International Consortium on Governmental Financial Management

“Working globally with governments, organizations, and individuals, the International Consortium on Governmental Financial Management is dedicated to improving financial management so that governments may better serve their citizens.”

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Foreword

Public financial management reform appears to be entering a new stage. The experience of the last decade with mega-reforms such as Integrated Financial Management Information Systems, Medium Term Expenditure Frameworks and the adoption of accrual accounting has shown that the promise of such reforms is not necessarily being delivered. This was at least the personal view of Bill Dorotinsky which he shared at the ICGFM DC Forum in June. Most of this talk is readily available on the newly launched ICGFM BlogSpot - http://icgfm.blogspot.com

We hope that this issue of the Journal will continue the debate over public financial management reform. We need to identify those reforms that are actually working and delivering sustained benefits and so should be considered by colleagues in other countries.

The first two contributions to this issue are both concerned with budgeting and are provided by authors who are based in West Africa. Joseph Mensah and Samuel Nana Yaw Simpson consider the different academic disciplines which have influenced government budgeting and argue for a more active contribution from the accounting profession. Femi Aborisade takes a more practical and critical view of budgeting. Femi assesses the extent to which budgeting, as financial planning, enables the Nigerian Government to use progressive taxation to achieve poverty reduction by providing basic services to all of its citizens.

The third and fourth contributions both consider recent developments with standards for annual reporting by governments. Specifically, they review the requirements of the International Public Sector Accounting Standards and the IMF’s Government Financial System for statistical reporting. Pawan Adhikari and Frode Mellemvik take a more general view of these developments, whilst Necdet Saglam relates them to the specific case of Turkey.

Norvald Monsen provided an introduction to cameral accounting in our last issue and complements this with a more detailed study and exposition of administrative cameralistics. This accounting system was specifically designed to be used by government organisations in contrast to the private sector approach of accrual accounting. However, Hassan Ouda, a regular contributor to this journal, is an ardent supporter of accrual accounting for the public sector. In his current paper he develops a generic model of government sector reform (including accrual accounting) as comprehensively implemented by New Zealand. This model of New Public Financial Management has been adopted, at least partially, by a number of other countries. However, given the loss of faith in the unseen hand of the market resulting from the fall-out of the credit crunch and the recent global economic slow down, the critiques of this approach are gaining in confidence. Andy Wynne reviews some of the evidence for the actual achievements of accrual
accounting in those few countries which have implemented this approach to government financial reporting.

In contrast to our normal, more academic contributions, Frank Knight provides a short, but practical introduction to developing audit findings in the public sector. We would encourage other potential contributors to the Journal to follow Frank’s example. We would like to hear from your successes. These do not have to be described in long, academically rigorous articles! Daniel Edelman, Virginia Fullwood, Gordon Heslop and Tim Wilson follow the same approach by briefly considering the challenges and implications of public sector investigations into alleged misdemeanours.

George F. Summers and Thomas R. Noland provide an introduction to the municipal bond market in the US, showing that the credit crunch has not devastated all forms of credit and that many governments will continue to borrow to provide essential infrastructure for their jurisdictions.

Finally, in another departure from past practice, we provide a summary of the winter 2007 ICGFM Conference on the Use of Financial Management Information Systems to Improve Financial Management and Accountability in the Public Sector.

As always, we invite your comments on these papers and the topics covered in any prior issues of the Journal – these are available from the ICGFM website at www.icgfm.org. Please contact the editor - andywynne@lineone.net - if you would like to contribute an article, or discuss any issue which you believe we should consider. Alternatively, feel free to contact us by telephone, facsimile, or email - icgfm@icgfm.org

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The Accounting Discipline and the Government Budgeting Concept

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Abstract

The government budget has been influenced by different disciplines with different emphases. This paper discusses some disciplines which through time have influenced the budgeting concept – political science, economics, public administration and accounting – stressing that government accounting, and its research, which earlier has been almost ignored, especially in developing countries, should be revisited. This can engender positive developments; the adoption of sound accounting practices in budgeting and public finance, engagement of skilled accounting personnel and can limit considerably the misapplication and misuse of budgetary resources that have characterised public institutions especially in developing countries, and ensure better budgetary outcomes.

Introduction

Government budgeting has been a complex field of study, cutting across many disciplines. Rubin (1988) sees it as multidisciplinary, having been influenced by many disciplines, while to Schick (1988), it is social science in nature, qualifying as a subset of disciplines like public administration, political science, economics, sociology, psychology and anthropology, with each having some influence on the concept. The government budget is therefore an economic and financial policy statement resulting from the interplay of economists, politicians, bureaucrats or public administrators, accountants, statisticians, and other social scientists.

Rubin (1988) observes a problem here with this multidisciplinary feature:

“Different parts of the budget seem to have very different characteristics, and that a theory that describes one part of the budget often fails to describe other parts…”

The varying disciplinary influences on the concept meant that they all approached it “…with their own theoretical apparatus and methodology, creating multidisciplinary rather than interdisciplinary studies”. (p. 2)
This paper examines the disciplines of political science, economics, public administration and accounting and their association with government budgeting. The next section discusses these disciplines, followed by a discussion of the UN/international position on accounting and government budgeting. Cases from Ghana are then presented, with some concluding comments and suggestions.

Disciplines Associated With Government Budgeting

The Historical Disciplines
Rubin (1988) argues that budget has been significantly influenced by several disciplines, especially political science, public administration, and economics over the years.

Political science stands tall in the history of budgeting. Its contribution has been significant; hence, the study of budgeting is at times seen as the study of politics, or a subset of the study of legislative behaviour (Rubin, 1988; Wildavsky, 1964).

In the politics of ancient England, the budget was seen as the purse of the King, a notion reformed over time through constitutional revolution (Schiavo-Campo, 2007). Jones and Pendlebury (1988) mention that historically, the concept came into being because parliament wanted a means to control central government activities. Politically again, the budget was seen as the tax proposals of the government, linking it with taxation rather than planned government or other public expenditure.

To Rubin (1988), the budget has been seen as an instrument of political power and control over policy (i.e. as a tool of executive control). Ruling political parties have often considered it as the key political document through which their party policies, manifestos and promises are carried out. Political support has been achieved and strengthened when the budget is used for sector development to reward certain groups of the electorate or to give a share of resources for development to reward party affiliates – companies, pressure groups and influential individuals – who mattered and continue to matter in the party’s organization and financing. Brown and Jackson (1990) mention that politicians are often interested in granting a budget that will maximize the quantity of output supplied for a given level of quality of service, and that in a vote-maximising model of the world, this will help to secure re-election.

Caiden and Wildavsky (1974) hold the view that politicians play down strict economic considerations in planning or budgeting, giving prominence to issues in either the plan or budget that will reward supporters, allay regional animosities and even keep prices artificially low to ward off discontent.
Political science, therefore, has had considerable influence on the budget, contributing to the shaping of its literature and practice through political scientists in both the academia and practice.

Public Administration has similarly influenced the budgeting concept. This concerns the execution of public services, relating to the activities and responsibilities of the government ministries, departments and agencies (MDAs) concerned with carrying out the various services of government. Thus, this discipline’s influence is clear since it is concerned with the execution and implementation of government activities.

According to the OECD: “budgeting is also a process which governs the behaviour of public servants in actually managing and delivering assistance and services to the public, and in the subsequent accounting for public money used and results achieved” (OECD, 1987:10). Since the budget is expected to govern their actions, it can be argued that they can reciprocally influence its preparation and content.

The discipline sets out the administrative principles which the bureaucrats are to follow in rendering policy advice to the top executives and ministers of the ruling government, policies all of which have budgetary implications. Hall et al., (1975:69) for instance think that since ideas arise, are developed and are stored within ministries, where public administrators are key players, there is the possibility that “civil servants heavily influence their Ministers”. They emphasise the influence of public administration in Britain by postulating that

“The upper reaches of the main government departments contain many of the most influential policy-makers in British political life” and that… “it is in the departments that a policy acquires its ultimate form or the seal of its rejection” (Hall et al., 1975:58).

Wilding’s (1980) position strengthens the policy advisory role of the bureaucrat, making the inference that the public administrator cannot be bypassed by politicians in any policy decision making. Hence public administration influences ultimately the form and content of government policy identification, formulation and implementation, all aiming at ensuring that government resources are well used.

A discipline that is close to public administration is public finance, which is concerned with a nation’s revenue mobilisation and utilisation. Donaldson (2006) discusses the new public finance concept and how as an analytical discipline, has gone through “two far-reaching reforms over the past two decades”. He discusses these two reforms; first, “the evolution of public-private partnerships and the pursuit of public policy purposes through the regulation and mobilisation of private sector activity and co-operation with civil society organisations”, and second “the growing role of international co-operation in public affairs” (p126). By implication, such public-private relationship and international cooperation can relieve government budget of some activities and resulting financial
commitments. Donaldson urges, among others, that budget institutions should be streamlined to ensure that they are effective in their service delivery.

**Economics** as a discipline similarly has had significant influence on government budget, which influence can be seen from two main views: the Keynesian view and the Neo-liberal (monetarist) view.

The Keynesian view, concerned with full employment in the economy, sees the state as having the responsibilities of:

- providing affordable services to the working class and poor
- re-distributing wealth and income through taxation and social benefit payments
- regulating economic activity to protect workers and the environment.

The government, therefore, is expected to use the budget to resolve these responsibilities.

The responsibilities of the state under this Keynesian view, is an expansion of the basics of economics which is explained as the study of the relationship between unlimited wants (of individuals, society) and scarce resources which have alternative uses.

Wildavsky (1975:3) humorously justifies this economics stance thus:

> “Behind currencies stand human limitations; unless one lives on an everlasting lake of oil or possesses an alchemist’s stone for turning base metals into gold, resources are limited. But human desires are not. Hence some way must be found to appropriate available funds among competing people and purposes … Invariably there are more wants than money. Given the infinite variety of human desires, the budget of collectivity (like government) can never be just one thing but must be many”.

Since the government acts in taking care of the unlimited communal needs of society, but with limited resources, the government has an economic function to perform – how to allocate the scarce means to satisfy the many wants.

The Keynesian economists argue that the budget is a tool for stabilization, a term considered as a misnomer because “it may erroneously suggest that the objective is nil economic growth” (Sanford, 1978:227). The stabilisation role covers the government’s macro-economic policies of high employment, low inflation, sound foreign currency reserves and an acceptable rate of economic growth (Musgrave & Musgrave, 1989; Keynes, 1936). Without government intervention in the economic activities through the budget, achieving these goals will be a mirage, according to Forte & Peacock (1985).

This stabilisation role is justified, as where there is lack of sufficient co-ordination among economic activities, general disequilibrium results in the economy in the form of (for instance) rapid under- or un-employment of both capital and labour, inflation, lack of foreign reserves, price distortions as well as savings and investments deficiencies.
According to Sanford (1978), governments, in such cases, use budgetary or fiscal policy for such stabilization purposes. Stopler (1971) mentions this role as an interventionist one, calling it ‘budgetary economics’ to refer to measures applied in this role to correct market imperfections, where the market signals cannot be trusted to lead to “pareto-optimal” decisions (allocating societal resources in a way that optimises every citizen’s well-being in the long run).

The other view, Neo-liberalism, became active as a result of the economic crisis in the mid 1970s and was more concerned with reduced state involvement in economic activity. This view was in favour of:

- Selling off state-owned enterprises, especially in manufacturing, mining and telecommunications.
- A reduction in government spending on social services and a general move toward ‘fiscal discipline’
- The introduction of fees or increased charges for services like health, transport and education.
- Lowering company taxes and income tax on the rich.
- Introducing sales tax such as VAT.

Neo-liberalism emphasises the balanced budget and fiscal stability. The influence, therefore, of economics has also been strong; with Burkhead (1956) remarking that studying government budgeting is just the study of applied economics. So while the study of the budget, to some scholars, is just like the study of politics (Rubin, 1988; Wildavsky, 1964), it is considered by Burkhead to be synonymous with the study of applied economics.

From the above, we can see how these three disciplines have related to and influenced the budgeting concept, a case confirmed in a study where it was noted that budget officers or vote (funds) controllers in some government institutions had formal graduate education in these disciplines rather than in accounting, with few of them having had limited workshops and seminars on budgeting (Onumah, 1995). Some of these officers also mentioned that they never had any formal in-service training on budget preparation, except for information gleaned from budget circulars.

### The Accounting Discipline

The association of accounting with government budgeting has traditionally been obscured. Some scholars did not see the budget as relevant for accountants and recently the International Public Sector Accounting Standards Board (IPSASB) has debated whether
budget reporting was relevant or within the scope of accounting setters (Budget Research Report 2006). To Davis (1969), even if the budget was once the accountant’s preserve, it is no more; anyone seriously concerned with public issues must now be concerned with the public budget. While the argument cannot be ruled out, it nevertheless seems to add to the view that there is no meaningful role for the accounting discipline in government budgeting. On the contrary, we would argue that accounting should have an influence on the budgeting concept in some remarkable ways.

The basic concern of accounting starts from the financial implications of the budgetary transactions and goes on to consider:

- the recording of payments and receipts leading to the creation of assets and liabilities
- whether the results of the transactions were those initially intended, and
- whether the state resources are used properly and efficiently.

The stress here is on accounting’s concern with the implementation of budgetary decisions in line with the relevant regulatory authorities, although we would argue that there is also a role for the accountant in the budget formulation process.

**Links between Accounting and Budgeting**

Accounting and budgeting are seen as having stronger links in government financial administration than in the private sector (United Nations, 1988).

Government organizations are allocated resources, budgetary appropriations, with classifications showing the respective line items or potential expenditure objects – wages and salaries, office equipment and expenses, transport and travels, stationery and others. In accounting for the use of these resources, the accounting system uses the same budgetary classifications. This process helps to hold officials to account for the following aspects:

- how much was spent?
- by what authority was it spent?
- what was the funding source?
- what special purpose was served? and
- what types of goods or services were acquired? (United Nations, 1988).

Accounting enables appropriate answers to be provided to these questions, hence ensuring meaningful use of budgetary resources.

Interim accounting reports are prepared and submitted to a higher authority for purposes of monitoring and evaluation, while annual reports are produced to reveal how the budgeted
resources were used. Variance analysis, through comparison of budget and actuals, reveals whether a government organization has been able to operate within its authorized resources. A positive or a negative variance often calls for reasons and explanations, especially in the latter circumstance (although explanations for under spending compared to the budget or collecting more revenue than expected may also enhance accountability). The Legislature, for instance, is able to demand the necessary explanations to ensure the appropriate level of accountability for the use and administration of budgetary resources.

Furthermore, Budget preparation involves a regular exercise where proposed activities are brought together and reviewed over and over again, taking into account the financial implications of activities. Taking policy decisions on the various activities involves certain decision trade-offs, for example:
- whether to accept a new project; or
- whether to expand, contract or discontinue ongoing projects.

With such decisions, several possible alternatives are available and here the accounting discipline plays the role of ensuring that the best alternative is considered: accounting (with its twin discipline, finance) uses varied tools and techniques for decision making to arrive at appropriate selection criteria. This does not rule out the fact that other socio-politico-economic variables come into play to influence the final budgetary choices. For instance the pure capitalist stance of minimising costs can be ignored, for the socialist (or the politician’s) position of satisfying public demand for core basic services even when these have to be delivered at a loss and so are subsidised from the state budget.

**And Financial Statement and Budget**

The objective of the IPSASB to develop quality accounting standards to be adopted by member countries in the preparation of general purpose financial statements is equally aimed at enhancing the quality and transparency of public sector financial reporting and strengthening public confidence in public sector financial management (Budget Research Report 2006).

Hughes (2004:4) puts forward the case that “Making budget data publicly available is necessary to enable transparent reporting of the government’s financial intentions and of its use of taxes”. He further recommends, among others, that “Ex-post budget reports reflecting budget to actual comparisons should be part of the general purpose financial statements issued at the end of the fiscal period for each reporting entity at each level of government”.

Accountability will therefore be complete if budget information is provided alongside the financial statements that report the outcomes of budget utilisation; users and public confidence will further be strengthened and assured in this regard.
The position of this paper is that transparency is enhanced if the financial outcomes revealed through financial statements are reported alongside the relevant budget. The argument therefore whether budget reporting is within the responsibility of the accounting standard setters should settle positively on the side of the accounting setters; the budget is relevant for the accountant, hence setters of accounting standards should never ignore budgetary issues in the standard setting process.

The International Scene

United Nation’s Position
The concern of the UN, for instance, for a positive role for accounting in the public administration of member countries is seen in practice as it endeavours to give support for the institution of proper accounting systems. For instance the UN (1970:14-15) describes a range of purposes that an adequate government accounting system should serve:

- a) Accounting systems have to be designed to comply with the constitutional, statutory and other legal requirements of the country;
- b) Accounting systems must be related to the budget classifications. The budgetary and accounting functions are complementary elements of financial management and must be closely integrated;
- c) The accounts must be maintained in a manner that will clearly identify the objects and purposes for which funds have been received and expended and the executive authorities who are responsible for custody and use of funds in programme execution;
- d) Accounting systems must be maintained in a way that will facilitate audit by external audit review authorities and readily furnish the information needed for effective audit;
- e) Accounting systems must be developed in a manner that will permit effective administrative control of funds and operations, programme management and internal audit and appraisal;
- f) The accounts should be developed so that they effectively disclose the economic and financial results of programme operations, including the measurement of revenues, identification of costs and determination of the operating results (the surplus or deficit position) of the government and its programmes and organizations;
- g) Accounting systems should be capable of serving the basic financial information needs of development planning and programming, and the review and appraisal of performance in physical and financial terms;
- h) The accounts should be maintained in a manner that will provide financial data useful for economic analysis and reclassification of governmental transactions and assist in development of national accounts.”
The UN (1988:19-20) has also considered the various user-needs for sound government accounting information. These can indicate the objectives of the accounting system needed to deliver this information. These are to:

a) give general reassurance concerning the efficiency of the government’s financial management system;

b) indicate the sector impact, economic nature and regional distribution of government spending; and to reveal the make-up of government revenue, as a basis for planning and policy analysis;

c) identify trends in government expenditure and revenue as a basis for forecasting;

d) assess the government’s ability to service its loans;

e) provide inputs to the estimation of national income and to the articulation of certain subsidiary national income accounts relating to the public sector; and

f) monitor the implementation of national plans.

The list above provides an indication of the emergence of the new public management drive since 1970, and which emphasises efficiency and the economic impact of fiscal activity rather than the mere emphasis (in the past) on sound administration, control and probity. Jackson and Lapsley (2003) collaborate this when they studied the emerged public sector reforms in the last two decades and how accounting is to play a significant role in the new public management paradigm. Mir and Rahaman (2007) have similarly studied how accounting moved along with public sector reforms (the new public management concept), studying the experience in a state organisation.

The users of the information provided from the achievement of such accounting objectives listed above range from the central government (cabinet), through its central budget agency, planning commission, the central bank, and the statistical office to external users like the business community, journalists, bankers, international financial institutions and donor agencies. But in democracies, surely the key users are its citizens and their representatives in parliament and the information is assessed by the extent to which such users are able to hold the government (ministers) and public officials to account for the sound administration of public finances.

Again, the UN (1991) has stressed, through many conferences and publications, the important role accounting has to play in government budgeting. For instance, the UN mentions that effective budgeting should facilitate the business transactions of government, plays an essential part in the control of public resources and that the records and other transaction evidence that it provides facilitate audit verification. The accounting records and reports coupled with auditor’s report are then means of satisfying, in part at least, the need for proper accountability. Finally it provides user-information to improve business and government decision making and to ensure more effective resource use.

The influential role of accounting in the government administrative machinery, and especially in budgeting is thus significant. Therefore a proper government accounting system embodying well established financial recording systems, internal control- and
check- mechanisms in government organizations can impact positively on the budgeting concept, satisfy the identified user needs and give accounting additional attraction in the sense that such a system can ensure the provision of good accounting data for proper budget formulation, execution, monitoring and control.

**Added Strength**

Ghartey (1990) joins the proponents, pointing to the contributory role of the accountant in government. With the constant stress on accountability throughout government in the wake of resource limitation, foreign debt and domestic socio-economic crisis, Ghartey points out that the focus now is on planning, programming, budgeting and adequate financial disclosure. He rightly adds that the government accountant has a participative role to play here in:

- the management of the government policy variables mentioned above
- assisting in planning by estimating national revenues and costs
- setting standards for financial control
- programming to ensure a consistent links between planning and budgeting; and
- ensuring a suitable combination of accounting and budgetary controls to ensure legal compliance, efficiency, economy and adequate information disclosure.

Government accounting should therefore have sufficient influence on budgeting considering the role of the government accountant, and the role of adequate accounting systems as outlined by the UN.

**A Subordinate Role**

The influence, however, of accounting has not generally been recognized sufficiently, at least compared with the three disciplines of political science, public administration, and economics as discussed earlier.

Pendlebury and Jones (1985:301), looking at the case in Britain, have observed this omission and make a case for the need to correct this:

“For many years now the academic governmental-budgeting literature has concentrated almost exclusively on the politics and economics of the budgetary process at the expense of the mechanical foundations… What we do not see is a discussion of the accounting perspective.”

This scenario has resulted because the discipline has been played down in government budgeting. The accounting function is seen as an ordinary service exercise, a routine mechanism to satisfy only financial legalism and established procedures. The thought pattern is that it is only in the execution of the budget that accounting has a role to play –
to record the transactions that are effected by government organizations. Premchand (1983) confirms the notion of this routine role accorded the accounting discipline, which is almost the permanent order: a subordinate role which has resulted from historical development. The UN (1952:1) decried this notion: “In spite of the importance of government accounting… relatively little attention has been devoted to this subject in most countries in recent years”; and although this observation dates from many decades ago, much has not changed. Linowes, in Chan and Jones (1988:186), put forward the point that “The involvement of accountancy in national and international affairs has been limited to the traditional role of quantitative measurement. Yet accounting as a social science can provide a unique and needed function through the application of measurement of social data”.

**Forgotten Role, Especially in Developing Countries!**

However, while political scientists, lawyers and economists feature greatly in policy making and evaluation exercises, accountants are often forgotten. They are not thought to have any significant contribution to make in such processes, although when it comes to “… measuring the cost-benefit of a specific social program, the accountant is the one who is trained to function effectively” (Linowes, 1988:188). The accountants’ lack of influence in government has been seen to be traditional, for example, Pendlebury and Jones (1985). While this unfortunate situation lingers on in many countries, it is significantly worse in developing countries where operations of government accounting systems have regressed to the extent that governments are now grappling with a series of problems relating to weak public financial management. The developments of such systems weaknesses and shortcomings in recent decades are indicated by financial malpractices and improprieties that have characterized many public sector activities.

**The Research Dimension**

While government accounting systems in developing countries may have weakened as a result of the economic problems of the late 1970s and 1980s, academic research of this discipline has similarly been limited. Such research could help to re-build the systems through the unearthing of weaknesses and recommending practical improvements. Alluding to this dimension, even in developed countries, Lapsley (1988) mentions how accounting researchers have given limited attention to the subject, which according to Pallot (1992) has resulted in an underdeveloped theoretical framework. Monsen (1993) adds that governmental accounting research has lagged behind its counterpart, business accounting. The subject’s literature has therefore been scarce (Pendlebury and Jones, 1985). Again, one possibility is that such limitation has arisen from the limited view of accounting’s role in the government budgeting process.
It is believed that awakened research in public sector accounting can create awareness of the important role of the discipline in government budgeting. The result will be that sovereign governments will be alert to the research findings that can impact positively their budgetary policy decisions and choices. The accounting discipline generally ensures proper use of the entity’s resources; and research findings should improve the methods and procedures used in accounting for budgetary resources.

This paper argues that accounting has not been given its right and responsible role and this has affected public financial management drastically.

**Scenarios in Ghana (Historical and Current)**

A series of findings of the Auditor-General in Ghana revealed such weak accounting and financial management procedures and practices. Audit reports (1966, 1967) of particular public sector organisations revealed inaccuracies in accounting recordings, recordings which were untimely, unreliable breakdown in the systems of internal controls, and neglect of the whole accounting recordings which created problems for audit compilations.

Tuffour, onetime Acting Controller and Accountant-General, added that some public departments had failed to present their annual financial reports for the past twenty years in violation of the Financial Administration Decree 1979 (Ghanaian Times, October 21, 1979).

However, in the late 1970s and 1980s such problems became more common and general across the public sector. After the audit report for 1979, a ten-year gap occurred when subsequent accounts could not be audited even if presented. It was reported that:

“A review of the Public Accounts covering the ten year period, 1st July, 1979-31st December, 1989 disclosed that the accounts were characterized by serious discrepancies, omissions, misstatements, lack of supporting evidence, non adherence to generally accepted accounting standards and departure from the Financial Administration Decree and Regulations making the accounts unacceptable in the form in which they had been published” (Auditor-General’s Report, 1993:3).

**Attempted Reforms in Ghana**

The Ghanaian Government has recognized the general weaknesses in the public sector financial management system which had developed in the form of weak budgetary framework, improper accounting, ineffective auditing, and unreliable, inaccurate and untimely information for decision-making and ineffective public expenditure monitoring (PUFMARP, 1997). Thus the Public Financial Management Reform Programme was
launched in July 1995 with the laudable objective of improving public sector organisations’ budgetary, financial management and reporting systems.

The Old Order Changeth Slowly!

While attempts are still being made to resolve the systems’ weaknesses, recent revelations of the Auditor-General continue to point to some shortcomings in the public accounts, both for the accounts of individual ministries, departments and agencies as well as the accounts of the consolidated fund. For instance the Auditor-General gave some limitations in the accounts through reservation statements and other compliance failures (Consolidated Fund, 2004) as well as series of weaknesses in authorisation, poor recording, omissions, etc, in the accounts of public institutions (MDAs Accounts, 2004).

Again, outcomes from the recent sittings/investigations of the Public Accounts Select Committee (PAC) of Parliament reveal serious financial authorisation and supervision lapses, poor internal auditing systems and procedures and poor accounting recording and documentation. The PAC announced its presence to public institutions, (The Daily Searchlight, 2007:3) ready to call such institutions to book, with the Ministry of Health, among others, having its share of this scrutiny with reported financial lapses (The Daily Despatch, 2007:6).

However, reforms are impacting (though slowly) on the government financial administration, and specifically in the auditing and accounting systems and procedures with the enactment and review of the Internal Audit Act and the Financial Administration Regulations (FAR). Again, the call to adopt the International Public Sector Accounting Standards (IPSAS) and the measures by the Controller and Accountant-General towards accountability (for instance the development of an accounting manual for the government institutions) are additional positive issues (Business & Financial Times, 2007:3; The Ghanaian Times, 2007:28)

Conclusion

While it is seen that the budgeting concept continues to be multidisciplinary, the influence of accounting has been limited; policy makers and bureaucrats have seen accounting as operating in a subordinate position, merely concerned with juggling the figures. Hence the re-institution of proper accounting systems in public sector organisations is an important priority, especially in developing countries after the economic ravages of the late 1970s and 1980s led to poorer financial administration and accountability. The need for a new orientation towards accounting’s key role in the public financial management apparatus is imperative.
With the disciplines of economics, political science and public administration securing tighter links with the budget, accounting can also contribute significantly to ensure efficient use of the budgetary resources to satisfy society, its citizens and their representatives in parliament, the ultimate objective of government budgeting. The call is for government accounting and its research to be seen in a new light to enable it to have a stronger and more positive influence on public financial management systems.
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Fiscal and Budget Management System: Principles, Issues and Debates

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Introduction

The budget is a government’s key financial plan. It should enable the government to achieve the main international objective of poverty reduction by ensuring that basic services (including, health, education, water, housing, electricity) are available to all citizens and that progressive taxation is used to fund these services and reduce the prevailing levels of inequality. This paper considers Nigeria as an example of a major developing country and considers the extent to which the government’s budgetary process is achieving these objectives. It also considers some of the major current debates around fiscal and budget management.

The paper is structured as follows:

- Definition of Key Terms – Fiscal Policy, Budget  
- Characteristics of a Good Budget  
- The Budget Cycle  
- The Roles of Progressive Legislators, Opposition/Civil Society Movements at Each Stage of the Budget Cycle  
- Budget, Accounting Procedure and Fundamental Governance Principles  
- Political Loyalty And Accountability, Issues And Debates
  - Are Budget deficits to be avoided?  
  - The Illegality of the Process of Increasing petroleum products’ prices in the domestic economy  
  - Ensuring Availability of Funds for Important Programs: Are government Revenue Projections Realistic?  
  - Who Bears the Burden of A Tax?  
  - Progressive Taxation  
  - Tax Capital and the Rich
Definition of Key Terms

The key terms for this paper are fiscal policy and the budget. A discussion of these two terms will allow us to begin an examination of the basic principles involved in budget management.

Fiscal Policy
Fiscal policy refers to the primary means by which government influences the economy in terms of the aggregate levels of revenue and expenditure and the resultant surpluses and deficits. Therefore, a ‘tight’ fiscal policy refers to government policy to restrain short term demand by reducing public expenditure and raising taxes, which measure is intended to restrain inflation. An ‘easy’ fiscal policy on the other hand means a policy to stimulate short term demand or economic growth by increasing government spending or reducing revenues. A government sets and implements fiscal policy through the budget.

Budget
The budget is one of the most important documents of a government, which should be subjected to close public scrutiny and debate with a view to being positively influenced in the interest of the poor. The budget is not only a technical document, which states expected revenue and expenditure; it is also a comprehensive statement of government policies, commitments and priorities in terms of social services that are planned to be provided. The fiscal year, which is government’s 12-month accounting period, may not coincide with the calendar year. Ideally, the budget captures the totality of government financial transactions, revenue to be collected, funds to be expended, debts (external and domestic) to be paid, new liabilities to be incurred, etc, so as to avoid situations of unexpected programs or commitments being ‘off-budget’ or outside the budget, which may cause financial dislocation and bring about failure to attain set priorities or goals.

There are two basic sides to a budget – estimates of revenue and expenditure. The major components of government revenue are tax revenue and non-tax revenue. Governments gain their revenue from taxes and other sources. Taxes may be direct or indirect. Direct taxes include income taxes on personal income and business profit tax. Indirect taxes include consumption taxes such as value-added, sales and trade taxes. Non-tax income
may include grants from donors, income from natural resource extraction, marketing board surpluses, rent on government property, interest on loans, taxes on public utilities for supply of water, electricity, airfields, car parks, roads, docks, issuance of licenses and permits. If government revenue is not sufficient to finance its expenditure then the balance may be borrowed from domestic or foreign sources. In Nigeria, the bulk of government revenue, for Federal, State and Local Governments, comes from sale of crude oil.

**Characteristics of a Good Budget**

The characteristics of a good budget may be represented by the acronym, ‘SMART’.

A budget should be:

- **Specific**, e.g. building of schools, hospitals, health centre, bore holes, etc
- **Measurable**, e.g. two schools, to be built
- **Achievable**, e.g. will enable the government to provide the services required and achieve its agreed policy objectives
- **Realistic**, e.g. within budgetary limits, which are known to the public and
- **Time-Related**, i.e. time bound, e.g. two secondary classrooms to be built in the first two months of the financial year

The above characteristics should be used as a guide in assessing a government’s budgetary proposals sent to parliament in the form of Appropriation Bills or Supplementary Appropriation Bills.

**The Budget Cycle**

The budget cycle consists of four stages:

1. **Budget formulation stage**, i.e. the drawing up of the budget by the executive arm of government
2. **Budget Enactment stage**, i.e. the stage of debating, alteration and enactment into law by the legislative arm of government
3. **Budget Execution stage**, i.e. the implementation of the budget as approved by the legislature
4. **Budget Auditing and Assessment stage**, i.e. the stage of auditing actual expenditures and assessing them for effectiveness.
The Roles Of Progressive Legislators, Opposition/Civil Society Movements At Each Stage Of The Budget Cycle

The opposition and/or civil society movements have opportunities to influence each stage of the budget process.

**Budget Formulation Stage**
The executive (ministry of finance and cabinet) may formulate the budget behind closed doors. However, the opposition and civil society can have a positive role in providing critical commentary on issues that are considered to be of high priority, but which the executive might have ignored or not given adequate attention. It is a stage to undertake criticism of the past performance of the executive or the ruling party. When civil society organizations draw attention to projects that are considered of high priority, it affords them opportunity to make inputs at the phase of project formulation. The legislature too will cease to be a mere rubber stamp if it draws public attention to projects at the budget formulation stage, rather than being mere recipients of ideas supplied by the executive.

The budget formulation stage may also be conceptualized as the project formulation stage. Section 81 (1) and (2) of the 1999 Constitution of Nigeria makes provision for this stage. It prescribes that the President shall cause to be prepared and laid before the National Assembly at any time in each financial year estimates of the revenues and expenditure of the Federation for the next following year. The estimates shall be contained in a Bill called ‘Appropriation Bill’. [The Constitution also makes similar provisions for the States, but this paper will only refer to those covering the Federal Government].

The Constitution also makes provisions for Supplementary Estimates. Section 81(4) states that Supplementary Appropriation Bill shall be prepared and presented to the National Assembly in the following situations: if it is found that the amount appropriated for any purpose is insufficient or a need has arisen for expenditure for a purpose for which no amount has been appropriated.

**Budget Enactment Stage**
This is the stage when the executive formally presents the budget to the legislature and it is subject to debate. Based on the debates, the budget may be adopted as presented by the executive, amended and enacted into law or rejected altogether and replaced by the legislature’s own proposals. However, the extent to which the legislative can amend the budget presented by the minister of finance is heavily restricted in some countries.

The enactment stage therefore offers the greatest opportunity for the civil society to influence the budget. There is often opportunity for public hearings. Presentations and analysis of the likely effects of budget proposals by opposition parties, progressive
politicians and civil society organizations during public hearings may influence legislative debates and voting.

At this stage, the following types of analysis may be undertaken and given wide publicity:

- broad assessment of the key issues in the budget proposals as presented to the legislature by the executive;
- budgets and general economic analysis such as an analysis of the economic and fiscal assumptions of the budget and their likely effects on annual deficit, and national debt, inflation, growth and employment;
- sector analysis, in terms of comparative allocation to defence and social services sub sectors, for instance; analysis of effects on different population groups, based on income, women and children, etc;
- analysis of effects on economic and social rights, e.g. wages and salaries, minimum wage, housing, water, employment security, education, physical and mental health, etc;
- revenue analysis, which answers questions such as: are revenue projections realistic; are the tax policies favourable to the rich or the poor; is the tax system regressive, progressive, or proportional; how high or low would be the cost of tax administration, and what level of tax compliance is expected.

