
Accounting Revolution in Sapporo and Usuki City

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I. Introducing corporate accounting to local governments

1. Criticizing the “Boom”

For many local governments, introducing corporate accounting has become important. In many specific and general queries to the general assembly, too, and as part of questions on administrative reforms, a new trend has developed, looking closely at possibility of introducing project evaluation and corporate accounting. Presently, introducing corporate accounting has been strongly called for, triggered by balance sheets and revenue-expenditure statements made under accrual accounting, as Mie Prefecture officially announced in February 1998. Since Mie Prefecture officially announcing final accounts, covering fiscal years 1992 through 1996, many advanced local governments in such places as Tokyo and Kanagawa prefectures, have provided and announced their balance sheets and other financial statements. Although some statements were announced despite obvious errors, many related to local governments have raised the question of whether such final accounts using corporate accounting actually provide local government financial restructuring and administrative reform prescriptions. The current situation, where such a question remains unanswered, is in the background of criticizing corporate accounting as a “boom.”

After I had a chance to be involved in introducing Mie Prefecture accrual accounting, I had further chances to be directly involved in making balance sheets and other financial statements for advanced local governments, such as Usuki City, Oita Prefecture, Wakayama Prefecture, Amagasaki City, Hyogo Prefecture, and Fukuoka City. Each of these local governments did not necessarily use the same accounting policies, but each policy, resulting from careful government staff thinking, was an attempt to provide final accounts prepared under corporate accounting to suit their own governments. Directing arguments especially to detailed accounting policy consistency among local governments raises concern that, inevitably, corporate accounting’s role in local government administrative and financial reform might not be fully appreciated. Dealing with the argument that comparison among local governments is most important, accumulating numerical figures based on corporate accounting that may be somewhat standardized as a survey on a local government’s financial conditions is not enough. I believe the main purpose of introducing corporate accounting should be to more properly

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disclose local government financial conditions and decision-making for strengthening the community through public and private sector collaboration. In other words, rather than comparing with other local governments, introducing corporate accounting as a communication tool with local residents including original ideas devised by local governments will have a significant effect in prescribing administrative and financial reform.

What does a balance sheet tell us after all? You may work hard to make a balance sheet, but none of the assemblymen, let alone residents could really understand the content. Even few local government staff members can read a balance sheet. For housewives to readily understand local government financial conditions, we could better use single-entry bookkeeping, like a household account book, rather than a set of corporate accounting financial accounts. Providing a balance sheet is merely a formality performed by a governor. All these endless lines of criticism, many by laymen who do not understand corporate accounting, do, in a sense, reflect the truth. We have such criticisms particularly where a local government has introduced corporate accounting without a real sense of purpose when introduced.

While occasionally, as with Sapporo and Usuki Cities, considered later in this paper, local government staff members are positively involved in preparing balance sheets and other financial statements, in most cases, local government staff members rarely take part. This is because local government can prepare balance sheets under corporate accounting using outside contractors to provide virtually a perfect balance sheet for only a small consultancy fee. Nonetheless, until recently mass media have strongly focused on such final accounts prepared under corporate accounting. We often see final accounts (without drawing major interest or being fully reviewed by local government staff members), widely published by mass media, becoming well-known and local governments that announced balance sheets and other financial statements without fully understanding corporate accounting are quickly upset when asked questions about merits of introducing final accounts under corporate accounting.

What are the significance and merits of introducing corporate accounting? Very recently, local governments have made careful reviews, which should be considered before introducing corporate accounting. This trend reveals local governments are determined to positively disclose their financial situation to residents, to help establish decision-making for building a community through public and private sector collaboration. By introducing such local government activities, this paper proposes to identify merits of introducing corporate accounting and to suggest the future of corporate accounting, although the method is currently criticized as simply a "boom."

2. Corporate accounting concepts

Few serious arguments have been made so far as to how to define corporate accounting. Terminology often used varies from 'method like corporate accounting' to 'accrual accounting.' In this paper, introducing corporate accounting to local government is not necessarily limited to accrual accounting, because this paper recognizes that the most appropriate approach is to broadly describe corporate accounting as accounting methods actually applied by the private sector in such areas as financial and administrative accounting, and business analysis. For example, if an accounting method recognizes cash expenditure, it might be classified as cash accounting, and classifying expenditures into categories by division or by goods is particularly useful for local governments. While many personnel expenses (as with the 1999 Osaka Prefecture General Budget) are built into expenditure structure comprising articles, item and sub-items, using a collective aggregate for items such as general affairs expenses (article), general affairs administrative costs (item), and general administrative costs (sub-item), or such things as welfare costs (article), social welfare costs (item), and general affairs expense for social welfare (sub-item), cost information from distributing project personnel expenses to a department division, section, and sub-section, may be a basis for promoting innovative local government accounting reforms. Of course, this accounting method does not include retirement allowance reserves. Even though such reserves are not included, local government staff members involved in administrative reform still understand that distributing personnel expense to each project or each division will have a positive impact on reforming local

government awareness. We need to remember that, even within the cash accounting principle framework, much remains to be done.

We define corporate accounting not merely as producing a balance sheet, but more broadly, for other reasons. First, frameworks serving each accounting system must provide a method enabling each system to yield the highest cost-benefit result. The framework must incorporate both philosophy of achieving such effectiveness in allocating resources, as provided by accounting science, and users' need to use accounting as a technique. Thus, accounting science should not seek a single, ideal accounting method, but should be a practical science providing methods serving the particular use. As such, whenever local governments refer to possibility of introducing corporate accounting, this should include accounting methods introduced by the private sector, reflecting various purposes. Consequently, it follows that, where local government is introducing corporate accounting, the applicable method will include accrual and cash accounting, and purchase-cost and current-cost accounting concepts must be introduced.

