

### **3.1 The improvement of the asset element.**

Asset is defined as an economic resource which can be measured by money and formed by a physical object owned or controlled by the military accounting subject from the past transactions or reasons. It includes property, appropriation, and account receivable, etc.[1] This definition specifies the time, space and nature of the asset. But, constrained by the cash basis, the range recognitions of the assets is still relatively narrow. On the accrual basis, we need to enlarge the recognitions of the range about military asset elements and classify them in categories scientifically for this reason.

As long as it meets the definition of the military asset elements, any measurable military asset can be enrolled in the accounting statements as the asset elements. On the other hand, those immeasurable assets could be record as the non-currency information attached to the statements.

In addition to the monetary assets, physical assets and debts assets owned by the Army, the other assets like weapons, projects in construction, intangible assets and land for military use can be included as the military assets and record in the accounting statements [1]. Meanwhile, there should be a clear classification on the asset elements. The standard of the time to supplement the cost is entirely due to the potential ability that how long these military assets could provide for the future service.

According to the particularity of military assets, we should focus on the liquidity of them. Furthermore, to be more scientifically, the military assets we are talking about here can be divided into four categories considering two aspects - the liquidity (or the available consuming time) and the physical one. These four categories are financial asset, real asset, intangible asset and other capital asset.

Among them, the financial asset can be subdivided into monetary asset, accounts receivable and advanced payment, securities investment and other financial assets. And the real asset is subdivided into inventories, fixed asset, project in construction, equipment asset, etc.

Besides, the intangible asset refers to an identifiable non money-like asset which bought by the Army at a high price (such as the patented technologies from abroad and the domestic research achievements and so on), and has a potential ability in order to serve the Army in the future. For instance, the achievement of the researches on the military equipment which belongs to the equipment asset should be record as the intangible asset. The other capital assets mainly refer to the free land and mineral resources, etc. allotted by the state for the Army for free use.

**3.2 The improvement of the liability element.** In military accounting system, liability refers to those monetary debts of every working unit that could be paid or served by assets or the final budget, including the appropriation from the superior, the funds should be turned over, and the suspense credits and so on.

In a sense, there is also a scope limitation for the liability elements on the accrual basis. So, it's necessary for us to improve definition, recognitions and classification of the liability elements in the military accounting.

The first strategy is to redefine the liability elements. Being similar to the asset elements, we should redefine the time and character factors of it again. For the time factor, the liability element represents the current responsibilities that the Army should or has already taken. Budget, is a key to settle down which is the current responsibilities. The budget revenue is a form of the legal responsibilities permitted by the legislation institutions of the state to a certain degree. Its presence objectively limits the range of the responsibilities that the Army should take on. On the other hand, according to its character, these responsibilities must be fulfilled in the future by cost necessary resources. Therefore, we can recognize it as the future risk of the military finance that causes the military resources flowing out without fail. In view of this situation, the military liability element can be defined as: the debt in military accounting system is a current responsibility taken by the accounting subject and formed by some reasons or operations in the past. This responsibility will cost some military resources in the future.

The second step is to enlarge the range recognitions of the liability element. This range recognitions must meet two conditions: Firstly, it should correspond to the definition above; then, it should be accountable reliably.

At present, the liabilities record in the military accounting statements are all the current internal ones. In fact, the Army is taking the obligation to pay for the military social security fund, to deal with the various uncertain emergency incidents and to pay back the loans for the military basic unit construction offered by the financial institutions. Due to the cash basis principles, current military accounting just accounts the current direct explicit liabilities by cash, which leads to the result of a narrow range concerning the military liability accounting. In addition, a number of direct recessive and contingent liabilities still don't fall under the military accounting.

Because of these reasons, the Army could not make sure about their responsibilities of the liability that they should bear to pay. That is to say, the current situation is that it covers the real information of the balance sheet from the user of information in the military accounting statements, even would mislead them and cause some wrong decisions related to the military financial part. On accrual basis, the liabilities should not only reflect the internal flowing liabilities of the Army mainly directing at the accounts, but also record the short- and long-term loans as the direct explicit liabilities. According to this principle, both of the social security fund, paid and taken as the direct recessive liabilities by the Army in the future, and the contingent liabilities which are responsibilities on dealing with all kinds of unexpected emergencies, etc. should be included in the recognitions of the range of liability. If it cannot be reliably measured actually, such as the contingent liabilities, we could appropriately disclose them in the notes of the accounting statements.