It is important to pay attention to the constitutional procedure for passage of ordinary bills and money bills so that the maximum advantage can be taken of the processes to advance the cause of the poor, thereby distinguishing the opposition from the ruling party in concrete terms that citizens can appreciate and understand.

The usual procedure for the exercise of legislative power is amended for bills, comprising the following:

- appropriation bills; supplementary appropriation bills;
- any other bills for payment, issue or withdrawal from the Consolidated Revenue Fund or any other public fund of the Federation;
- bills for the imposition of or increase in any tax, duty or fee or any reduction, withdrawal or cancellation.

Any bill relating to any of the above issues is also to be passed separately in each house of National Assembly.

**Budget Execution**

In reality, budgets may not be implemented exactly as agreed in the annual budget. Deviation of actual spending from the budget could arise as a result of executive abuse, conscious change of policy direction or fundamental economic or other changes beyond
the control of the executive. The basis for any deviation from the budget ought to be assessed by civil society organizations and progressive opposition politicians, whose interests should be strict adherence to the budget as enacted into law by the legislature, unless changes are agreed in the proper fashion and are appropriate. Concern should be concentrated on projects that are of key importance to the electorate so that public attention is drawn to resources that may not be used for the purposes for which they were appropriated or cases of funds not being released for specified projects.

Section 80 of the 1999 Constitution addresses the budget execution stage, in that it provides for creation of Funds, withdrawal of funds and manner of withdrawal for approved projects. Section 80(1) establishes the Consolidated Revenue Fund. All revenues or other moneys raised or received by the Federation shall be paid into and form one Consolidated Revenue Fund of the Federation.

Section 80(2): No moneys shall be withdrawn from the Consolidated Revenue Fund except to meet expenditure charged upon the Fund by the Constitution or as authorized by the Appropriation Act and Supplementary Appropriation Act.

The Constitution also envisages that at the execution stage, there may be need for contingencies or unforeseen needs for expenditure and delays in legislative approval of Appropriation Bills.

Section 83(1) also empowers the National Assembly to establish, by law, a Contingencies Fund and to authorize the President to make advances for urgent and unforeseen needs for expenditure for which no other provision exists.

**Budget Auditing and Assessment**

Though it appears last, budget auditing and assessment is actually a continuous exercise. The goal is to determine whether there has been an effective utilization of public resources. The legislature has a responsibility to evaluate the performance of the executive. For this to be achieved, it has to demand from the executive, regular reports of its fiscal activities. The legislature should also insist on the Auditor General carrying out its audit function and producing reports, which can be assessed and used to evaluate the fiscal activities of the Executive and ensure they were consistent with the Constitution, relevant laws and regulations.

However, it is not only the Auditor-General for the Federation that is constitutionally empowered to carry out the audit and assessment role. The legislature is also empowered to carry out a similar role. Section 88(1) empowers each House of the National Assembly to direct or cause to be directed, by resolution, investigation into any matter or thing with respect to which it has power to make laws or into the conduct of the affairs of any person, authority, Ministry or government department charged or intended to be charged with any duty or responsibility for executing or administering laws or disbursing or administering moneys appropriated by the National Assembly.
The legislature could create a forum for regular appraisal of the budget, on monthly, quarterly, mid-year, and end of year basis. Such a forum should be open to members of the public, civil society organizations, civil servants and trade unions. The goal is to compare budgeted figures (both revenue and expenditures) with actual performance. The legislature or the civil society organizations may also engage the services of independent experts to assess projects with a view to objectively and factually determining the quality of such projects as well as the judicious use of public funds.

Section 89 invests in the National Assembly or a committee appointed by it the power to procure evidence, summon any person or issue a warrant to compel the attendance of any person who, after having been summoned to attend, fails, refuses or neglects to do so. The summons or warrant issued under this section may be served or executed by any member of the Nigeria Police Force or by any person authorized by the President of Senate or Speaker of the House of Representatives.

Corruption in public office shows that the auditing and assessment process is weak. The legislature ought to make more use of the investigation role, which is different from auditing in the following respects:

- It is more comprehensive than an audit
- The scope depends on the purpose or reason for establishing it, and
- It involves a consideration of financial and non-financial information.

**Budget, Accounting Procedure and Fundamental Governance Principles**

There are certain fundamental governance principles, which should be applied to the budget process:

- Openness and objectivity
- Integrity and honesty: formal *Codes of Conduct* for politicians and civil servants; declaration of wealth by senior politicians, civil servants and army officers, including their relatives. Such declarations should be available for public inspection and sent to both the Auditor-General and trade unions.
- Competence: staff training to ensure that they are competent to perform their work
- Public participation in governance processes: involvement of trade unions, professional bodies and credible civil society organizations
- Political loyalty and accountability

To this extent, the following established accounting principles and procedures should be adopted by each ministry and budget agency:
Revenue Controls

- List sources of internally generated revenue, rates charged per source and total revenue from each source
- All revenue to be receipted and banked
- Income to be reconciled with bank statements and inconsistencies investigated
- Publication of monthly allocation from the Federal Government Account
- Monthly publication of any other revenue from the Federal Government, e.g. oil windfall
- Publication of any external grants or loans, on a monthly basis.
- Monthly summary of all revenue to be published and made available for interested public inspection

Expenditure Controls

Contracts

- Advertise contracts in the press, where direct labour is not used.
- Publish all bids received and contracts awarded
- Tender board for all large contracts to include trade union representatives
- Contract register should be made available for public inspection

Payroll

- Computerize payroll
- Check changes between monthly payroll
- Check employee list regularly for ghost workers
- Electronic employee list held by Accountant-General and trade unions
- All appointments to be formally authorized
- Official Limit to number of aides to political office holders
- Payroll report to be published monthly showing post, name, gross pay, net pay; Vacant posts, showing: post, salary, name of media where advertised; All appointments, showing: post, name, starting salary, date, where advertised.

General Expenditures

- Invoice or receipt should be kept for all expenditure
- There should be an approved list of suppliers
- Proper Division of labour, so that three separate individuals or sections undertake:
  1. authorization of purchase orders and payment vouchers; 2. receipt of goods or services; 3. maintenance of purchase ledger and cash book

Government Assets/properties

- Maintain Fixed Asset register
- Independent stock taking of all properties on an annual basis
• Public auctions for all significant asset disposals

**Auditing and Investigation**

• The investigative role of the legislature should be taken seriously because the Auditor-General may be compromised by the appointing executive or other influences.

• The investigative role of the legislature can also complement the effective performance of the internal auditing function of Accountant-General.

• Auditors-General’s Annual Reports should be published and made publicly available, and be independent of the Ministry of Finance and government.

• The Auditor-General should be made responsible for the audit of the whole public sector. In Nigeria there are two auditors general for each state, one to audit the state administration and one for local government. In addition, state owned corporations are audited by private sector firms. These arrangements severely weaken the status and independence of the auditor general.

Section 85(3) prescribes that the Auditor-General is not empowered to audit the accounts of statutory corporations, commissions, authorities, agencies, including all persons and bodies established by an Act of the National Assembly. But the Auditor-General shall provide such bodies with a list of qualified auditors from which the bodies shall appoint their external auditors. The Auditor-General is also empowered to comment on their annual accounts and auditors’ reports, and conduct periodic checks on them.

**Whistle blowing and Complaints Procedures**

The legislature could enact laws to require all public sector organizations to adopt suitable whistle blowing and complaints procedures. Such procedures should aim at encouraging staff and others to raise appropriate concerns internally and externally. The policies and procedure should ensure that those who raise concerns receive a response, are not victimized and are informed about how their concerns are dealt with. To this extent, the Official Secret Act and provisions of the Civil Service Rules, which frown at divulging official matters to the press and the public, must be re-looked with a view to reviewing them.

**Political Loyalty and Accountability, Issues and Debates**

The key concern raised by the issue of political loyalty and accountability is commitment to party philosophy, programs and perspectives. Within this context, the following issues, perspectives, debates and methodology of work could be identified.

**Poverty Reduction Through the Provision of Basic Services**
There has been widespread agreement that the following Millennium Development Goals should be implemented in each country by 2015:

- Eradicate extreme poverty and hunger
- Achieve universal primary education
- Promote gender equality and empower women
- Reduce child mortality
- Improve maternal health
- Combat HIV/AIDS, malaria and other diseases
- Ensure environmental sustainability
- Develop a global partnership for development.

Governments have a key direct role in ensuring that these Goals are actually achieved and so should ensure that the following basic services are made available to all:

- Free education including books, breakfast and lunch for at least 10 years
- Free health including medicines and food whilst in hospital
- Free access to safe water within 100 meters of each home
- Free electricity up to a kilowatt hour per person per day
- Minimum Government wage which is more than a Basic Needs Basket
- Adequate housing to be made available for all households.

Nigeria’s oil wealth means that the resources to provide these basic services are available within the country. It is the responsibility of the politicians to ensure that the Government’s budget is used to prioritise the provision of these basic services.

Are Budget Deficits to be Avoided?

The perception of a balanced budget and reduced debt as an ideal is just a recent phenomenon. For almost 30 years after the end of the Second World War in 1945, until the mid-1970s, the international consensus was that government budgets would have a deficit in order to be able to provide the necessary public sector investment to maintain full employment. The deficit was to be financed by borrowing. The economy was to be managed through Keynesian demand management. It was widely accepted that the state should own important industries to fulfil the following responsibilities:

- Provision of affordable social services to the working class and the poor
- Redistributing income and wealth through progressive taxation and payment of social benefits
- Regulating economic activities to protect workers, the public and the environment

The experience of deficit budgets in Europe and America showed that deficit budgeting was beneficial. Wynne (2007) asserted that for most of the century between 1750 and
1850, and for much of the 20th century, periods associated with industrialization and sustained economic growth, the UK national debt was above 100% of its national income. Similarly in the US, government debt reached 100% of GDP in 1945. The sustained golden age of economic growth in the 1950s through the 1960s was a further evidence that deficit budget could be positively related to economic growth.

Contrary to the historic positive American and European experiences in deficit budgeting, the World Bank Public Expenditure Handbook (1998) sees the budget as essentially a technical exercise and advocates aggregate fiscal discipline, hinged mainly on cuts in public expenditure on social services, for developing countries in particular. This policy direction is however based on the less successful experiences of developing countries, which borrowed heavily in the late 1970s and then suffered from the twin effects of increased interest payments and decline in the world economy. For many of the developing countries, interest payments soared while the level of their exports was declining.

In the UK, Gordon Brown’s famous prudent economic rules allow government borrowing on condition that it is targeted at investment. The only problem is in the definition of ‘investment’. Traditionally, investment is limited to capital projects and public infrastructure. But spending on education and other social services, which is traditionally considered to be current expenditure, could arguably be categorized as investment in the future workforce. The IMF/World Bank ideas must be challenged in the light of world experiences. Budget deficits could be promoted on the conditions of investment in human and capital projects and popular participation in the budget process. Indeed, recent empirical study (of 45 developing countries over 30 years since 1945) by two academics at Oxford University (Adam and Bevan, 2005) shows an association between maximum economic growth and budget deficit of around 1.5% of GDP. In fact, the scholars suggest that ‘deficit may be growth-enhancing if financed by limited seignior age’ (i.e. printing of money) (Cited by Wynne, 2007). It should be noted that while subsidies are discouraged in the periphery capitalist states, the core capitalist states retain them. For example, the industrial world spends around $1bn a day on agricultural subsidies.

**Government Debt and Conditionality**

In the late 1970s and 1980s developing countries were encouraged to borrow to fund development by the World Bank and others. However, the increase in interest rates and the slow down in the world economy which quickly followed meant that these loans were no longer affordable. Nigeria for example was encouraged to borrow, even when there was no economic or financial reason to do so. The debt crisis is finally being addressed through a number of initiatives, including the Highly Indebted Poor Country (HIPC) program. Since 1999, the IMF Poverty Reduction Strategy Papers (PRSPs) took centre stage in development arena. Poor countries intending to borrow from International Financial Institutions (IFIs) and other ‘donors’ are made to first implement certain conditions
enshrined in the Poverty Reduction Growth Facility (PRGF) of the PRSPs. The PRGF was introduced in 1999 to replace the IMF Enhanced Structural Adjustment Facility (ESAF). The PRGF was supposed to usher in an era of reduced conditions imposed on borrowing countries by the IFIs. The signing of the Millennium Development Goals (MDGs) in 2000 also allowed the IMF to make poverty reduction the cornerstone of its activities through the PRGF. The Poverty Reduction Growth Facility was premised on broad participation in the formulation of poverty reduction strategies, more pro-poor growth, greater flexibility in fiscal targets and social impact analysis of major macroeconomic adjustments and structural reforms. But in reality, this had not been the case. Rather, the only thing that has changed is in name, from ESAF to PRGF. Some of the conditions attached to PRGF included privatization of public utilities such as water and energy services and charging of user fees for education and health services. The conditions are implemented through the surveillance role of the IMF on behalf of donors. The donors justify imposition of the conditions as a measure of discipline by the borrowing country and for surety that they would get their money back. But the PRSPs and PRGF contain no measures to which donors will be answerable in cases where the policies fail. Civil society in both the North and the South have long pointed out that the conditions actually hurt the poor and draw back on progress.

In view of the reported failure of the IMF/World Bank imposed policies and the acceptance implicit in the PRGF, of the necessity for formulation of poverty reduction strategies, more pro-poor growth, greater flexibility in fiscal targets and social impact analysis of major macroeconomic adjustments and structural reforms, the opposition parties/civil society should canvass arguments in support of growth-oriented deficit budgeting.

The Illegality of the Process of Increasing Prices of Petroleum Products

An Act of the National Assembly established a body called the Petroleum Products Pricing Regulatory Agency (PPRA), which is charged with the responsibility of determining the pricing policy of petroleum products and reviewing the prices periodically. The bulk of petroleum products consumed in the domestic market are imported. Prices therefore tend to vary depending on the variations in the international market. Section 2 of the Petroleum Products Pricing Regulatory Agency Act No. 8 of 2003 specifies the 25 members of the PPRA Board. It includes representatives of organized labour such as the representatives of the Nigeria Labour Congress, Trade Union Congress, National Union of Petroleum and Natural Gas Workers, Petroleum and Natural Gas Senior Staff Association, National Union of Road Transport Workers. In addition, there are further delegates from the Nigerian Employers Consultative Association, National Association of Road Transport Owners, Manufacturers Association of Nigeria and the mass media. The labour representatives allege that the PPRA Board rarely meets. Instead the Secretariat of PPRA unilaterally increases the prices of petroleum products as it deems necessary. The price increases of
petroleum products determined by the PPRA Secretariat should therefore be seen as illegal, as they are in violation of the PPRA Act.

In addition, the creation and mandate of the PPRA undermines the law-making powers of the National Assembly. The Constitution clearly requires that the imposition of or increase in any tax, duty or fee or any reduction, withdrawal or cancellation is to be effected through bills passed by the National Assembly and/or assented to by the President (S. 59(1)(b). Giving the PPRA the power to amend the prices of petroleum products tends to undermine possible inputs from the poorer citizens, through public hearings, lobbying, representations and mass protests.

No Economic Rationale for Increases in the Prices of Petroleum Products

Rasheed (2007: 23) asserts that the cost of producing a barrel of crude oil in Nigeria varies between $5 (for Mobil with no serious community-related problems) and $7 (for Shell Petroleum Development Company with more serious community-related problems). However, a barrel of crude oil sells at up to $100 on the international market. In other words, the cost of producing one litre of crude oil equals $0.03 or N3.82, excluding other costs. Assuming all other variable costs amount to 100% of production cost, the retail cost of refined products per litre should be less than one seventh of the official prevailing rate of N70/litre of petrol.

It is the reliance on the importing of refined products by the private sector that causes their high prices in the domestic market as shown in the tabulation below. So, when government claims to be subsidizing petroleum products in Nigeria, it is the private importers that are being subsidized.

<table>
<thead>
<tr>
<th>Component</th>
<th>Currency</th>
<th>PMS</th>
<th>AGO</th>
<th>DPK</th>
</tr>
</thead>
<tbody>
<tr>
<td>C+F (NGN Port)</td>
<td>$</td>
<td>0.60</td>
<td>0.59</td>
<td>0.62</td>
</tr>
<tr>
<td></td>
<td>N</td>
<td>76.71</td>
<td>75.10</td>
<td>78.61</td>
</tr>
<tr>
<td>Other Charges</td>
<td>N</td>
<td>5.30</td>
<td>5.30</td>
<td>5.30</td>
</tr>
<tr>
<td>Landing Cost</td>
<td>N</td>
<td>82.01</td>
<td>80.40</td>
<td>83.91</td>
</tr>
<tr>
<td>Margins</td>
<td>N</td>
<td>9.95</td>
<td>9.95</td>
<td>9.95</td>
</tr>
<tr>
<td>Expected price</td>
<td>N</td>
<td>91.96</td>
<td>90.34</td>
<td>93.86</td>
</tr>
<tr>
<td>Retail price</td>
<td>N</td>
<td>75.00</td>
<td>60.00</td>
<td></td>
</tr>
</tbody>
</table>

Exchange Rate: N 127.46:$1.00
Source: Daily Independent, 26 June 2007: C5.

The recent increases in the international price of crude oil have provided a huge windfall gain for the Government which could have been used to improve the services provided to the poor. The Government’s 2007 budget was prepared on the basis of a benchmark price
of $30 per barrel. With the price on the international market of up to $100 a barrel, this results in up to $70 per barrel going into the excess crude oil account.

**Ensuring Availability of Funds for Important Programs: Are Government Revenue Projections Realistic?**

No government program can be implemented without the availability of adequate funds; this includes the provision of social services. A key stage of budget formulation is therefore the determination of the ‘fiscal envelope’. This may be determined from the amount of money the government can afford to spend from the standpoint of fiscal prudence. Alternatively, the starting point could be the cost of the government’s programme of expenditure. One of the responsibilities of opposition parties and civil society organizations is to assess government revenue policies and the extent to which they will be sufficient to meet the necessary social services and investment in public infrastructure. For instance, a government may deliberately inflate its expected revenue in order to create the impression that it has the capacity to supply certain popular public goods. When a shortfall in revenue arises, it rationalizes expenditure cuts. In such circumstances, from the standpoint of an anti-poor government, expenditures designed to improve the lives of poorer citizens are usually the first to be affected.

It is important to remove the effects of inflation so that the real increase/decrease in allocation can be appreciated. For example, if the inflation rate is estimated to be 10%, an item will cost 10% more. Therefore, there will need to be an increased allocation of at least 10% merely to fund a program at the same level as the previous year. Adjusting budget figures for inflation facilitates comparative analysis of trends in budgetary allocation. Similarly, budgets need to be assessed in the light of population growth. If government funding remains static in the face of a growing population, either of two things may happen – the proportion of citizens receiving a given public service will fall or the average benefits received by each citizen will reduce.

**Introduce Progressive Taxation**

Who bears the burden of tax depends on the tax base, that is, whether the tax is on income or consumption. Income tax is generally progressive as the more an individual earns the higher rate of tax they pay. On the other hand, if tax is based on consumption (for example VAT), the poor bear a heavier tax burden because they tend to spend a great portion of their income on consumption. Income tax should be considered more equitable than consumption based taxes as it is based on the ability to pay and it facilitates poverty reduction by redistribution of resources. Progressive taxation helps to reduce inequality and avoid extremes of poverty and wealth.
However, the predominant practice in many states of the Federation in Nigeria is proportional taxation by which 10% of gross pay is deducted as tax. This undermines the progressive benefits of income tax. In addition, whilst the gross pay of ordinary public sector workers, including their fringe benefits, are taxed at the rate of 10%, the Income Tax Management Act 1961 exempts the incomes of certain people or classes of people from being taxed (Ariwodola, 1993: 23 – 24). The list of those exempt from income tax includes the official emoluments of the Head of State of the Federation and those of the State Governors. Yet, these are the categories of public officials who earn the highest pay.

The extent to which fiscal policy helps to reduce poverty is also determined by the levels and types of expenditure undertaken by the government. Consequently, when a government fails to fund, reduces funding or entirely stops the funding of certain strategic goods and services, this is equivalent to indirect taxation of the poor who must begin to pay individually or pay higher prices for such strategic goods and services.

**Tax Capital and the Rich**

The taxation of large companies is clearly more efficient than trying to tax the mass of poor people existing on $1 a day or less (70% if Nigerians). Taxing rich companies is also more equitable than depending on general consumption taxes like VAT. Many people, including increasingly the World Bank (2006), recognize the problems which increasing inequality across the world is causing. Taxation policy should be designed to reduce such inequality.

Establishing large company units in tax agencies is a key reform for effective taxation thus enabling the adequate funding of public projects. Taxes could also be imposed on individual ‘net worth’ – i.e. personal assets such as investments, houses and other property.

However, in Nigeria, companies are given tax relief for facilities like water, roads, etc that are not provided by the state, whilst ordinary people have to pay for such services.

**Tax competition**

The dominant view in recent years is that governments have to reduce at least the higher rates of corporate and income taxes to attract foreign direct investment. This leads to tax competition between countries as they compete to attract investment by further reductions in rates of tax. This results in an erosion of each country’s tax base and a reduction in the level of services they are able to provide for their citizens.

However, evidence suggests that low rates of corporate taxation, tax breaks etc are much less important in attracting investment than is supposed. The presence of skilled workers,
efficient transport and communications are more important. The Economic Policy Institute (2004) has found that:

*There is little evidence that state and local government tax cuts – when paid for by reducing public services – stimulate economic activity or create jobs. There is evidence, however, that increases in taxes, when used to expand the quantity and quality of public services, can promote economic development and employment growth.*

In the context of Nigeria, the work of Ekpo (2005) has also confirmed authoritatively that:

*There have been bold efforts by the Federal Government in providing the enabling environment for FDI. … Several incentives for FDI include tax and duty concessions… Firms that locate in the export processing zones in Nigeria have additional benefits such as no taxation, easy repatriation of profits…Despite the incentive packages; FDI has not played a significant role in the Nigerian economy.*

**The Role of Independent Corrupt Practices and Other Related Offences Commission (ICPC) in the Budget Process**

The ICPC also has a role to play in the budget system and the opposition parties/civil society should not hesitate to make use of all available avenues to establish transparency and accountability. Sections 8 to 26 of the Corrupt Practices and Other Related Offences Commission (ICPC) Act contain a list of punishable offences. The list includes:

- Public officer giving, asking, and receiving bribe or gratification;
- Any public officer inflating the price of any goods or services above the prevailing market price or professional standard;
- Any public officer awarding or signing any contract without budget provision, approval or cash backing;
- Any public officer transferring or spending any sum allocated for a particular project or service on another project or service;
- Any public officer failing to report bribery transaction
- Any person who, with the intention of defrauding or concealing a crime or frustrating the Commission in its investigation, destroys, alters, mutilates, falsifies, or omits any materials from any books, documents, valuable security, account, computer system, diskette, computer printout or other electronic device of his employer;
- Any person, who being an officer charged with the receipt, custody, use or management of any part of the public revenue or property, knowingly furnishes any false statement or return in respect of any money or property received by him.
Trade unions, civil society and opposition politicians should use these provisions to support citizens who have evidence of such crimes to report them to the relevant authorities and ensure appropriate action is taken.

**The Role of the Economic and Financial Crimes Commission (EFCC) in the Budget Process**

The EFCC was established as an ant-corruption agency. Though the Commission can be rightly criticized for selective and discriminatory activity, the opposition could mount pressure on it to positively influence the budget process. Section 40 of the EFCC Act defines economic and financial crime to include:

The non-violent criminal and illicit activity committed with the objective of earning wealth illegally either individually or in a group of organized manner thereby violating existing legislation governing economic activities of government and its administration and includes any form of fraud, narcotic drug trafficking, money laundering, embezzlement, bribery, looting and any form of corrupt malpractices, illegal arms deal, smuggling, human trafficking and child labour, illegal oil bunkering and illegal mining, tax evasion, foreign exchange malpractices including counterfeiting currency, theft of intellectual property and piracy, dumping of toxic waste and prohibited goods, etc.

The EFCC is also charged with enforcement of the provisions of all other laws relating to economic and financial crimes, including:

- The Advance Fee Fraud and Other Fraud Related Offences Act, 1995
- Failed Banks (Recovery of Debts) and Financial Malpractices in Banks Act, 1994
- The Banks and Other Financial Institutions Act, 1991, as amended.

The foregoing suggests that external bodies such as banks and other financial institutions that may be involved in aiding the process of looting public resources can also be brought to book.

**The Use of the Code of Conduct for Public Officers in Effective Budget System**

The Code of Conduct for Public Officers is contained in the Fifth Schedule (Part I) of the 1999 Constitution. The Code could also be used to enforce a credible and transparent budget system. For example, Paragraph 11(3) provides:

Any property or assets acquired by a public officer after any declaration required under this Constitution and which is not fairly attributable to income, gift, or loan approved by this Code shall be deemed to have been acquired in breach of this Code unless the contrary is proved.
Paragraph 18(2) also prescribes the penalties, which the Code of Conduct Tribunal may impose on any public officer found guilty:

(a) vacation of office or seat in any legislative house, as the case may be;
(b) disqualification from membership of a legislative house and from the holding of any public office for a period not exceeding ten years; and
(c) seizure and forfeiture to the State of any property acquired in abuse or corruption of office

The effectiveness of the budget system will be enhanced if the opposition parties/civil society organizations avoid falling foul of the law and acting in accordance with Paragraph 12 of the Code of Conduct, which provides that ‘any allegation that a public officer has committed a breach of or has not complied with the provisions of this Code shall be made to the Code of Conduct Bureau’.

The Code of Conduct makes provisions against the public officer putting himself in a position where his personal interest conflicts with his duties and responsibilities (Paragraph 1); against receiving remunerations from more than one public office (Paragraph 2); against maintaining foreign bank accounts (Paragraph 3); against receiving gifts or benefits in kind on account of anything done or omitted to be done by him in the discharge of his duties (Paragraph 6); against receiving any property, gift or benefit of any kind for the granting of any favour (Paragraph 8); declaration of assets immediately after taking office, and thereafter at the end of every four years, and at the end of his term of office (Paragraph 11).

The Code of Conduct, Code of Conduct Tribunal, the ICPC and the EFCC, etc, can be useful to sanitize the political space and gradually ensure an effective, efficient and equitable budget system.

**Conclusion**

This paper has discussed ‘fiscal and budget management system, principles, issues and debates’. The discussion has revealed that budget matter is not simply a technical matter. It is essentially a political matter. To succeed in establishing an effective budget system or positively influencing the process requires not only technical competence on the part of the staff, it also requires developing pro-poor political philosophy, mastery of governance processes, having a sense of vision, mission, commitment to positive values and ideals and determination to establish a striking leadership by political office holders.
References


International Trends in Government Accounting

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Abstract

There is no standardized global framework for the adoption and implementation of accrual government accounting. This has lead to a questioning of the consistency and comparability of financial statements prepared and presented in different jurisdictions. Two approaches are widespread which deal with the issue of financial consistency and comparability across nations and organizations; the accounting approach and the statistical approach. Whilst the former uses accounting standards for the preparation and presentation of general purpose financial statements, the latter emphasizes the statistical bases for producing accounting information for economic analysis and policy making. Many countries have adopted both approaches providing widely different financial measurements. This seems not to be an effective way of using resources. However, there are some promising bridges between them in applying and requiring consistent financial information. Harmonizing these two systems into a single set of government reports is a significant issue in international issue in public sector accounting.

Introduction

The last three decades have witnessed substantial efforts to re-invent the public sector around the world. Public sector reform ideas, which started more as a political and ideological phenomenon such ‘Thatcherism’ (in the UK), 'Reagonomics' (in the USA), and 'Rodgernomics' (in New Zealand) are becoming a reality (Broadbent and Guthrie, 1992). Collectively these public sector reform ideas have been referred to as ‘New Public Management’ (Hood, 1995; Guthrie et al., 1998, 1999 and 2005). Couched in the language of economic rationalism or neo-liberalism, new public management aims to replace the Weberian approach to public administration with a management model, which is used in private enterprises (Hood, 1995; Carlin, 2006).
Connolly and Hyndman (2006) state that new public management reforms underpin six core elements in public sector governance: privatization, marketization, decentralization, output orientation, quality systems, and intensity of implementation. A primary goal is to boost efficiency, effectiveness, transparency, and accountability in public service delivery and resource management. This has led governments to introduce cost improvement programs, performance indicators, financial management information systems, financial targets, delegated budgets and resource allocation rules (Arrington and Watkins, 2007; Pettersen, 1999; Groot, 1999). Consequently, government agencies have been transformed into competitive business units, and citizens have become customers (Chan, 2003). OECD (2005) claims that contemporary governments in most OECD countries are more efficient, more transparent, and more focused on performance than 20 years ago.

Business like governments or entrepreneur governments often use private sector financial management techniques (Chan, 2003). Thus accounting reorientation has been part of new public management reforms in several countries. Accrual accounting is probably the most visible phenomena within this accounting reorientation, referred to as ‘New Public Financial Management’ (Guthrie et al., 1998, 1999 and 2005; Lapsley, 1999). However, the number of governments which have actually adopted accrual accounting is relatively modest. Wynne (2007) lists only nine countries which had actually taken this step and, although the IPSAS Board lists approximately 70 countries which have agreed to move towards accrual accounting, only five of these are “Governments that already apply full accrual accounting standards and apply accounting standards that are broadly consistent with IPSAS requirements” (IFAC, 2007b, page 4). In addition, studies have shown that the implementation of new financial public management, particularly the adoption of accrual accounting has not been uniform nor pursued with discernible coordination (Guthrie et al., 1998, 1999 and 2005). The types and degrees of accrual accounting vary significantly from government to government. Moreover, while some countries have adopted accrual accounting reforms at their central governments, others have embarked on reforms at local levels and within government agencies.

There is no standardized global framework for the adoption and implementation of accrual government accounting. This has lead to a questioning of the consistency and comparability of financial statements prepared and presented in different jurisdictions. Two approaches are widespread, which deal with the issue of financial consistency and comparability across nations and organizations; the accounting approach and the statistical approach. Whilst the former uses accounting standards for the preparation and presentation of general purpose financial statements, the later emphasizes the statistical bases for producing accounting information for economic analysis and policy making. With the statistical approach, the IMF’s Government Financial Statistical Manual (GFS Manual) is designed exclusively for the use of governments. All governments are required to submit annual financial returns, or GFS tables, to the IMF in line with the GFS Manual. Although it is accepted that not all governments, and especially those of developing countries, will not be able to apply the accrual aspects of the 2001 manual (IMF, 2001). Many countries
have adopted both approaches providing widely different financial measurements. This seems not be an efficient way of using resources. There are several conflicting areas between these two approaches and consequently tensions between them. However, there are some promising bridges between these two approaches in applying and requiring consistent financial information. Harmonizing these two systems into a single set of government reports is a significant international issue in international public sector accounting.

The aim of this paper is to reflect international trends in government accounting by describing ongoing endeavours to harmonize the accounting and statistical approaches to financial reporting. In doing so, the paper reflects similarities and differences in these two approaches and progress made in achieving convergence between them in recent years. The paper proceeds as follows. The next section outlines the emergence of accrual accounting in the public sector. The following two sections provide descriptions of the accounting and the statistical bases of accounting with reference to the IPSASs and the GFS Manual respectively. Ongoing attempts to harmonize these two bases of accounting are then discussed in the section before the conclusion.

**Evolution and Proliferation of Accrual Accounting**

An aspect of new public management reforms is the move from cash to accrual accounting. Cash and accrual accounting have different principles for recognizing, recording and presenting financial information. While accrual accounting aims to recognize transactions and other events when the associated goods or services are used, cash accounting records transactions at the time cash is exchanged. Financial statements prepared and presented under the accrual basis of accounting include the statement of financial position, the statement of financial performance, the cash flow statement and the statement of change in net assets/equity (IFAC, 2007a). A statement of cash receipts and payments is the primary financial report under the cash basis, although many governments also provide a balance sheet including financial assets (for example, bank balances) and liabilities (for example, debts). Traditionally, governments have also provided detailed comparisons of actual receipts and payments with their agreed annual budget.

Accrual accounting has long been the generally accepted accounting basis for the private sector, whilst governments’ financial statements aimed to provide evidence of budgetary compliance. The cash basis of accounting was used by governments to discharge their accountability to parliament by showing that no money had been collected nor spent except in ways and amounts approved by parliament (Barton, 2007). With the rise of new public management, accrual accounting has been included as part of these reforms in at least some developed countries. The introduction of accrual accounting may be considered necessary to realize the potential benefits of new public management (FEE, 2006). Carlin (2005) outlines the supposed superiority of accrual accounting and reporting compared to
The adoption of accrual accounting enhances transparency and accountability both externally and internally. Next, accrual accounting leads to greater organizational performance and outputs though improved resource allocation. And, lastly accrual accounting allows public entities to identify full costs of their activities, which is pivotal to ensure greater efficiency. In contrast, others (for example, Connolly and Hyndman (2006) and Mellett et al., (2007)) have found that these presumed benefits have not been realized in practice.

The current moves towards accrual accounting, which began to take place in the late 1980s, primarily in Australia and New Zealand, is now claimed to be a global trend (although it has been used in some significant public sector jurisdictions for at least 150 years (Wynne, 2007)). Presently, more than half of the OECD member countries use some form of accrual accounting in their different administrative hierarchies (Matheson, 2002). Although the actual level of implementation, in central government ministries at least, has been relatively modest. Accrual accounting is also being introduced in some international organizations. The European Commission has been developing its general purpose financial statements on the accrual basis since 2005 (FEE, 2006). The UN aims to practice a full fledged accrual based system by 2010 (PWC, 2006). Other international organizations such as the OECD, IFAC, NATO and Interpol are in the process of implementing the accrual basis International Public Sector Accounting Standards. The main international frameworks for the statistical approaches to accounting, including the UN’s 1993 System of National Accounts, the European System of Accounts 95 and the IMF GFS Manual, have, in recent years, also adopted the accrual basis.