Through this method of revamping corporate accounting the accrual accounting principle may be seen as part of local government corporate accounting. Also, local governments should see a corporate accounting scheme as a stock assessment method, somewhere between cash and accrual accounting principles. As a typical assessment tool, this stock assessment method is widely used by the private sector for business analysis. Corporate accounting referred to by local governments is a concept including these various accounting methods; therefore, it should be considered a mixture of methods for coping with diverse requirements.

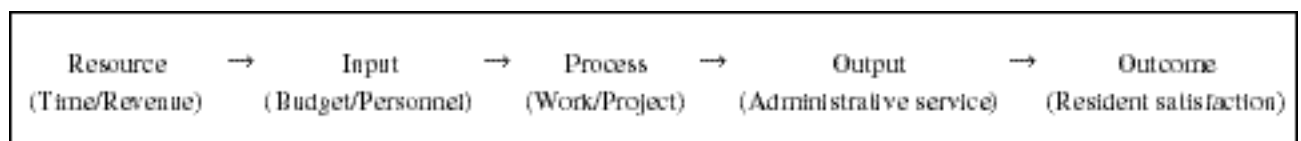
3. Shifting from Balance Sheet to Cost-Resource Calculations

With a broader corporate accounting view, introducing corporate accounting to local governments should enable them, at various levels (i.e., quality and volume of accounting information), to provide residents with information useful for decision-making. This suggests that, while local government, understandably, needs accurate administrative cost calculation, no cost calculation can be totally controlled by only one policy or accounting method. This is the case where local government, or calculation subject varies in function and structure from prefecture (Todofuken) to municipality (Shichoson) and, where the level of promoting local government staff member and resident awareness is multifarious, using the accounting policy that fits best with circumstances would be the main approach to assuring proper communication with residents. We should also remember this when considering possibility of introducing corporate accounting related to such things as cost calculations.

The framework in Chart 1 traces communication now with residents after introducing corporate accounting. Chart 1 shows the conventional system where public funds collected as a resource fund is converted into inputs as project budgets or fixed distributions and, through works and projects, are then converted into administrative services (output). Administrative services provided thereafter are assessed by degree to which they enhance residents' satisfaction (outcome).

Note that in Chart 1 any administrative service that does not enhance resident satisfaction provides no service, no matter how efficiently it is given. Also note that, if in terms of enhancing resident satisfaction (i.e. effectiveness) we have similar kinds of administrative services, we should choose the less expensive service (i.e. more economical service) or lower unit cost service (i.e. more efficient service) as the optimum administrative service. To do this, we have to fully understand each input designed to provide respective administrative

Chart 1 Basic Administrative Service Evaluation Concept



services and continue improving job performance (i.e., process).

Resource funds peculiar to local governments are another important consideration. Here, we should consider resource fund content. This may consist of local allocation tax, general resource fund, or local subsidies, special resource fund from the national government or bigger administrative units, or tax revenues, their own resource fund. This may be very important in decision-making when local government tries to arrange projects in priority order, or for subordinating. In an extreme case, such as where local government whole resource fund is appropriated from subsidies from the national government, etc., to infuse cash flow into local enterprises, the local government may willingly accept a subsidized project from the national government, even if it believes the project would not contribute much to enhancing local resident satisfaction. The choice here is whether to pursue micro- (local) or macro- (national) interest. For local governments where public and private sectors jointly design community planning, we cannot avoid this difficult situation.

Chart 1 shows corporate accounting characteristics, by showing monetary accounts; useful information about flow from resource fund through to output. A balance sheet explains what kind of assets the resource fund has been converted into, and a resource cost statement (tentatively named private sector profit-loss statement counterpart) explains what kind of public services the resource fund has been converted into. Further, by preparing a single set of final accounts for each project, we can check conversion from resource fund to assets or services, based on purposes (i.e. project or assets), rather than characteristics. Stock and flow figures thus calculated, when combined with project evaluation, will support the system, providing information essential for administrative evaluations, as shown in Chart 1. While corporate accounting provides various information through monetary figures, if we can establish, for each project, a system for comparing such monetary information and administrative outcome, this would create an information infrastructure useful for discussing resident and local government collaborative community planning. Also noting that the concept behind Chart 1 embodies essential factors for decision-making under the management “Do Check Action Plan” cycle, a process whereby local government staff members do their work and evaluate results to help plan for the next year. In any case, to establish such collaboration, the major problem is developing an open administrative and financial information system, consisting of corporate accounting and project evaluation. Next, focusing on corporate accounting, we will consider advanced local governments’ activities challenging these problems.

II. Sapporo City’s Enhanced Financial Information System

1. Attempted Introduction by Sapporo City

In December 1999, the ordinance-designated city, Sapporo, with a 1.8 million population, announced a full set of final accounts using corporate accounting. Contents are shown in materials published by Sapporo City (For inquiry: Financial Affairs Section), titled “Zaimu Joho no Jujitsu ni Tsuite - Kigyo Kaikeiteki Shuho no Donyu-shian (Gaiyo ban)” (Substantiating Our Financial Information - Tentative Plan for Introducing Corporate Accounting (Digest)) and “Zaimu Joho no Jujitsu ni Tsuite - Kokaikei-seido eno Kigyo Kaikeiteki Shuho no Donyu - (Shian)” (Substantiating Our Financial Information - Introducing Corporate Accounting to Public Accounting (draft)). The first is mainly for mass media, and the second for Sapporo City citizens.

