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”

The material published herein may be reproduced without the consent of the Consortium, which in fact encourages their reproduction, translations, and distribution. The views expressed in this publication do not necessarily reflect those of the editor or the positions taken by the Consortium.

The editor invites submission of articles, research papers, letters and reviews of books, and other relevant documents. Please submit material to the editor: Hassan Ouda – icgfm.ijeditor@icgfm.org.

Requests for information on the Consortium should be addressed to:

International Consortium on Governmental Financial Management
PO Box 1077
St Michaels, MD 21663
Telephone: (410) 745-8570
Fax: (410) 745-8569
Email: icgfm@icgfm.org
www.icgfm.org

Copyright 2015 by the International Consortium on Governmental Financial Management
General Information

“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.”

Our mission includes three key elements. First, it highlights that, within the international community, the International Consortium on Governmental Financial Management (ICGFM or the “Consortium”) is unique - it serves as an “umbrella” bringing together diverse governmental entities, organizations (including universities, firms, and other professional associations), and individuals. At the same time, it welcomes a broad array of financial management practitioners (accountants, auditors, comptrollers, information technology specialists, treasurers, and others) working in all levels of government (local/municipal, and national). Additionally the mission statement emphasizes the organization’s commitment to improving government infrastructure so that needs of the people are better met. Our programs provide activities and products to advance governmental financial management principles and standards and promote their implementation and application.

Internationally, the Consortium: (1) sponsors meetings, conferences, and training that bring together financial managers from around the world to share information about and experiences in governmental financial management; and (2) promotes best practices and professional standards in governmental financial management and disseminates information about best practices and professional standards to our members and the public. ICGFM provides three options for membership:

1. Sustaining Members: organizations promoting professional development, training, research or technical assistance in financial management; willing to assume responsibility for and to actively participate in the affairs of the Consortium. Each Sustaining Member has a seat on the ICGFM Board of Directors. (Dues: $1,000)

2. Organization Members: government entities with financial management responsibilities, educational institutions, firms, regional and governmental organizations, and other professional associations. Six organization members serve on the ICGFM Board of Directors. (Dues: $250/$150*)

3. Individual Members: persons interested in or dedicated to activities directly related to financial management and who wish to be members in their own right. Six members of the ICGFM Board of Directors will be selected from among all individual members. (Dues: $100/$50*)

4. Student Members: persons enrolled at a college or university who are interested in financial management are eligible and will enjoy the benefits of Individual Members. (Dues: $25)

---

*A special discount is offered to Low and middle lower income economies, as classified by the World Bank (Gross National Income GNI). This discount is available to the following countries: Afghanistan, Albania, Algeria, Angola, Armenia Azerbaijan, Bangladesh, Benin, Bhutan, Bolivia, Bosnia and Herzegovina, Burkina Faso, Burundi, Cambodia, Cameroon, Cape Verde, Central African Republic, Chad, China, Colombia, Comoros, Congo (Dem. Rep), Congo (Rep), Cote d’Ivoire, Eritrea, Djibouti, Dominican Republic, Ecuador, Egypt (Arab Rep), El Salvador, Ethiopia, Gambia, Georgia, Ghana, Guatemala, Guinea, Guinea-Bissau, Guyana, Haiti, Honduras, India, Indonesia, Iran (Islamic Rep), Iraq, Jordan, Kenya, Kiribati, Korea (Dem. Rep), Kyrgyz Republic, Lao PDR, Lesotho, Liberia, Macedonia (FYR), Madagascar, Malawi, Maldives, Mali, Marshall Islands, Mauritania, Micronesia (Fed Sts), Moldova, Mongolia, Morocco, Mozambique, Myanmar, Namibia, Nepal, Nicaragua, Nepal, Niger, Nigeria, Pakistan, Papua New Guinea, Paraguay, Peru, Philippines, Rwanda, Sao Tome and Principe, Samoa, Senegal, Sierra Leone, Solomon Islands, Somalia, Sri Lanka, Sudan, Swaziland, Syrian Arab Republic, Tajikistan, Tanzania, Thailand, Timor-Leste, Togo, Tonga, Tunisia, Turkmenistan, Uganda, Ukraine, Uzbekistan, Vanuatu, Vietnam, Yemen, West Bank and Gaza, Zambia, Zimbabwe
Foreword

Research in public sector accounting and budgeting should ultimately fulfill a practical purpose and should aim at improving the public sector accounting and budgeting practice in the same way that medical research is to improve medical practice. We as public financial management academics and practitioners should recognize that it is only when public sector accounting and budgeting research develops ideas that are directly related to the specific and immediate problems of practice that the research becomes relevant to practice. Now is the time that accounting and budgeting researchers should work together with practitioners to find practical solutions for outstanding public sector accounting and budgeting issues. This issue of the journal complements the previous issue by presenting articles that consider the public sector accounting and budgeting practice.