What is conspicuous, however, is the existence of multiple intermediary degrees of accrual accounting across countries and organizations. Chan (2003) categorizes these diversified forms of accrual accounting into four sub-groups; mild, moderate, strong and radical accrual. With mild accrual only short-term financial assets and liabilities are disclosed. Moderate accrual includes both the short term and long term financial assets and liabilities (and has actually been adopted by many governments broadly characterised as adopting the cash basis). In addition to short and long term assets and liabilities, strong accrual includes various categories of capital assets on the balance sheet. Radical accruals also reports legislated entitlement benefits as liabilities (for example, the cost of future state pensions). Countries have also adopted different methods for valuing assets ranging from original cost to value in use. The adoption of these varying degrees of accrual accounting has resulted in heterogeneity and inconsistency in the preparation and presentation of financial statements between jurisdictions.

At the national government level, there are two approaches which aim to reduce these ambiguities in financial reporting; the accounting approach and the statistical approach. The former consists of accounting standards, particularly International Public Sector Accounting Standards. The statistical approach is dominated by the IMF’s GFS Manual. The existence of these two systems has created tensions and questions about which sets of figures to accept and use, especially for countries preparing financial statements by
applying both approaches. In recent years, academicians, professional accountants and
users have been looking at the possible convergence between these two approaches to
accrual accounting. An International Task Force on the Harmonization of Public Sector
Accounting (TFHPSA) has been the forum to address this convergence.

An Accounting Approach to Harmonizing Government Accounting Practices

Globalization is credited with, among other things, the shrinking of the world and the
interdependence of major national economies (Barrett et al., 2005). This is striking also in
the government sector because governments today are not confined within their specified
territories. In fact, they have penetrated the global capital markets by issuing large debts
and holding significant equity investments. Their transactions are exerting an immediate
and substantial impact on multiple markets simultaneously. Additional to preparing and
presenting reliable and transparent accounting reports for sound decision making,
governments are therefore forced to reduce the prevailing diversities and inconsistencies in
accounting. These weaken the comparability of government financial information and
make the interpretation of financial statements difficult for holders of government debt
instruments (Alijarde, 2003).

Public sector accounting standards are often envisaged as a panacea in dealing with these
perceived diversities in financial reporting. Some countries, for instance, Australia and
New Zealand, have adopted a sector neutral approach and imposed IFRSs both for private
and public entities (Barton, 2007). There is however a growing interest on International
Public Sector Accounting Standards (IPSASs), especially after the WTO’s Singapore
declaration in 1996, which acknowledged IFAC as the ‘setters of international standards
for the accounting profession’ (Humphrey et al., 2006). The International Public Sector
Accounting Standards Board (IPSASB) (formerly the Public Sector Committee) is the
mandated body for issuing IPSASs under the auspicious of the International Federation of
Accountants (IFAC).

The IPSASB has issued 26 accrual basis IPSASs and a comprehensive cash basis IPSAS.
IPSASs specify criteria to recognize, measure, present and disclose transactions and events
in general purpose financial statements tailored to meet the demand of users that are unable
to ask for special information, for instance, taxpayers, members of legislature, creditors,
suppliers, the media and employees (IFAC, 2007a). The accrual basis IPSASs are to a
large extent based on the International Financial Reporting Standards (IFRSs). They
interpret the relevant IFRSs for the public sector, but also deal with those issues that are
either not addressed in the existing IFRSs or those issues for which there is no IFRSs.

The purpose of the cash basis IPSAS, i.e. ‘Financial Reporting under the Cash Basis of
Accounting’, is to improve the quality of cash statements, primarily the statements of cash
receipts and payments. The introduction of the cash basis IPSAS was seen as “an important
step forward in improving the consistency and comparability of financial reporting under
the cash basis of accounting” (Cash Basis IPSAS page 1). However, the IPSASB also
encourages governments to progress to the accrual basis of accounting. In addition to cash disclosures the cash IPSAS therefore encourages public sector entities to disclose voluntarily accrual-based information about assets and liabilities (paragraph 2.1.34 of the Cash IPSAS).

Some of the benefits of IPSASs include the application of the consistence and coherent financial reporting systems, both within a country and between countries, and the potential harmonization of financial reporting across jurisdictions (Adhemar, 2006). However, these attributes are undermined by the fact that so few governments have actually adopted the standards that are broadly consistent with IPSAS (IFAC, 2007b: page 4). According to Chan (2005), developing countries are the primary potential users of IPSASs. The major resource suppliers to developing nations such as the World Bank, the Asian Development Bank, and the UN have endorsed IPSASs for use in accounting for the financial assistance they offer. Reports on the accounting and auditing gap assessment, prepared by the World Bank for the South Asian countries, for instance, show that all South Asian countries (Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka) are either making or are committed to make a transition towards IPSASs, although it is likely that they will only adopt accrual accounting within the long term (Subramanian, 2007). In addition to developing countries, a few other countries that have already issued accounting standards for their public entities are considering IPSASs an input in the development of new standards or in the revision of existing standards in recent years (Dupuis et al., 2006).

Apart from issuing IPSASs and promoting convergence of IPSASs with IFRSs, the IPSASB is involved with two other programmes in co-operation with a number of national standards setters and international organizations. One of these includes the development of a public sector accounting conceptual framework. The framework that is anticipated to be completed by 2011 aims at aligning public sector accounting standards in many countries with IPSASs (IPSASB, 2006). The second programme is related to harmonizing IPSASs and the statistical bases of financial reporting, especially the IMF’s GFS Manual. The harmonization between these two bases of accounting is necessary to minimize the duplication of efforts in producing information for different reporting approaches and improving the reliability of accounting information.

A Statistical Approach to Producing Government Accounting Information

The IMF emphasizes the importance of the GFS Manual in terms of ensuring accountability and transparency in government finances, operations and oversight. The manual provides guidance on compiling detailed fiscal statistics on the general government sector and analyzing the impacts of the government’s operations on other sectors of the economy. The fiscal statistics required by the GFS Manual basically demonstrate resource mobilization, monetary condition, national indebtedness, the level of tax, tariff protection and the social safety net (IMF, 2001). Such statistics are necessary to delineate a government’s overall contribution to aggregate national demand, investment, and saving. Moreover, they can also be used to report and evaluate the effectiveness of a government’s spending, the sustainability of fiscal policies, net debt, net wealth and contingent claims against governments.

The GFS Manual 2001 updates the earlier manual (1986 GFS Manual) in five main areas; coverage, basis of recording, valuation, balance sheet and integration of flows and stocks. The GFS Manual 2001 defines the general government sector, which is its main coverage, on the basis of institutional units analogous to that used in the 1993 SNA. In contrast, the 1986 GFS Manual adopted a functional basis and incorporates the transactions of any unit within the boarder public sector performing a function of government. While the 1986 GFS Manual is developed on the cash basis, the GFS Manual 2001 adopts the accrual basis. The GFS Manual 2001 uses current market prices for the valuation of assets, liabilities, net worth and other economic flows. The 1986 GFS Manual differs in the way that debt securities are to be valued; the amounts which the government is obligated to pay when the debts mature. Such amounts often vary from the current market value. Another divergence between the two manuals exists on the presentation of the balance sheet. The GFS Manual 2001 requires the presentation of a more comprehensive balance sheet, which should include all financial assets, non-financial assets, liabilities, and net worth. In contrast, the 1986 Manual incorporates only the stocks of certain debt liabilities onto the balance sheet. The GFS Manual 2001 therefore permits governments to integrate their flows and stocks and reconcile variations between the opening and closing balance sheets, which are not possible from the approach outlined in the 1986 GFS Manual without the collection of additional information.

The analytical frameworks and balancing items required by the GFS Manual 2001 are concerned with providing a range of possibilities on fiscal liquidity and sustainability issues. The manual is built upon four analytical statements: statement of government operations, statement of other economic flows, balance sheet, and statement of sources and uses of cash. The statement of government operations includes summary information on all transactions during an accounting period and derives analytical balances from this information. The second statement, i.e. the statement of other economic flows, portrays changes in net worth. The balance sheet presents the stocks of assets, liabilities and net worth at the beginning and the end of the fiscal year. The last statement, i.e. the statement
of sources and uses of cash, is meant to reflect cash flows from operations and other transactions related to assets and liabilities.

Incorporated in these four statements, the main balancing items of the GFS Manual 2001 are net operating balance, net lending/borrowing, and net worth. The net operating balance provides a summary of the effects of a government’s transactions on net worth, which is derived by subtracting revenues from expenses. Another balancing item, i.e. net lending/borrowing is calculated by deducting the net acquisition of nonfinancial assets from the net operating balance. The balance of net lending/borrowing reflects the extent to which governments either provide financial resources to the other sectors of the economy and the rest of the world (net lending) or consume resources produced by the other sectors (net borrowing) (Bjorgvinsson, 2004). The final item, net worth, is meant to show a variation between governments' total assets and total liabilities (although, like other systems, the right to tax, the largest asset of almost all governments, is ignored). These balancing items along with the analytical frameworks used in the GFS Manual 2001 show that the later is more focused on an economic sector rather than an entity which is the focus for accounting standards.

### Harmonization of the Accounting and Statistical Bases of Accounting

As discussed above, the IPSASs and IFRSs are the accounting approaches to financial reporting. The accounting approaches are intended to serve those users, who are not in a position to express their specific needs, by providing information in a format and context they can best understand (DiPiazza et al., 2006). The statistical approach presents another way of financial reporting that enable policymakers and analysts to study the economic and financial developments in the general government sector or the public sector in a consistent and systematic manner (IFAC, 2005). The 1993 System of National Accounts (1993 SNA) - produced jointly by the UN, IMF, the European Commission, the OECD and the World Bank - is the overarching model for macroeconomic statistics. The 1993 SNA provides a frame for the detailed description of the total national economy and its components including the general government sector and its relations with other sectors and economies. Other internationally acknowledged statistical models, for instance, the European System of Accounts (ESA 95) and the GFS Manual 2001 are largely consistent with the 1993 SNA. The 1993 SNA is being updated with the objective of publishing a revision in 2008.

The accounting and statistical bases for reporting financial information possess a number of similarities as well as differences. They offer some promising bridges as they represent a collective effort by international organizations to contribute both to the accounting profession and economic growth and development of a nation. Each of these systems provides a distinct perspective on the same underlying economic realities (Laliberte, 2004). The national accounts, for instance, portray a macro reading of the economic activities of entities, which are presented in accounting statements at the micro level. While accounting
data provides a basis for the production of national accounts, the aggregated statistics envisage the economic events, which are to be measured by accounting statements. These two bases of accounting have also many similarities in the recognition and measurement of financial information due to the adoption of accrual principles, and in some cases have a similar type of report structure (IFAC, 2005).

Despite some similarities, the two systems of accounting can be differentiated substantially in terms of objectives and scope (Laliberte, 2004). Accountability and decision making are the primary objectives of accounting statements. On the other hand, the objective of the statistical reporting bases is to provide economic data by describing the behavior of all the economic units of a national economy. The reporting unit for the statistical guidelines is defined by an economic sector, which consists of an institutional entity or a group of entities (Dupuis et al., 2006). In contrast, the accounting statements incorporate and report the financial results of individual entities and collections of such entities. While the statistical bases are top down the accounting approaches are bottom up starting with individual entities. Moreover, these two bases of accounting can also be differentiated on the basis of ownership relationships and recognition and measurement of assets, liabilities and net equity (IFAC, 2005).

Technological and methodological differences are however envisaged not only between the accounting and statistical approaches but also among the statistical bases, particularly between the GFS Manual 2001 and the other statistical approaches, despite attempts at harmonization. The GFS Manual, for instance, is more focused on fiscal analysis and deals with statistics related to financial operations, financial position and liquidity situation within the general government sector. The manual addresses financial transactions related to taxing, spending, borrowing and lending. In contrast, the other statistical bases cover the entire public sector. They are designed for economic analysis and therefore demonstrate the balance of payments and monetary and financial statistics, which report the production and consumption of goods and services. Table 1 summarizes the existing differences between the GFS Manual and the other statistical bases.

Table 1. Differences between the GFS Manual and the Other Statistical Bases

<table>
<thead>
<tr>
<th>Areas</th>
<th>The GFS Manual</th>
<th>The 1993 SNA, ESA 95 and the Other Statistical Bases</th>
</tr>
</thead>
<tbody>
<tr>
<td>Objective</td>
<td>Fiscal analysis (cover the performance of the general government sector).</td>
<td>Economic analysis (cover the broader public sector).</td>
</tr>
<tr>
<td>Coverage</td>
<td>Taxing, spending, borrowing and lending</td>
<td>Production and consumption of goods and services.</td>
</tr>
<tr>
<td>Design</td>
<td>For statistics related to the financial operations, financial position and liquidity situation.</td>
<td>For the balance of payments and monetary and financial statistics.</td>
</tr>
</tbody>
</table>
The variations between the GFS Manual and the other statistical bases, and accounting bases for financial reporting have confused the users of financial reports (IFAC, 2005). The demand for convergence between these reporting systems is therefore increasing. It is suggested that ‘convergence would minimize costly duplication of efforts in producing information for different reporting bases’ (IFAC, 2005, Page 15). In that way, it could offer an efficient way of using resources. Additionally, it is seen that the reports produced under the different bases are purported to reflect the same economic phenomena using accrual principles but with different results. Convergence is therefore emphasized also to improve the reliability of the information.

The International Task Force on Harmonization of Public Sector Accounting (TFHPSA) is in operation since 2003 in order to address this issue of achieving convergence. The task force consists of senior statisticians and public sector accountants from various countries, and representatives of international and regions agencies (European Central bank, Eurostat, IMF, IFAC-IPSASB, OECD and World Bank). It is tasked with examining ways of minimizing unnecessary differences between the accounting and statistical approaches to financial reporting (IFAC, 2005). The task force has also been the forum for making recommendations to various groups including the IPSASB and IMF involved in providing inputs to the update of the System of National Accounts 1993 (1993 SNA) by 2008. Chaired by the IMF, the task force operates on the basis of two working groups (WGs). WG I, led by the IPSASB, deals with the harmonization issues between the accounting and statistical standards, particularly between the IPSASs and the GFS Manual 2001. It also monitors the convergence activities of international accounting and statistical bodies responsible for setting financial reporting requirements. WG II, on the other hand, focuses on issues related to the harmonization of the GFS Manual 2001 and the 1993 SNA/ESA95. The group, which is chaired by the OECD, also provides inputs to the revision of the 1993 SNA (IFAC, 2005).

The WGI has in recent years made a number of recommendations for achieving convergence between the accounting and statistical approaches to reporting financial information. The primary one is concerned with the development of IPSASs that allow disclosure of information about the general government sector (as defined in the statistical approaches) in whole of government general purpose financial statements (IFAC, 2005). Another recommendation is the development or amendment of IPSASs that will require or allow the adoption of current values in IPSASs. Moreover, the working group has demonstrated the need for formulating a long term project on reporting financial performance that integrates the distinction between transactions and other economic flows adopted by the statistical approaches. At the same time, the working group has also envisaged some differences, which may not be overcome in the longer term due to the different objectives and focuses of the accounting and statistical financial reporting bases. The major issues in which these differences are identified include; accounting for controlled, determination of net assets/equity and contributions from owners, tax effect
accounting, investment in associates, biological assets and formats and presentation of the statement of financial performance, among others. In the longer term it is therefore emphasized to develop a reconciliation statement to deal with these differences and to illustrate the relationship between accounting and statistical reporting bases (IFAC, 2005).

Conclusion

The adoption of accrual accounting has often been integral to New Public Management reforms over the past few decades. This transition towards accrual accounting has been the subject of considerable debate drawing arguments both in support for and against the project. There is however a great variation in the approaches adopted for accrual accounting, even in the few countries which have implemented such reforms. This has led to ambiguities in the comprehension of financial statements between governments. IFAC has been exhorting the governments to consider the use of IPSASs as a possible remedy to these variations in financial reporting. In contrast, a number of organizations are preparing and promoting statistical approaches, which emphasise macroeconomic developments in the government sector. The IMF presents the GFS Manual 2001, as a basis of financial reporting by governments. While there are many similarities, there are also many differences and tensions between these approaches to financial reporting. Many governments have in fact adopted both the systems of reporting. In recent years, the issue of achieving convergence between the accounting and statistical approaches to reporting has gained increased international attention. The TFHPSA is actively seeking convergence between the accounting and statistical approaches and also between the different statistical bases. Ongoing reforms and concerns on achieving convergence have eventually made public sector accounting an international issue and an emerging arena for further research.
References


GOVERNMENT FINANCE
STATISTICS IN TURKEY

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Introduction

The foundation of modern public financial reporting lies in the communication of financial information about the government’s activities to its citizens and their representatives in parliament. This information should refer to the activities of public administrators for the entire state, covering pre-determined periods. This is a key aspect of the accountability of the Government and its administration to parliament and the electorate more widely. It is increasingly a requirement of international obligations as required by, for example, the IMF and the European Union.

In Turkey there will be challenges in providing financial information in the required formats. These will include technical, legal, financial data quality and consolidation of financial data, human resources etc. In this study some of these problems are investigated and ideas are offered clear to help the authorities in harmonizing the two systems.

The study provides a literature review of Government Finance Statistics and Disclosures in international and local level and interviews with key persons in Turkey. The next section introduces the statistical approaches to financial reporting developed by the UN and IMF. The third section considers the differences between the international public sector accounting standards and this statistical approach. The fourth section considers the approach adopted by Turkish Governments for accounting and financial reporting. The paper ends with a conclusion.

Financial Reporting in Government Sector

The Structure of the Public Sector

Government structures are generally more complex than the structures of private sector organisations. Figure 1 illustrates¹ common government levels and sectors. Budgeting and accounting methods have generally differed between levels and sectors—for instance,

¹ http://www.adb.org/Documents/Reports/Accrual_Budgeting_Accounting/chap02.pdf
central government agencies might use cash accounting while provincial and local governments, state enterprises, and statutory bodies prepare accrual-based reports.

The Turkish Government like most other governments owns and controls a number of state enterprises. Although these enterprises may appear to be run in a comparable manner to private sector companies their primary objective is to provide goods and services and not to produce a profit. However, in recent years it has been accepted that such entities should adopt the private sector approach to financial reporting. This has emphasised the importance of their annual surplus (profit) or loss which has often consequently been adopted as the main measure of their success. This is despite the fact that such organisations are usually part of the public sector because of the importance of the goods or services which they provide and because these were not adequately provided by private sector companies.

Figure: 1 Common Government Accounting and Reporting Structures

**International Standards for Public Sector Financial Reporting**

Government accounting systems determine how financial and statistical information is prepared and presented. The three major international systems have slightly different
purposes and applicability —Figure 2 illustrates\textsuperscript{2} differences in coverage. However, the prime aim is to increase the level of comparability of national financial statistics to facilitate comparisons between countries.

- The European Union (EU), International Monetary Fund (IMF), OECD, United Nations (UN) and World Bank jointly publish the System of National Accounts (SNA). It compiles aggregate financial statistics for an entire economy. The public and private sector activities are combined together.

- The IMF Government Finance Statistics (GFS) is a specialized system intended to support public sector analysis. The IMF designed GFS so that government financial information could be compared across economies.

- The International Federation of Accountants (IFAC) began promulgating International Public Sector Accounting Standards (IPSAS) in 2000. They are designed for use in the preparation of general purpose financial reports by public sector entities (individual government agencies or whole-of-government reports).

![Figure: 2 Coverage of Accounting/Statistical Systems](image_url)

SNA, GFS and IPSAS have been developed, or radically overhauled, in the past 15 years—all are now accrual based (although most governments still submit cash based GFS returns and produce cash based financial statements). The European System of Accounts (ESA 95) also mandates accrual-based financial reporting.

\textsuperscript{2} http://www.adb.org/Documents/Reports/Accrual_Budgeting_Accounting/chap02.pdf
**System of National Accounts**

The 1993 System of National Accounts (1993 SNA) is a conceptual framework that sets the international statistical standard for the measurement of the market economy. It is published jointly by the United Nations, the European Commission, the International Monetary Fund, the Organisation for Economic Co-operation and Development, and the World Bank.

**Government Finance Statistics**

Government Finance Statistics (GFS) is an internationally accepted system for presenting data on the financial activities of government in a format suitable for economic analyses, planning, and policy determination. The GFS table is a statistical statement that systematically summarizes, for a specific time period, the economic transactions of the government with other units. GFS focus upon financial transactions - taxing, borrowing, spending, and lending - rather than on the utilization of labour, the consumption and production of goods and services, and other measures of physical volume. The GFS organizes transactions in categories dealing with aspects of government activity such as revenue, expenditure, and deficit/surplus that arises when spending is higher/lower than revenue. Also included in the GFS are tables covering the financing of any deficit/surplus, as well as tables on outstanding debt of the government.

The Government Finance Statistics Manual 2001 (IMF - GFS Manual) relates to other statistical systems which include the overarching 1993 SNA and two specialized systems that focus on the balance of payments and monetary and financial statistics. The GFS manual draws heavily on the text of the 1993 SNA to avoid the inference that different meanings are intended.

Separate statistics about government finances are needed because of (i) the important role of the government in a nation’s economy. Governments affect the economy through taxation policies, expenditure policies (e.g., subsidies), and financing activities (e.g., borrowing on the financial markets), (ii) the special characters of governments activities (the activities are selective, and the motivation to carry out the activities are different for the government compared to other units in the economy - policy rather than profit), and (iii) the need to monitor the government’s operations and financial needs.³

GFS is distinguished from two other accounting systems of government records/accounts and national accounts statistics. Government accounts are maintained by operating units for purposes of control and accountability, while national accounts recast the income and expenditure of government in a form common to all institutional sectors in the economy so

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as to measure and aggregate their production, consumption, other income and expenditures, capital accumulation and finance, as well as capital and financial balances. All systems meet separate and important needs, however, they are closely linked together in the way that government, or administrative, accounts are the source for GFS, and GFS provide data that are necessary for the compilation of national accounts statistics. The IMF released a revised GFS Manual in 2001 (see Box 1).

In recent years, public sector financial analysts have become increasingly interested in assessing the effectiveness of spending on poverty reduction, the sustainability of fiscal policies, net debt, net wealth, and contingent claims against government, including obligations for social security pensions. Given these widened objectives for fiscal analysis, the revised GFS Manual has introduced the accrual basis of recording economic events. GFS concepts and principles are now harmonized with those of 1993 SNA so that government finance statistics can be used jointly with other macroeconomic statistics.

The GFS system is designed to provide statistics that enable policymakers and analysts to study developments in the financial operations, financial position, and liquidity situation of the general government sector (GGS) or the public sector in a consistent and systematic manner. The GFS analytic framework can be used to analyze the operations of a specific level of government and transactions between levels of government as well as the entire general government or public sector.

Two types of flows are recorded in the GFS system:
1-Transactions and
2- Other economic flows.

For the most part, transactions are interactions between two institutional units that take place by mutual agreement. The Statement of Government Operations records the results of all transactions during an accounting period and classifies them as revenue, expense, net acquisitions of non-financial assets, net acquisitions of financial assets, or net incurrence of liabilities. Transactions that generate revenue or expense result in a change in net worth. Other types of transactions result in equal changes to assets and/or liabilities and do not result in a change to net worth.

The Balance Sheet (for the general government or public sector) is a statement of the stocks of financial and non-financial assets owned, the stock of claims of other units against the owners of those assets in the form of liabilities, and the sector’s net worth, equal to the total value of all assets less the total value of all liabilities.

Various classifications are applied to the flows and stocks recorded in the GFS system. For example, each revenue transaction is classified according to whether it is a tax or another type of revenue; expense transactions are classified by purpose and by economic type; assets are classified according to whether they are financial or non-financial; and financial
assets and liabilities are classified both by type of instrument and the sector of the unit that issued the asset held by government or that holds the liability issued by government.\textsuperscript{4}

\section*{International Public Sector Accounting Standards and Government Finance Statistics}

\subsection*{International Public Sector Accounting Standards}

The International Federation of Accountants (IFAC) began issuing accrual-based Public Sector Accounting Standards (IPSASs) in May 2000. IFAC has issued 26 accrual-based IPSASs and a comprehensive cash-based IPSAS. The accrual-based IPSASs are based on the private sector International Accounting Standards (IAS) which are now being re-named as International Financial Reporting Standards (IFRS). Entities which say they are applying the accrual-based IPSAS prepare their financial statements in accordance with all of the 26 accrual-based IPSAS.

The use of accrual accounting by public sector entities is still unusual. Very few governments have actually adopted this approach, certainly at the national level. Spain was possibly the first in 1989 followed by the celebrated case of New Zealand by 1993 and Australia in 1994. A few other countries followed over the next decade or so, but the total is still around 10 of the nearly 200 countries in the world. Even fewer have adopted the accrual basis for their central government budgeting system\textsuperscript{5}.

\begin{table}[h]
\centering
\begin{tabular}{|l|c|c|}
\hline
Country & Adopted by central government & Accrual budgeting used \\
\hline
Spain & 1989 & No \\
New Zealand & 1993 & Yes \\
Sweden & 1993 & Yes \\
Australia & 1994 & Yes \\
USA & 1998 & No \\
UK & 2002 & Yes \\
Canada & 2003 & No \\
Finland & 2005 & No \\
France & 2006 & No \\
\hline
\end{tabular}
\caption{Adoption of Accrual Accounting}
\end{table}

No countries directly refer to the accrual-based IPSAS as their public sector reporting standards (all the above countries have developed their own standards). However, there is a trend for countries to refer to IPSAS when developing such government accounting

\textsuperscript{5} Wynne 2007
standards. For instance, in designing its government budgetary reforms, the Peoples Republic of China referred to IPSAS 13. Additionally, the Public Sector Commission of the Spanish Association for Accounting and Business Administration is preparing a conceptual framework for public entities, mostly in line with IPSAS. Furthermore; several international organizations have recently decided to implement the accrual-based IPSASs (e.g., European Commission, OECD and the United Nations).  

Disclosure of Financial Information about the General Government Sector (IPSAS 22)

Statistical bases of financial reporting such as the 1993 SNA, GFS Manual, and the ESA 95 require governments to compile financial information about the general government sector. For statistical purposes, the general government sector comprises government controlled entities primarily engaged in non-market activities. The general government sector is sometimes described as comprising those entities that fulfil the core functions of government as their primary activity.

Current IPSASs require entities to prepare financial statements that include information about all the resources controlled by the reporting entity, and prescribe rules for consolidation of all controlled entities. IPSASs also require financial statements to make disclosures about segments. A segment is defined as “a distinguishable activity or group of activities of an entity for which it is appropriate to separately report financial information for the purpose of evaluating the entity’s past performance in achieving its objectives and for making decisions about the future allocation of resources.” IPSASs do not require public sector entities to disclose information about the GGS in their financial statements.

The objective of IPSAS 22 is to prescribe disclosure requirements for governments which elect to present information about the General Government Sector (GGS) in their consolidated financial statements. The disclosure of appropriate information about the GGS can enhance the transparency of financial reports, and provide for a better understanding of the relationship between the market and non-market activities of the government and between financial statements and statistical bases of financial reporting.

Governments raise funds from taxes, transfers and a range of non-market and market activities to fund their service delivery activities. They operate through a variety of entities to provide goods and services to their constituents. Some entities rely primarily on appropriations or allocations from taxes or other government revenues to fund their service delivery activities, but may also undertake additional revenue generating activities including commercial activities in some cases. Other entities may generate their funds primarily or substantially from commercial activities.

http://www.adb.org/Documents/Reports/Accrual_Budgeting_Accounting/chap02.pdf

IPSAS 22, IN2.
Disclosures

IPSAS 22 requires the amounts disclosed in respect of the GGS to be reconciled to their equivalent amounts in the consolidated financial statements of the government. In addition, entities may, but are not required to, disclose separately the amount of the adjustment to each item attributable to the PFC and the PNFC sectors. This reconciliation will enable the government to better discharge its accountability obligations by demonstrating the relationship between the amounts of each item for the GGS with the total amount of that item for the government.

GOVERNMENT ACCOUNTING AND FINANCE STATISTICS IN TURKEY

Turkish Administrative System
Turkey has a tradition of centralized government. There are 81 Provincial Administrations in Turkey that are not considered to be part of local administrations however. Each province is administered by a governor appointed by the Council of Ministers and approved by the President. The provincial government consists of the governor and five members from amongst the Provincial Council, whose members are elected by popular vote. Provincial administrations have a coordinating role within their province, but not a supervisory role of the municipalities located in their territory.

There are also 81 Special Provincial Administrations that are governed by Law No. 5302 of February 22, 2005. The role of Special Provincial Administrations is improving. Although there is interaction between Provincial Administrations and Special Provincial Administrations, they remain two separate administrative structures. Provincial functions fall into two parts:

(i) General provincial functions such as services for meeting health requirements, agriculture, industry and trade; environmental planning of the province, public works and settlement.

(ii) Municipal functions for the rural areas outside municipal jurisdictions. They also provide water and sewage services outside municipal boundaries.

Municipalities fall under the Law No. 5393 of July 3, 2005. There are 3225 municipalities in the country, with a prescribed minimum population of 5,000 persons, covering about three quarters of the country’s territory. Smaller settlements are considered villages, and fall directly under the authority of provincial administrations. The municipalities’ executives (mayors) and local assemblies are elected by popular vote. According to Article 14 of the law, municipalities must primarily provide urban infrastructure services and important functions such as education and health.
There are 16 Metropolitan municipalities and they are subject to Law No. 5216 of July 10, 2004. They are formed from urban areas whose total population exceeds 750,000 persons. Municipalities continue to exist under the umbrella of the metropolis (for instance there are 34 municipalities in the capital city Ankara). Their responsibilities include strategic urban planning and other metropolitan services including water and sewerage.

General government is broadly defined in accordance with Government Finance Statistics (GFS) principles. The units of general government are listed in Box 1. There are, however, several problems relative to GFS definitions. The general government sector according to the new Public Financial Management and Control Law\(^8\) includes some commercial activities undertaken by certain revolving funds (the authorities have not yet performed a full assessment of their activities). On the other hand, the definition excludes foundations set up by line ministries. It also excludes a special bank (İller Bank) which, while nominally an investment Bank, operates under the Ministry of Public Works and has many characteristics of an extra-budgetary fund (it provides financial and other services to municipalities, and invests in municipal infrastructure). The definition of general government employed in the Central Bank of Turkey’s monetary survey is slightly different: it includes ministerial foundations, but excludes the savings and deposit insurance fund. It, too, excludes İller Bank.

**Box 1. General Government in Turkey\(^9\)**

General government in Turkey comprises the following at present:

**Central Government Units Covered by the Budget**

1. General Public Services, including parliament, president’s office, judiciary, and 51 other ministries and agencies
2. Special budget agencies, including universities (102 in total)

**Central Government Units with Individual Budgets**

3. Extra budgetary Funds (5), including the Defence Industry Support Fund, the Social Solidarity and Aid Fund, the Privatization Authority, the Promotions Fund and the Savings and Deposit Insurance Fund (excluded by the Central Bank of Turkey).
4. Social security institutions (5), including SSK (workers), Bag-Kur (self-employed and agriculture), Emekli-Sandiği (civil servants), Is-Kur (unemployed), and Amele Birligi (coal workers fund)
5. Regulatory boards (10)
6. Revolving funds (1,434) (the law adds some commercial funds)
7. Ministerial foundations (excluded by the law)

**Local Government**

8. Special Provincial Administrations (81)
9. Metropolitan municipalities (16)

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\(^8\) Official Gazette, 24-12-2003.

10. Other municipalities (3,212)
11. Extra-budgetary Funds (Ille Bank and Central Bank of Turkey)
12. Semi-autonomous bodies under metropolitan municipalities (gas, water and sewer administrations)

The government owns significant shareholdings in a number of corporations, which are governed by appointed Boards. The 39 state economic enterprises in the government’s portfolio (Table 1) were expected to produce earnings (before interest, taxes, depreciation, amortization, and other provisions) of about 2 percent of Gross Domestic Product (GDP) in 2005\textsuperscript{10}. IPSAS-22 paragraph 16 says:

*Government Business Enterprises (GBEs) include both trading enterprises, such as utilities, and financial enterprises, such as financial institutions. GBEs are, in substance, no different from entities conducting similar activities in the private sector. GBEs generally operate to make a profit, although some may have limited community service obligations under which they are required to provide some individuals and organizations in the community with goods and services at either no charge or a significantly reduced charge.*

Five of these enterprises are listed companies with minority private holdings, and are thus subject to more stringent audit and reporting requirements. The government also fully owns three large state banks, which account for 36 percent of banking system assets, and 41 percent of deposits.

**Government Accounting Applications in Turkey**

**History**
The Ottoman Empire existed from 1299 to 1922 developing many institutions and organizations which were advanced compared to its contemporaries. The accounting system developed during the Ottoman era was successful in establishing and preserving detailed records of expenses and revenues over centuries which in its peak had spread through to Hungary and Algeria in the west, Crimea in the north, Middle East in the east and almost to the Sahara in the south. Ottoman rulers were flexible in their adaptation of experiences of previous Turkish-Islamic states. Accountancy profession with its roots in the Emawiad, Abbasid, Ilhans and Seljuk states was perfected under Ottoman rule.\textsuperscript{11}

In the pre-Ottoman era the term “siyakat” was used to refer to accountancy profession. The oldest accounting book to survive to the present day is the “Sa’adetname” written by

\textsuperscript{10} International Monetary Fund, 2006, p.5.
Felek-alay-i Tebrizi in 1307, 187 years before Pacioli who, in the west at least, is accepted as the founder of modern accounting\textsuperscript{12}.

Turkish accounting practices, at least until the 19th century, followed the traditional Ottoman approach. This system was developed indigenously by the Ottomans and was completely different to the system of single entry bookkeeping which had been developed in Western Europe. The Ottoman Empire’s initial experience with double entry bookkeeping dates from the second half of the 19th century\textsuperscript{13}.

**General Accounting Law**

The General Accounting Law No 1050 was adopted in 1927. The Ministry of Finance (Ministry of Finance), based on this authority, established an accounting system for administrations with general and annexed budgets. This mainly covered the recording and reporting the results of budget transactions.

More recently, the Government Accounting Regulation was published in 1990. This Regulation extends the basis of government accounting beyond the cash basis to include the following:

- liabilities, such as trusts and loans with no cash creation capacity,
- assets such as participations, loans and extra-budgetary capital formations, and
- transactions such as the recording of accrued revenues.

In 1999 the Ministry of Finance issued an Accounting Regulation requiring Establishments with Revolving Funds to adopt full accrual based accounting. This regulation is also consistent with private sector accounting principles. However, the idea of reporting the accounts for these funds along with the accounts of their parent administrations is gaining momentum. Revolving funds should be considered as part of the general government instead of a public corporation. This will allow for all the revenues received by a public institution from the institution’s budget and the revolving fund, and all the expenses made by the institution to be reported together.