While many local governments are using corporate accounting, you feel the big change of the times that at last a city furnished a full balance sheet instead of that listing inventories or the like. The Sapporo City local government has been actively involved in administrative and financial reforms, in particularly with citizens, trying to get its administrative operations to meet the needs of the times; one practical outcome was introducing corporate accounting. With a framework in which many governors often mention that citizens are leading players, those leading players, or residents, are not being given enough information periodically about their own local government and hardly have any chance to be heard on government affairs. Thus, Sapporo City’s introducing corporate accounting should deserve more appreciation. The government explains the purpose of

introducing corporate accounting: “In Sapporo, we have been actively involved in administrative and financial reform in partnership with our citizens, trying to get our administrative operations to meet needs of the times. Our introducing corporate accounting is one of these new systems.” Objectives are (1) to provide citizens with more easily understandable information, and (2) to make the most accurate cost calculations for our performance, or project evaluation. The following are three possible effects of introducing corporate accounting:

(1) With corporate accounting, we can compare assets with liabilities and provide readily understandable information shown by monetary figures.

(2) While we can compute a single year’s revenue and expenditure or cost by usual public accounting, we can estimate middle-/long-term costs.

(3) Corporate accounting will tend to improve our administrative performance efficiency, such as enhancing staff cost-consciousness and effective use of resources.

2. Balance Sheet and General Administrative Costs Charts

Chart 2 [Sapporo City Balance Sheet]

Sapporo City			(Unit: Million yen)		
Item	1997	1998	Item	1997	1998
【Assets】			【Liabilities】		
(1) Cash revenue	3,656	9,100	(1) Municipal bonds		
(2) Unsettled municipal tax	24,725	25,452	Municipal bonds to procure public property	654,033	711,166
(3) Reserve for unpaid municipal tax deficits	▲12,362	▲12,726	Ⓐ Living (roads, parks, housing, etc.)	354,964	396,091
(4) Public property			Ⓑ Environment, Sanitation	60,120	66,417
Ⓐ Living (roads, parks, housing, etc.)	1,804,453	1,909,386	Ⓒ Health, Welfare	15,928	16,300
Ⓑ Environment, Sanitation	119,287	128,612	Ⓓ Education, Culture	188,236	197,197
Ⓒ Health, Welfare	63,341	72,339	Ⓔ Industry	13,384	13,764
Ⓓ Education, Culture	634,130	655,763	Ⓚ Disaster prevention	6,974	6,920
Ⓔ Industry	29,865	30,724	Ⓛ Community	14,427	14,477
Ⓚ Disaster prevention	32,659	33,254	Other municipal bonds	204,047	225,134
Ⓛ Community	163,019	167,539	Ⓐ Equity bonds	85,278	92,917
Total public property	2,846,754	2,997,617	Ⓑ Reserved bonds for tax reduction and revenue loss	118,769	132,217
Non-depreciable assets (inclusive)	1,037,254	1,105,768	Total municipal bonds	858,080	936,300
Depreciable assets (inclusive)	1,809,539	1,891,849	Bonds to be depreciated next fiscal year (inclusive)	40,258	45,147
Purchase price	2,533,925	2,685,964	(2) Reserve for retirement allowance	84,330	87,204
Accumulated depreciation	▲724,386	▲794,115	Payment to be made next fiscal year (inclusive)	8,400	10,312
(5) Investments	143,682	154,699	Total liabilities	942,410	1,023,504
(6) Loans	22,240	22,196			
(7) Funds			【Net property】		
Financial adjustment fund	8,796	7,082	(1) Resource fund to procure public property		
Reserved fund for devalued bonds	33,687	35,365	Ⓐ General resource fund	1,331,956	1,379,115
Fund for special purposes	36,043	34,268	Ⓑ Subsidy, national or prefectural	556,947	587,910
Land development fund	67,121	67,789	Ⓒ Allotments, Charges	27,651	27,831
Total funds	145,647	144,504	(2) Other net properties	315,370	322,482
Total assets	3,174,342	3,340,842	Total net property	2,231,932	2,317,338
			Total liabilities and net property	3,174,342	3,340,842

Chart 3 [General Administrative Performance Cost]

Sapporo City (Unit: Million yen)

Item	1997	1998
Special and general resource funds for general administrative performance		
Municipal tax (inclusive of those unpaid)	300,556	289,493
Local grants	31,015	42,874
Local allocation tax	123,502	124,593
Subsidy, national or prefectural	80,312	88,916
Fees, Commissions	18,722	17,438
Allotment, Charge, Contribution	4,745	5,010
Other revenues	22,809	19,526
Total special and general resource funds for general administrative performance	581,661	587,850
General administrative performance cost		
Living (roads, parks, housing, etc.)	137,913	141,942
Environment, Sanitation	55,600	55,880
Health, Welfare	180,022	191,537
Education, Culture	84,991	81,183
Industry	8,492	8,794
Disaster prevention	22,233	22,099
Community	52,249	52,190
Total general administrative costs	541,500	553,625
Amount contributed to increase of net property	40,161	34,225

Chart 4 [Shift in Net Property - Breakdown]

Sapporo City (Unit: Million yen)

Item	1997	1998
Beginning balance	2,144,045	2,231,932
Contributory amount to general administrative costs	40,161	34,225
Subsidy for construction investment, national or prefectural	47,726	51,181
Ending balance	2,231,932	2,317,338

Sapporo City has made their balance sheet (Chart 2) and general administrative costs (Chart 3) public. They have also provided details of shift in net property breakdown (Chart 4). We can also see balance sheet and general administrative cost linkage through monetary figures on net property. They have also prepared a cash flow statement. This was intended to coordinate accrued general administrative performance cost and cash balance, and the statement provides, in substance, a supplement to both balance sheet and general administrative performance cost.