The third strategy is the classification of the liability element. According to the recognitions of the debt range we talked previously, we can classify these elements into two types based on their time-limitation of payment: the current liability and the long-term liability. Currently, the items like the incoming budget, temporary collection and the payment funds included in the military accounting principles belong to the current liability. On this basis, the short-term loan owing to the financial institutions, the money paid for the suppliers, the advance payment for the constructor, and the accrued expenses should also be included in the current liability category and are listed in the balance sheet.

For the long-term loan, borrowing from the financial institutions and the expected liabilities [2] as the one to pay for the social security funds after several years can be record in the balance sheet as the long-term liability category. And if there were the liabilities in the long-term item are due within one year, it could be listed in the current liability category of that year as "will be due within one year long-term liability" item.

### 3.3 The improvement of the net asset.

The net asset is the balance of assets minus liabilities. The relationship of the net asset, the asset and the liability can be shown as the static accounting equation - "asset - liability = net asset". Therefore, the recognitions and measurement of the net asset depend on the recognitions and measurement of the asset and liability. The International Federation of Accountants (IFAC) Public Sector Committee considers that the governmental net asset mainly comes from three aspects: the first aspect is the unused financial resources in accordance with the budget, contract agreement definition; the second aspect is the funds which the government purchased by using the current financial resources through the budget arrangements or by accepting long-term asset donations; and the third aspect is the accumulation of the operating results after years [3]. According to this standpoint, except the "special fund", the rest contained in the net asset of the military accounting principles of PLA conform to the net asset. For the "special fund", from the accounting content, it includes the "insurance fund", "housing finance" and "other funds". Due to its main source is money collection and transaction, donations and interest income, the "other funds" should belong to the net asset. However, both the "insurance fund" and "housing fund" belong to the social security funds, which are the military obligations in the future that meet the recognitions criterion of liability, and should be included in the that element. We have talked about it in the liability part above.

**3.4 The improvement of the revenue element.** In the military accounting principles, the revenue refers to the legal non-repayment funds, including the budget funds, the extra budgetary funds and the Party expenses. Similarly, because of the limits of the cash basis, the recognitions of the revenue element should meet the two basic characteristics: time limit within the current year and can be measured by currency.

Therefore, on the accrual basis, we need take some measures to improve the following elements of revenue:

Firstly, modify the connotation of the revenue element. The IFAC Public Sector Committee considers that the revenue on the accrual basis is an increased economic interest during a certain accounting period. It is in the form of an increased net asset caused by either the inflows or gains of assets or decrease in liability without the similar items related to the investment by the owners [3]. It also pointed out that this definition can apply to the government departments. According to this standpoint, the author thinks that on the accrual basis the revenue element can be defined like this: the revenue of military accounting subject refers to the total inflow of the economic interests of it in a certain accounting period. Its form is much similar as the one we have just referred to, an increased net assets caused by either the inflows or gains of assets or decrease in liabilities, however, without the direct investment by the net asset owners.

Secondly, define the recognitions conditions of the revenue element. The recognitions conditions of the revenue element, firstly must meet the definition of the revenue. Then it should be obtained and can be measured reliably. And the so-called “be obtained”, refers to any forecast economic benefits relating to the revenue will flow into the main body; the so-called “be measured”, refers to the increase of the economic profits caused by the revenue can be measured reliably. Due to the criterion of the recognitions connected with the asset and liability, the revenue only can be recognized under the conditions that are the possible increasing of asset or reducing of liability, which can be reliably measured.

Thirdly, classify the revenue elements. Based on the sources of the revenue, it can be divided into three categories: budget income, extra budgetary funds income and other financial income. This classification is basically in tune with the one in the current military accounting system.

#### 4. CONCLUSIONS

The reform of the military accounting should start with the revised cash basis; then moves to the modified accrual basis when conditions permit.

Before the introduction of accrual basis into the military accounting, there must be some changes of the accounting statement elements. To be specific, firstly, the intangible assets should be enlisted into the elements; moreover, the real assets ought to be categorized into aspects as inventories, fixed assets, projects in construction, and equipment assets, etc. Next, the range recognitions of the liability element should be enlarged; and furthermore, these elements can be classified into two types based on their time-limitation of payment: the current liability and the long-term liability. Finally, the elements as income, expenses and costs should be separated. We need to redefine the income element in order to cover the balance element as a new concept.

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