Thus it is necessary to revise the Accounting Regulation for revolving funds, especially the operational accounts section, in accordance with the new revenue and expense classification of the GFS. In addition, their budgets should be prepared in line with this classification. The Ministry of Finance issued an Accounting Regulation\textsuperscript{14} in 1 May 2007. This regulation is also consistent with governmental sector accounting principles.

\textsuperscript{12} Toraman, C. Ögreten, A., Yılmaz, S., . , p.3-4.
\textsuperscript{13} Toraman, C. Ögreten, A., Yılmaz, S., p.3-4
\textsuperscript{14} Official Gazette, 1 May 2007. No: 26509.
The key criticism of the international financial institutions has been the inability to generate statistics for the general government. A summary of the problems identified in relation to government accounting in Turkey includes:15

- There were no common accounting and reporting standards,
- The public sector did not have a unified accounting system,
- The Accounting system concentrated on the implementation of the cash budget,
- Fixed assets and inventories were not recorded and reported,
- The government accounting system did not classify accounts in accordance with international standards; expenditure arrears are not captured and accounted for by the fiscal accounts (World Bank 2001),
- Transfers to local administrations were deducted from budget revenues,
- Accrued budget expenses were not recorded and reported,
- The existing accounting system was mostly focused on the cash budget,
- In the chart of accounts the accounts were not classified in accordance with the accounting and reporting principles and logic.

On December 31, 2002, the accounting and reporting standards and model chart of accounts were completed and were used from 1 January 2004. In 2004, the new accounting system started to be used in general and annexed budgets and the coverage of the new accounting system was extended to all other general government units, including all local authorities, in 2005.

**Public Financial Management and Control Law**

The Public Financial Management Control Law - (Law No. 5018) was adopted in December 2003 to replace the existing General Accounting Law No 1050 of 1927. It has been a challenge to implement all the provisions of the law by the deadline of 2007. The purpose of this Law was to regulate the structure and functioning of the public financial management, the preparation and implementation of the public budgets, the accounting and reporting of all financial transactions, and financial control in line with the politics and objectives covered in the development plans and programs, in order to ensure accountability, transparency and the effective, economic and efficient collection and utilization of public resources. This Law covers the financial management and control of public administrations within the scope of general government, encompassing public administrations within the scope of central government, social security institutions, and local administrations.

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The main changes in the budget process include:\footnote{International Monetary Fund, 2006, p.13}
- Increased coverage of the central government budget. The existing system excludes many institutions such as Extra-budgetary Funds, revolving funds, social security institutions and foundations. The new Public Financial Management Control Law, when fully implemented will abolish the remaining Extra-budgetary Funds and revolving funds and incorporate their activities in the central government budget on a gross basis. Remaining weaknesses will include the exclusion of, foundations and the Iller Bank. Social security institutions will also remain outside of central government budget coverage, although this is not consistent with the provisions of GFSM 2001.

- Adoption of a medium-term budget. The existing budget process is based on an annual budget horizon whereas the Public Financial Management Control Law provides for the adoption of a medium-term horizon of three years.

- Development of performance based budgeting. The existing budget system is input based with appropriations being approved on the basis of economic and functional input classifications. The Public Financial Management Control Law envisages the adoption of a performance based budgeting system which will necessitate the re-orientation of budget proposals to a more programmatic approach based on outputs and outcomes. It also plans for a more devolved system of budget management. The current financial management system is tightly controlled by the central government both at the budget preparation and execution stages. The new Public Financial Management Control Law envisages a system where the budget agencies take more control over the formulation and execution of their budgets. Spending agencies will develop their internal control function and the existing central ex-ante control apparatus will be dismantled with a focus on ex-post external audit and assessment of performance.

The Public Financial Management Control Law will improve the system of budget management, but three central institutions will continue to have a key role. The Ministry of Finance will remain responsible for budget preparation, budget execution, accounting and reporting, and revenue collection; the State Planning Office (State Planning Organisation) will continue to prepare and monitor the public investment program, develop the macroeconomic framework, and report public sector statistics; and the Treasury will remain responsible for cash and debt management, operations of most Extra-budgetary Funds and state owned enterprises, and relations with international financial institutions.

Coverage of the budget has improved since 2000, but full coverage of central government institutions remains incomplete under the existing budget system, the coverage of central government is limited to the general budget and annexed budget agencies. The number of
extra budgetary and revolving funds has, however, been considerably reduced since 2000. Nevertheless, five Extra-budgetary Funds remain, together with over 1,455 revolving funds which still conduct off-budget operations. These funds only report surpluses as transfers to the general budget, or the financing of deficits as transfers from the general budget. A large number of “foundations” which are closely linked to individual ministries and public agencies, collect resources through a number of means, including through the provision of public services, and operate outside the Budget framework and their activities are not reported within it. There are also ten regulatory bodies which are currently not included in the central government budget. 15 Social security institutions whose total expenditure is about 11 percent of GDP are also outside central budget coverage. They report to the Ministry of Labour and are audited by the High Audit Board of the Prime Minister, but the reports are not publicly available 17.

The full implementation of the Public Financial Management Control Law would apply the same budget systems to all general government and eliminate most, but not all, remaining omissions in coverage of central government. The new Public Financial Management Control Law includes all of the central government budgetary and Extra-budgetary Funds under a single budgetary framework. The remaining revolving funds are due to be abolished by 2007 and incorporated in the budgets of their controlling agencies.

Accounting and reporting of local government operations could be improved. Local governments report their final accounts to the Ministry of Information, which however does not publish information on budget outcomes. More comprehensive data (the final accounts of municipalities and Special Provincial Administrations) is available from the Statistical Office, but is only available with a lag of two years, often longer. Information on municipal government enterprises, which are growing in number and size, is incomplete.

Public Accounting System and Financial Statistics


“The accounting system shall be established and managed in a manner to constitute the basis for the preparation of financial reports and establishment of the final account and to ensure the efficient performance of the decision, control and accountability processes”. (Article 49)

“Public accounts shall be kept with a view to provide necessary information for the public and for the officials in charge of management and audit, by ensuring that all kinds of transactions on revenues, expenditures and assets of the public administrations and

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17 International Monetary Fund, 2006, p.13-14
transactions having financial consequences, or causing a decrease or increase in the equity, and guarantees and liabilities are recorded in the accounts under a defined system”. (Article 50)

The accounting and reporting standards to be implemented by the administrations within the scope of the general government, shall be set forth by the Government Accounting Standards Board to be established with the participation of the representatives of the Court of Accounts, Ministry of Finance, the Under-secretariat of the State Planning Organization, the Under-secretariat of Treasury and the other related organizations in accordance with the international standards within the organization of the Ministry of Finance. These standards will be published in the Official Gazette.

The arrangements regarding the form and types of the documents to be used in the accounting transactions, chart of accounts and accounting of the transactions shall be determined, in line with the Regulation, by the Ministry of Finance for the public administrations within the scope of the central government; by the concerned administrations for the social security institutions, and by the Ministry of Interior for local governments. The detailed chart of accounts of the public administrations within the scope of general government are determined by the Ministry of Finance.

An economic value shall be booked when it is produced, transformed, exchanged, transferred or terminated (accrual accounting). It is mandatory that all financial transactions are booked, and all accounting records are based on documents. (Article 50)

Article 52 of Public Financial Management Control Law is on Scope, Basic Principles and Institutional Environment of Financial Statistics. Financial statistics shall cover the financial transactions of the public administrations within the scope of general government. Within the framework of the principles of integrity, reliability, usefulness, methodological validity and accessibility and in consistency with the international standards, the financial statistics shall be prepared by the staffs, who have received proper professional training, on the basis of the data in the accounting records and by using statistical methods. During the preparation of the financial statistics, the administrators of public administrations shall take necessary measures for the creation of a suitable institutional environment.

Article 53 of Public Financial Management Control Law is on Preparing and Publicizing Financial Statistics. The financial statistics relating to public administrations within the scope of general government shall be compiled by the Ministry of Finance. The public administrations outside the scope of central government shall prepare their financial statistics in accordance with the predetermined principles and submit them to the Ministry of Finance within the prescribed periods.
The financial statistics of the public administrations within the scope of central government shall be published monthly by the Ministry of Finance\textsuperscript{18}. The financial statistics of the public administrations within the scope of general government shall be obtained through combining the financial statistics of the social security institutions, local administrations and the public administrations within the scope of central government, and shall be published quarterly by the Ministry of Finance. It is essential that the financial statistics are understandable and easily accessible to the users.

The annual financial statements shall be evaluated by the Court of Accounts in March of the following year in terms of preparation, publication, accuracy, reliability and conformity to the predetermined standards. The evaluation report prepared for this purpose by the Court of Accounts shall be submitted to the Turkish Grand National Assembly and the Ministry of Finance, and the Ministry of Finance shall take the necessary measures concerning these evaluations (Article 54).

**Recent Developments and Reforms on Accounting and Reporting**

The Public Financial Management Control Law revoked the authority of the Court of Accounts and Ministry of Finance to grant visas (authority for payments to be made resulting from pre-payment audit). Previously budget officers who worked in spending agencies were employees of Ministry of Finance, now they will be part of the financial service units within each spending agency\textsuperscript{19}.

An IT online accounting system has been developed by the Ministry of Finance called Say2000i. (Payments, Accounting and Reporting System) Up and running since 2002, 1,500 national nodes\textsuperscript{20} input to the system in real-time with all transactions being available immediately. The system can produce periodic financial statements without the typical delays of decentralized accounting systems. The system covers all general budgetary institutions except the Office of the President and accounting office for the State Debt within the Treasury. It includes the majority of special budget institutions and the regulatory supervisory agencies Say2000i system does not extend to social security institutions as well as local governments such as special provincial administrations and municipalities. The General Directorate of Budget and Fiscal Control (GDBFC) has developed Budget Management Information System (BYES - also called eBudget) to keep track of budget appropriations, allocations, and utilization\textsuperscript{21}. The interface between

\textsuperscript{18} Revolving fund enterprises established in the public administrations under the scope of PFMCL were to be restructured by 31/12/2007.
\textsuperscript{20} A node is a processing location in a network. A node can be a computer or some other device, such as a printer.
Say2000i and BYES ensures the transfer of data on budget allocations to the Say2000i system as well as actual expenditures from Say2000i back to BYES.

Periodic financial statements are prepared regularly and on time. General Directorate of Public Accounts prepares aggregated financial reports for the central government, which are published as a monthly bulletin. Since late 1998, the monthly data have also been publicly available on the General Directorate of Public Accounts website\textsuperscript{22}. A monthly public accounts bulletin (for the previous month) is published by the General Directorate of Public Accounts within 3 weeks of the previous month’s end. The accounts bulletin is recorded on a cumulative basis, with the December bulletin forming the basis of the annual budget execution report. The coverage of the monthly report is confined to the existing narrow definition of central government and does not include detailed information on Extra-budgetary Funds, social security institutions, revolving funds or foundations. The GDPA does not publish details of budget execution of local government. There is no separate formal in-year report produced for the Legislature.\textsuperscript{23}

Like most of the countries which have adopted accrual accounting, Turkey plans to adopt a “dual” system for budgeting and accounting using a cash-based approach for the budget and an accrual-based approach for accounting. Since the annual budgets are cash-based, the General Directorate of Public Accounts in the Ministry of Finance has devised an intricate method for accounting entries that keeps track of both the cash-based and accrual entries. Cash-based budget outturns are therefore easily distinguished from accrual-based expenditures.

Commitment accounting has also been introduced with the new accounting system. Say2000i can capture and set aside spending agency commitments against the budget appropriation and budget allocation, thus preventing budget commitments in excess of appropriations.

A uniform chart of accounts that is harmonized with budget classification has been implemented. The General Directorate of Public Accounts has issued a new framework for the accrual-based chart of accounts. It is harmonized with the economic classification of the newly adopted GFS budget classification system. A new chart of accounts enabled the General Directorate of Public Accounts to compile financial statements consistent with the 2001-GFS budget classification. Uniform accounting standards have been introduced and a single authority to set standards has been established. Article 49 of the Public Financial Management Control law mandates that accounting be harmonized with the international

\textsuperscript{22} http://www.muhasebat.gov.tr/mbulten/indexE.asp
\textsuperscript{23} The General Government Accounting Regulation is currently being reviewed by the Prime Minister’s office. For units outside the central government sector similar accounting regulations will be prepared, subject to Ministry of Finance approval. For local governments, a standard accounting regulation based on the State Accounting Regulation is being developed by the Ministry of the Interior, in consultation with (and subject to approval by) the Ministry of Finance.
standards and standards be issued by a Government Accounting Standards Board (GASB), which was established as the general government's sole standard-setting authority, and has been operating since June 2006. The GASB is under the Ministry of Finance, comprised of representatives from the Turkish Court of Accounts, State Planning Organization, Ministry of Finance, Treasury, and other agencies.

Public accountability of government is demonstrated in part by accounting standards that require fair presentation and full disclosure. The accounting regulation issued by General Directorate of Public Accounts in November 2003 was revised in June 2005. However, GASB, not the General Directorate of Public Accounts, has the authority to issue accounting standards for central government.

The Public Financial Management Control Law envisages secondary legislation to facilitate implementation of the law and provide detailed guidance to officials. For example, secondary legislation includes procedures for preliminary payment, transfer and set-off transactions, working principles for the GASB, and the accounting and reporting standards to be adopted.

Since 2004, institutions included in the general and annexed annual budget have reported on budget execution in line with the GFSM 2001 economic classification. Although all public institutions prepared, and have been implementing, their 2005 budgets in accordance with the Public Financial Management Control Law, only the general and annexed budgets were submitted for the approval of the Parliament. GFSM 2001 codes have been incorporated into the master chart of accounts (COA) for transaction items, but this has not yet been done for balance sheet items. As indicated earlier however, the 2005 budget was prepared in accordance with the provisions of the General Accounting Law of 1927 and therefore, many government expenditures were excluded or only partially recorded in the budget estimates. While the new COA is GFSM 2001 compliant, the budget classification system is still based on the GFSM 1986 system, which broadly aligns with the GFSM 2001 system but has some important differences. Extra-budgetary Funds, social security funds, and local governments currently have separate accounting systems, but from 2006 onwards will have to adopt accounting regulations based on the State Accounting Regulation approved by the Ministry of Finance. In order to do this extensive training of local government, Extra-budgetary Fund and the social security funds’ officials will be necessary.

In terms of reporting, some of the current weaknesses of the system will be addressed in the next Budget. The Turkish Constitution mandates that draft final accounts of budget should be submitted to the National Assembly within six months of the end of the fiscal

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25 A new chart of accounts has been prepared by the Ministry of Finance for revolving funds and waiting the approval of Turkish Court of Accounts.
year and that the Court of Accounts shall submit its certification within seventy five days of the submission. The Public Financial Management Control Law provides that the accounts will be submitted by the end of June with a copy to the Court of Accounts. This system works in practice. Reporting of final accounts is currently on an adjusted cash basis, although the Public Financial Management Control Law allows for the Ministry of Finance to determine the accounting principles to be adopted in preparation of the final accounts. Parliamentary scrutiny of the budget process will continue to be limited as long as the budget coverage remains affected by off-budget activities and the complexity of the budget structure. The Public Financial Management Control Law requires the reporting of central government accounts on a monthly basis, and general government accounts on a quarterly basis.

This would constitute an improvement over existing practices, where there is no consolidated reporting on general government and where information on financial operations of local governments is based on surveys conducted by the State Planning Organisation and published with a 6-month time lag; final data, published by the Statistical Office three years later, are not comprehensive. Implementation of the provisions of the Public Financial Management Control Law should also help to improve the reporting of activities that are currently outside the Budget. Article 13 stipulates that all budget revenues and expenditures shall be shown on a gross basis. One notable omission to fiscal reports relates to in-kind military expenditure and borrowing. Public enterprises are also excluded from public reports, although individual reports for internal purposes are prepared. The Treasury separately reports information on state enterprises as a sector, but this information is aggregated, and not consolidated (there are many transactions between these organisations which have not been netted out).

**Public Availability of Information**

Coverage in the budget documents of central government fiscal activities has strict limitations, but the provisions of the Public Financial Management Control Law will greatly increase the coverage. At present, budget documents exclude Extra-budgetary Fund, social security institutions, regulatory boards, revolving funds, and ministerial foundations. Article 18 of the Public Financial Management Control Law stipulates that the draft Budget Bill would be accompanied by: the Budget memorandum, including the medium term fiscal strategy; the annual economic report; a list of tax exemptions and their cost; the public debt management report; the last two years budget realizations and next two year forecast for general government; budget estimates of local administrations and social security institutions; the budget of regulatory boards and other similar bodies; and a list of public administrations not within the scope of central government but financed by it. The documents include information on defence spending, but exclude military borrowing from foreign sources for goods received in-kind.\(^\text{26}\)

Information on government financial assets is not published. However, details of receivables are reported in the quarterly debt management report which will be attached to the budget documentation as from the 2006 budget. A monthly cash balance report is posted on the Treasury’s website although, as already indicated, this report does not include the balances of spending institutions, revolving funds, Extra-budgetary Funds and foundations that have accounts outside the Central Bank of Turkey. The government has not produced a full balance sheet compatible with GFSM 2001, partly reflecting the absence of a statement of non-financial assets and liabilities.

There is no statement of accounting policies included in the budget or in financial reports. The accounting system is ostensibly cash based although a line item is included in the accounts to act as a balance for discrepancies between approved expenditures and actual cash payments. Currently, there is no published manual of accounting policies although an internal manual exists in the GDPA in the Ministry of Finance. A working group has been established to produce a comprehensive manual of accounting policies which is expected to be completed in 2006.

**Future Agenda and Remaining Challenges**

The government is in the process of implementing Say2000i compatible accounting systems in the social security institutions and local administrations. However, the large number of local administrations (more than 3,200) poses an implementation challenge. Since 2004, the Say2000i system has been able to capture the acquisition of new assets. However, valuation of existing assets (including heritage assets) and depreciation policies are still to be agreed.

The Say2000i system interfaces with the treasury system for accessing data on public debt, with the budget management and information system (BYES) for obtaining budget appropriation and cash allocations and transmitting actual expenditure data), and VEDOP revenue system (for obtaining accrual-based tax data). This will enable them to monitor the financial performance of their respective units. Currently, GDPA policy provides line ministry staff with access to the Say2000i system upon request, but access needs to be expanded and made more widely available.

Liabilities are fully captured in the Say2000i system. However, until recently only commitments for large multiyear capital expenditure projects were fully recorded. The revised accounting regulation issued in June 2005 requires recording of all commitments to ensure budget discipline and avoid accumulation of arrears.

The Ministry of Finance has made significant efforts in training a large body of public accountant across the country. Accrual-based financial reporting is not an end in itself but
may provide information useful for multiple purposes. Accrual-based accounting statements are difficult to understand, especially for non-accountants. For accrual-based financial statements to be fully useful as management decision-making tools, it is therefore important that users, including heads of departments and program managers, be extensively trained in how to use and interpret accrual accounting statements.

Turkey still falls short of the requirements of the IMF’s transparency code (2007a) in several areas and further reforms are needed to move towards meeting best international standards. Specific areas of concern include that:27

• Current fragmentation of responsibilities between the State Planning Organisation, the Ministry of Finance and the Treasury. Generally an integrated approach coordinated by a single institution would be regarded as best practice internationally as fragmentation complicates the budget preparation process.
• The new framework does not fully address the off-budget channels for spending that have been a pervasive features of the fiscal system in Turkey—in particular, line ministry foundations and Iller Bank; and newer amending legislation appears to backtrack on hard-won discipline in this area, allowing for spending beyond appropriations (hence off budget) subject to Ministry of Finance regularization in a subsequent budget;

• Training of officials, although ongoing, remains insufficient, especially for:
  • the formulation of medium-term performance-based budgets;
  • the roll out of the new system to local governments;
  • the implementation of the new chart of accounts particularly at local government level; and,
  • the adherence to new reporting requirements;

• Development of the internal control function in spending agencies is at a very early stage, and some confusion remains concerning the future role of the agencies currently involved in the internal control process;

• Budget documentation is still too focused on inputs, and the budget management and accounting systems, although substantially improved, are not yet configured to manage a programmatic, performance based budgeting system; and

• Complexity of the tax system (both policy and administration) as well as its significant discretion.

In Turkey there will be challenges in harmonizing with GFS and ESA95. These will include technical, legal, financial data quality and consolidation of financial data, human  

27 International Monetary Fund, 2006, p.33.
resources etc. Revolving funds and extra budgetary funds continue to operate outside the budget coverage at the risk of distorting budget discipline.

Conclusion

A bureaucratic culture that has traditionally been closed, conservative, centralized, control-oriented, and hierarchical could be transformed towards transparency and public service, opening itself to participation by civil society and enhancing accountability to citizens. Yet to succeed, the reform agenda must be fully planned and effectively executed in Turkey. Although some aspects of the new legal framework are being piloted, most of the secondary regulations (that is, those related to practical implementation) are yet to be issued. Many of the reforms have yet been fully implemented. The government’s decision to undertake fundamental changes in the responsibilities of provincial and municipal governments also injects new complexity and considerable uncertainty into the PFMC implementation schedule (e.g. skilled person, technical hardware and software, training on new accounting rules etc.).

Implementation of major public reforms needs strong coordination and monitoring. By the nature of the issues they address, public sector reforms tend to be cross-cutting, and they require time for implementation. Strong high-level leadership must articulate a clear vision of the objectives. Pragmatic midstream adjustments must adapt to changing circumstances, and coordination must be effective across units of government. In part, the PFMC and the Public Finance and Debt Management (PFMD) laws spearheaded the public sector reforms to address concerns about recurring fiscal crises. Weak inter-agency coordination would pose the inherent risk of provisions being enacted that are inconsistent with or contradict the previous reforms. It is crucial that Turkey maintains the credibility of its major public financial management reforms; so the need for strong, effective coordination to reconcile such conflicts cannot be overstated. Without arrangements to ensure effective leadership, implementation of the reform agenda will remain at high-risk.
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ADMINISTRATIVE CAMERALISTICS

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It should be obvious that the accounting problems are only possible to illustrate by using examples, which would require a not insignificant effort by the interested reader.
(Mülhaupt, 1997, p. 2; translated from German)

Introduction

Cameral accounting is an accounting model, which was developed in the continental European German-speaking countries (Austria, Germany and Switzerland; see Buschor, 1994) to be used in government organizations as an alternative to accrual accounting. In the previous issue of *International Journal on Governmental Financial Management*, Monsen (2008) presents this particular accounting model, consisting of two main versions, namely *administrative cameralistics* and *enterprise cameralistics*. Administrative cameralistics, the main version, was developed for use by core government organizations. These are primarily financed from tax revenues through the annual budget (agreed by parliament). Enterprise cameralistics was developed for use by government owned enterprises. These are more similar to business enterprises (being market-financed) than core government organizations.

Use of cameral accounting, however, requires a thorough understanding not only of cameral accounting at a general theoretical level, but also at a technical or bookkeeping level. Most of the literature explaining cameral accounting, including cameral bookkeeping, is presented in German, so there is only a limited knowledge of this type of bookkeeping outside German speaking countries. The purpose of this paper is, therefore, to explain cameralistic bookkeeping to a non-German speaking audience.

Bookkeeping within administrative cameralistics

Administrative cameralistics uses a cameral account, consisting of two sides: *Receipts* and *Payments* (see Table 1) as well as the principle of single-entry bookkeeping. This particular bookkeeping method can be referred to as the *single-entry bookkeeping method of administrative cameralistics*. The use of this bookkeeping method is outlined in the following paragraphs, followed by detailed explanations using numerical examples.
Table 1: The cameral account

<table>
<thead>
<tr>
<th>Receipts</th>
<th>Payments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balances or residual dues b/f (BD)</td>
<td>Current dues (CD)</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The column *Balances or residual dues brought forward* (BD) shows the amounts brought forward from previous periods. On the receipts side outstanding claims are shown (compared with accounts receivable in double-entry commercial bookkeeping), and on the payments side obligations are shown (compared with liabilities). The BD-column constitutes an opening balance sheet, because outstanding amounts from the previous period are brought forward here. The column *current dues* (CD) shows the new claims on the receipts side (compared to revenues) and the new obligations on the payments side (compared to expenditures). Entries are made in the *current dues* column when a payment instruction is completed (receipts side) or an invoice is instructed for payment (payments side).

The column *Actuals* (A) has a double task within administrative cameralistics. First, it is a settlement account for the balances brought forward (BD) and/or current dues (CD), by showing how much of these amounts have actually been realized in cash. Second, when we study the column vertically, it shows cash inflows on the receipts side and the cash outflows on the payments side. Entries will be made in the receipts side of the *actuals* column when cash or cash cheques are received. Similarly entries will be made in this column on the payments side when cash is paid or cheques are prepared. The A-column could also contain some non-cash transactions (see example 4 below), but these amounts will be recorded with the same amounts on both the receipts and the payments sides. Hence, the net difference between A-receipts and A-payments reports the net change of cash.

The column *Balances or residual dues carried forward* (B) shows the value of the total dues (i.e., BD+CD) which have yet to be realized in cash (A). Hence, this column constitutes an end of period balance sheet. The amounts in this column (compared to accounts receivable or liabilities in commercial accounting) are carried forward to the BD-column for the following period. Within administrative cameralistics, the B-column represents non-comprehensive balance sheets, since only payment-instructed receipts and
payments (reported in the CD-columns), but not cash-realized receipts and payments (not yet reported in the A-columns) are reported here. This follows from the two key cameralistic rules which must always be followed when entering transactions in to a cameral account:

1) No A-entry without an earlier or simultaneous CD-entry
2) \( B = BD + CD - A \)

These two rules apply separately to the receipts and payments sides.

**Transactions are reported horizontally on one side, i.e., either on the receipts side or on the payments side.** This use of only one side of one account distinguishes the cameralist’s single-entry bookkeeping method clearly from commercial double-entry bookkeeping, which always uses two sides of two different accounts (the debit side of one account and the credit side of another account) to record each transaction.

**Numerical examples**

**Example 1**
Payments for providing social services (home help) are entered on the payments side of the cameral account. In year 1, such a payment obligation has occurred, amounting to 300, and a payment instruction has been issued for this amount (Payments-CD=300), but due to liquidity problems only 200 is paid out in cash this year (Payments-A=200). At the end of year 1, an end of period balance of 100 is recorded (Payments-B=100) (see Table 2).

**Table 2**

<table>
<thead>
<tr>
<th>Year 1</th>
<th>Receipts</th>
<th>Payments</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Social services</td>
<td>BD</td>
</tr>
<tr>
<td>Payment instr.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Balance c/f</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The balance at the end of year 1 is brought forward in year 2 on the cameral account (Payments-BD=100). When this balance is paid, the payment is reported in the A-column (Payments-A=100), resulting in no ending balance (Payments-B=0) (see Table 3).
Table 3

<table>
<thead>
<tr>
<th>Social services</th>
<th>Receipts</th>
<th>Payments</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>BD</td>
<td>CD</td>
</tr>
<tr>
<td>Balance b/f</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Balance c/f</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Example 2
Receipts resulting from delivering services are entered on the receipts side of the cameral account. In year 1 a payment instruction (or invoice) for 600 has been issued for renting out apartments (Receipts-CD=600). Of this amount 400 is received in cash during year 1 (Payments-A=400), while 200 is carried forward to year 2 as an outstanding balance or rent arrears (Receipts-B=200) (see Table 4).

Table 4

<table>
<thead>
<tr>
<th>Year 1</th>
<th>Receipts</th>
<th>Payments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hiring out</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payment instr.</td>
<td>600</td>
<td></td>
</tr>
<tr>
<td>Payments</td>
<td></td>
<td>400</td>
</tr>
<tr>
<td>Balance c/f</td>
<td></td>
<td>200</td>
</tr>
<tr>
<td></td>
<td>600</td>
<td>400</td>
</tr>
</tbody>
</table>

The balance of rent arrears carried forward from year 1 is reported as the balance brought forward in year 2 (Receipts-BD=200). When the outstanding balance is received as a cash payment during year 2, this cash inflow is entered in the A-column on the receipts side (Receipts-A=200), resulting in no ending balance (Payments-B=0) (see Table 5).
Table 5

<table>
<thead>
<tr>
<th>Year 2</th>
<th>Receipts</th>
<th>Payments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hiring out</td>
<td>BD</td>
<td>CD</td>
</tr>
<tr>
<td>Balance b/f</td>
<td>200</td>
<td></td>
</tr>
<tr>
<td>Payment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Balance c/f</td>
<td>200</td>
<td>200</td>
</tr>
</tbody>
</table>

Example 3
A local government receives a cash inflow of 500 from the national government during year 1, which is to be paid out as lending to the inhabitants during year 2, so they can buy their own houses. This requires the following bookkeeping entries: First, a payment instruction for receiving the amount is entered on the receipts side of the cameral account (Receipts-CD=500), followed by entering the actual cash receipt (cash inflow) on the same side of the account (Receipts-A=500). The obligation for paying this amount to the inhabitants is simultaneously entered in the CD-column on the payments side (Payments-CD=500). Since this amount will not be paid out during year 1, a balance carried forward will be reported (Payments-B=500) (see Table 6).

Table 6

<table>
<thead>
<tr>
<th>Year 1</th>
<th>Receipts</th>
<th>Payments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Safe-keeping of money for later out-payments</td>
<td>BD</td>
<td>CD</td>
</tr>
<tr>
<td>Payment instr.</td>
<td>500</td>
<td></td>
</tr>
<tr>
<td>Amount received</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Obligation to pay</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Balance c/f</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

When this amount of 500 is paid out during year 2, the payment is entered in the A-column on the payments side (Payments-A=500). This payment cancels the balance brought
forward (Payments-BD=500), implying no balance amount to be carried forward to the following year (Payments-B=0) (see Table 7).

Table 7

<table>
<thead>
<tr>
<th>Year 2</th>
<th>Receipts</th>
<th>Payments</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>BD</td>
<td>CD</td>
</tr>
<tr>
<td>Safe-keeping of money for later out-payments</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Balance b/f</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Balance c/f</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Example 4

In a local government there is a car department, renting out cars to the other government departments. When the school department rents a car with the value of 700, this amount is to be charged to this department. Here we deal with a payment in kind, as opposed to a real payment transaction. Hence, cameral accounting, which is based on the bookkeeping of payment transactions, must “transform” this payment in kind to a payment transaction. This is done by assuming that the renting of the car is paid cash, making it possible to enter this “artificial” payment transaction on the cameral account. This will give us the following entries on the cameral account:

In the account “Car department” we enter 700 on the receipts side (Receipts-CD=700, Receipts-A=700). Simultaneously we enter this amount on the payments side of the account “School department” (Payments-CD=700, Payments-A=700) (see table 8).
Table 8

<table>
<thead>
<tr>
<th></th>
<th>Receipts</th>
<th></th>
<th>Payments</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>BD</td>
<td>CD</td>
<td>A</td>
<td>B</td>
</tr>
<tr>
<td>Car department</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Refund from school department</td>
<td>700</td>
<td>700</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>700</td>
<td>700</td>
</tr>
<tr>
<td>School department</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Refund to car department</td>
<td></td>
<td></td>
<td>700</td>
<td>700</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>700</td>
<td>700</td>
</tr>
</tbody>
</table>

Example 5
A local government borrows 1000 in year 1 to pay for investment expenditures (see example 6 below). First, on the receipts side of the cameral account, the payment instruction for receiving the loan payment is entered (Receipts-CD=1000), and thereafter the actual loan payment can be received and entered on the same side of the account (Receipts-A=1000) (see Table 9).

At the end of year 1, a loan instalment of 100 is paid. First, on the payments side of the cameral account, the payment instruction is entered (Payments-CD=100), and then the loan instalment is recorded on the same side of the account (Payments-A=100) (see Table 9).

Table 9

<table>
<thead>
<tr>
<th>Year 1</th>
<th>Receipts</th>
<th></th>
<th>Payments</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Long-term debt</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loan received</td>
<td>1000</td>
<td>1000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loan instalment paid</td>
<td>1000</td>
<td>1000</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

Example 6
The local government uses the borrowed money (1000; see example 5 above) to invest in a new vehicle. First, a payment instruction must be issued and entered on the cameral account on the payments side (Payments-CD=1000). Then the payment is made and recorded on the same side of the account (Payments-A=1000) (see Table 10).
Table 10

<table>
<thead>
<tr>
<th>Year 1</th>
<th>Receipts</th>
<th>Payments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vehicle</td>
<td>BD</td>
<td>CD</td>
</tr>
<tr>
<td>Investment expenditure</td>
<td></td>
<td></td>
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<tr>
<td></td>
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</tr>
</tbody>
</table>

Comment
Administrative cameralistics represents the original and core version of cameral accounting. Its main objectives are cash management, budgetary control and payment control.

Cash Management
Administrative cameralistics focuses on the cash effect of the receipts (revenues) and payments (expenditures). Therefore, the terms receipts and payments are used as the main concepts in the cameral account (see Table 1). Since the principle of single-entry bookkeeping is a principle developed for preparing cash accounts (Oettle, 1990), cameral accounting uses this bookkeeping principle. Another reason for using this principle, as opposed to the principle of double-entry bookkeeping, is the fact that single-entry bookkeeping is more flexible than double-entry bookkeeping (Wysocki, 1965). In particular, use of the latter principle always requires debiting one account and crediting another account with the same amount. Use of the former principle, however, allows for entering one single-entry on the account if that would record the desired information, or alternatively more single-entries, if more types of information are desirable to record. Moreover, by using the principle of single-entry bookkeeping and the cameral account (with four different columns on both the receipts and the payments sides), not only actual payments (in the A-columns) are recorded on the account, but also payment instructions (in the CD-columns) as well as any payment instructions not realized in cash (in the B-columns).

Returning to our numerical examples, we will see that the actual payments are entered in the A-columns. In this respect, Mülhaupt (1987) states:

“While the commercial bookkeeping method always requires two different accounts (the double-entry bookkeeping principle), the cameral bookkeeping method only requires one, because every account represents a combination of two or more accounts within the commercial bookkeeping method. Any activity is reported on a result and stock account and is directly linked to a payment transaction or a credit transaction, implying that separate accounts for the payment and credit transactions, which result from these activities, are not necessary.” (Mülhaupt, 1987, p. 97; translated from German)
This means that it is not necessary to have a separate cash account within cameral accounting. The A-column on the receipts side of the cameral account contains the cash inflows, and the A-column on the payments side contains the cash outflows. Thus, it is easy to get an overview of the cash inflows and outflows, by simply studying the A-columns vertically.