Basic principles governing these statements provided by Sapporo City include historical cost, accrual, and constructive depreciation of net property. This approach does not necessarily agree with other local government approaches, but still depends generally on basic principles used by Amagasaki City, Hyogo Prefecture and Usuki City, Oita Prefecture. As described below, basic principles (constructive depreciation of net property concept) used in the Usuki City method, have recently been introduced by many local governments. Significantly, following the lead of the Usuki method, Sapporo completed its final accounts using corporate accounting. We should especially note the technique of, within the net property column, applying constructive depreciation to the resource fund to procure public property, because, as a general accounting principle, this tech-

nique will surely become a de facto standard. In March 2000, Fukuoka City also completed its balance sheet for ordinary accounting, applying constructive depreciation to net property. Furthermore, we see the same scheme with Zentsuji City, Kagawa Prefecture, Takarazuka City, Hyogo Prefecture, and Hobetsu Town, Hokkaido.

The Sapporo balance sheet has several characteristics. Its balance sheet explains seven purposes for public property and for the municipal bonds to procure public property. To assure positive disclosure of information to citizens on municipal bonds, (in a context where local government might not want the information made public) they published information on reserved bonds for revenue loss or for tax deduction, deficit local bonds, under a separate title. The Sapporo government dared use the definition “capacity of providing future services” in a balance sheet footnote to explain the meaning of assets. All these disclosure aspects are worth special mention, compared with cases heretofore made public.

In general administrative performance cost, as with public property and municipal bonds for procuring public property, costs are divided into seven categories from living items through to community items. The Usuki City accounting scheme touched off this categorizing by purpose group. To enable Sapporo citizens to be actively involved in administrative activities, purposes for which taxes and other revenues are appropriated (expenditure) must be disclosed and, in this context, disclosing information by purpose will contribute to citizen’s benefit. Unlike private corporations, local governments are not supposed to earn incomes such as sales revenue. All municipal taxes, local allocation taxes, and subsidies, national or prefectural, are usually recognized as resource funds for providing public services. As such, reviewing resource funds is very important and, with Sapporo, too, general performance cost would further improve by indicating, in the revenue column, the seven purposes. Appropriating, in the revenue column, the specific resource fund for seven purposes and the general resource fund for the eighth, under a separate title, permits checking the fund/cost ratio. This kind of analysis will allow people, for evaluation, to use components other than mere monetary amounts and, for example, an appropriation rate of specific programs accounting for the total general resource fund will permit reviewing administration quality (or policy orientation). With local government disclosing financial information, nothing is more important than a cautious assortment of user-oriented information as referred to above. This, in turn, suggests that any local government should be sensible enough to respond to the need to disclose such information.

3. Balance Sheet Per Capita - A Device for Drawing Interest -

The Sapporo City approach is attractive enough to encourage new ideas about disclosure to its residents. This is especially true concerning balance sheet per citizen as disclosed in Chart 5, which will greatly encourage citizens to take an interest in accounts. While Chart 5 figures are derived by simply dividing overall balance sheet figures in Chart 2 by total number of citizens, such an approach as adding such a device on disclosing final accounts under corporate accounting is very attractive.

Final accounts under corporate accounting need to draw interest of as many citizens as possible, including laymen involved with business accounting. When local governments prepare balance sheets and other financial statements, they must be careful not to use difficult terminology, and to make such statements as visual as possible, so they are easy for citizens to read. This Sapporo City approach makes the government more aware of objectives and outcomes when they prepare a balance sheet and general administrative performance cost (which take considerable time and labor) and makes the government strongly conscious of being considerate to residents, or users of final accounts. In conclusion, many local governments should be encouraged to be interested in preparing their financial accounts now more than ever, also because the need to enhance listening to public opinion and for public relations.

Chart 5 [Balance Sheet Per Citizen]

(Unit: yen)