In the first article, Wojciech Nowak considers the possibilities and ways of putting future EPSAS (European Public Sector Accounting Standards) into the Polish government accounting system. The article introduces the current system of Polish government accounting and reporting, and outlines a potential way of transforming it under future EPSAS introduction.

The second article considers the current discussion about the implementation of accrual accounting in Europe based on harmonized European Public Sector Accounting Standards (EPSAS). Andreas Glöckner compares the opposing conceptual basis of the International Public Sector Accounting Standards Board (as stated in its 2014 framework) and the German federal state of Hessen (as guided by the German Commercial Code). He concludes that the discussion about accounting harmonization in the European Union seems like a flashback.

In the third contribution, Hassan Ouda has attempted to explore a number of the technical challenges that can face the implementation of performance budgeting and accrual budgeting in the public sector. First, the paper concludes that the implementation of performance budgeting will face the following technical challenges: specifying the outcomes; specifying the output; and linking outcomes to outputs. Second, the paper concludes that the implementation of accrual budgeting will encounter the following technical challenges: appropriations for non-cash items; treatment of capital charging in the budget; and cash management systems.

As a further step in improving public sector accounting and financial reporting practices in Sri Lanka, Nagalinagm Nagendrakumar and his colleagues have adopted the Institutional Theory as theoretical lens and using semi-structured interviews in an attempt to these practices. The study finds that mimetic practices played a dominant role, and normative and coercive practices seemed poor in making the accrual accounting practices a success in the public entities.

In the last contribution, Bassam Albassam examines the relationship between budget transparency (measured by Open Budget Index (OBI)) and governance quality (measured by Worldwide Governance Indicators (WGI)). While the result of the analysis shows a significant relationship between budget transparency and governance quality, which is inconsistent with the literature, the findings indicate minimal influence of the human development level of nations on this relationship.

We hope the articles in this issue will stimulate discussion on contemporary problems of public organizations. If you would like to participate in such discussions, please contribute to the next issue of this Journal and/or attend future ICGFM events. We would also be pleased to receive reviews and suggestions for future issues. Send them to icgfm@icgfm.org.

We look forward to hearing from you!

Prof. Dr. Hassan Ouda  
Editor

Kevin Johnson  
Vice President of Communications

Jack Maykoski  
President
November 2015 Issue

Suitability of EPSAS for the government accounting system in Poland

Wojciech A. Nowak

Towards a common conceptual framework for Public Sector Accounting in Europe? - A comparative study of the IPSAS framework and the conceptual approach applied by the German federal state of Hessen

Andreas Glöckner

Technical Challenges Facing the Implementation of Performance Budgeting and Accrual budgeting

Hassan Ouda

The Development of Public Sector Accounting and Financial Reporting in Sri Lanka

Nagalinagm Nagendrakumar, Mangala Fonseka and Kumudinie Dissanayake

The Influence of Budget Transparency on Quality of Governance

Bassam A. Albassam

About IJGFM
Suitability of EPSAS for the government accounting system in Poland

Wojciech A. Nowak, Accounting Department
University of Lodz, Poland

Abstract

The paper is devoted to the analysis of the possibilities and ways of putting future EPSAS into Polish government accounting system. In Poland for decades the accounting and reporting of central and local government entities are relying on the accrual convention and the double record, whereas the accounting and reporting of budgets are leaning on the cash convention, also with the double record. So, implementation alone EPSAS by entities should be relatively simple. However, probably, more attention and efforts will be needed for the transformation and development of adequate reporting infrastructure. The article is introducing the current system of Polish government accounting and reporting as well as is outlining a potential way of transforming it under the angle of future EPSAS introduction.

1. Introduction

The progress of works of the European Commission on EPSAS establishing is inducing to deepened reflection over their compatibility to currently functioning national systems of accounting and reporting, and over approach to their implementation in Member States. This approach will have to take into account the EPSAS nature and the current situation in the given country as to the public finance sector financial and budgetary accounting and reporting. In the article these issues were presented and discussed on the example of Poland. The prospects for the implementation of EPSAS in Poland are quite well for public finance sector accounting is traditionally based on accrual convention and double recording. The method applied in this paper is of descriptive-analytical character.

2. Public finance and the public finance sector in Poland

The public finance and the sector of the public finance are being defined in Poland both on the academic land, and on the land of regulations. In the academic sphere, the public finance is being seen both from the object prospect and functional prospect, as the thing or the process, that is as the resource or the process of the resource flow (Wiśniewski, 2005, pp. 27-28). As the resource, a public finance is a sum of cash being at the public sector disposal, as the process – a public finance is flows of money at the production of public goods by entities of the public sector. In the connected material-functional (resource-process) presentation, a public finance is defined as the collection of cash by entities of the public sector and its allocation on the production and distribution the public goods (there, p. 28). In the light of the resource-process approach, it is emphasizing that the public finance associated with the public sector is a subsystem of the national economy, having dual substitution-complementary character towards the private sector (Wiśniewski, 2005, pp. 6-17).
On land of the law, the public finance is defined in the act on public finance, in the procedural presentation, as "processes associated with the collection of public means and their allocation" (uofp, 2009, Art. 3.), occurring in the sector of the public finance. The act defines public means as resources, mainly cash, coming from the sources presented in the form of catalogue (ibidem, Art. 5), and allocated on public expenditures and other purposes determined by the act (ibidem, Art. 6). In addition, the act demands to periodically determining the surplus/deficit of the public finance sector as a whole (ibidem, Art. 7). Within the public finance act, the public sector has been narrowed to the public finance sector, and defined as the set of the following entities (ibidem, Art. 9):