**Budgetary Control**

In core governmental organizations being financed through the annual budget decided by the politicians, budgetary control is particularly important. This requires a comparison of the actual receipts and payments with the related budgetary figures. Regarding comparisons of budgetary and accounting figures, there exists many misunderstandings:

“As particularly Walb (1926, p. 234 and onwards) and Winckelmann (1950, p. 47 and onwards) point out, the comparison of the amounts in cameral cash accounting with the budgetary amounts are the source of many misunderstandings about cameral accounting. The misunderstandings result from confusing the CD-amounts on the cameral account with the CD-amounts in the budget. ... Walb (1926, p. 235 and onwards) points out that the amounts are divided into three parts, namely the budgetary amounts (CD-budgetary figures), the current due amounts (CD-accounting figures) and payments (A-accounting figures), and in principle, none of these figures are identical with the others. Like the budgetary current due amount may be different from the accounting current due amount, actual payments may be different from the payment instructions (accounting current due amounts), something which occurs, for example, by missing payments from debtors.” (Wysocki, 1965, p. 35; italics in the original).

This means that budgetary control takes place within the framework of administrative cameralistics, but outside the cameral account, since budgetary figures are not entered on the cameral account, where accounting figures are entered (compare only accounting figures are entered on the cameral account in the numerical examples above). Let us return to example 1 and extend it with budgetary figures:

Budgeted payments (expenditures) for social services (home help) during year 1 are 350, as decided by the politicians. Due to a reduction of the number of old people needing home help during year 1, the chief administrative officer issued a payment instruction to the cashier, instructing him to pay out 300 (Payments-CD=300 in Table 2), as opposed to the budgeted amount of 350 (not entered on the cameral account). However, due to liquidity problems, the cashier only paid out 200 in year 1 (Payments-A=200 in Table 2), and the rest amount of 100 was paid out during year 2 (Payments-A=100 in Table 3). Within administrative cameralistics, the following comparison of budgeting and accounting figures for year 1 will now be undertaken (as a supplement to the bookkeeping of the accounting figures on the cameral account, as illustrated in Table 2):
Year 1:
Budgetary payments (CD-budget figure; from the budget): 350
Accounting payments (CD-accounting figure; from the cameral account) -300
Budget variance 50

Payment control
In addition to cash management within the limits of the budget, it is also important to control the actual payment transactions. According to Mülhaupt (1987), the cameral account with its CD-columns (payment instructions) and A-columns (actual payments) both on the receipts and payments sides has been specifically designed to help carry out this important form of control. The two cameralistic rules (no A-entry without an earlier or simultaneous CD-entry; B=BD+CD-A) aim at contributing to ensuring that no cash is received or paid by a person, without having received a payment instruction from another person with such an authority.

Returning to example 1 above (see Table 2), we will see that the payment control appears by comparing the payment instructions (CD-accounting figures) with the actual payments (A-accounting figures). During year 1, a payment instruction of 300 was issued (CD=300), but only 200 was paid out (A=200), implying that the actual cash payment was within the payment instructions (B=BD+CD-A=0+300-200=100). Before paying the rest amount of 100 during year 2, no new payment instruction is needed, because the cash payment of 100 during year 2 fulfils that part of the payment instruction issued in year 1, which was not carried out during year 1 (B=BD+CD-A=100+0-100=0; see Table 3).

Let us also return to example 2 above. In this example a payment instruction was issued during year 1 with 600, and entered in the CD-column on the cameral account (see Table 4). This payment instruction is compared to the corresponding budgetary amount. For the purpose of illustration, assume that the CD-budget payment also was 600, implying no budgetary variance (as the difference between CD-budget payment and CD-accounting payment). Due to the fact that one of the service recipients did not have money to pay for the services he received during year 1, only 400 (Receipts-A=400 in Table 4) of the payment instructed receipts of 600 (Receipts-CD=600 in Table 4) were received in cash during year 1. The difference of 200 (B=BD+CD-A=0+600-400=200; see Table 4) is related to the actual cash process (one of the service recipients did not pay). It is not related to the budget execution. Therefore, as explained above, budgetary control takes place by comparing budgetary figures (as stated in the budget) and CD-accounting figures (as reported on the cameral account). It does not take place by comparing CD- and A-figures on the cameral account. On the other hand, payment control takes place when comparing the latter figures on the cameral account.

Non-comprehensive Balance Sheets
If we take a closer look at the balance columns (BD and B) in the cameral account, we will find that they represent non-comprehensive balance sheets. First, only receipts and
payments for which payment instructions have been issued (and thus entered in the CD-columns), but have not yet been paid (and thus not entered in the A-columns), are reported in the balance columns (B=BD+CD-A). For example, the long-term debt at the end of year 1 (see example 5 with Table 9) of 900 (1000-100) is not entered in the balance column (B) (on the payments side) of the cameral account, because no payment instruction has been issued for this debt. Second, the vehicle (fixed asset) does not appear in the balance column (B) (on the receipts side) of the cameral account, since no payment instruction has been issued here (see example 6 with Table 10).

There is no problem, however, in extending the interpretation of the balance columns, so that long-term debt and fixed assets could be reported in these columns. In fact, such an extension of the balance columns has actually been undertaken, when developing enterprise cameralistics, intended to be used for governmental enterprises (see e.g., Monsen, 2008). If however, the balance columns had been developed in this way within administrative cameralistics, fulfilling the main objectives of administrative cameralistics (cash management, budgetary control and payment control) would have become more difficult to achieve. This is due to the fact that the interpretation of the CD-columns also would have to be extended, if the balance columns (BD- and B-columns) were to represent complete balance sheets (not only containing non-paid payment instructed amounts, but total assets and total liabilities; B=BD+CD-A). Moreover, the number of non-cash transactions reported in the A-columns would also increase in this case, although these transactions would still be reported with the same amount in the A-columns on the receipts and payments sides. A better strategy would then be to prepare supplementary information, containing overviews of accounts receivable, accounts payable (e.g., long term debt) and fixed assets, where no payment instructions have been issued. By so doing, we would not have to change the interpretation of the CD-columns, and the number of non-cash transactions in the A-columns could be kept at a minimum. Hence, the CD-columns could still report the payment instructions and the A-columns (with a few exceptions, such as illustrated in example 4) could still report the actual payments.

**Conclusion**

Administrative cameralistics has been developed for use in government organizations, contributing to the management of public money within the limits of the budget, as well as contributing to payment control. Specifically, in order to control the actual cash payments, the cameral account contains separate columns for payment instructions (CD-columns) and for actual payments (A-columns) both on the receipts and payments sides. Hence, payment control can easily be undertaken when applying the cameralist’s single-entry bookkeeping method, by simply comparing the payment instructed amounts in the CD-columns with the actual payments in the A-columns.
In summary, the term “cash accounting”, which is often used when referring to traditional governmental accounting, does not capture the full extent of administrative cameralistics. In addition to reporting the actual cash flows, payment instructions as well as the balance of payment instructions not fulfilled as payments is also reported within administrative cameralistics. Also, the comparison of accounting and budgeting figures for budgetary control purposes, is a key issue of administrative cameralistics.
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TOWARDS A GENERIC MODEL FOR GOVERNMENT SECTOR REFORM: THE NEW ZEALAND EXPERIENCE

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Introduction

The past two decades have witnessed a metamorphosis in the government sector of several countries. One particular reform approach has been adopted by such countries as New Zealand, UK, Australia, the Netherlands, Sweden, Finland, Canada, USA, etc. A considerable body of studies have been conducted with the aim of modeling the government accounting innovations of these countries (Luder, 1992, 1994, 2001, Jaruga and Nowak, 1996, Godfrey et al, 2001, Christensen, 2002 and Ouda 2001, 2004 and 2005). Other studies have tried to model the totality of their public sector management reform (Pollit and Bouckaert, 2000). Whilst these studies have attempted to model some components of this type of government sector reform, no study has tried to model these government sector reforms from a generic perspective and to give a comprehensive picture of the whole spectrum of this type of government sector reform. This study will attempt to fill this gap in the literature by developing a generic model for government sector reform based on (1) a profound study of the practical experience of New Zealand as a pathfinder country in respect of the comprehensive government sector reform and (2) on the Basic Requirements Model (BRM) for Successful Implementation of Accrual Accounting in the Public Sector (Ouda, 2001, 2004 & 2005) which can assist in determining the basic requirements for success with this approach to government sector reform.

The New Zealand experience has been chosen to assist in developing the generic model of government sector reform for several reasons. Firstly, in the 1980’s, governments of New Zealand undertook sweeping reforms of social and economic policies and of the government sector reform. Secondly, this country applied bold ideas and cutting edge theories to undertake that reform. For instance, the treasury played a key role in developing a theoretical framework for public service reforms, making extensive use of economic and management theory. Six theoretical elements have been identified: agency theory; public choice; contracting; finance; accounting; and management. The treasury articulated the
policy implications of the theories at appropriate moments in the genesis and implementation of reform (Holmes 2002). This allowed coherent and consistent solutions to problems in government sector management to be put forward as the government dealt with the economic crisis and undertook major economic and social change. Thirdly, there were specific circumstances underlying the reform such as: adverse economic conditions that made continuation of the status quo untenable, accommodating political arrangements that facilitated swift change, and novel economic and management concepts that encouraged political and bureaucratic leaders to prescribe new practices without testing them in advance. Finally, Schick (2001) states that this convergence of economic stress and perceived failure in government performance, new political capacity and exciting theories was unique to New Zealand which is why it alone has transformed the state sector so comprehensively.

The reform of the New Zealand system of government management included the following elements:
- separating commercial from non-commercial activities and constituting State-Owned Enterprises (SOEs) to carry on commercially oriented activities;
- privatization of those state-owned enterprises in commercially competitive markets;
- strengthening line of the ministerial and executive accountability;
- designing budget and financial management systems to improve measurement of government sector performance;

This last reform included:
- shifting from an input to an output-based budgeting system;
- changing from a cash based to an accrual based accounting system; and
- creating different forms of appropriations for different types of government activities.

Thus, the New Zealand experience will assist in giving a generic picture with respect to the components of this approach to government sector reform which has been adopted by a number of other counties. In addition, the Basic Requirements Model (BRM) for successful implementation of accrual accounting in the public sector will be used to specify the basic requirements that are needed if this approach to government sector reform is adopted. Accordingly, the intention here is to provide an overview of the government sector reform initiatives in New Zealand and of the Ouda’s Basic Requirements Model (BRM). Based on the practical experience of New Zealand and the BRM, the generic model for government sector reform will be developed. Therefore, this paper:
- briefly summaries the background to, and context of, the New Zealand reforms;
- outlines the ideas behind the separation of commercial from non-commercial activities, namely, it will discuss, briefly, the ideas behind the corporatization and privatization;
- discusses the implications for strengthening line of the ministerial and executive accountability;
identifies the characteristics of financial management systems reform that can assist in improving the measurement of government sector performance;
gives an overview of the Basic Requirements Model; and
makes an attempt to develop the General Model for Government Sector Reform.

New Zealand’s Government Sector Reforms

Background to, and context of, the reforms. The government sector reform is now a worldwide phenomenon, as governments grapple with rapid social, economic and technological change, including the effects of globalization. While globalization is the most important reason underlying government sector reform in the world, poor economic performance was the impetus for the New Zealand government sector reform. In order to better understand the background of the government sector reform initiatives in New Zealand, the economic situation leading up to the 1984 economic crisis will be briefly discussed.

From the 1960s to 1980, there was a notable decline in the performance of the New Zealand economy compared with other OECD (Organization for Economic Co-operation and Development) countries. Per capita, income grew just 1.4 percent per annum compared to 2.9 percent for the OECD as a whole (OECD 1993:p.11). Moreover, over the same period, the Gross National Product per capita fell from fifth in the world to the twentieth in 1980s. The main reason behind this decline was that the productivity of capital and labor was growing more slowly than the OECD average. The economic policies of the New Zealand government, from 1975 to 1984, have been characterized as:

“...a heavy reliance on particular forms of interventions in the economy... [that did] not achieve their objectives and frustrated the achievement of higher living standards.”(The Treasury 1984:p.106).

Many reasons have been given for the poor use of resources, low productivity and low growth at this time. These include:

- **inefficient and inequitable tax system**: the tax system emboldened unproductive investments and burdened individuals with a high marginal tax rate (66 percent), although it did ensure that New Zealand was a relatively equitable society;
- **distortion in the price system**: through regulations, subsidies and taxes, the entire price system in New Zealand had been distorted away from reflecting the true value of goods, services, labor and capital. This price distortion and poor macroeconomic policy meant that New lost its competitive ability in the external market.
- **effects of tariffs and controls**: high tariffs and import controls provided high levels of assistance to domestic industry, but they also raised the costs of the export industry.
- *poor productivity and low innovation*: the above effects also contributed to the poor use of resources, low productivity and low growth.

- *inefficient labor market*: extensive regulation of labor market was tied to income distribution rather than productivity.

As a result of the above situation, the government-owned enterprises, which controlled a large portion of the economy, suffered from poor management, low productivity and poor investment decisions. In 1984, a new government was elected which faced an economy with: an extended history of slow growth; high deficits; high debt including substantial liabilities resulting from various guarantees given by previous governments; and highly sheltered private sector (MacCulloch & Ball 1992). In addition, Richardson (New Zealand’s Minster of Finance, 1990 -1993) stated that New Zealand suffered from two deficits:

- Financial deficit – in continuous deficit for two decades (70s and 80s) pushing net public debt levels up from 5% of Gross Domestic Product (GDP) to over 50% of GDP

- Performance deficit – while public expenditure levels climbed from 30% of GDP to over 42% of GDP over those two decades the standard and quality of performance in our public institutions and agencies dropped (IFAC 1997).

The new government quickly embarked on a program of significant reforms aimed at achieving sustainable medium-term growth with a more market-oriented economy. In addition, the New Zealand government recognized the importance of reform of the government sector, which accounted for a significant proportion of the economy.

One can conclude that the major government sector reforms that began in 1984 were linked to the economic crisis and the conditions leading to it, as well as with political change, the election of a Labour Government.

**Government Sector Reforms**

**Separating commercial activities from direct government control (corporatization and privatization).** The process of moving commercial type operations from direct government control and constituting State-Owned Enterprises (SOE) is called corporatization. The corporatization program was announced in May 1986 (Douglas 1985 and 1986). The necessary legislation, the State-Owned Enterprises Act, was enacted in 1986, and the first of these new enterprises came into existence on 1 April 1987. Major commercial activities were organised into State-Owned Enterprises, whilst other commercial activities continued to be undertaken by government departments, but were accounted and managed separately. In both cases, commercial activities were to be run as
business enterprises subject to competitive pressure from comparable private sector businesses.

The main reasons given for separating commercial activities from other government services were that the performance of these commercial activities were suffering from:

a- lack of clear objectives. For instance, the Forest Service had objectives covering commercial forestry, conservation, regional development and employment generation. The relative weights of these objectives, and tradeoffs between them, were rarely articulated explicitly, and, consequently, it was difficult to assess clearly the performance of the service (Scott, Bushnell and Sallee 1990).

b- The existence of competitive advantages and disadvantages. Government departments operated with both advantages and disadvantages relative to private sector managers. For instance:
- they were exempt from taxes and many obligations;
- their capital was provided at no cost (encouraging oversupply of capital-intensive outputs);
- they were given statutory monopolies for their output; and
- their revenues were obtained from the supply of goods and services to government in a way, which allowed cross-subsidization of sales to third parties (Scott, Bushnell and Sallee 1990).

However, they also had some disadvantages, such as:
- a set of general and financial rules which limited their freedom to make decisions on the purchase and use of inputs; and
- labour market constraints on remuneration levels; and lengthy, uncertain and often tardy process of funding with parliamentary appropriations.

Thus, when governmental departments operate in such environment, it is difficult to evaluate the quality of performance by state managers relative to their private sector counterparts.

c- A lack of information on the commercial cost of outputs and so an inability to measure performance.

The State-Owned Enterprises Act-1986 included the following five elements:

- that SOE should have “clear commercial objectives”;
- that they should operate under competitive neutrality;
- that there should be greater managerial flexibility and authority over key decisions;
- that greater performance monitoring should occur; and
that the government would make explicit grants to cover any non-commercial objectives it wanted the SOE to pursue – but these may be difficult to define and so be neglected.

In addition, with their second term, 1987-1990, the Labour government privatized many of the SOEs. This helped to reduce government debt and allowed the substitution of market mechanisms for government monitoring of SOEs operations in the hope that this would lead to efficient operations, pricing and management.

**Strengthening Lines of Ministerial and Executive Accountability (Management Reforms)**

After separating the commercial activities from other government production, the attention quickly turned to improve the performance of the core state sector, namely, to improve the management of those tasks which remain the responsibility of the government. Following Labour’s re-election in 1987, the theme of greater efficiency in government- embodied in corporatization and related initiatives – together with a willingness to apply economic theories and new policies, led to fundamental revision of legislation governing the public service (Holmes 2002). This included two pieces of legislation: the State Sector Act of 1988 and the Public Finance Act of 1989. This section will focus on the State Sector Act of 1988. The Public Finance Act of 1989 will be dealt with in the next section.

Under the previous legislation, the public service was uniform and unified, with a service-wide classification system. Moreover, a permanent head of a department was responsible to the Minister in charge of the department for its efficient administration. However, the Minister could do little in response to actual performance. There were few sanctions for poor performance. The system was designed for micro-control of inputs rather than performance in the production of effective public service. The Minister was making the detailed decisions about the internal management of department for which he did not have adequate knowledge and suitable incentives (Scott 1996).

Schick (2001) has described the situation under the old legislation as follows: that public servants “act as extensions of the Minister, without having any independent existence and consequently no independent responsibility. The Minister was held to be directly responsible for all departmental activities.” (p.64). This pretence diluted responsibility: department heads could not be held accountable because any particular action was the responsibility of the Minister; but the Minister could not reasonably be held to account for all the things the department did without his direct involvement. To make matters worse, “in most of the government sector the tendency has been to keep managers’ discretion to a minimum by controlling their use of inputs.” (p.58) The ex ante control of inputs “reduces incentives to monitor output and performance and creates incentives for department to withhold information” (p. 59).
In addition, the manner in which the appointment, promotion and pay setting systems worked tended to be cumbersome and inflexible (Palmer 1987:p. 82). The appointment of civil servants was based on a permanent tenure system. For instance, there was a career service, offering employees a 40-year career if they so desired. Public servants moved among departments and enjoyed a standard set of working conditions and rates of pay.

In contrast the State Sector Act of 1988 aims to:
- redefine the relationship between Ministers and department heads in order to make the permanent heads more accountable to their respective Ministers for the performance of their departments;
- apply similar labour – market regulations to both state and private sector employment.

Departmental heads lost their permanent tenure and generally became known as “Chief Executives”. They were appointed on contracts for up to five years, with the possibility of reappointment. The State Service Commission, in conjunction with responsible Minister, determined the performance specifications and evaluated the Chief Executives (CEs). Moreover, according to this Act, chief executives were given more power to manage. Chief executives had greater powers to hire, fire, and set salaries of staff as in the private sector (Ball 1994). Thus, the chief executives are accorded all the rights, duties and powers of an employer with respect to the employees of their departments. Furthermore, they had extensive authority over purchasing, travel, office accommodation, information technology …etc. However, this could lead to the loss of the public sector ethos, co-operation a team spirit and the incentive of working for the public good.

**An Effective Accountability Relationship**

Under the State Sector Act – 1988, the Minister is formally responsible for specifying the performance agreements of the departmental chief executive who is responsible for service delivery. On the other hand, in order for chief executive to be able to deliver the agreed performance, he needs to be accorded the decision-making authority that can enable him to do that. Moreover, there should be incentives to perform and requirements for performance information. Therefore, in the design of the management system, attention is paid to the structure of an effective accountability relationship. According to the State Sector Act 1988, there are four elements to the effective accountability relationship:
- Performance specification:
- Decision-making authority:
- Incentives on behaviour:
- Performance information

Thus, the management reform has assisted in development of annual performance agreements between the ministers and chief executives. The agreements specify what is to
be delivered, and expectations of quality and cost, together with management objectives for ensuring effective use of resources. However, the employment of the chief executives is based on a contract. This contract prescribes the determination of remuneration and the manner in which performance objectives will be set and recorded in a performance agreement and the process for assessing performance (Scott 1996). This also means that the accountability relationships between ministers and chief executives were seen as: Contract focus; Decentralization; Incentives driven; and Performance information. Moreover, these accountability relationships were seen to be more efficient when ex-post monitoring, assessment, and reporting were based on clear ex-ante agreements about performance expectations (Scott 1996 and Ball 1994).

**Financial management reform – The Public Finance Act –1989**

The overall aim of the financial management reforms was to achieve better value for public spending. The Public Finance Act of 1989 is considered to be the most important pillar of public service reform. It complements the State Sector Act of 1988. The key ideas associated with the Public Finance Act of 1989 - financial management reform - includes the following:

1- Clarification of the notion of performance by making the following distinctions:
   a. the distinction between output and outcome;
   b. the distinction of the owner and purchaser interest of the government in department;
   c. the crown/department distinction; and
   d. the distinction of policy advice as an output from other departmental outputs.
2- shifting from an input to an output-based budgeting system;
3- Changing from cash to accrual accounting system.

Each of these reforms will now be considered in turn.

**Clarification of the notion of performance**

In order to define the performance in concept and to specify it in practice, the New Zealand government had made the following distinctions:

*a. The output and outcome distinction:*

Under the accountability relationship, the governmental departments are responsible for the delivery of the services and goods (output) as agreed between the chief executives and ministers. The chief executive is responsible for producing the outputs agreed for the price agreed. The minister is responsible for the choice of the outputs and, by implications, for their impacts on the community (outcomes). The purpose of the government activity is to produce desired outcomes. Therefore, the distinction between the outputs and outcomes is
critical to the concepts of the financial appropriation and accountability. The main reason underlying this distinction is that outputs are easier to measure than outcomes, so that it is easier to hold chief executives accountable to deliver agreed specific services and goods (outputs) rather than the final desired outcomes for the community.

To illustrate the significance of the distinction between them, consider, for example, road safety. Assume that a reduction in road accidents is an outcome sought by ministers; they might seek from appropriate department’s outputs such as vehicle safety checks, road maintenance and driver testing. So the reduction in road accidents as an outcome is the result of many departments. Consequently, if the accountability were based on the outcomes, this would provide the chief executives with ready-made excuses for poor performance. Moreover, it will result in diluting the responsibility and punishing some departments although they had provided the outputs agreed. It can also result in rewarding some departments when they did not deliver the outputs agreed. These problems mean that the use of outcomes, as the basis for assessment of the performance and for effective accountability relationships, is of limited value. In contrast, the use of the output, as the basis for effective accountability relationship, assessment of the performance and for organizing a budgeting system, is a more appropriate and practical measurement tool than outcome.

b- The owner – purchaser distinction:
The government sector reform has caused New Zealand ministers to have two relationships with their departments: 1) as their “owner”, and 2) as the “purchaser” of the goods and services they produce. The different interests of the government in departments (as owner and purchaser) imply different approaches to performance measurement. With respect to ownership interest, the minister wants to obtain the best possible return on the resources allocated to the department and, moreover, he is interested in how effectively resources are being maintained and enhanced. This requires the same types of financial reporting, as are generally accepted practices in the private sector (Ball 94). This includes distinguishing between capital and current expenditure, notion of capital maintenance, and hence, the use of accrual accounting.

As “purchaser” of services from the departments, the government is looking for quality of goods and services at the best competitive price. Here the government is concerned in getting value for money as when buying from independent suppliers. Therefore, the government as purchaser wants to know the full cost of services, which are delivered by the departments, and this also has required the adoption of accrual accounting. On the other hand, the government, as owner, desires the best return possible from resources used by departments. If the government cannot achieve a rate of return with the resources in the department equivalent to the level they would have earned in private ownership then public production lowers the wealth of the society. In fact, the owner-purchaser distinction has required better asset management and improved the financial information, including a
wider specification of the costs of departmental services. This, in turn, has assisted in improving performance measurement.

c- the crown/department distinction:
A further step in the clarification of the notion of performance is the distinction between those things over which the chief executive has control - departmental issues - and those over which they have little or no control - Crown issues (Ball 1994). The chief executive should not be held accountable for something beyond their control.

d- the distinction of policy advice as an output from other departmental outputs:
As previously mentioned, the minister is responsible for the choice of the output and, by implications, for their impacts on the community (outcomes). In order to assist the minister in doing this task efficiently and effectively, the New Zealand government established a policy advice department (agency). The first task of this department is to identify the connection between the outputs and outcomes. Accordingly, there should be a visible connection between the outputs and outcomes, if that is not the case; there is no demonstrable justification for that spending. The second task for policy advisers was to identify tradeoffs between different outcomes, and identify the most cost effective source or process for the necessary inputs. It also involved costing alternative outputs and other interventions; monitoring production of outputs and achievement of outcomes; and providing advice on the quality of departmental management and especially on the outcomes resulting from any output or transfers.

However, policy advice involves responsiveness to ministers in an environment of uncertainty, and is therefore more difficult to specify than other outputs (Holmes 2001). Therefore, performance measures used to assess the quality of policy advice differ from those used for other outputs. Consequently, this has resulted in segregating policy advice from operational output production. The performance of advisory departments is assessed by ministers, in part, by checking that the advice tendered covers all the above aspects.

**Shifting From an Input to an Output-Based Budgeting System**

The previous budgeting system was dominated by line item budgeting (single departmental votes subdivided into sections and, within sections, into categories of input). The line item budget (traditional budget) is an aggregation of line items or inputs such as: salaries, travel expenses, rent and maintenance, postage and telephone expenses, and the like. So this budget stresses inputs rather than outputs. It provides data on what government consumes instead of data about what government does or about purposes for which money is spent. Moreover, it does not indicate the relationship between the expenditure and results and has a limited time horizon, usually of one year. It may make the proper political choice among objectives and the rational allocation of resources more difficult as well as limiting the public understanding of government activity (Wilenski 1982). Moreover, stressing inputs
rather than outputs inhibited managers to flexibly manage resources to achieve agreed objectives. However, this still remains the dominant form of budgeting across the world despite repeated attempts at major reform in many other countries.

In New Zealand, the new budgeting approach involved a change from cost-based to price based charges for government purchases. Shifting from input to output budgeting is accompanied by a shifting from centralized management by the government on departments to decentralized decision-making within the departments (Goldman and Brashares 1991). The chief executive became responsible for choosing the mix of inputs to produce a given output at least cost. Government is concerned only with the price charged for outputs. However, the shift from input to output-based budgeting system means that the New Zealand government shifted from traditional budget to performance-program budget. The latter aims to provide a systematic method of improving the allocation process; to incorporate in planning activity recognition of costs of alternatives programs resources available; and to provide a basis for choosing between the feasible alternative programs (Mills 87).

Changing From Cash to Accrual Accounting System

Managing the Government like the private sector naturally led to the adoption of private sector approaches to accounting – accrual accounting. This avoided extensive academic debate over cash versus accrual in the government sector (McCulloch and Ball 1992 and Ouda, 2001, 2003, 2004).

The Public Finance Act of 1989 requires departments to produce ex post financial statements, annually and half-yearly which include (Miah 1991):

a- **Statement of Objectives:** This outlines the mission and overall objectives for which the reporting entity exists and the broad goals, which the entity intends to achieve.

b- **Statement of Service Performance:** This provides specific targets undertaken by an entity and reports on the degree of their achievements in both quantitative and qualitative terms.

c- **Statement of Accounting Policies:** This outlines the basis on which the financial reports have been prepared and highlights and changes which have had an impact on the results for the period.

d- **Statement of Costs of Services:** This discloses the costs incurred for each significant activity by the reporting entity and includes cost expressed in unit terms.

e- **Statement of Cash Flow:** This discloses cash flow of the entity from all sources including operating, financing, and investing activities and comprises all funds maintained by the entity.

f- **Statement of Financial Position:** This discloses all assets and liabilities of the entity including contingencies but excluding community assets (considered below).
Statement of Resources: This describes in physical terms the major resources held by the reporting entity.

Statement of Commitments: This discloses the funds that are authorized and/or already committed to significant future activities.

Comparative Figures for Previous years of all of the above mentioned statements. and;

Notes to the Financial Statements.

The financial statements are accompanied by a management statement signed by the chief executive and chief financial officer of the department which sets out their responsibility with respect to the integrity of the financial statements, and that those statements fairly reflect the position and operations of the department for the reporting period.

Basic Requirements Model for Successful Implementation of Accrual Accounting in the Public Sector

The Basic Requirements Model (Ouda, 2001& 2004) is essentially aimed to evolve a clear and intellectual implementation framework for the successful transition to accrual accounting in the government sector. The primary task of the Basic Requirements Model (BRM) is to specify the main pre-conditions that are necessary if a country wants to undertake a successful change to accrual accounting. Giving a comprehensive picture of the components of government sector reform is not enough or a sufficient condition for undertaking successful government sector reforms. This was the reason underlying the development of the BRM. In addition, the BRM has been developed in order to cover the shortcomings of the Contingency Model (Lüder, 1992), which aims only to explain why government accrual accounting innovations took place in some countries and not in others. In other words, while the main focus of Lüder’s Contingency Model is on the Explanatory factors, the main focus of the BRM is on the Implementation factors. Therefore, the BRM complements the Contingency Model. The BRM has emphasized that the transition from the traditional governmental accounting system to the accrual accounting system can better be understood in the light of the following factors:

- **Explanatory factors**: they explain how and why the change process has taken place in some countries and not in others; what are the factors or variables underlying the change process while it takes place.

- **Implementation factors**: they specify the factors that are required to bring the change process into practice to create conditions appropriate for the introduction of accounting changes and for putting them into practice.

The Luder’s Contingency Model has highlighted the explanatory factors (Explanation Framework) whereas the Ouda’s Basic Requirements Model has cast the light on the factors (Implementation Framework) that facilitate the transition process. There is a
relationship between the two models, as the understanding of the explanatory factors can assist to a great extent in identifying the implementation factors which in turn ensure successful transition to accrual accounting in the government sector.

The Basic Requirements Model consists of the following elements:

1- **Stimuli:**
The Basic Requirements Model (BRM) agrees with the Contingency Model (Lüder Model 1992 and 1994) that there should be at least one stimulus (driving force) for the change to accrual accounting. For New Zealand, the economic crisis was the main stimulus behind their economic and government sector reforms. However, in other countries, such as the USA, UK, Australia, Sweden etc, globalization, financial problems, scandals, corruption and fraud are/were the main driving forces (stimuli) for government sector reforms. In addition, Godfrey, Patrick and Merrouche have added, in their model (A Diffusion – Contingency Model for Government Accounting Innovation) one further stimulus which is the impact of the international organizations such as International Monetary Fund (IMF) and World Bank (WB) and other aid donors. These organizations require particular government sector reform to be effected as a sine qua non of assistance being provided (Godfrey et al 1999). This can be seen, particularly in underdeveloped and transitional economies. Thus, the international organizations are acting as *change agent.* Therefore, the stimuli (driving forces) for accounting reform can be one or more of the following factors:
- Economic crisis;
- Globalization;
- Financial problems;
- Financial scandal;
- Corruption and fraud; and
- Change agent (such as: IMF and WB).

2- **Reform Decision:**
On the other hand, the basic requirements model (BRM) has also shown that the existence of one or more stimuli is not a sufficient condition or guarantee for undertaking the move to accrual accounting. In this model, “irrespective of what the driving forces (stimuli) for the accounting changes are, the role of the basic requirements model starts after the government had taken a *decision* to make these accounting changes. In fact, the *decision* to adopt accrual accounting in the government sector has been seen as a starting *point* of the basic requirements model, because it could happen that there is a strong stimulus for the accounting changes but the government did not take the decision to reform the accounting system” (Ouda, 2004).

3- **Implementation Framework:**
The implementation framework specifies the factors that should simultaneously and in parallel be available if governments want to implement accrual accounting in the government sector in an *efficient, effective and economic* way, to attain the *target benefits*
from that reform and to avoid the problems which can emerge if these factors or one of
them have not been taken into consideration. Moreover, the Basic Requirements Model
evolves a clear implementation framework that can assist in overcoming the
implementation barriers (Ouda, 2004). Thus, the BRM specified the collaborated factors
behind the successful implementation of accrual accounting in the government sector.
These factors and changes can be reflected in the following equation:

\[ AC\,(\text{ps}) \, = \, f\,(\text{MCC} + \text{PBS} + \text{PAS} + \text{CS} + \text{WC} + \text{CC} + \text{BAC} + \text{SAI} + \text{ABC} + \text{ITC} + \text{IFS}) \]

Where:
- **AC (ps)** = *Accounting Change* (transition to accrual accounting in the public sector)
- **f** = function
- **MCC** = *Management Culture Changes* (internal management changes/NPM);
- **PBS** = *Political and Bureaucratic Support* (legislative, executive and bureaucracy support);
- **PAS** = *Professional and Academic (advisory) Support* (in the accounting field);
- **CS** = *Communication Strategy* (includes booklet, journal, conferences, seminars, etc.);
- **WC** = *Willingness to Change* (staff motivation, will, training and qualification);
- **CC** = *Consultation and Co-ordination* (an essential step for central guidance accounting change);
- **BAC** = *Budgeting of Adoption Costs* (for the whole implementation period);
- **SAI** = *Tackling of Specific Accounting Issues* (assets identification and valuation, assets register, reporting entity, opening balances, etc.);
- **ABC** = *Accounting and Budgeting Consistency* (integration);
- **ITC** = *Information Technology Capability*; and
- **IFS** = *International Financial Support*.

Considering each of these factors in turn:

- **Management Culture Change**: a change of management culture towards focusing on the output instead of input, granting the managers extensive discretion in the use of resources and measuring the performance in terms of efficiency and effectiveness, and hence demanding reliable financial information by the managers, will all generate the support of those managers to adopt a new accounting system that satisfies their needs (United Nations, 1995).