Item	1997	1998	Item	1997	1998
【Assets】			【Liabilities】		
(1) Cash revenue	2,051	5,078	(1) Municipal bonds	0	0
(2) Unsettled municipal tax	13,869	14,202	Municipal bonds to procure public property	366,863	396,819
(3) Reserve for unpaid municipal tax deficits	▲6,934	▲7,101	①Living (roads, parks, housing, etc.)	199,108	221,012
(4) Public property	0	0	②Environment, Sanitation	33,723	37,060
①Living (roads, parks, housing, etc.)	1,012,163	1,065,406	③Health, Welfare	8,934	9,095
②Environment, Sanitation	66,911	71,763	④Education, Culture	105,586	110,033
③Health, Welfare	35,530	40,364	⑤Industry	7,507	7,680
④Education, Culture	355,699	365,905	⑥Disaster prevention	3,912	3,861
⑤Industry	16,752	17,143	⑦Community	8,092	8,078
⑥Disaster prevention	18,319	18,555	Other municipal bonds	114,455	125,621
⑦Community	91,441	93,484	⑧Equity bonds	47,835	51,846
Total public property	1,596,815	1,672,621	⑨Reserved bonds for tax reduction and revenue loss	66,620	73,775
Non-depreciable assets (inclusive)	581,800	617,001	Total municipal bonds	481,318	522,440
Depreciable assets (inclusive)	1,015,085	1,055,621	Bonds to be depreciated next fiscal year (inclusive)	22,582	25,191
Purchase price	1,421,342	1,498,724	(2) Reserve for retirement allowance	47,303	48,658
Accumulated depreciation	▲406,326	▲443,103	Payment to be made next fiscal year (inclusive)	4,712	5,754
(5) Investments	80,595	86,319	Total liabilities	528,621	571,099
(6) Loans	12,475	12,385	【Net property】		
(7) Funds	0	0	(1) Resource fund to procure public property	1,075,043	1,113,097
Financial adjustment fund	4,934	3,952	①General resource fund	747,127	769,524
Reserved fund for devalued bonds	18,896	19,733	②Subsidies, national or prefectural	312,405	328,044
Fund for special purposes	20,217	19,121	③Allotments, Charges	15,510	15,529
Land development fund	37,650	37,825	(2) Other net properties	176,903	179,940
Total funds	81,697	80,631	Total net property	1,251,946	1,293,037
Total assets	1,780,567	1,864,135	Total liabilities and net property	1,780,567	1,864,135

III. Entry of Usuki City Service Provision Account

1. Great Reforms in a Small Municipality

In January 1997, Usuki City, Oita Prefecture, with a population of only 36,000, elected its new mayor, Kunitoshi Goto. Mayor Goto set up a “Department to Promote our Municipal Government to the Top in Japan,” so that municipal staff members can have a chance to launch self directed reform of its administrative and financial systems; later in April 1998, and on his own initiative, the mayor established a “Balance Sheet Section”. Mayor Goto, formerly a private corporation owner-manager, noticed that not having a local government balance sheet showing shifts in assets and liabilities had hindered taking practical measures for financial restructuring and, as such, he decided to introduce such a balance sheet, intending to get clues on administrative and financial operations from disclosing difficult financial conditions to residents.

The mayor announced the Usuki City balance sheet at the general assembly in December 1998. The response was sensational and, Usuki City has become a mecca, getting many administrative missions from other local governments. In the summer of 1999, the balance sheet was put on the air by TV Asahi and NHK (Nihon Hoso Kyokai) on their nationwide programs. At an earlier stage, some bigger local governments watched calmly,

coolly considering this as simply applicable to small local government. Later, however, having listened to powerful voices in their assemblies and residents claiming their own government should be able to make such a balance sheet - all the more because it was a big self-government, they are now preparing to make their own full balance sheets. During the general assembly in December 1999, the Usuki City mayor explained the service provision account before assembly members, using a title they had never heard before: What is the service provision account all about?

2. Logic in Preparing a Balance Sheet - a Service Provision Account Image

Where a local government makes its own balance sheet, accounting specialists, especially CPAs are inclined to fall into a certain pitfall: they consider local government revenue, such as local taxes or local allocation taxes, as corresponding to private enterprise income. Such an understanding of local government revenue may be useful for the government to prepare its final accounts by accrual. However, we must remember that once you view local taxes or local grants as income, you can run the risk of losing potential corporate accounting advantages.

Although statements such as “the local government accounting objective is not calculating profit” are usually referred to as a matter of course, the kind of accounting reflected in this statement is limited. Local government mission is to better use local taxes to get maximum benefits for residents. A local government is supposed to provide its property and services to promote residents’ benefits. Consequently, it is critically important that we consider revenues, such as local taxes or local allocation taxes, as resource funds (finances). A survey of local governments’ financial conditions clearly supports this view. For example, the most important thing in such a survey is the “Breakdown of Expenditure and Resource Fund” table, an exact diagram showing expenditure-resource fund relationship, not expenditure-revenue relationship, a characteristic local governments should not ignore in their accounting. In other words, local governments must review expenditure as a method of procuring funds for administrative performance, meaning that it is really a financing means.

Viewing expenditure this way, the next question is what local government income corresponds to private enterprise sales. The answer is simple. I have had many chances to be involved in some local government in-service training on requested themes; the most popular is administrative cost-benefit analysis. This suggests that, for a local government, the most important formula relates to spending, how much improvement in community benefit has been achieved, and, if so, income (or result, to be more precise) - corresponding to enterprise sales - is outcome for residents.

Chart 6 Local Government Benefit Formula

$$\text{Outcome} - \text{Burden (Resource Fund} = \text{Administrative Cost)} = \text{Local Government Income}$$

Local government final accounts should be prepared in a way indicated by the resultant formula in Chart 6. Here, available tools are project evaluation for community benefits and accounting for corporate administrative costs. In deducting administrative cost, stated in figures, from benefit (outcome) not necessarily so valued, we should use residents’ participation as an “on-the-table” tool. Some more advanced local governments are trying to link their project evaluation with accurate cost calculations under corporate accounting. Remember, such an attitude toward objectives is in the background.