- **Political and bureaucracy support** encourages most public managers to welcome the change (Pallot, 2002). Unless such support exists, the governmental entities may be reluctant to implement any accounting change in the central government. Political commitment and sustained leadership of the Minister of Finance and other key Ministers is crucial for the transition to accrual accounting in the central government (Scott, 1996).
- **Professional and academic support** play an essential role in rendering assistance to the government sector in the development and design of an accounting system that would meet the needs of the politicians and other users. These bodies facilitate the transition to accrual accounting in the government sector through the undertaking of the following tasks: proposing accounting standards and procedures; commenting on accounting standard proposals and supplying recommendations; professional consultancy (advisory role) before and during the implementation process; and developing and designing an accounting system consistent with the government sector (Ouda, 2004).

- **Communication strategy** is essentially important to describe the elements of the reform and the nature of the new legislation, explain the new ideas, guide the accounting transition process, and clear up any misunderstanding during the implementation process (Ball 2000).

- **Willingness to change**: It is not possible to successfully implement accrual accounting in the government sector and to achieve the target benefits from that implementation without taking into consideration the following human aspects: appropriately trained and qualified accounting personnel; staff motivation and will; staff conviction about the benefits that can be reaped from the new system; and existence of an appropriate incentive systems (Scott, 1996 and Ouda, 2004).

- **Consultation and co-ordination** among and within the governmental entities, which will apply the accrual accounting system, is of fundamental importance for obtaining comments and suggestions from the primary sources about the required improvements and for being well posted with their own internal problems and constraints that may preclude the successful transition to accrual accounting (United Nations, 1984, Ouda, 2004).

- **Budgeting for the cost of adoption** is critical in determining the volume of the financial resources that are required for the whole transition process and can assist in overcoming the future financial problems by having a staged transition to full accrual accounting and by dividing this budget by a number of years.

- **Overcoming and tackling specific accounting issues** in the initial phase, such as assets identification and valuation, assets register, identification of reporting entity and its boundaries and opening balances, are of fundamental importance for facilitating the transition process.

- **The integration of budgeting and accounting systems** based on common classification and measurement techniques constitutes a prerequisite for good management. Therefore, the implementation of accrual accounting should not be undertaken without regard to the requisite changes in the budgetary system (Hepworth, 2001).
- **Information technology capability**: In the era of information technology, the reform process should involve an increasing use of computerized information systems as a key component of accounting, budgeting and financial management. Introduction of accrual accounting is unthinkable without availability of appropriate and affordable standard software (Hepworth, 2003 and Lüder and Jones, 2003).

- **International financial support**: many of the developing countries do not have the financial means to meet their international obligations without adequate financial and technical support from the international community (Ouda, 2004 and 2005).

4- **Result**: furthermore, the BRM has shown the result of the implementation framework which is: Successful implementation of accrual accounting in the government sector. Similarly, the model for successful implementation of government sector reform should also show the result of the implementation framework, which it will be: Successful Government Sector Reform.

5- **Consequences**: the BRM has also shown the impact of the governmental accounting reform in the real world. For example: (Ouda, 2003 and 2004)
- Presentation of the financial position of the government;
- Improving performance measurements;
- Providing total costs of government programs and activities;
- Improving financial transparency;
- Better assets and liabilities management.

Similarly, the Generic Model for Government Sector Reform should also show the consequences of reform process. These are: Achieving the three Es- Economy, Efficiency and Effectiveness. And hence, attaining better transparency, better accountability and better performance.

**A Generic Model for Government Sector Reform**

As stated in the introduction, even though several studies have attempted to modeling of some component of the government sector reform, no study has tried to modeling of the government sector reform from a generic perspective and to give a comprehensive picture about the government sector reform and the basic requirements that are essential for underpinning the reform process. This section will make an attempt to fill a gap in the literature by developing the Generic Model for Government Sector Reform. The fundamental aim of the Generic Model for Government Sector Reform is twofold:

- Determining the elements/components of the government sector reform, namely, specifying the most important government activities that should be reformed; and
- Specifying the basic requirements that should be available for underpinning those reforms.
The development of the Generic Model for Government Sector reform will be based on the following three cornerstones:

The New Zealand experience regarding the government sector reform, as it is presented in the previous sections. This experience will assist in specifying the components of government sector reform. In reality, this experience outlines what should be reformed in the government sector in order to achieve the economy, efficiency and effectiveness; and hence, attaining better transparency, better performance and better accountability with respect to the use of government sector resources.

**Components of Government Sector Reform**

Based on the New Zealand experience, it is possible to deduct the components of government sector reform. In fact, the New Zealand experience with respect to the government sector reform has emphasized on directions.

**The first** direction was focused on the exclusion of the government from activities it was inherently poor at managing. Therefore, the New Zealand government had separated the commercial operations from other government production. Accordingly, the process of moving purely commercial operations from government production and constituting State-Owned Enterprises has been called Corporatization. After that, the New Zealand government had privatized many of the State-Owned Enterprises by selling them to the private sector.

In summary, the first direction was concerned with:
- Corporatization; and
- Privatization.

**The second** direction was focused on improving the management of those tasks that remain the responsibility of the government. The reform initiatives regarding those tasks were directed to establishment of new institutional frameworks in order to set objectives, to strengthen manager’s incentives to achieve those objectives and to use resources efficiently, and to give managers the freedom to manage, but with tight accountability and monitoring and reporting on performance. These initiatives have led to the following reforms:

- Management Reform: which had led to establishment of an effective accountability relationship. This relationship was based on:
  a- Contracting;
  b- Decentralization;
  c- Incentives;
  d- Performance information.
- Financial Management Reform: this reform was seen as an essential step in achieving better value for public spending. The financial management in government is conventionally defined as the process of planning and programming; budgeting, budget execution; accounting; audit and evaluation (Scott 1996). The Financial management reforms were focused on:
  1- Clarifying the notion of performance by making the following distinctions:
     a- Output/outcome distinction;
     b- Owner/purchaser distinction;
     c- Crown/department distinction; and
     d- Distinction of policy advice as an output from other departmental outputs.

  2- Updating the budget system by shifting from an input to an output-based budgeting system and creating different types of appropriations for different types of government activities;

  3- Modernizing of governmental accounting system by shifting from the cash to accrual accounting system.

In addition to the above reforms, the New Zealand government reformed some specific sectors of government activities, this included reforms of, for example, the health, education, environment, transport, and defense sectors.

To summarize, the components of the government sector reform, as they have been undertaken by the New Zealand government are:

- Corporatization;
- Privatization;
- Management Reform;
- Financial Management Reform; and
- Specific Sector Reform.

Basic Requirements Model for Successful Implementation of Accrual Accounting in the Public Sector (Ouda, 2001 and 2004). This model specifies the basic requirements that should be available if a country confirmed its intention (decided) to adopt the accrual accounting system in the public sector. The primary aim of the Basic Requirements Model (BRM) is to outline the factors that can facilitate successful implementation of accrual accounting in the public sector. In general, it can be assumed that a great part of these basic requirements can also work for the government sector as a whole. In fact, we shall focus only on the factors that can facilitate the government sector reform with excluding the factors that are confined to accounting issues. Accordingly, the following factors can be used:

- Political and Bureaucracy Support (both legislative and executive support);
- Professional and Academic Support (in related fields);
- Communication Strategy (booklet, journal, seminars and conferences);
- **Willingness to Change** (staff qualification, will, motivations …etc.);
- **Consultation and Co-ordination** (with the governmental entities that will undertake the reform process);
- **Budgeting of Reform Costs** (for the whole reform process);
- **Information Technology Capability**; and
- **International Financial Support** (only for developing countries).

### Pollit/Bouckear Model of Public Management Reform

In addition to the New Zealand experience and the Basic Requirements Model, Pollit and Bouckeat propose a model of Public Management Reform (Pollit and Bouckeat, 2000). A core of the Pollit/Bouckear model is the elite’s perception of desirable and feasible (public management) reforms. The elite usually consist of a political and an administrative elite group (Pollit and Bouckeat, 2000, pp.31, 51) encompassing people that occupy power positions enabling them to decide on and launch reforms. In the Generic Model for Government Sector Reform, the elite’s perceptions of desirability and feasibility of the reform process can assist in making the reform decision and launching the Government Sector Reform.

### A Generic Model for Government Sector Reform

An incorporation of the New Zealand experience and the Basic Requirements Model, together with the elite’s perceptions, can generate “the Generic Model for Government Sector Reform”. The main objective of this model is to bring the government’s attention from the outset to the components of the government sector reform that should be integrated and to the factors that should be co-coordinated in order to underpin those reforms. And this is very helpful, particularly for the developing countries, as most of reform decisions are taken separately from each other. Thus, it gives the reform-makers a comprehensive picture of the elements of government sector reform and about the factors that should simultaneously be co-coordinated to facilitate the reform process. Accordingly, the successful implementation of government sector reform as a whole requires sustained efforts by several different parties. It requires the integration of a set of components and a collaboration of a set of factors. These components and factors can be reflected diagrammatically as in Figure 1, or in the following two equations:

\[
(GSR) = f (CP + MR + FMR + SSR) \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots (1)
\]

\[
= f (PBS + PAS + CS + WC + CC + BRC + ITC + IFS) \ldots \ldots (2)
\]

Where:
- **GSR** = Government Sector Reform
- **f** = function
(1) Reform Framework: (Integration Components)
- CP = Corporatization (changing the organization) and Privatization (changing the ownership);
- MR = Management Reform (New Public Management (NPM));
- FMR = Financial Management Reforms (Accounting reform, budgeting reform, auditing Reform and performance measurement reform);
- SSR = Specific Sectors Reform (such as health, education, transport, and defence sectors).

(2) Implementation Framework: (Collaboration/Underpinning factors):
- PBS = Political and Bureaucracy Support;
- PSA = Professional and Academic Support;
- CS = Communication Strategy;
- WC = Willingness to Change;
- CC = Consultation and Co-ordination (with the governmental entities that will undertake the reform process);
- BRC = Budgeting of Reform Costs;
- ITC = Information Technology Capability; and
- IFS = International Financial Support (only for developing countries).

Consequently, the Generic Model for Government Sector Reform consists of the following elements:

1- Stimuli:
- Financial problems;
- Financial Scandal;
- Corruption and Fraud;
- Globalization;
- Economic crisis; and
- Change agent.

2- Elite’s Perceptions: (people that occupy power positions)

3- Reform Decision: (for launching the reform process)

4- Content of the Reform Framework: (Integration components):
- Corporatization and Privatization
- Management Reforms (internal management changes, NPM)
- Financial Management Reform (Application of accrual accounting, shifting to output-based budget, auditing reform and clarification of the notion of performance)
- Specific Sectors Reform (such as health, education, transport, and defense sectors)
5- Implementation Framework: (Collaboration/underpinning factors):
- Political Support (both Legislative & Executive Bodies Support);
- Academic and Profession Support (in related fields);
- Communication Strategy (booklet, journal, seminars and conferences);
- Willingness to Change (staff Motivation and staff Qualification …etc);
- Consultation and Co-ordination (with the governmental entities that will undertake the reform process);
- Budgeting of Reform Costs (for the whole reform process);
- Information Technology Capability; and
- International Financial Support (for the developing countries)

6- The Result: Successful Government Sector Reform; and

7- Consequences: achieving the three Es – Economy, Efficiency and Effectiveness in the government sector. Moreover, the reform process leads to better transparency, better accountability and better performance.

Conclusion

The New Zealand experience has shown that, to be successful, a significant government reform program must be crystallized as an integrated whole; the pieces must come together. The international experience has also demonstrated that some governments have succeeded in putting the pieces together reasonably well, other have not. The New Zealand approach to government sector reform has been followed to a greater or lesser extent by several other governments, but the model developed in this paper would have relevance in any country where significant government sector reforms are envisaged.

This is in addition to the value of having a coherent conceptual framework for the design of the proposed reform process. Such a framework should ensure that the various elements of reform are internally consistent. This greatly facilitates the implementation process. In addition the Basic Requirements Model also makes clear that coherence and consistency in a major reform program are unlikely to be succeeded without the availability of specific requirements, for example: a strong and sustained commitment from political leaders and the bureaucracy. It is necessary for ministers and officials to agree on a reform strategy that links improved governance with improved management. Accordingly, the Generic Model for Government Sector Reform has tried to model major government sector reform from a generic perspective and to give a comprehensive picture of the reform process. It aims at:

- Determining the elements/components of government sector reform; and
- Specifying the basic requirements that should be available for underpinning these reforms.
Figure 1: A GENERIC MODEL FOR GOVERNMENT SECTOR REFORM

Stimuli
- Financial problems;
- Financial Scandal;
- Corruption and Fraud;
- Economic crisis; and
- Change agent

Elite perceptions of desired government sector reforms

Reform Decision
(at legislative and executive level)

Elite perceptions of feasible government sector reforms

Content of Reform Framework: Integration factors

- Corporatization and Privatization
- Management Reforms
- Financial Management Reforms
- Specific Sectors Reform

Implementation framework: Underpinning factors

- Political & Bureaucratic Support
- Communication Strategy
- Budgeting of Reform Costs
- Willingness to Change
- Consultation & Co-ordination
- Professional & Academic Support
- Information Technology Capability
- International Financial Support (developing countries)

Result: Successful Government Sector Reform

Consequences: Achieving the three Es – Economy, Efficiency and Effectiveness in the government sector. Attaining: better transparency, better accountability, and better performance. However, this needs to be balanced with the fourth E, Equity.
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ACCRUAL ACCOUNTING FOR THE PUBLIC SECTOR -- A FAD THAT HAS HAD ITS DAY?

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Introduction

For the last decade accrual accounting has been presented as the reform for public sector accounting and the basis for the wider New Public Management reforms and the marketisation of the public sector (Barton 2005, Ellwood and Newberry 2007, Ouda 2004 & 2005, Wynne 2007, etc). However, it is becoming increasingly clear that the claimed benefits of introducing accrual accounting are not being realised in practice. In the few countries which have actually adopted this reform, for example, Australia New Zealand and the UK, the evidence is now suggesting that, if their governments’ knew then what they know now, that the move to accrual accounting may never have taken place (Dorotinsky, 2008).

Several other countries have also reviewed the evidence and have decided that a move to accrual accounting is not appropriate, at least in the short-term (for example, China, Ghana Malaysia, Mauritius, Namibia, Netherlands, Pakistan). So what are the claims made for the advantages of moving to accrual accounting and what is the actual evidence for the extent to which they have been delivered? This paper reviews the evidence which is available so that governments considering this type of reform can base their decisions on the actual experience of those few countries which have adopted this approach. This is important as those individuals and organisations which promote this idea appear to base this on their faith in the value of the public sector adopting private sector practice rather than objective evidence. Just as the current fall-out from the credit crunch is undermining the previously dominant view on the efficacy of the free market, so the failure of accrual accounting to deliver on its promises is having a demoralising effect on at least some of its previous supporters.

International Public Sector Accounting Standards Board

IFAC’s International Public Sector Accounting Standards Board (IPSAS Board) has set itself the task of developing a full set of accruals-based international public sector accounting standards, promoting its standards and ensuring that these are adopted as widely as possible (IPSAS Board, 2008b). The Board arranges its meetings in different places around the world, including, for example, China, Ghana, Russia and Switzerland in
the last two years. This enables it to combine these meetings with local promotional events. IPSAS Board argues strongly that all governments should adopt the accrual basis. Even in the introduction to its Cash Basis IPSAS (IPSAS Board, 2007: page 1) it states that the Board “encourages governments to progress to the accrual basis of accounting”. However, the standing of the IPSAS was significantly undermined in early 2007 when the UK Government (home to the IPSASB Chair) announced that it would be adopting the International Financial Reporting Standards rather than the IPSAS.

The IPSAS Board (IFAC, 2003: page 7) summarises the advantages of reporting on an accrual basis in the public sector as follows:

- it shows how a government has financed its activities and met its cash requirements
- it allows users to evaluate a government’s ongoing ability to finance its activities and to meet its liabilities and commitments
- it shows the financial position of a government and changes in its financial position
- it provides a government with the opportunity to demonstrate successful management of its resources and
- it is useful in evaluating a government’s performance in terms of its service costs, efficiency and accomplishments.

Despite this promotional work by the IPSAS Board and others, the actual use of accrual accounting by public sector entities is still unusual. Few governments have actually adopted this approach, certainly at the national government level. Spain was possibly the first in 1989 followed by the celebrated case of New Zealand by 1993 and Australia in 1994. A few other governments followed over the next decade or so, but by 2006 the total was still only around 10 of the nearly 200 countries in the world (Wynne, 2007). Even fewer have adopted the accrual basis for their central government budgeting system (Pina and Torres, 2003).

<table>
<thead>
<tr>
<th>Country</th>
<th>Adopted by central government</th>
<th>Accrual budgeting used</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spain</td>
<td>1989</td>
<td>No</td>
</tr>
<tr>
<td>New Zealand</td>
<td>1993</td>
<td>Yes</td>
</tr>
<tr>
<td>Sweden</td>
<td>1993</td>
<td>Yes</td>
</tr>
<tr>
<td>Australia</td>
<td>1994</td>
<td>Yes</td>
</tr>
<tr>
<td>USA</td>
<td>1998</td>
<td>No</td>
</tr>
<tr>
<td>UK</td>
<td>2002</td>
<td>Yes</td>
</tr>
<tr>
<td>Canada</td>
<td>2003</td>
<td>No</td>
</tr>
<tr>
<td>Finland</td>
<td>2005</td>
<td>No</td>
</tr>
<tr>
<td>France</td>
<td>2006</td>
<td>No</td>
</tr>
</tbody>
</table>
Several of the central governments of the largest economies in the world have yet to introduce such changes, for example, China, Germany, Italy, Japan and Russia. In December 2007, Mike Hathorn (chair of the IPSAS Board) said that only six governments across the world had actually issued financial statements on the full accrual basis (at the FEE Public Sector meeting, Brussels).

In their summary of the extent of adoption of IPSAS, the IPSAS Board (IPSAS Board, 2008a: page 4) list more than 50 countries which have made moves towards adopting IPSAS, but then admit that only five countries have fully adopted accrual accounting in line with their approach:

 Governments that already apply full accrual accounting standards and apply accounting standards that are broadly consistent with IPSAS requirements:

- Australia
- Canada
- New Zealand
- United Kingdom
- United States of America.

So what is the actual evidence of the real benefits achieved by introducing full accrual accounting in these countries? In the following sections we review the evidence from the UK, Australia and New Zealand.

**Evidence from the UK**

The UK has possibly the most extensive experience of adopting this approach for its public sector financial statements. Birmingham City Council, then the sixth biggest economic entity in the UK, moved to a form of accrual accounting in 1850, other local governments slowly followed over the next century. However, the current moves to accrual accounting in the UK only really started with the health service in 1991. Central government only introduced accrual accounting from around 2000 (Wynne, 2007).

Despite this long experience of using accrual accounting in the public sector, the use of cash accounting and budgeting, for central government at least, was almost universally accepted until relatively recently. So, for example, Andrew Likierman (the person who was later responsible for the transition to accrual based accounting in UK central government) was able to say, in a book published as late as 1992 that:

“Those who believe that private sector accounts are superior need to bear two factors in mind. First, that there are no immutable accounting or other financial reporting rules which apply irrespective of the nature and purposes of the
organisation whose activities and results are being displayed or the objectives of presentation. Second, that cash accounts, despite their crudeness, have a degree of transparency that accrual accounts cannot give and that many private sector financial reports do not seek to offer.” (page 23)

Once accrual accounting was eventually adopted by central government the assumed benefits appeared to be slow to arrive. So in a report issued in 2003 on the Government’s financial management reforms, the UK National Audit Office’s conclusion on the move to accrual accounting (first announced ten years earlier) was that:

"In most cases it is too soon to identify any discernible benefits from better resource management in terms of contributing to improved public services from for example, enhanced efficiency (Page 31)."

The National Audit Office published a follow-up report five years later, in February 2008. On the actual benefits of moving to accrual accounting this report concluded that:

"Departments have made significant progress in using accruals-based accounting and budgeting systems since our previous study. This has allowed departments to better understand how they are using their financial resources, for example by offering more detailed information to manage their assets and liabilities. Departments have used this information to help identify under-utilised assets and to dispose of those no longer required. (paragraph 9, page 7)"

So the only specific benefit of the move to accrual accounting appeared to be that ministries (called departments in the UK) were able to identify and sell assets (mainly buildings) which were no longer needed. Similar conclusions on the limited nature of the benefits of moving to accrual accounting are provided by academic research undertaken in the UK over the last few years.

In 2005, researchers from Queens University, Belfast published the results of their research in the costs and benefits of adopting accrual accounting in Northern Ireland (NI), a region of the UK (Hyndman and Connolly, 2005). Their research concluded that:

"Serious deficiencies in the accounting skills available… contributed to a rushed, confusing and uneven implementation process (page 6)"

"There was little evidence that [accrual accounting] information was extensively used in decision making within the NI public sector... Many interviewees identified the problems of unnecessary complexity and incomprehensibility of the information as undermining its potential use. (page 7)"
While no department had prepared a budget for the introduction of [accrual accounting], or kept records of actual costs, the costs were perceived as being substantial. (page 7)

Many of the costs of introducing accrual accounting will be ongoing rather than being ‘one off’. This will include, for example, the increased costs of employing significantly more professionally qualified accountants (Hyndman and Connolly, 2005). Governments have traditionally had few qualified accountants in their civil service because of the simplicity of their cash accounting systems; for example, in 2002 Norway had only one professionally qualified accountant on the staff of its Ministry of Finance. The UK public sector, especially local government, has a tradition of employing qualified accountants (perhaps because of its early adoption of accrual accounting) and they have their own professional body, CIPFA. Despite this, the number of professionally qualified accountants working across the UK central government increased nearly fourfold from almost 600 in 1989 to 2200 in 2003 (the period over which accrual based accounting was introduced) (Wynne, 2007). In addition, for example, the auditors fees for the UK National Audit Office increased by 67% with the introduction of accrual accounting in 2001/02 (NAO, 2002).

The UK health service is highly capital intensive and so it may be assumed that the move to accrual accounting from 1991 would have provided significant benefits in terms of the more efficient use of these capital assets, for example, hospitals and medical equipment. However, a research report by leading UK academics in the field (Mellet, Macniven & Marriott, 2007), funded by the Scottish Institute of Chartered Accounting, concluded that:

There was no evidence that the perceived benefits from the introduction of... accruals accounting... were being realised. (page ix)

In an article for the International Public Sector Bulletin (February, 2008) outlining the results of this study, the lead researcher, Howard Mellett provided further details, indicating that:

No positive impact on decision making was found. Accounting measures did not influence ‘rent or buy’ or ‘retain or dispose’ decisions, although the desire not to take an adverse ‘hit to the bottom line’ could impede disposal decisions. Similarly, no evidence was found of the opportunity cost of capital expenditure being recognised, as reflected through measures based on resource accounting, this being a matter for active consideration when acquiring or constructing fixed assets. (page 7)

In this article, Mellett concluded by saying:

Governments which have undertaken to implement accruals accounting should therefore beware of the fact that... any potential benefits may not be realised. (page 8)
The final stage of the move to accrual accounting in the UK was to have been the production of Whole of Government Accounts (WGA). However, recently published research suggests that this is facing significant problems:

The longer the delays in publication of WGA financial statements, the more it is likely to be argued that the problems encountered are fundamental ones, rather than initial teething troubles or resource issues. (Chow et al, 2008, page 27)

Several other people from the UK are concerned that the claimed benefits of accrual accounting are being over-sold especially to the governments of developing or transitional countries, for example, Noel Hepworth, the former leader of CIPFA (the UK’s public sector accounting body) and formerly Chair of the Federation of European Accountants’ Public Sector Committee. Based on his experience of moves towards the introduction of accrual accounting in Eastern Europe, Hepworth (2003) concluded that:

To introduce accrual accounting is costly, time consuming and requires a diversion of resources from other activities. It requires a great deal of cooperation from key actors and will need significant changes of substance to the organisation, procedures and responsibilities of managers. As Parliament is also affected because of the changes that will be needed to the cash allocation and budgetary control processes it too will need to be consulted. What is more, accrual accounting provides wide scope for the exercise of judgement and this requires technical knowledge, a disciplined approach and an audit system capable of monitoring how judgement is exercised... For these reasons the introduction of accrual accounting also carries considerable risk. (page 42)

Members of the UK parliament have recently complained about the complexity of the Government’s financial reporting. They claimed that “even Members with financial or business experience struggle to understand the financial information provided” and that “had such a system been deliberately designed, it could fairly be assumed that it had been set up with the specific purpose of making it impossible to hold the Government and Departments to account” (House of Commons, 2008). It is also recognised by HM Treasury (the ministry of finance in the UK) that current arrangements:

Can cause confusion and inefficiency and make effective Parliamentary scrutiny of public spending more difficult. This is, moreover, a reform that many in Parliament have themselves called for. (Financial Reporting Advisory Board, 2007, page 2)

As a result, HM Treasury is currently working on a project designed to achieve better alignment between ministries’ budgets, estimates and financial accounts. The aim is to create a single, coherent regime that (NAO, 2008, page 13):
• improves the effectiveness, efficiency and transparency of the process
• enhances accountability to Parliament and the public and underpins the Government fiscal framework
• incentivises good value for money; and
• supports delivery of public services.

The wide ranging nature of these aims suggests that the British Government has been forced to recognise that the benefits claimed for its move to accrual accounting have not actually been delivered and that further major reforms to financial reporting are needed over the next few years.

Australia

The message from Australia is similar. In an academic review of international public financial management reforms (Guthrie, Humphrey, Jones and Olson, 2005: page 4) it was noted that “observations of actual outcomes of the NPFM change processes [including accrual accounting] have been limited to those made by the initiators themselves, while formal independent studies of public sector change impact have been rare” (page 4). Another leading Australian academic has claimed that the “present mode of presentation of the accrual budgets and financial statements of Australian Government departments has become a controversial matter. It has led to widespread dissatisfaction in Parliament and parts of the Public Service” (Barton, 2004).

In March 2007, the Australian Senate Finance and Public Administration Committee (Executive Summary: page iv) noted that:


The Committee considers that the adoption of accrual accounting and budgeting has the potential for enhancing the management of the Commonwealth’s funding and expenditure and has done so to an extent. Nevertheless, accrual budgeting and especially the associated outcomes and outputs framework, while resulting in some improvements in transparency, have posed challenges for Parliament’s control of the appropriations processes.

The fact that a decade after its introduction Australian parliamentarians are still noting the ‘potential’ for accrual accounting and budgeting does not really provide a ringing endorsement of this type of reform. In addition, as in the UK, members of parliament are
complaining about its detrimental effect on parliamentary financial control. Indeed a leading Australian academic, Prof Alan Barton (2007), recommended to the same committee that the:

reintroduction of the Cash Accounting and Budgeting System (CABS) is necessary for fiscal policy determination and management purposes and for cash management purposes (page 1).

In a recent multi-country review of accrual accounting and budgeting, the US Government Accountability Office (GAO, 2007) noted that:

Australia also reported that it is considering a model that would give the Parliament both cash and accrual information in a form that better meets its needs and preferences (page 28).

New Zealand

In the case of New Zealand, often held up as a model of this type of reform (Ouda, 2008), two academics (Guthrie et al, 2005) concluded that:

various financial mechanisms built on the accrual accounting base have, over the long term, had a detrimental effect on departmental capability in a manner that has escaped parliamentary understanding and control (page 8).

They also argued that this reform “promised significantly more in terms of efficiency, better service, and increased public choice than it delivered in practice” (page 7). They also point out that much of the literature evaluating New Zealand’s financial management reforms has been written by the key reformers themselves and appears more promotional than objective.

In addition, it has been noted in the context of accrual accounting reforms in the UK and New Zealand that “the fundamental purpose of governmental accounting is protection of public money, and that business sector accounting practices were not devised for that purpose” (Ellwood and Newberry, 2007: page 551).

As with the UK and Australia, the introduction of accrual accounting in New Zealand has been accompanied by misunderstandings and confusion. Debits and credits were muddled with fiscal targets and capital expenditure; and cash and accruals were muddled with departments being expected to retain cash from their accrual-based appropriations (Ellwood and Newbury, 2007). In addition, there was controversy over the accounting treatment of heritage assets with the regional museums refusing to neither value their collections nor include the result in their balance sheets (Ellwood and Newberry, 2007).
Developing countries

Given the dominance of view of the supposed advantages of accrual accounting and the belief that it is the modern approach to government accounting, many governments have indicated their intention of adopting accrual accounting. However, whether these intentions will or even should be realised is perhaps another matter. The eight countries of South Asia, for example, have apparently “expressed a desire to move in the direction of accrual accounting” (Subramanian, 2008: page 6), but, with the possible exception, of Sri Lanka, this is only likely to be achieved “in the long-run”.

In Africa, a number of countries have adopted public financial management laws in recent years with assistance from international consultants. In several counties these laws require the government’s financial statements to “be prepared in accordance with generally accepted accounting practice” (for example, Ghana, Tanzania, Uganda, and Zimbabwe). The implications of such statements (that the accrual basis of accounting should be adopted) may not have been realised by the relevant parliamentarians or subject to appropriate public debate. As a result, in few, if any, of these countries has any progress been made in actually implementing accrual accounting.

In Ghana, despite the Financial Administration Act having been passed into law in early 2003, little, if any, action has been taken to introduce accrual accounting. This is understandable; Ghana has suffered enough with such ‘state of the art reforms’. A senior manager from the Integrated Financial Management System said recently that the project had “spent US$30 million and 8 years and still can’t produce basic budget reports” (Sharples, 2008). Similarly with its Medium Term Expenditure Framework, after a promising start, it led to disillusionment and few clear benefits. (Wynne, 2005). In addition, as with all countries, basic financial management control is more important than leading edge, state-of-the-art reforms. A recent assessment of public financial management in Ghana found that financial controls and the timeliness of submission of audited accounts to parliament were only just within acceptable limits. (World Bank, 2006).

Despite, or because of, this lack of progress with the implementation of accrual accounting, Ghana was rewarded with the International Public Sector Accounting Standards Board holding its March 2007 meeting in Accra, the capital of Ghana. As usual, a seminar on the virtues and benefits of accrual accounting was organised alongside the IPSAS Board meeting for the local accounting profession.
International Financial Institutions

Multilateral institutions, such as the International Monetary Fund (IMF) and the World Bank have been the main providers of financial support for the International Public Sector Accounting Standards Board in developing its accrual based financial standards. These institutions have also encouraged governments especially in developing countries to introduce accrual accounting (Hepworth, 2003). This has included the World Bank’s recommendation to Nepal in 1981 and SIGMA, the advisory body for new and candidate countries of the European Union, making the same proposals for Cyprus in 2006 (Wynne, 2007).

However, this support for accrual accounting has not always been consistent. So, for example, in an IMF working paper (Diamond, 2002) the following points were made:

*often emerging economies have too eagerly accepted this reorientation [to accrual accounting], and have overlooked a number of important issues... while agreeing that accrual accounting systems are more comprehensive and provide a wealth of financial information, it is important at the same time not to overstate the case (page 3)*

*The experience of OECD Countries is that the implementation of accrual accounting is not easy; it takes time and requires sustained political support. Not surprisingly it cannot be considered a top priority for most countries. (page 18)*

In addition, staffs from the World Bank and IMF have recently encouraged more critical views to be expressed over the introduction of accrual accounting. This has been reflected on the IMF’s Public Financial Management Blog (see for example http://blog-pfm.imf.org/pfmblog/2008/02/transition-to-a.html and http://blog-pfm.imf.org/pfmblog/2008/07/going-hybrid-a.html).

The costs of introducing accrual accounting

Whilst the above research has shown that the potential benefits of any move to accrual accounting may be difficult to achieve, the costs of implementing accrual accounting are also difficult to estimate although they are generally accepted to be substantial. As a result, few organisations which have adopted accrual accounting developed a specific budget for this reform (and in the case of the UK this was actively discouraged - Hyndman and Connolly, 2005). Thus limited data is available on the associated costs of introducing accrual accounting in the public sector, however, the following examples confirm the view that this has involved significant on going investments.
The United Nations agreed in July 2006 that the accounts of all its member organisations would move to the accrual basis by 2010. A budget of US$23 million was agreed for this reform or around 1.8% of the UN Organisation’s annual budget (UN General Assembly, 2006). In 2002 Hong Kong agreed a one-off budget equivalent to US$6.3 million (only 0.02% of annual expenditure) with an estimated re-current cost of US$1.2 million (Hong Kong Treasury, 2002). The Hong Kong reforms were less expensive because they have not adopted the full requirements of the accrual based IPSAS, for example, infrastructure assets are not usually valued and valuation of capital assets was estimated to be 90% of the cost of the Hong Kong reforms (Wynne, 2007). The approach to accrual accounting which is generally being adopted requires regular revaluations of all capital assets. When Tanzania undertook such an exercise in 2005 the cost was comparable to the annual salary of all accountants employed within it central government ministries (Wynne, 2007).

Conclusions

Supporters of the move to accrual accounting argue that a range of significant benefits are available to governments which move from the cash to the accrual basis of accounting. Such arguments have been widely reported and repeated at many conferences. However, the authoritative independent research which is now available suggests that few, if any, of these benefits have been actually achieved in practice. In contrast, the costs of moving to accrual accounting are accepted as being substantial.

Unless the issues involved in moving to accrual accounting are carefully considered and all the associated risks are adequately managed it is possible that the past mistakes of governments adopting mega-reforms, for example, integrated financial management systems may be repeated. In this case, sophisticated computer systems were introduced with the objective of managing government finances across the whole of the public sector. However, as with the case of Ghana mentioned earlier, these reforms were rarely successful and after the expenditure of millions of dollars were not usually sustainable. World Bank staff estimated that only six per cent of the IFMIS projects which they had supported in the decade to 2003 were sustainable (Dorotinsky, 2008).

Some governments may consider that a move to accrual accounting will provide the opportunity for a complete overhaul of their financial management systems through the adoption of leading edge twenty first century reforms. However, Noel Hepworth (2003) argues against such a strategy and recommends that:

before this reform [accrual accounting] is introduced, cash accounting should be robust, control should be secure, external audit should be functioning well and the legislature should have an ability to call the executive to account. (page 37)
In addition it should be noted that several leading OECD countries are still not convinced of the overall benefits of moving to full accrual accounting and budgeting. A recent multi-country overview by the US General Accountability Office concluded “Accrual Budgeting useful in certain areas but does not provide sufficient information for reporting on our nation’s longer-term fiscal challenge”. This reinforces growing recent scepticism on the value of a full transition to accrual accounting and budgeting.
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DETERMINING AUDIT FINDINGS

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This article explores some of the challenges in developing audit findings. The message is that there are more ways than one to approach the audit and that the auditor should not be constrained by a rigid application of the standard methodology. We present here two alternative approaches. Simply stated they are:

Traditional Model: What should be; what is; finding results from identification of a gap or difference.

Alternative (or Converse) Model: What is; what could be; finding results from judgement of whether appropriate / not appropriate in the circumstances.

**Traditional Model**

The standard approach is to compare what is in place against a standard or criterion. The auditor defines what should be in place to manage a function. In financial audit, the audit refers to GAAP (generally accepted accounting practices). In performance audit, the auditors develop audit criteria against which the management systems, procedures and practices can be compared.

The auditor can then determine whether the organization is being managed according to these standards. In this way, the auditor generates findings where there is a gap between what should be in place and what is in fact in place. The auditor thus identifies a finding as a situation where there is a discrepancy between what should be (the criterion) and what is. In this way findings are generated. This is the theory normally presented in audit methodology.

Furthermore, it is commonly believed that without a criterion, a finding cannot exist. In practice, this is not a reasonable assumption. Especially in performance audit, it is possible to encounter situations that had not been anticipated. Or, the experience of the auditor is insufficient to develop a sufficiently complete set of criteria to apply to the area being audited.

During the audit process, the auditor may sometimes encounter, or observe, a situation that is obviously, or apparently, wrong but for which, no prior criterion had been developed. Some auditors then go back and “invent” the appropriate criterion. This is not intellectually honest.
Where an unsatisfactory situation is encountered where no prior criterion has been developed, the auditor should recognize, nevertheless that a reportable observation has been made. When discussing this type of observation with the management of the operations, it should be explained (if the original set of criteria had been given to management prior to the start of the audit) that no prior criterion had been developed but the concern is still a reality. Management should be persuaded that there is a concern, or, if there is a good explanation for the problem, the observation should take this into account.

**Alternative (or Converse) Model**

Another approach, as often applied in social studies, is to examine what is in place, i.e. how the managers are managing their business. With this approach, the auditor notes situations where results are not being achieved, where errors are occurring, where there is waste or mismanagement. Also, of course, the auditor notes, and in some cases provides assurances, where the operations are carried out successfully.

With this approach the auditor still needs to know what is usual practice and should always develop appropriate criteria. This knowledge and set of “expectations” is needed to conduct the audit. The emphasis of the audit work, however, is on understanding how the managers have chosen (or been forced) to manage the particular situation. The concept here is that if it works (and that there are no serious risks that it may fail in a particular situation) then the auditor may accept that it is appropriate even if it is different from normal practice.

At the same time, the auditor should understand why it may differ from the criteria developed before-hand or, where no criterion had been developed to address the situation, why an additional criterion is required. There can be many reasons why it does not conform to normal practice.

In discussion with management, the auditor confirms that there are problems or reasons for doing things differently, and determines the cause(s) of this condition. Thus the auditor confirms the situation and determines what observations are appropriate in the circumstances. Then the auditor concludes what changes should be made to improve the management structure, processes and practices and makes recommendations.

Often in governments that are short of funds the “best” management practices may not be realistic. For the auditor to recommend more funds (or suggest systems that would be beyond the budget of the organization) will not be helpful in the situation. The auditor should suggest perhaps different methods, or different allocation of effort to improve overall performance.
The Difference

In practice, both directions of logic are used. Yet, it is important that the auditor is aware of the alternative approaches. Understanding the reality and adjusting expectations accordingly is more realistic, and certainly more useful, than limiting the audit process to one of comparing “what is” with “what should be” to produce the audit findings.

Not Necessary to Have Every Criterion Addressed and Every Finding Reported

The “traditional” approach is often combined with the insistence that every criterion should be addressed and a finding reported, either that the practice is consistent with the criterion (a positive finding) or that there is a deficiency (a negative finding). The difficulty with this is two fold:

The auditor is forced into reporting matters that may not be of significance; and/or
In some cases, extensive evidence (e.g. a large sample size) is required to ensure the validity of a positive finding (i.e. the provision of assurance).

There should be continual review of the audit work to ensure a trade-off between allocating scarce audit resources to insignificant areas and obtaining sufficient evidence to arrive at supportable conclusions for significant findings. This means that the auditor should not always attempt to produce a complete set of findings.

It is more important to report on a few key audit concerns than provide a “complete” audit coverage. Furthermore, many small findings can detract from the main message the auditor wishes to provide management. Some managers want to be provided all the detailed findings, while others want a concise report that conveys just the important message. This is a reporting issue but from the findings perspective, the message is that many detailed findings are not necessary.

In most cases, where the report is more than say 15 pages long, there should be an Executive Summary. This should provide a clear and meaningful message that has limited details. It should provide a summary of the audit objectives and scope, the main findings, the significant conclusion(s) and a list of the more significant recommendations contained in the main body of the report. Even in the main body of the report, it is preferable to keep the communications simple and clear, placing detailed calculations and listings of detailed observations in appendices."
Clustering of Findings

The ability to cluster minor and/or detailed findings into a more generalized finding is a valuable skill the auditor should develop. For example, the auditor may discover: errors in reports / late in issuing reports / poor planning process for issuing reports / no knowledge of what information managers need / lack of clear/consistent definitions used in reports. These in themselves may not be very significant findings but collectively they indicate serious problems in the management of the reporting function. The higher level finding can be expressed as “inadequate reporting of the state of operations”. The conclusion can then be stated as “management are unable to rely on the reports provided them”. At all times, the auditor must ensure that the lower level findings are sufficient to be able to support the higher level finding.

Scope of the Audit Coverage

The INTOSAI standards state that only evidence related to the originally identified audit problem should be collected\(^2\). This position raises some interesting ethical issues. Presumably the intention is to not “conduct a witch hunt”. First, the auditor should never conduct the work in a subjective or personal manner. There should be no “hidden agenda” or a wish to blame an individual manager. Nevertheless limiting the collection of information solely with regard to the original audit scope presents some problems. As with a financial (or attest) audit, there are very clear procedures to follow and well defined scope of audit. Nevertheless, in for example a financial audit, should any evidence of fraud, or suspected fraud, come to light, it is the duty of the auditor to extend coverage as appropriate in these circumstances. Similarly, it is suggested that if any unacceptable situation is encountered during a performance audit, the evidence should not be ignored.

Proper procedures should be followed of course. Where evidence is found outside of the original scope or subject of audit, the auditor should consult with his/her audit manager and then with senior Audit Office management. After that, if it is still considered appropriate to pursue the area further, the contact at the audit entity should be consulted and the situation explained. At this point, it may be agreed that the area should be included in the audit.

Need for Judgement

In practice, the process of determining findings can vary considerably. Some findings are a clear “right” or “wrong”. Often, however, the findings are not that simple.

\(^2\) According to *Code of Ethics and Auditing Standards*, INTOSAI, 2001, page 70, Findings are “the specific evidence gathered by the auditor to satisfy the audit objectives”. This means that only findings that are directly or indirectly related to the selected audit problem(s) are relevant in the audit.
Some activities in audit are fairly mechanical. A set of calculations are made to determine whether the reported data are accurate. This could be in support of an assessment of the value of assets, the statement of revenue, the level of efficiency, or the amount of time a vehicle spent in maintenance and repair. Other activities can be highly judgemental.

**Example: Analysis of Investment Options**
In an investment analysis, the auditor needs to determine whether an appropriate set of options was considered before making the decision of which option to select. In this situation, the auditor would not accept:
- do nothing;
- spend at least ten times as much; and
- accept option presented.

This would not constitute a realistic set of options for analysis. On the other hand, if the auditor wishes to observe that insufficient options were considered, he/she must be prepared to put forward realistic and meaningful options that should/could have been assessed in the particular situation.

**Example: Responsibilities Clearly Allocated**
It is common to include a criterion that states: “roles and responsibilities should be clearly allocated”. It is generally a sound management practice to allocate responsibilities clearly and hold one individual responsible for certain activities. Another style of management, however, contradicts this principle. The “duplicate tasking” manager tasks more than one individual to carry out the same work. Then the manager receives more than one result and can select the preferred result (or even have a competition between the staff). On the basis of the pre-defined criterion, this “duplicate tasking” manager is not carrying out the job properly. The finding is that responsibilities have not been assigned clearly. Alternatively, the auditor documents the process followed by the “duplicate tasking” manager and before coming to a clear finding, explores the consequence of this manager’s approach. If morale suffers, and there is serious waste of effort then the “duplicate tasking” approach could be considered inappropriate. Alternatively, the auditor may find that the “duplicate tasking” manager receives much better information and makes more informed decisions with the duplication of effort.

**Example: Strategic Planning Process in Place**
The auditor must guard against acceptance of a process in place rather than testing whether the process is meaningful. An interesting example was an audit of military planning. The first auditor examined the systems and processes in place for strategic planning and concluded that these were well presented and applied. Another auditor came along and asked a simple question: “How would the department integrate the reserves with the regulars in the case of war?” This simple, but significant, question had not been addressed and the department agreed it was a key consideration. Thus the strategic process in place
may have been impressive as a process but had failed to recognize significant scenarios that the strategic process had to address.

Audit has to rely on sound professional knowledge and application of appropriate methodology but the successful auditor cannot operate without good judgement and an open and enquiring mind.
INTERNAL INVESTIGATIONS AND TRANSPARENCY: THE END OF MR. DOMINICK’S DISTINGUISHED CAREER

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Abstract

Investigations of allegations of misconduct are necessary to monitor and control actions of agents (employees). Reports on facts found are also necessary to provide transparency and to provide a basis for action or change. Reports on allegations found not to be true and resulting in no recommended action serve a limited purpose and sometimes cause harm to agents. A balance is needed between disclosures required for transparent agency relationships and the harm transparency causes to agents. The purpose of this paper is to describe the need for this balance, using the example of a specific investigation conducted by a Government Agency. The illustration will then be used to comment on the current state of internal controls over investigations of financial management and to suggest improvements in these controls.

Introduction

Organizations, such as businesses and government agencies, rely on human agents (employees) to achieve goals. Internal controls are needed to monitor and control the actions of agents and assure faithful performance of agency duties. Actions of agents are controlled and monitored by policies and procedures intended to assure agents do not act without authority and that they comply with procedures limiting and documenting their
actions. These policies and procedures should prevent unauthorized actions and provide a means to monitor actions taken. These policies and procedures form part of what is known as internal controls.

Effective internal controls require a willingness to investigate allegations of unauthorized action or failures to observe required procedures. Persons working as agents must expect to be subject to investigations regarding their performance of agency duties. For agents of the US Federal Government, allegations of misconduct are investigated by the Office of the Inspector General, within an agency. According to the US Department of Justice, the Office of the Inspector General “conducts independent investigations, audits, inspections, and special reviews of the United States Department of Justice personnel and programs to detect and deter waste, fraud, abuse, and misconduct, and to promote integrity, economy, efficiency, and effectiveness in Department of Justice operations” (www.USDOJ.gov/oig_index.html). We believe these goals to be similar at other Offices of Inspector Generals within other agencies.

Transparency requires investigations whenever reasonable suspicion of misconduct exists, and requires the scope and actions of an investigation to be driven by the facts discovered. Investigatory resources and credibility are reduced when investigations occur without reasonable suspicion and actions taken by investigators are not determined by findings of fact. Transparency in agency relations is increased when principals have reason to believe investigations are not used for political or other reasons not related to monitoring agency duties. The broad scope of the investigatory powers of the Office of the Inspector General does not necessarily provide this assurance. The purpose of this paper is to describe the delicate balance of disclosure of transparent investigations and allegations of misconduct. We describe an actual case, with fictitious identities (Roscoe B. Dominick) to illustrate our concerns.

The Case of Roscoe B. Dominick

Roscoe Dominick was a senior executive at a high profile agency (ABC). ABC is a branch of the Department of XYZ. During Dominick’s three year tenure at ABC, the political environment at XYZ was allegedly chaotic. A series of scandals occurred at XYZ during that time and its management was characterized in the media as “dysfunctional” by political leaders from both of the main parties.

In January, 200X, the Office of the Inspector General of XYZ received an anonymous letter alleging Dominick engaged in “egregious acts of gross mismanagement of public funds and failures of leadership.” The letter alleged eight incidents of financial mismanagement and also alleged Dominick engaged in unfair hiring practices and tolerated a hostile work environment. The Office of the Inspector General investigated the allegations and issued a report.
The OIG Report

The Office of the Inspector General’s report described eleven allegations against Dominick. Nine of the eleven were found to have no basis in fact. One was found to have an arguable basis, but a “de minimus” amount of funds were involved. Another was found to have a basis, but related to actions of subordinate ABC employees and was only indirectly attributable to Dominick. This allegation, in which Dominick was at fault, was discovered by the Office of the Inspector General while investigating the others. The Office of the Inspector General report made no material recommendations for changes and generally confirmed Dominick’s substantial compliance with internal controls. The report did offer lots of opinions and unsupported conclusions about issues outside the scope of the investigation or the expertise of the investigator. The report harshly criticized Dominick, using vague and sensationalistic terms. The opinions expressed in the report apparently substitute the judgment of an independent investigator for that of a politically appointed agent with biased responsibilities. The only change to result from the investigation was the resignation of Dominick. Press coverage of his resignation, “amid an inquiry into his spending”, suggests the investigation may have caused him to resign.

The allegations against Dominick, and the Office of the Inspector General report on them, may be summarized as follows:

1. Hiring Policies and their Budget Impact
Dominick was accused of hiring excessive numbers of ABC employees. The report found no unauthorized employees were hired and no policies or procedures were violated. The report then criticized Dominick for hiring new employees, expressed an opinion that the funds should have been used for other purposes, and suggested that Dominick denied ABC employees safety equipment and training programs.

2. Design Changes to ABC’s Headquarters Building
Dominick was accused of making unnecessary changes to the ABC headquarters building completed during his tenure. Again, the Office of the Inspector General report found no unauthorized acts or failures to follow policies and procedures.

The Office of the Inspector General report then proceeded to detail building expenditures, including the use of premium materials in portions of the building used by Dominick and other senior ABC managers. The report provided sensationalistic details and dollar amounts and expressed an opinion that funds expended for these offices could have been put to better use.
3. **Other Construction and Renovation Projects**
Dominick was also accused of making unnecessary changes to other construction projects. Again, the Office of the Inspector General report found Dominick acted within his authority. But, again, the report criticized operational decisions, this time Dominick’s decision to increase funds for gyms and training rooms in field offices and for an enclosed garage for an agency truck. The Office of the Inspector General again suggested that the funds could have been better used for other purposes.

4. **Assistance in Nephew’s High School Project**
This allegation was not contained in the anonymous letter, but was brought to Office of the Inspector General’s attention during the course of the investigation. Office of the Inspector General found that ABC resources had been used to assist Dominick’s nephew on a high school project. The project, which involved at least 20 ABC employees engaged in technical, time-consuming work over a ten month period, produced a 90 minute DVD. The project included the use of ABC space and several pieces of equipment, including computers, lights, mailing materials, film, and a teleprompter. The OIG report found Dominick exceeded his authority by directing and authorizing the use of ABC resources for his nephew’s high school class project.

5. **Use of the Executive Protection Branch**
Dominick was alleged to have misused bodyguards provided by ABC. The Office of the Inspector General report did not find he exceeded his authority or failed to follow policies and procedures, but noted amounts spent to provide bodyguards for all ABC executives and expressed the opinion that “selective ratcheting up and down of his security detail was driven more by considerations of appearance than security needs.”

6. **Travel**
The anonymous letter accused Dominick of improper spending on trips to London, England, New York City, Boston, and Ottawa, Canada. The Office of the Inspector General report found the purpose of the trips was directly related to the mission of the ABC. The report did not find Dominick exceeded his authority or failed to follow procedures. Nonetheless, in most instances, the report raised concerns as to the number of travelers (i.e. medic, security details, press relations personnel, and others), the procedures by which the travel arrangements were made, and the overall cost.

7. **Use of Representation Fund**
The anonymous complaint alleged that Dominick, on numerous occasions, invited individuals with no apparent connection to ABC activities to have lunch at government expense in his office or at nearby restaurants. ABC’s annual budget provides funds, called a “representation fund” to provide lunches to persons to “promote personal relationships necessary to enhance the performance of the ABC”.

The Office of the Inspector General identified three instances where Mr. Dominick hosted lunches in his office that did not appear to relate to ABC affairs. The total cost of the questionable expenditures was only $50.03. The report noted the amount was small.

8. Creation of a hostile work environment
Dominick was accused of requiring two female administrative assistants to arrange and serve lunches to him and his guests in his office. Allegedly, they were also required to announce that, “lunch is served.”

Office of the Inspector General concluded that Dominick encouraged or allowed the administrative assistants in his office to pick up meals, arrange table settings, heat and serve meals, and clean up afterwards. The Office of the Inspector General report did not find Dominick exceeded his authority, but expressed an opinion that “these duties were not among those reasonably expected of administrative assistants.” The report also expressed the opinion that Dominick exercised “poor judgment by placing subordinates in the demeaning position of serving lunch to him and his guests”.

Conclusion

The Dominick report provides an example of a failure of internal controls over investigations. The decision to investigate was based on an uncorroborated anonymous letter. With relatively minor exceptions, the Office of the Inspector General found no abuse of authority or failure to follow procedures, yet their public report contained sensationalistic, vague, and difficult to rebut opinions, such as “believed”, “questioned Mr. Dominick’s judgment”, “he bears ultimate responsibility”, “poor judgment”, and “did not act properly”.

Most of the opinions expressed by the report related to narrow operational issues not related to compliance with internal controls. These issues were outside the scope of the investigation and perhaps outside the expertise of the investigator. The report found no material wrong was done, and confirmed the faithful performance of agency duties, and then proceeded to unnecessarily harm the person investigated.

Transparency in agency relationships is best served when investigations do not occur without reasonable cause and when reports on investigations are limited to findings of fact and do not include opinions on operational matters outside the expertise of the investigator. On the other hand, when investigations can begin and end without clearly defined standards, investigations harm public interests by consuming scarce resources, discouraging persons from entering or continuing public service, and undermining the moral authority of legitimate investigations.
Reasonable standards for the reliability of evidence required initiating an investigation, clearly defined limits on the scope of an investigation, and a reasonable relationship between facts reported and recommendations for change are needed to conserve scarce resources and mitigate harm to persons investigated. When these standards do not exist, all investigations are tainted by the suggestion that they may have some purpose other than the public good.

The Dominick report shows no reasonable basis for an investigation and no relationship between facts reported and recommendations for change. The only tangible result of the investigation was the resignation of Dominick, even though he was not found to have committed any material breach of his agency duties. The absence of credible evidence that an investigation was needed, as well as the lack of a relationship between facts reported and recommendations for change, suggests the true reason for the investigation may have been to cause Dominick’s resignation. If true, the legitimate purpose of investigations would have been corrupted and the relatively anonymous judgment of the investigator would be substituted for the legitimate and transparent processes normally used to monitor the actions of public servants. If this is true, arbitrary and capricious investigations could become the true source or power and authority in an organization, subverting legitimate internal control procedures.

The case of Roscoe B. Dominick suggests changes are needed to assure investigations are not used to subvert or replace legitimate decision making processes. Changes are needed to assure the public that:

1. Investigations do not occur until there is credible evidence an agent has exceeded their authority or failed to follow required procedures;
2. The scope of investigations is clearly defined as the investigation begins;
3. Ongoing investigations are monitored and discontinued in the absence of sufficient credible evidence of wrongdoing; and,
4. Public statements of investigators are limited to findings of fact; excluding opinions or conclusions not related to recommendations for changes.

Internal control policies and procedures limiting and controlling the actions of investigatory agents are needed to protect their integrity and to preserve the value of investigations into the performance of agency duties.
AN INTRODUCTION TO THE U.S. MUNICIPAL BOND MARKET

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Abstract

With a market value exceeding $2.6 trillion, the U.S. municipal securities market offers state and local governments many capital investment-financing opportunities. Many readers, however, may lack an understanding of the issuance process, the quality of the available information, or the inherent risks associated with these instruments. We describe the traditional municipal bonds process beginning with the initial offering preparations and the methods of sale. We discuss the types of interest costs and the use of the bond proceeds. We identify typical bond types and call provisions. We then turn to a discussion of the investment characteristics of municipal bonds. We explain credit ratings, credit enhancements, potential risks, and oversight and reporting. Our discussion is supplemented with data from the municipal bond market from 2001-2007. Our paper provides the reader with a basic understanding of the institutional structure, available information, and potential risks for this economically significant market.

An Introduction to the U.S. Municipal Bond Market

Introduction

While American equities enjoy nearly nonstop attention, worldwide, municipal securities in the United States have received far less attention than one might expect of a $2.6 trillion market. Indeed, many readers – particularly those outside the U.S. – may have little knowledge of municipal securities. This paper provides an introduction to state and local governmental borrowing in the primary market, which deals with new bond issues, rather than the secondary market, which deals with transactions in already outstanding bond issues. We hope to stimulate interest in both academic and institutional research in this area by providing the reader with an understanding of the basic structure and available data for the municipal bond market.
Preparing the Bond Offering

When a governmental or municipal entity needs to borrow money, the first step in that process is to hire a financial advisor. A financial advisor conducts an in-depth assessment of the issuer’s financial capacity and offers options for addressing its borrowing needs. If the entity decides to tap the capital markets for funds, the financial advisor makes recommendations as to the particular type of debt to issue, its method of issue, and any features that will enhance marketability or risk management. We discuss each of these aspects later in the paper. In addition, if voter approval is necessary to issue debt, the advisor may help the entity strategize for passage of public bond measures.

After many of the specifics of the bond offering are finalized, the financial advisor then begins the marketing efforts for the bond sale. The most important instrument for this purpose is the official statement (OS). The official statement is the public sector counterpart to the private sector prospectus, and contains detailed information on the securities to be offered. Although OS content and quality will vary according to state laws and the financial advisor’s diligence, it will typically list various geographic, economic, legal, and financial details about the issuer. It will also contain (1) the purpose for issuing the bonds, (2) the revenue sources pledged for debt service, (3) the bond counsel’s opinion as to the tax status of the bonds, (4) the dates and amounts of the maturity payouts – along with applicable call price information, (5) the bonds’ credit rating(s), and (6) credit enhancement provisions such as bond insurance or state aid funds. Financial statements are the perhaps the most important content within the OS, and may range from selected audited statements to the entire comprehensive annual financial report (CAFR). The CAFR contains a full set of financial and auditor statements, plus various other components such as management discussion and analysis and statistical tables.

Methods of Sale

After the financial advisor compiles the official statement, he or she may advertise in the professional media the intention to solicit bids or proposals from underwriters. Underwriters actually purchase the bond issue for subsequent placement or distribution among investors interested in buying the bonds. Public bond sales typically involve either a competitive or a negotiated arrangement. In a competitive bid, inquiring underwriters are given the OS, the date and time of the bid, and the bid parameters such as the basis for awarding the bid (usually the lowest interest cost of the issue), coupon limitations, and premium or discount limitations. The advisor then administers the bidding process, confers with the issuer about the bids received, and announces the underwriters with the winning bid. If the bond issue is a negotiated deal instead of a competitive bid, the financial advisor will oversee the negotiation process on behalf of the bond issuer. Negotiated deals are often preferred to competitive bids during periods of volatility or if the bond issue is large and complex. Negotiated issues are also controversial. Research
studies generally find that negotiated issues increase the interest cost on the bonds compared to competitive bids, and leading professional organizations, such as the Government Finance Officers Association (GFOA), recommend against their use, preferring instead competitive bids. A third type of bond sale, the private placement, is directly placed with an investor and does not involve any public underwriting or resale. It is used less frequently than the other methods. As can be seen in Table 1, bond placement is dominated by negotiated deals.

Table 1

Municipal Issuance
Long-Term Competitive, Negotiated & Private Placement

($ Billion)

<table>
<thead>
<tr>
<th>Year</th>
<th>Competitive</th>
<th>Negotiated</th>
<th>Private Placement</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>63.1</td>
<td>221.5</td>
<td>3.1</td>
<td>287.7</td>
</tr>
<tr>
<td>2002</td>
<td>71.8</td>
<td>283.0</td>
<td>2.7</td>
<td>357.5</td>
</tr>
<tr>
<td>2003</td>
<td>75.8</td>
<td>303.0</td>
<td>3.9</td>
<td>382.7</td>
</tr>
<tr>
<td>2004</td>
<td>68.8</td>
<td>288.1</td>
<td>2.9</td>
<td>359.8</td>
</tr>
<tr>
<td>2005</td>
<td>76.1</td>
<td>330.3</td>
<td>1.8</td>
<td>408.2</td>
</tr>
<tr>
<td>2006</td>
<td>69.6</td>
<td>312.5</td>
<td>4.4</td>
<td>386.5</td>
</tr>
<tr>
<td>2007</td>
<td>72.7</td>
<td>351.7</td>
<td>4.6</td>
<td>429.0</td>
</tr>
</tbody>
</table>

Source: Thomson Financial Securities Data (available on the Securities Industry and Financial Markets

Just as financial advisors are mediators for bond issuers, so too are underwriters mediators for bond investors – albeit less formally. As part of the sales process, underwriters confer with their clients – both individual and institutional investors – to determine how the prospective bond issue structure may satisfy their portfolio needs and preferences. The bond issue is then priced accordingly, subject to the bid parameters established by the bond issuer and the hoped-for underwriter’s spread, or gross profit. Very often, several underwriting firms may enter into a partnership – known as a syndicate – to bid collectively on a particular bond issue. For this purpose, one firm is selected as the lead manager along with one or more co-managers from other firms in the syndicate. The lead manager is responsible for bid compliance, calculation, and submission.
Use of Bond Proceeds

Municipal bond proceeds are used for a variety of purposes that are stipulated in the bond’s official statement, and must be used for those stated purposes. New bond issues can generally be classified as a new financing (i.e., new capital), a refunding, or a combination of new financing and refunding. A new financing applies bond proceeds to capital projects or special uses not adequately covered by normal funding during the fiscal year(s), such as facilities construction or resource maintenance. In contrast, a refunding issue provides the issuer with funds to refinance other bonds. Typically, the proceeds from the refunding bond issue are invested into an escrow account that pledges or dedicates the monies to service or pay off other outstanding debt. Why issue new bonds to service existing bonds? Wood (2008) lists three types of refunding reasons. The first is to “call” or buy back an outstanding bond issue if interest cost savings can be realized. If a bond contains a call option, the bond issuer can buy back the bond from bondholders during a certain “call period” (prior to the maturity date) and at a certain price, both specified in the OS. Secondly, the bond issuer may want to restructure debt repayments – usually by lengthening the payback period – in an attempt to reduce the overall cost of debt. The third reason involves “defeasing” or changing legal restrictions on an outstanding bond. The bond issuer can use the refunding proceeds to establish an account of dedicated investment securities, a defeasance escrow, to service the outstanding bonds. If the bond’s defeasance provisions are satisfied, the issuer may alter its legal restrictions concerning funding sources, debt limitations, and so on.

Thus, unlike new financings, which are concerned with construction and maintenance of infrastructure, refundings are refinancings of outstanding bonds. As can be seen from Table 2, most new bond issues are for new financings.
Table 2

Municipal Issuance
Long-Term New Capital & Refunding

($ Billion)

<table>
<thead>
<tr>
<th>Year</th>
<th>New Capital</th>
<th>Refunding</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>197.2</td>
<td>90.5</td>
<td>287.7</td>
</tr>
<tr>
<td>2002</td>
<td>236.9</td>
<td>120.6</td>
<td>357.5</td>
</tr>
<tr>
<td>2003</td>
<td>262.2</td>
<td>120.5</td>
<td>382.7</td>
</tr>
<tr>
<td>2004</td>
<td>229.1</td>
<td>130.7</td>
<td>359.8</td>
</tr>
<tr>
<td>2005</td>
<td>222.3</td>
<td>185.9</td>
<td>408.2</td>
</tr>
<tr>
<td>2006</td>
<td>256.0</td>
<td>130.5</td>
<td>386.5</td>
</tr>
<tr>
<td>2007</td>
<td>274.5</td>
<td>154.6</td>
<td>429.1</td>
</tr>
</tbody>
</table>

Source: Thomson Financial Securities Data (available on the Securities Industry and Financial Markets)

Bond Types

Long-term securities – those with a final maturity in excess of thirteen months – are generally deemed to be bonds. The two most common types of bonds are general obligations (GO) and revenue bonds. Revenue bonds commit certain specified (and therefore limited) revenue sources to support principal and interest payments. Accordingly, they usually contain several restrictive covenants. Due to the limited scope of cash inflows associated with revenue bonds, investors regard such investments as risky relative to GOs. General obligation bonds, in contrast to revenue bonds, provide broader debt service support by committing the issuer’s general taxing authority to support principal and interest payment obligations. Overall, more revenue bonds are issued than general obligation bonds. See Table 3 for a comparison.
Table 3

Municipal Long-Term General Obligation & Revenue Issuance

($ Billion)

<table>
<thead>
<tr>
<th>Year</th>
<th>General Obligation</th>
<th>Revenue</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>101.7</td>
<td>186.0</td>
<td>287.7</td>
</tr>
<tr>
<td>2002</td>
<td>125.7</td>
<td>231.8</td>
<td>357.5</td>
</tr>
<tr>
<td>2003</td>
<td>142.1</td>
<td>240.6</td>
<td>382.7</td>
</tr>
<tr>
<td>2004</td>
<td>129.6</td>
<td>230.1</td>
<td>359.7</td>
</tr>
<tr>
<td>2005</td>
<td>144.2</td>
<td>264.0</td>
<td>408.2</td>
</tr>
<tr>
<td>2006</td>
<td>114.8</td>
<td>272.0</td>
<td>386.8</td>
</tr>
<tr>
<td>2007</td>
<td>131.1</td>
<td>293.2</td>
<td>424.3</td>
</tr>
</tbody>
</table>

Source: Thomson Financial Securities Data (available on the Securities Industry and Financial Markets)

It should also be pointed out that GOs are most often issued in serial form and revenue bonds are often issued as term bonds. Term bonds have only a single payout maturity at one specific future date. Serial bond issues have staggered maturity payouts with their own individual coupons and prices.

Securities with final maturities of thirteen months or less are generally deemed to be notes. Some short-term securities known as anticipation notes are considered bridge financings used to ease cash shortages, and are secured by anticipated funding sources such as bonds and tax revenues. These are known respectively as bond anticipation notes (BANs) and tax revenue anticipation notes (TRANs). As Table 4 illustrates, long-term securities outstrip short-term issuances.
Table 4

Municipal Issuance, Short-Term and Long-Term Maturities

($ Billion)

<table>
<thead>
<tr>
<th>Year</th>
<th>Short-Term</th>
<th>Long-Term</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>56.6</td>
<td>287.7</td>
<td>344.3</td>
</tr>
<tr>
<td>2002</td>
<td>72.4</td>
<td>357.5</td>
<td>429.9</td>
</tr>
<tr>
<td>2003</td>
<td>69.8</td>
<td>382.7</td>
<td>452.5</td>
</tr>
<tr>
<td>2004</td>
<td>57.0</td>
<td>359.8</td>
<td>416.8</td>
</tr>
<tr>
<td>2005</td>
<td>50.5</td>
<td>408.2</td>
<td>458.7</td>
</tr>
<tr>
<td>2006</td>
<td>44.0</td>
<td>386.5</td>
<td>430.5</td>
</tr>
<tr>
<td>2007</td>
<td>58.0</td>
<td>429.0</td>
<td>487.0</td>
</tr>
</tbody>
</table>

Source: Thomson Financial Securities Data (available on the Securities Industry and Financial Markets Association’s website)

Types of Interest Costs

Because municipal bonds are generally exempt from federal taxation, investors do not demand as high a yield as comparable taxable bonds. Despite this advantage when competing for capital, state and local governments should seek to minimize their borrowing costs. Historically, the most common interest cost calculation used by issuers for awarding bids is the net interest cost, or NIC. The NIC is “the average annual cost to borrow, expressed as a percent per year” and is calculated by taking the total interest paid over the life of the bond, plus or minus the amount of any discount or premium, respectively, and dividing the total net interest amount by the total number of bond years (Zipf, 1995). Bond years are calculated by multiplying each serial maturity amount by the number of years to maturity.

For example, assume a bond issue consists of serial maturities paying $100,000 over each of the next three years. The first maturity occurs in one year and has a coupon rate of 6.00%, paid semiannually. The second and third maturities occur in two and three years, respectively, and have a coupon rate of 4.00%, paid semiannually. Assume further that after subtracting out its gross profit and assessing prevailing interest rates in the municipal bond market, the underwriter offers to buy the bond issue for $298,000 instead of the face...
value of $300,000. Since the bond issuer only receives $298,000 in return for an obligation to pay back $300,000 (plus pay interest semiannually), the $2,000 difference is a discount and effectively constitutes additional interest cost to the bond issuer. The net interest cost in dollars, then, equals the entire amount of coupon interest paid plus the discount for a total of $28,000. Dividing this amount by 600,000 bond years (i.e., [1 year + 2 years + 3 years] multiplied by $100,000 maturity payout for each serial bond) equals a net interest cost rate of approximately 4.67%. See Exhibit 1 for the computation.

Exhibit 1
Computation of Net Interest Cost (NIC) and True Interest Cost (TIC)

<table>
<thead>
<tr>
<th>Years to Maturity</th>
<th>Principle Maturing</th>
<th>Coupon Rate</th>
<th>Total Payments</th>
<th>Bond Years</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$100,000</td>
<td>6.00%</td>
<td>$6,000</td>
<td>100,000</td>
</tr>
<tr>
<td>2</td>
<td>$100,000</td>
<td>4.00%</td>
<td>$8,000</td>
<td>200,000</td>
</tr>
<tr>
<td>3</td>
<td>$100,000</td>
<td>4.00%</td>
<td>$12,000</td>
<td>300,000</td>
</tr>
<tr>
<td>Total</td>
<td>$300,000</td>
<td></td>
<td>$26,000</td>
<td>600,000</td>
</tr>
</tbody>
</table>

Discount applied to issue  $2,000
Net interest cost in dollars  $28,000

NIC rate ($28,000 / 600,000 bond years) = 4.67%
While NIC has been the most customary measure of interest cost used by the U.S. market, it has also been widely criticized as an inaccurate shorthand calculation, since it does not consider present value. Underwriters frequently “frontload,” or invert, coupon payout structures on serial bonds by establishing higher coupon rates on the shorter maturities and lower rates on the longer maturities. Such a structure is intended to lower the mathematically calculated NIC for the issue.