3. How to Indicate Administrative Costs

Chart 7 Providing-Service-Account Image (ordinary accounting)

Providing service cost	Resource funds for providing service
Living Environment Welfare Education Industry General affairs Reserve allocation - Construction account Reserve allocation - Investment account	Local tax Local allocation tax Other general resource funds as revenue Specific resource fund (ordinary accounting) Carried-back general resource fund for providing social capital Carried-back subsidy, national or prefectural
Current term surplus	

The ultimate local government objective is to maximize its residents' satisfaction in a way based on tax levied and public concern. We must have a dual image of residents: one as beneficiaries and the other as taxpayers. When you calculate administrative costs spend on providing public properties or services, it should be done accurately. To further provide residents in this dual position of beneficiary and taxpayer, accurate information, in a true sense, about administrative costs, you should also disclose resource funds spent for such provisions. It follows that local government final accounts on administrative costs must contain a relational equation of "administrative costs = corresponding resource funds".

Suppose we introduce the approach with accrual into local government accounting and management. We still have an unresolved problem. That is how to explain a resultant formula for local government such as that in Chart 6 solely by accounting tools. The accounting method would provide accurate information about local government administrative costs and assets and liabilities, according to its balance sheet and cost calculation sheet, but no more. This is not an issue of accounting limitation, but should be viewed as a constraint in that such a formula has elements not necessarily susceptible to monetary evaluation.

In this way, we can see that the Usuki City providing-service-account serves to check and report accurate cost information for each project in final accounts. The overall Usuki City providing-service-account shown by private enterprise accounting methods, would form a compound image of a manufacturing and an ordinary profit-and-loss account.

Chart 7 explains the cost and resource fund of an administrative service provision in ordinary accounting; thus no specific resource fund (including local bonds) for construction or investment accounts is entered in the resource fund for providing ordinary services. On the other hand, the general resource fund and public monies (subsidies), national and prefectural, appropriated to provide social capital (i.e. infrastructure assets, except land and non-infrastructure assets), are indicated as carried-back general resource fund for providing social capital or as carried-back subsidy, national and prefectural; thus, not offsetting the constructive value of the depreciable portion with the appropriate amount of depreciation. Under a service provision account, both costs (amount of depreciation) and resource funds (carried-back general resource fund for providing social capital

and carried-back subsidy, national and prefectural) are set down side by side so we can cross-reference them to each other on ordinary services.

A question here is how to treat a portion of the resource fund for providing social capital to which a local bond has been appropriated. For the portion appropriated for a local bond, depreciation cost would be entered as a service-providing-cost for each item (e.g. living or environment) classified by a purpose group through depreciation. However, the resource fund corresponding to that portion, unlike general resource fund or subsidy, national or prefectural appropriation, does not provide for including the carried-back amount. While the general resource fund for providing social capital and the subsidy, national or prefectural, have a capital or net property character, a local bond is obviously a liability and, therefore, not susceptible to carried-back treatment. Here breakdown by double-entry bookkeeping is as follows:

[debtor] cash 1000	/	[creditor] local tax 1000
[debtor] local bond 100	/	[creditor] cash 100

The above is a hypothetical journalizing example where a local government with a 100 billion yen revenue from local tax redeemed 10 billion yen, for which the due date was reached, from part of a local bond that had been issued to procure a resource fund for providing social capital. Mutual offsetting of cash accounts, under debtor or creditor, as shown in the column, leaves “[debtor] local bond 100 / [creditor] local tax 100.” An important point to note is that this remaining account of “[creditor] local tax 100” may be seen as a resource fund for depreciating the portion of which a resource fund from a local bond has been appropriated. In line with this approach, the image in Chart 8 demonstrates underlying recognition of the resource fund corresponding to the depreciation amount (i.e, service cost) in social capital. When we have a discrepancy (as in most cases) between life of depreciable assets and local bond redemption period, the relation between service cost and the resource fund could create a subtle difference affecting the current surplus amount. This problem can be corrected either through the view that life of depreciation assets and local bond redemption period should be harmonized, or by a policy that the current surplus difference shall be left as it is for the time being, since current surplus would be offset finally at the local bond redemption stage and canceling or writing-off social capital.

Also, remember that ordinary service provisions are not the only administrative services a local government covers. For example, providing a low-interest loan service for supporting small and medium sized enterprises, wherein a straight loan of principal is made to local enterprises with virtually no room for bearing ordinary expenditure (except personnel expenses). How should we evaluate administrative service cost here? The approach used in the Mie Prefecture profit-loss statement, which handles opportunity cost accompanied by low-interest loan as a service provision cost, must also apply here. Despite the small amount of such opportunity cost, it may appear to be the most effective service for a small and medium sized enterprises, as long as they get a big loan. An issue may come up that, as a service cost, allocating only an opportunity cost may not be enough. Handling the providing-service-account would confront us with various issues involved.