An increasingly popular interest cost alternative among market participants – and researchers – is the true interest cost, or TIC. The TIC is an annual interest rate, which equates all of a bond’s payments to the bid price of the issue (i.e., the purchase price of the entire bond issue offered by the underwriter after adjusting for gross profit and any discount or premium). In common usage, the TIC is the same calculation as the internal rate of return, or IRR, except from the issuer’s point of view instead of the investor’s. Theoretically, the TIC is a more appropriate cost measure, since it incorporates present value discounting into its computation, and is arrived at using a search algorithm called successive approximations (Zipf, 1995). The interest rate that most closely matches the sum of discounted cash flows with the value of the bond proceeds is the TIC. This approximation method normally results in a small rounding error, depending upon the number of decimal places used in the calculation. Most electronic spreadsheets have some type of IRR function that easily approximates the TIC. Based on the example above, Exhibit 1 illustrates the discounting of cash flows using a TIC rate given by the IRR function of an electronic spreadsheet. Notice that the TIC of 4.70% does not precisely match the discounted cash flows of $297,996.56 with the bond proceeds of $298,000.

<table>
<thead>
<tr>
<th>Payment Period (every 6 months)</th>
<th>Year</th>
<th>Payment</th>
<th>Present Value Factor</th>
<th>Present Value of Payment</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>0.5</td>
<td>7,000</td>
<td>0.977039570</td>
<td>6,839.28</td>
</tr>
<tr>
<td>2</td>
<td>1</td>
<td>107,000</td>
<td>0.954606322</td>
<td>102,142.88</td>
</tr>
<tr>
<td>3</td>
<td>1.5</td>
<td>4,000</td>
<td>0.932688150</td>
<td>3,730.75</td>
</tr>
<tr>
<td>4</td>
<td>2</td>
<td>104,000</td>
<td>0.911273229</td>
<td>94,772.42</td>
</tr>
<tr>
<td>5</td>
<td>2.5</td>
<td>2,000</td>
<td>0.890350004</td>
<td>1,780.70</td>
</tr>
<tr>
<td>6</td>
<td>3</td>
<td>102,000</td>
<td>0.869907185</td>
<td>88,730.53</td>
</tr>
</tbody>
</table>

Total Present Value of All Payments = $297,996.56

TIC rate equating bond payments to bond proceeds received = 4.70%

Present Value Factor = \[\frac{1}{1 + \frac{\text{TIC}}{2}}\]^\text{Payment Period}
However, due to their composite nature, both NIC and TIC have been determined to be imperfect measures of cost. Cook (1982) stresses the fact that many, if not most, bond issues are serial issues comprised of two or more individual bonds with staggered maturities. These individual bonds can vary in several respects, including maturity amount, maturity date, coupon, credit rating, price, and call features. As aggregate interest cost measures, neither NIC nor TIC captures these idiosyncrasies.

**Call Provisions**

Most municipal bonds contain embedded call options that allow issuers to buy back outstanding obligations from bondholders at specific prices and dates. The ability to call a particular bond issue before its maturity date can be quite valuable to any bond issuer when prevailing interest rates are low relative to the coupon rates on the outstanding bonds, although it can represent a risk for the investor for the same reason. Hence, interest costs are higher for callable bonds. The risks associated with calls are discussed later. Refer to Table 5 for a comparison of callable and non-callable bonds.

**Table 5**

**Municipal Bond Issuance1 -- Callable vs. Non-Callable**

($ Billion)

<table>
<thead>
<tr>
<th>Year</th>
<th>Callable</th>
<th>Non-callable</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>227.2</td>
<td>60.5</td>
<td>287.7</td>
</tr>
<tr>
<td>2002</td>
<td>283.0</td>
<td>74.5</td>
<td>357.5</td>
</tr>
<tr>
<td>2003</td>
<td>267.8</td>
<td>114.9</td>
<td>382.7</td>
</tr>
<tr>
<td>2004</td>
<td>283.7</td>
<td>76.2</td>
<td>359.9</td>
</tr>
<tr>
<td>2005</td>
<td>341.0</td>
<td>67.2</td>
<td>408.2</td>
</tr>
<tr>
<td>2006</td>
<td>342.6</td>
<td>43.9</td>
<td>386.5</td>
</tr>
<tr>
<td>2007</td>
<td>390.1</td>
<td>39.0</td>
<td>429.1</td>
</tr>
</tbody>
</table>

1 Excludes maturities of 13 months or less.

Source: Thomson Financial Securities Data (available on the Securities Industry and Financial Markets Association’s website)
Credit Ratings

One of the most important aspects of the bond issuer is its credit worthiness – that is, the ability to reliably service obligations to bondholders. The higher its credit rating, the lower its interest cost on bonds. For a fee, one or more of the three national credit rating agencies, Moody’s, Standard & Poor’s, or Fitch, will conduct a credit analysis of the bond issuer and assess a credit rating for the bonds. Despite some differences in methodological philosophies and standards, the ratings of all three companies are fairly analogous. See Figure 1 for Moody’s and Standard & Poor’s ratings definitions. Furthermore, the rating ranges fall into two broad categories of non-defaulted debt: investment grade and speculative. Investment grade securities have a rating in the Baa/BBB categories or higher. Speculative grade securities fall below the investment grade minimum ratings. Rating philosophies and standards notwithstanding, a credit rating is essentially an assessment of a bond issuer’s future debt servicing abilities and therefore, a measure of default risk.

Figure 1

Moody’s and Standard & Poor’s Rating Definitions

Moody’s

<table>
<thead>
<tr>
<th>Rating</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aaa</td>
<td>Best quality; carry the smallest degree of investment risk.</td>
</tr>
<tr>
<td>Aa</td>
<td>High quality; margins of protection not quite as large as the Aaa bonds.</td>
</tr>
<tr>
<td>A</td>
<td>Upper medium grade; security adequate but could be susceptible to impairment</td>
</tr>
<tr>
<td>Baa</td>
<td>Medium grade; neither highly protected nor poorly secured – lack outstanding investment characteristics and sensitive to changes in economic circumstances.</td>
</tr>
<tr>
<td>Ba</td>
<td>Speculative; protection is very moderate.</td>
</tr>
<tr>
<td>B</td>
<td>Not desirable investment; sensitive to day-to-day economic circumstances.</td>
</tr>
<tr>
<td>Caa</td>
<td>Poor standing; may be in default but with a workout plan.</td>
</tr>
<tr>
<td>Ca</td>
<td>Highly speculative; may be in default with nominal workout plan.</td>
</tr>
<tr>
<td>C</td>
<td>Hopelessly in default.</td>
</tr>
</tbody>
</table>

Note: Moody’s applies modifiers for ratings Aa to B. The modifiers 1, 2, and 3 signify a higher, midrank, and lower ranking, respectively, within the rating category.
Standard & Poor’s

<table>
<thead>
<tr>
<th>Rating</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAA</td>
<td>Highest rating; extremely strong security.</td>
</tr>
<tr>
<td>AA</td>
<td>Very strong security; differs from AAA in only a small degree.</td>
</tr>
<tr>
<td>A</td>
<td>Strong capacity but more susceptible to adverse economic effects than above two categories.</td>
</tr>
<tr>
<td>BBB</td>
<td>Adequate capacity but adverse economic conditions more likely to weaken capacity.</td>
</tr>
<tr>
<td>BB</td>
<td>Lowest degree of speculation; risk exposure.</td>
</tr>
<tr>
<td>B</td>
<td>Speculative; risk exposure.</td>
</tr>
<tr>
<td>CCC</td>
<td>Speculative; major risk exposure.</td>
</tr>
<tr>
<td>CC</td>
<td>Highest degree of speculation; major risk exposure.</td>
</tr>
<tr>
<td>C</td>
<td>No interest being paid.</td>
</tr>
<tr>
<td>D</td>
<td>Bonds in default with interest and/or repayment of principal in arrears.</td>
</tr>
</tbody>
</table>

Note: Standard & Poor’s applies modifiers for ratings AA to CCC. The modifiers plus (+) or minus (-) signify a higher and lower ranking, respectively, within the rating category.

Credit Enhancements

Enhancing credit quality raises the credit rating of bonds and results in lower overall interest costs due to a lowered default risk. One way of improving the credit rating of an issuer’s bonds is to purchase bond insurance. Bond or financial guarantee insurance ensures that bondholders will receive all of their principal and interest payments in the event of a default by the issuer. Credit rating agencies will substitute their assessed credit rating of the presumably higher-rated insurance company for that of the issuer. Most bond insurers enjoy the highest credit rating (Aaa or AAA).

Another guarantee mechanism is the state-aid or credit enhancement fund. Credit enhancement funds are created for offering credit support to local government debt, particularly school district bonds. While fund provisions and eligibility requirements vary from state to state, credit enhancement funds are intended to cover debt service payments on behalf of entities that are in danger of defaulting on their bonds. Bonds supported by these funds may experience a credit rating boost and a reduction in interest costs. Figure 2 lists examples of credit enhancement funds, the funds’ credit ratings from Standard and Poor’s, and the type of enhancement.
**Figure 2**

**Examples of Credit Enhancement Fund Programs**

<table>
<thead>
<tr>
<th>State</th>
<th>Debt type covered</th>
<th>Rating</th>
<th>Enhancement</th>
</tr>
</thead>
<tbody>
<tr>
<td>California</td>
<td>Eligible city and county bonds</td>
<td>A</td>
<td>Motor vehicle license fee and leases</td>
</tr>
<tr>
<td>California</td>
<td>Eligible health care bonds</td>
<td>A+</td>
<td>Construction Loan Insurance Fund</td>
</tr>
<tr>
<td>Colorado</td>
<td>Local school bonds</td>
<td>AA-</td>
<td>State aid withholding law</td>
</tr>
<tr>
<td>Texas</td>
<td>Approved local school AAA bonds</td>
<td>AAA</td>
<td>Constitutional Permanent School Fund</td>
</tr>
<tr>
<td>Texas</td>
<td>Higher education bonds</td>
<td>AA</td>
<td>Direct and continuing state appropriations</td>
</tr>
<tr>
<td>Virginia</td>
<td>All local G.O. debt</td>
<td>A</td>
<td>State aid withholding law</td>
</tr>
</tbody>
</table>

Source: Standard & Poor’s Public Finance Criteria 2007

**Risks Associated with Municipal Bonds**

Fabozzi, Fabozzi, and Feldstein (1995) discuss seven risks that holders of municipal bonds face. These are: (1) default or credit risk, (2) interest rate risk, (3) reinvestment risk, (4) call risk, (5) volatility risk, (6) tax risk, and (7) inflation risk.

Default risk is perhaps the most serious risk posed by municipal bonds and pertains to the possibility that the bond issuer may default on payment. Depending on the severity of the financial situation, investors stand to lose some or all of their investment – unless the securities are insured. To address these concerns, bond issuers usually recruit the services of credit rating agencies to assess the credit risk of their bonds. Risks associated with interest rates, reinvestment, calls, and volatility are all related to the level of interest rates in the market. Given the inverse price and yield relationship of fixed-income securities, a relative rise in interest rates will cause the price of a bond to fall.

If investors must sell their bonds during a rise in interest rates, they will suffer a loss in the bond price. This is known as interest rate risk (if the bond is held to maturity, interest rate risk is not a consideration). If interest rates fall relative to the original yield investors are receiving on a bond, interest and principal payments received on the bond must be reinvested at a lower yield. This is known as reinvestment risk.

Another risk associated with lower market interest rates is call risk: bond issuers may realize substantial interest cost savings by exercising any call options attached to their
outstanding bonds and reissuing debt at the lower prevailing market rates. While call prices are often offered at a premium, the amounts received may not adequately compensate investors who must reinvest in the lower interest rate environment. Call risk premiums are therefore commonly impounded into the interest rates demanded by investors. To the extent that rapid increases and decreases in interest rates inject uncertainty into bond values – especially bonds with embedded call options – investors experience volatility risk.

Inflation and taxes are factors that also affect bond investments. Inflation risk gages the unanticipated loss of purchasing power from cash flows due to an inadequate inflation premium on the investment’s yield. Tax risk can be twofold: (1) reductions in the top federal marginal tax rates may diminish the attractiveness of tax-exempt securities and result in lower market values, and (2) in rare instances, the U.S. government’s tax enforcement agency, the Internal Revenue Service (IRS), may revoke a bond’s tax-exempt status, exposing the interest received to federal taxation.

Wilson and Howard (1985) also describe a “marketability” risk stemming from the inherent imperfections in the municipal bond market. As seen from the various tables in this paper, the primary (i.e., new issuance) market for municipal bonds is quite active, and is the focus of most research in this area. The secondary market, however, is relatively inactive and therefore lacks liquidity. An investor wishing to close out a position in a municipal bond may be forced to substantially lower his asking price due to the thinness of the secondary market. Buying a municipal bond may be just as problematic if there are no readily available sellers. Thus, without any competitive offers, a buyer may be forced to consider a premium purchase price.

**Oversight and Reporting**

Unlike their private sector counterparts, public sector securities issuers are subject to relatively little scrutiny by federal regulatory authorities. Historically, this derives from the perception that at the time of the enactments of the Securities Act of 1933 and the Securities Exchange Act of 1934, municipal securities were safe compared to private sector securities, which were deemed more susceptible to “misrepresentation.” As a result, municipal issuers were generally exempted from the stringent provisions of the securities laws. Hence, other than in instances of fraud, the Securities and Exchange Commission (SEC) exercises little direct authority over municipal bond issuers or their disclosure practices (under the 1934 Act, the anti-fraud provisions of Rule 10b-5 are considered broad enough to include municipal issuers, and the provisions of Rule 15c2-12 requiring continuing disclosures of issuer information are deemed to apply to municipal dealers and brokers).
Likewise, its surrogate agency, the Municipal Securities Rulemaking Board (MSRB), a self-regulatory organization that provides professional guidelines for the municipal securities industry, has authority over brokers and dealers, but not issuers. As Lamb and Rappaport (1987, page 228) observe, “[d]ue to the fact that municipal securities are authorized and issued by states and their political subdivisions, federal regulation of that activity may be contested on the age-old battlefield of states’ rights. Thus, the MSRB does not directly regulate the disclosure practices of municipal issuers; more important, these issuers are still exempt from federal securities laws….the MSRB requires dealers to provide certain information, and this must be obtained from the issuers, who are not subject to MSRB rulings. This, then, further complicates the issue of disclosure and adequate investigation of the issuer by the underwriter.”

Recently, however, the MSRB has begun to centralize it reporting requirements by brokers and dealers online with the Electronic Municipal Market Access system, or EMMA. EMMA provides free public access to real-time and historical official statements and trading data. Historical OS data are available back to 1990, and trading data are available back to 2005.

The task of formulating and disseminating disclosure practices has largely fallen to professional organizations. The Governmental Accounting Standards Board (GASB) issues financial reporting guidelines for state and local governments, which are known as generally accepted accounting principles (GAAP). Compliance with GAAP reporting is a highly desirable feature of a bond issuer’s financial statements, and is the main focus of audits.

Another major professional organization, the Government Finance Officers Association (GFOA), issues “recommended practices” for state and local governments. Recommended practices span critical financial functions such as auditing, financial reporting, budgeting, cash management, debt management, capital planning, and benefits administration. Additionally, the GFOA sponsors an annual program to award a “Certificate of Achievement for Excellence in Financial Reporting” to public sector entities whose CAFR surpasses minimum GAAP standards. Note that the certificate award is based upon financial reporting quality, not financial health.

**Conclusion**

With a market value exceeding $2.6 trillion, the U.S. municipal securities market offers state and local governments many capital investment-financing opportunities. Even entities with a solid revenue base often need to tap the governmental capital markets to adequately support and maintain infrastructure or to refinance existing debt. We provide an introductory overview to the conventional debt instruments, general obligation bonds and revenue bonds, and the processes by which these bonds are issued in the primary
market. Additionally, we discuss interest cost measures, investment features and risks, and oversight concerns. We also supply the reader with various characteristics of the market from 2001 to 2007 with the hope that it will spur further academic and institutional research into this area.
References


Conference Proceedings

“Use of Financial Management Information Systems (FMIS) to Improve Financial Management and Accountability in the Public Sector”

December 2007
Washington, DC
Introduction

Over the past few decades, governments and development agencies alike have invested enormous financial and human resources into automating public financial management (PFM) systems, and often the results have been less than hoped. Governments have had difficulty implementing systems, and have not achieved desired functionality. And development partners have invested large sums of money, only to find systems delayed in implementation, having limited impact, and often with real challenges to the sustainability of the systems.

On December 2-4, 2007, the International Consortium of Governmental Financial Management (ICGFM) held a two-day workshop in Washington DC entitled "Use of Financial Management Information Systems (FMIS) to Improve Financial Management and Accountability in the Public Sector". The conference goal was to share current thinking on Public Financial Management (PFM) system automation, and provide practical advice to those concerned with PFM implementation.

The event focused on the practical issues faced by Governments when designing and implementing such systems. Key themes included:

- The potential of IT to support development and poverty reduction
- Creating context and conditions for successful implementation
- Critical elements of a financial management information system design
- Approaches to implementation and the application of new technologies
- Enhancing transparency through effective use of a FMIS
- Harvesting the benefits of integrating the FMIS into financial operations

Over 120 people from 28 countries attended.

- Antigua and Barbuda
- Argentina
- Benin
- Brazil
- Cambodia
- Canada
- Colombia
- Dominican Republic
- Ethiopia
- Georgia
- Ghana
- Haiti
- Honduras
- India
- Laos
- Malawi
- Moldova
- Nigeria
- Panama
- Paraguay
- Peru
- Serbia and Montenegro
- Sierra Leone
- South Africa
- Sudan
- Uganda
- United Kingdom
- United States

Attendees comprised members of parliament, ministers of finance, accountants general, treasury officials and chief information officers. Overall feedback from the conference was excellent, with delegates giving the program strong marks for the usefulness of the information presented and the professional development. One comment from a participant
sums up the collective feedback “this was a very timely and useful conference, with very practical advice to anyone embarking on FMIS implementation.”

Fernando Fernandez from the Inter-American Development Bank delivers his key note opening

The program was organized around four main themes – planning, design, implementation and impacts. Topics included how FMIS fits within the over-all PFM reform agenda; planning for FMIS development; FMIS design components; IT alternatives; project management; procurement; capacity building; and, harvesting benefits. There was also a session focused on the unique aspects of FMIS implementation in post conflict countries. Each topic was presented by a subject matter expert teamed with a country representative who could relay specific experiences.

The FMIS Implementation Challenge
Generally, the objective of implementing a FMIS is to increase the effectiveness and efficiency of state financial management and facilitate the adoption of modern public expenditure practices in keeping with international standards and benchmarks.

The Joint Financial Management Improvement Program (JFMP) described the core financial system requirements\(^{29}\) of a “good” system as the ability to:

- Collect accurate, timely, complete, reliable and consistent information
- Provide adequate management reporting
- Support government-wide and agency policy decisions
- Support budget preparation and execution

\(^{29}\) From Core Financial System Requirement – JFMIP-SR-02-01
• Facilitate financial statement preparation
• Provide information for central agency budgeting, analysis and government-wide reporting
• Provide complete audit trail to facilitate audits

The often quoted statistics regarding the success of FMIS implementations derive from a study of World Bank funded projects conducted by Bill Dorotinsky in 2003. This study found that on average it took 7 years to complete the FMIS project and, of the 34 projects studied at that time, 43% were delivered as specified, 50% were delivered on budget and only 21% were delivered on time. In terms of the impact on financial management and government operations, there were generally no performance indicators and no baseline against which performance improvements could be measured. In terms of sustainability, the majority was likely or highly likely sustainable, but 25% of the implementations was found to be unsustainable.

The top five project risks were identified as:
• Lack of institutional capacity
• Lack or weak government commitment
• Too many project components leading to coordination and integration problems
• Overly complex information systems
• Pursuit of vested interests by various stakeholders

The three main critical success factors were identified as:
• A full-time project manager to manage coordination, manage expectations and constantly monitor the project approach
• A champion at the political level to work with all stakeholders in the pursuit of a common vision
• A capacity building plan that addresses the training and on-going support of everyone touched by the new system

An objective of this conference was to see how much of this advice had been applied and to hear of current challenges and successes in FMIS implementation
Discussion Summary

Planning

- **Governance.** PFM systems are at the forefront of public financial reform as they provide for improved governance and better management of risk. Poor governance and corruption undermine efforts to reduce poverty and diminish the availability of aid. A good process of governance requires more than compliance with laws and regulations, and is based on principles rather than rules. An environment needs to be created in which employees who witness unethical behavior feel they can share their concerns. A strong government and Ministry of Finance are critical to reform, but good governance also involves reaching out to the press, NGOs and the private sector to stop backsliding.

- **Government in the driving seat.** Institutional reform is not easily done. It takes time, commitment, champions and courage. While often ill-defined, country ownership of the reforms and automation are core to any success. The decision to introduce a PFM system needs to be accompanied by strong commitment, sufficient manpower and financial resources, widespread internal support, and an agenda for effective change management. Unless these are in place, the chances of success are limited. The PFM reform effort should be structured as a program of change with a mission, objectives and set milestones. The FMIS should not be viewed as an isolated intervention, but should be accompanied by, and related to, other reforms in public sector financial management. It is also necessary that the
FMIS objectives and outputs are both relevant and consistent with wider fiscal policy reforms.

- **Sequencing PFM reforms and automation.** Frequently, the IT developments drive the reform process, rather than the other way around. More work is needed on sequencing of PFM reforms, which are driven by country specific needs. A starting point is the most pressing PFM problem balanced with the pace and direction of change against the capacity to absorb. Automation should follow this pattern, rather than driving the change. The business needs of the government should be the primary factors taken into account, with IT supporting the reforms and process improvements sought. It is important to recognize that this is not primarily an IT or accounting reform, the FMIS should be in support of comprehensive financial management process reforms. It is also important not to focus solely on the needs of the Ministry of Finance. The requirements of the line ministries need to be addressed if the system is to be successful. Finally, it is recommended that there should not be significant changes to the law until the systems are in place.

- **Capable project management.** The government needs to provide a team of dedicated resources who can represent the major stakeholders. The government program manager should be a senior official from the functional side with stature across the impacted government departments and adequate financial and administrative powers. Consultants should be used to supplement the skills of the
team, but they should not just be people who know the technology; they need to have gone through previous PFM system implementations. The team should strive to adhere to the plan, but there should be flexibility to address inevitable changes, with approval through a program governance structure. As the program evolves and full implementation nears, it is important to plan the transition from a project organization to a sustaining organization. This transition must include the appropriate alignment to career aspirations and rewards.

**Design**

- **FMIS versus IFMIS.** Much of the work in automating PFM systems has focused on implementing an integrated financial management information system, including general ledger, accounts payable, accounts receivable, procurement, payroll, asset management, debt management, budgeting, etc. This approach might be too large to implement effectively, in a timely fashion, or to achieve results. It is better to think of automating some core part of the system, such as general ledger, and accounts payable and receivable, with an eye to adding-on or replacing the system within a few years. Other points in this regard were to start from where you are in terms of PFM system development, rather than from where you want to be, and also to recognize that not everything may need to be automated. As PFM systems evolve, the needs will change, so the scope of the automation can be expanded. Given the rapid change in technology, it may not be feasible to plan all of these potential needs or IT options in advance.
• **Off-the-shelf packages versus customized packages.** It is difficult to make that decision ex ante, before identifying reform objectives and scope of the project. There are numerous factors that need to be taken into account, including the extent of business process re-engineering required or desired, the capacity to support the system or afford the system once developed, the number of users and scope of functionality to be developed, among other factors. Whichever path is taken, it is critical to understand ahead of any software configuration/development the concept of operations, the scope of work, the functional requirements and the desired outcomes. As all of these efforts have some goods or services that need to be procured, there was agreement that good procurement practices are one of the key predictors of implementation success.

![Delegates listen to Dr. Stephen Peterson present on the Ethiopian FMIS experience](image)

• **Decentralization is driving many second-generation automation efforts.** Globally, countries are trying to decentralize decision-making to sub-national or municipal governments, as well as de-concentrate to spending ministries and agencies. For many countries, next generation FMIS systems are being developed or implemented to support these new processes and decision-making responsibilities. Providing automation solutions that support financial management decisions and processes at these levels, as well as enable timely and accurate
reporting of revenues and spending to the central government, are core challenges in FMIS design and implementation.

**Implementation**

- **Capacity building is central to sustainability.** Sustainability was agreed to be the main challenge facing any FMIS implementation and it is crucial to plan for a lot of training and “hand holding” before, during and after implementation. It was noted that it is important to create a learning environment early in the project and to treat the whole process as a learning opportunity with training being part of an on-going function. Particularly important is not to focus on the automated system, but to create a clear understanding of end-to-end transactions. Considerations for success include creating a layer of power users who provide support to others; making sure that career plans are updated to accommodate new responsibilities; creating new functions for IT and application support; realigning salaries to reflect market conditions; and, implementing civil service rotations to promote shared understanding and a support network.

*Peter Walker presenting on one of the critical success areas – Capacity Building*

- **Post conflict situations apply the same fundamentals.** Post conflict countries may be regarded as unique and having few lessons that are applicable to other developing countries. The reality is that while there are different circumstances, many of the fundamentals are the same. First, you need a fast, pragmatic solution
to get basic functionality such as expenditure management in place – you need reports on where spending is taking place. Second, you need to build from whatever is/has been in place - a country needs to develop its own financial management processes, rather than have another one imposed upon it. Third, you need a government champion to take control – organizations such as the UN, WB are not in the business of running countries, they can provide technical assistance, but the country needs to own the public financial management system. Fourth, the chart of accounts and business processes are the most important starting points - legislation is important but should be kept simple. Finally, you need to consider how the system will be sustained and aim to keep support as simple as possible.

- **Risk management is a required core competence.** Everyone at the conference noted that embarking on PFM system implementation carries with it a high level of risk. Most implementations take at least 7 years and very few are easily sustained post implementation. It is acknowledged that many government officials are risk averse to long term projects. The main risks such as lack of capacity, weak sponsorship, high system complexity, lack of change management or changing priorities and vested interests are known. They can all be mitigated or avoided with appropriate planning, communication and expectations management. It is therefore critical for governments to build a risk smart workforce with increased delegation of decision making with enhanced accountability. Also, given the size of automation investments in human and capital resources, building some quality assurance steps into the process is useful, including periodic review by external expert panels.

- Steve Symansky from the IMF presents on the implementation approach in Post Conflict Countries
Benefits

The objective of implementing a FMIS system is to increase the effectiveness and efficiency of state financial management and facilitate the adoption of modern public expenditure management practices in keeping with international standards and benchmarks. The main benefits that a government should seek to harvest include the ability to:

- **Improve service to citizens** through improved decentralization, reduction in bureaucracy and better access to information.
- **Improve citizen confidence** through increased transparency, improved predictability in budget execution and better monitoring and evaluation to reduce fraud and corruption.
- **Increase government revenue** through improved collections.
- **Reduce costs** through improved expenditure control leading to reduced borrowing and debt cancellation.
- **Improved decision making and planning** through better access to accurate, timely information.
• **Enable government reform and enhance political stability** through improved
  financial discipline, reduced bureaucracy and increased public accountability

However, the conference delegates and speakers acknowledged that there is still a lot of
work to do in determining the linkage between performance and investments in financial
management

**Continuing the Dialogue**
The conference program and all the presentations made are available on-line at the ICGFM
website at [http://www.icgfm.org](http://www.icgfm.org) under “Winter Conference”. The conference has also
started the development of a community of interest in PFM with contributions from
participants to a blog at [http://icgfm.blogspot.com/](http://icgfm.blogspot.com/) and the publishing of related materials

ICGFM has continued the dialogue that was initiated at this meeting at its subsequent
conferences. At the Miami Conference in May 2008, there was session specifically dealing
with auditing of financial management systems. In December 2008, the Washington
Conference focused on the issue of performance and discussions were held on how we
measure success with financial management systems by demonstrating the contribution
made to improved financial management and government operations.
Invitation to Potential Authors

The *International Journal on Governmental Financial Management* (IJGFM) aims to provide a forum for academics, practitioners and the general public to discuss the many disciplines involved with governmental financial management. These include accounting, auditing, budgeting, debt management, information technology, tax management and treasury management.

We would like to be able to publish articles and comment which will:

- encourage collaboration among professionals and others concerned about public financial management
- contribute to the advancement of government financial management principles and standards, especially through describing existing good practice
- identify problems or weaknesses through the critique of currently dominant views on public sector financial management reforms; and
- assist public sector financial managers to identify their own solutions to common challenges.

We would particularly welcome contributions from individuals or teams working in the developing countries of the global south. We invite potential authors to review past issues of the journal at: [http://www.icgfm.org/digest.htm](http://www.icgfm.org/digest.htm)

Submission of Manuscripts

*We do not charge a fee for submission or publication of articles.*

Manuscripts should be sent as email attachments to the editor, Andy Wynne – [andywynne@lineone.net](mailto:andywynne@lineone.net) and be copied to icgfm@icgfm.org

Ideas for articles are welcome and may be discussed with the editor before submission of the full text.
Format and Style

The manuscripts should include:

- an abstract not exceeding 150 words - it should summarize the purpose, methodology, and major conclusions of the article;

- the title, the authors name(s), position/post and institutional affiliation (university, ministry etc), email address and any acknowledgements

- authors should write in a non-sexist and non-discriminatory style, using, for example, "her/him"; or "s/he"

- the text should include appropriate references (see below) to the literature on the subject to support facts, assertions and opinions; all quotations should be fully referenced

- footnotes, identified in the text by a numeral that is superscripted, should not include literature citations, and should be listed at the end of the paper, before the bibliography.

Referencing the text

References in the text to books, articles etc should include the authors' names, the year of publication, and the specific page numbers if direct quotations are provided (e.g. Mickey & Donald, 1968, p.24). For more than two authors, the citation should be abbreviated as follows: (Kramdon et al., 1988, p.1). Multiple citations of the same author(s) in the same year should be distinguished in the text (and in the bibliography) by a, b, c, etc following the year of publication. Latin terms, for example, op cit or ibid should not be use.

Bibliography

A bibliography should be included at the end of the text containing details of all books, articles papers etc which have been referred to in the text. The bibliography should only include references cited in the text. These should be arranged in alphabetical order according to the surname of the first author. The following details should be included: author and initials, full title and subtitle, place of publication, publisher, date, and page references (for direct quotations). References to journal articles must include the volume and number of the journal.

Where possible, details should be provided of the web address for material which is available on the Internet. In this case the date the material was read should be provided.
The layout should adhere to the following convention:

1. **articles:**

2. **books:**

3. **citations from edited books:**

4. **translated books**

5. **reference to a report.**

6. **references to material on the Internet**
   http://icgfm.blogspot.com (6 September 2008)

**Charts, Diagrams, Figures and Tables**

These should all be called figures, numbered consecutively in Arabic numerals, with a brief title in capitals and labeled axes etc. The text should indicate where the figure is to appear.

**Undertaking**

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Invitation to Join the Editorial Board

We would like to establish an editorial board for the *International Journal on Governmental Financial Management*.

We would like to hear from individuals who would be willing to assist with the editorial work of this journal. The work would consist of reviewing potential contributions, suggesting whether they should be accepted for publication and making editorial recommendations to improve the quality of submissions. In addition, editors would help to identify and solicit contributions from potential authors.

Please contact the editor, Andy Wynne - andywynne@lineone.net - if you would like to discuss your possible role on the editorial board or gain further details.
ICGFM DIRECTORS AND OFFICERS
Members of the Board of Directors

Members for the Board of Directors serve a two-year term. Each Sustaining Organization is represented on the Board. The Nominating Committee solicits nominations to select six Organization Members and six Individual Members to fill remaining Board seats.

ICGFM Board of Directors as of January 1, 2008

January 1, 2008 - December 31, 2008

Sustaining Members
Association of Chartered Certified Accountants (UK)
Association of Government Accountants (USA)
Casals & Associates
FreeBalance, Inc.
Graduate School, USDA-Government Audit Training Institute (GATI)
Grant Thornton, LLP
Inter-American Development Bank - Auditor General
International Monetary Fund
Institute of Internal Auditors
Organization of American States - Inspector General
SAP
US Agency for International Development - Inspector General
US Government Accountability Office
Williams, Adley & Company
The Development Gateway Foundation
The World Bank

Organization Members (six elected for a 2-year term)
Hungary: State Audit Office
India - Comptroller and Auditor General and Controller General of Accounts
Philippine Commission on Audit
Mosley & Associates (USA)
Uganda Office of the Auditor General
WYG International (UK)

Individual Members (6 elected for a 2-year term)
Mr. Dean Evanson (Antigua & Barbuda)
Mr. David Mathias (Haiti)
Jean-Baptiste Sawadogo (Canada)
Temistocles Rosas (Panama)
Allyson Ugarte (USA)
Tyrone Watkins (Barbados)
ICGFM Officers (Executive Committee)

Officers may be re-elected to the same position or a new one. Officers are nominated by the Nominating Committee based on input from the ICGFM members.

<table>
<thead>
<tr>
<th>Position</th>
<th>Name</th>
<th>Company/Institution</th>
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</thead>
<tbody>
<tr>
<td>President</td>
<td>Beatriz Casals</td>
<td>Casals &amp; Associates</td>
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<tr>
<td>President-elect</td>
<td>James Ebbitt</td>
<td>USAID - r</td>
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<tr>
<td>Vice President: Membership &amp; Development</td>
<td>Martin Guozden</td>
<td>IDB</td>
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<tr>
<td>Vice President: Programs</td>
<td>Rhoda Canter</td>
<td>Grant Thornton, LLP</td>
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<tr>
<td>Vice President: Publications &amp; Communications</td>
<td>Jesse Hughes</td>
<td>Consultant</td>
</tr>
<tr>
<td>Secretary</td>
<td>Melissa Simpson</td>
<td>Casals &amp; A</td>
</tr>
<tr>
<td>Treasurer</td>
<td>Millie Seijo</td>
<td>KPMG</td>
</tr>
</tbody>
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Executive Director - Nina Powell

Chief Financial Officer - James Bonnell
Good governance enables people throughout the world to pursue their hopes and dreams. Good governance rests on a base that includes sound financial management. Join us in the pursuit of our mutual goals.