4. Analyzing by Numerical Examples

Let us confirm by simple numerical examples, contents we have just considered. Say that on January 1, 2001, a local government established non-infrastructure assets of 9 billion yen, comprising 4 billion yen of general resource funds, 3 billion yen of local bonds, and 2 billion yen of subsidies, national and prefectural (for simplicity here, land acquisition cost is entered as zero). Let us assume that the local bond is redeemable annually in an equal amount, with a six year redemption period (here, the bond is assumed to accrue no interest) and that, for depreciation purposes, non-infrastructure asset life is 10 years, with no residual amount. Assume further that the local government is supposed to get annually no other revenues than the 1.5 billion yen local tax

revenue. Based on these assumptions, breakdown of accounts as of December 31, 2001 would be as follows:

[debtor] cash	15	[creditor] local tax	15
local bonds	5	cash	5
depreciation	9	accumulated depreciation	9
general resource fund for providing social capital	4	carried-back general resource fund for providing social capital	4
subsidies, national and prefectural	2	carried-back subsidies, national and prefectural	2

Chart 8 Usuki City Final Accounts Method Image

Chart 8 illustrates shift of final accounts where transactions occur continually, showing that, after redeeming local bonds (6 years later), when non-infrastructure property life (10 years) has passed, the balance sheet will still have a 12 billion yen debit and a 12 billion yen carried-forward surplus credit. We can confirm that, at the time, the accumulated carried-forward surplus (1.2 billion yen × 10 years) as calculated from the annual profit-loss statement does not agree with the 12 billion yen carried-forth surplus shown in the balance sheet credit column. According to the cash flow calculation for the 10 year period, local tax revenues would total 15 billion yen, of which 3 billion yen would be appropriated for redemption, leaving, after 10 years, 12 billion yen cash inflow; matching the balance sheet 12 billion yen cash shown in the balance sheet debit column. As such, Usuki City logic in preparing their balance sheet is consistent with preparing profit-loss or cash flow statements.

In local government accounting, you would think we would consider a new accounting system where we consider revenue not as income but as resource funds to meet expenditure costs. If so, the general resource fund appropriated for providing social capital would not be added to the equity (net property) balance sheet column, because the amount appropriated would be subject to annual partial redemption under constructive redemption. Rather, we can enter the general resource fund appropriated as resource fund reserved for future administrative services cost (depreciation) as long-term advanced payment received or, alternatively, in long-term deposit received. (Note that if handled otherwise as long-term advanced income received, it would have to link revenue only with income.) We can handle national and prefectural subsidies the same way. While a local bond may be somewhat complex to handle, it can be understood as general resource fund carried-back amounts for providing social capital, prefectural subsidy, and national subsidy, all of which comprise ultimate resources derived from residents' tax payments as citizens of Usuki City, Oita Prefecture, and Japan, used for providing social capital service. Viewed in that light, the Usuki City approach devised in preparing its balance sheet and providing-service-account may deserve further attention as a tool for providing useful information. Viewing local government as a service industry, various methods have been developed for administrative and financial reform, yet we cannot ignore particular local government characteristics which differ from those of a private enterprise. Thus, the approach to balance sheet and providing-service-account taken by Usuki City suggests a very promising vision in searching for a desirable local government accounting system.

5. Usuki City Providing-Service-Account and Breakdown

Based on the above described logic, the providing-service-account and its breakdown were prepared and announced at the general assembly in December 1999 (See Charts 9 and 10). Note, also, that the service-providing-account image and logic are similar enough to remind us of the Sapporo City general administrative performance cost. The Usuki statements differ from the Sapporo cost table in that the first identifies the amount of appropriation from ordinary account to a construction or an investment account and specifies the resource fund, dividing it into a general resource fund and specific consumptive expenditure resource fund. Clearly, general administrative performance costs and service-providing-account do not have the same purposes. Hence, comparing them to regard the Usuki City service-providing-account as better simply because it provides information does not make sense. The important thing is to see how calculation sheets achieve their original purposes to help contribute to establishing a resident-local government collaborative social system.

Considering these points as utmost important, Usuki City made a table titled Service-Providing-Account Breakdown (Chart 10). Besides Living, this table covers another five administrative purposes. In the table, cost of each project implemented by the government in living, environment, welfare, education, agriculture, and general affairs is shown by group next to corresponding resource fund. Note in particular that cost factors introduced, such as depreciation, are based on the accrual approach and personnel expenses include personnel-related costs such as retirement allowance reserve, which can be calculated based on the same approach. This warrants our attention at a new scheme with interests on public bonds consciously arranged so they show linkages with projects involved.

In this way, Usuki City has used accrual to calculate costs at specific project level. Moreover, they apply this relational reference under the accrual approach to costs and to applicable resource funds. Clarifying the real amount (reached by accrual not based on cash) spent on providing administrative services by Usuki City, and disclosing positively to residents how resource funds have been procured, they are establishing an administrative system supporting financial restructuring and resident participation. If Usuki City can incorporate such administrative service outcomes as assessed by project evaluation into this service-providing-account, this would mean, as mentioned in Chart 1, that Usuki City will be the first local government fully endowed with information infrastructures essential to community planning through public and private sector collaboration.

Chart 9 Usuki City Service Providing Account Statement (1998)

(Unit: 1,000 yen)

Expenditures		Amount	Revenue		Amount
Living		2,334,072			
Personnel expenses		686,436	Local taxes		3,534,616
Property costs		62,553			
Maintenance and repair costs		66,027	Local tax grant		132,257
Grant-in-aid		38,458			
Reserve allocation		520,000	Local allocation taxes		4,695,915
Disaster restoration reserve		263,944			
Interest on public bonds		219,901			
Depreciation		476,753			
Environment		962,742			
Personnel expenses		321,601	Distribution of local allocation tax		33,878
Property costs		355,149			
Maintenance and repair costs		12,687	Local consumption tax grants		349,728
Allowance-in-aid		29,632			
Grant-in-aid		50,494	Others		120,049
Reserve allocation		1,697			
Interest on public bonds		58,002			
Depreciation		133,480			
Welfare		3,061,945			
Personnel expenses		366,977	Total general resource funds		8,866,443
Property costs		341,991			
Allowance-in-aid		1,597,409	Subsidies, national and prefectural		1,690,842
Grant-in-aid		153,321			
Reserve allocation		565,731	Carried-back subsidies, national and prefectural		298,467
Interest on public bonds		15,002			
Depreciation		21,514	Fees and Commissions		164,897
Education		1,518,236	Alotment, Charges and Contributions		369,747
Personnel expenses		694,062			
Property costs		351,985	Carried-back allotments, charges and contributions		45,670
Maintenance and repair costs		11,842			
Allowance-in-aid		13,882	Carried-back general resource fund for providing social capital		397,863
Grant-in-aid		60,240			
Disaster restoration reserve		4,878	Others		247,226
Interest on public bonds		147,589			
Depreciation		233,758			
Industry		850,272	Total specific resource funds		3,214,712
Personnel expenses		271,771			
Property costs		46,717			
Maintenance and repair costs		3,222			
Grant-in-aid		181,398			
Reserve allocation		16,637			
Disaster restoration reserve		31,518			
Interest on public bonds		48,969			
Depreciation		250,040			
General affairs		1,856,668			
Personnel expenses		1,144,742			
Property costs		380,471			
Maintenance and repair costs		1,649			
Grant-in-aid		139,233			
Reserve allocation		0			
Interest on public bonds		73,312			
Depreciation		101,703			
Reserve for unpaid tax deficit		15,558			
Subtotal		10,583,935			
Allocation for construction account		563,407			
Allocation for investment account		251,095			
Ordinary surplus		682,718			
Total		12,081,155	Total		12,081,155

Chart 10 "1998 Usuki City Service Providing Account Breakdown Statement (Living)"

Classification	Project	Personnel expenses	Property costs	Maintenance and repair costs	Grant-in-aid	Reserve allocation	Disaster restoration reserve	Interest on public bonds	Depreciation	Total	Subsidy, national and prefectural	Others	General resource funds
Living	Civil engineering - general affairs	78,957	24		658					79,639			79,639
	Roads and bridges - construction and improvement	34,111	7,104	60,340	2,087			89,270	266,187	459,099	665	3,200	455,234
	Eastern Kyushu Highway Construction Promotion Project	18,948	13,261		300					32,509	240		32,269
	River improvement, Sand protection		79		2,039			9,221		11,339			11,339
	Harbor construction		166		1,668			25,647		27,481			27,481
	City planning - general affairs	88,794	526		255	520,000				609,575	155		609,420
	Street maintenance		7,624		40			13,574		21,238			21,238
	Public sewerage facilities		72	162	9			58		301			301
	Parks		10,997		17			33,196	38,358	81,668		26	81,642
	Housing maintenance		3,830	5,525	674			32,373	43,536	85,938	6,174	16,452	63,312
	Fire defense	465,626	17,240		28,582				1,429	512,877		18,217	494,660
	Fire facilities, Flood control		645		1,509			4,320	6,955	13,429			13,429
	Disaster prevention		1,885		620					2,505		900	1,605
	Public works for disaster restoration						263,944			276,186	173,860		102,326
	Others								120,288	120,288			120,288
	Subtotal	686,436	62,553	66,027	38,458	520,000	263,944	219,901	476,753	2,334,072	181,094	38,795	2,114,183

IV. Local Governments Pursuing Collaboration with Residents

As we have seen in this paper, neither of the approaches taken by Sapporo and Usuki Cities are designed to respond to the prevailing boom, by simply providing a balance sheet through introducing corporate accounting. With a definite sense of purpose and careful logic, these two governments are actively pursuing establishing collaborative decision-making where residents and the local government are jointly involved in, and responsible for, decision-making.

The important point for such collaboration is to permit promoting planning toward the 21st century and establish an information infrastructure that can provide them with a common basis for discussion. A not-for-profit local government introducing resultant formula such as in Chart 6 in place of the balance sheet would be a critical posture. If we grasp the two items of resident satisfaction through project evaluation and their monetary burden through corporate accounting, and if we want to calculate the difference between them seen as local government profit, we need to devise a tool to link these two items. The effort begins with strengthening awareness by residents and local government staff and, technically, through associating two evaluation methods by a budget making and final accounting system adopted project-by-project.

Sapporo City's success in devising a tool useful especially for promoting resident awareness has already resulted in disclosing a balance sheet related to each citizen. For Usuki City, input from its resource fund can be identified project-by-project and introducing project evaluation, which has already been used by many local governments, would enable them to establish a total administrative evaluation system based on logic described in Chart 1.

One point often raised in administrative and financial reform is a concern that these evaluation tools tend to become tenacious for their own sake, but like Sapporo or Usuki City, any local government with a definite sense of purpose will be least likely to fail in reforming its own. Of course, many local residents are looking for success in reforming their own local governments and financial situations. In the future, such reform should be made as part of the collaborative system involving local government staff members and residents. This is why, in Japan, we should look for other local governments to follow the challenges Sapporo and Usuki Cities have assumed.

[Footnote]: For details of cases introducing corporate accounting and accrual accounting by Mie Prefecture, Amagasaki City, Usuki City, etc., as mentioned above, see ISHIHARA, Toshihiko, "Chiho-jichitai no Jigyohyoka to Hasseishugi-kaikei - Gyosei-hyoka no Shinchoryu - " (Project Evaluation and Accrual Accounting of Local Governments - A New Trend in Administrative Evaluation) Chapters 4-7, Chuo Keizai Sha, November 1999.