1) public authorities, including government administration authorities, national inspection authorities, protection authorities of the law, and courts and tribunals;
2) self-government entities and their associations;
3) budgetary entities;
4) local government budget utility company;
5) implementation agencies;
6) institutions of the budget economy;
7) national appropriated funds;
8) the Social Insurance Institution and funds administered by it, and the Agricultural Social Insurance Fund and funds administered by its Chairman;
9) National Health Fund;
10) self-contained public healthcare centers;
11) public higher schools;
12) Poland Academy of Sciences and organizational units formed by her;
13) state and self-government cultural institutions and film state-run institutions;
14) other national or self-government legal persons created based on separate acts to the purpose of the performance of public tasks, excluding enterprises, research institutes, banks, and commercial code partnerships or companies.
Demarcation of the public finance sector from a point of view of the control over resources and the type benefits from resources is shown on Schema 1.

**Schema 1**

![Diagram showing the demarcation of public finance sector from a point of view of control over resources.]

*Source: Author’s research*

3. **Current state of the public finance sector accounting regulation**

In Poland the accounting of the public finance sector is governed with provisions of the law, being based on the Polish constitution from 1997 (Konst, 1997). In her Art. 61 is stated, that "the Citizen has the right to get information about the operations of public authorities and persons performing public functions… The Right to obtain information includes the access to documents and the admission to sittings of joint public authorities coming from the general elections, with the possibility of the recording of sound or the image." With reference to the public finance sector, acquiring and announcing financial information (in accounting understanding) a public finance law is regulating (uofp, 2009). This act defines the general shape of the public finance sector accounting system, and in case of issues it not embraced, is ordering the application of provisions for accounting, at bases of which an Accounting Act lies (uor, 1994). Executory provisions are accompanying both acts, and they have the form of orders or dispositions, mainly by the minister of finance. Public finance sector entities are supposed to establish their accounting system pursuant to requirements of both groups of provisions that is pursuant to provisions on the public finance and provisions on accounting, in addition regulations on the public finance have supremacy. Provisions on the public finance govern both public finance sector entity’s accounting system, and the accounting or the budget of
official authorities (the state budget, the budget of local government), and connections among the entity’s accounting system and the accounting of budgets. Both entities’ accounting and the accounting for budgets are using the double record, in addition the entities’ accounting based at the accrual convention, and accounting of budgets on the (modified) cash convention. Model plans of accounts for entities’ and model plan of accounts for budgets are given in the order of the finance minister. Both the state budget, and budgets of local governments have a classical domain form, however the state budget has also a task form. Currently they comprise a set of regulations of the public finance taking the specificity into account place and implementation regulation to her:

- 2009 Public Finance Act;
- the order of the finance minister on special accounting principles, and plans of accounts for the state budget, budgets of local government, national appropriated funds and units executing the state budget and local government budgets;
- the order of the finance minister concerning the domain budgetary classification;
- the order of the finance minister on the budgetary reporting in the domain arrangement;
- the order of the finance minister on the budgetary reporting in the task arrangement.

The system of the regulation was presented to the accounting department of the sector of the public finance on Schema 2. The current state of this system has been reached due to almost seventy years evolution from the late 1940s till now, and it generates rather high quality accounting data.
Schema 2
System of Public Finance Sector Accounting Regulation in Poland
As in April 2015

Act on public finance

General regulations for accounting

Special accounting principles for budgets and executory entities

Plans of accounts for the state budget, local governments' budgets, and executory entities

Domain and task budgetary reporting

Executory entities' financial plans

The State Budget, and local governments' budgets

The long-standing financial plan of The State, and local governments’ multi-annual financial forecast

Act on accounting + MoF Orders

MoF Orders

MoF Orders

MoF Orders

...   ...   ...

Accounting regulations for entities

Source: Author’s research
4. Connections of the Polish regulations of public sector entities accounting representation processes with international regulations

The 2009 Public Finance Act had considered regulations from the 2008 Protocol No. 12 of Treaty on functioning of the European Union (ToUE Protocol No., 2008) on the procedure concerning the excessive deficit, but next has been adapted to 2011/85 Directive on budgetary frameworks for Member States (EUDir 2011/85).

From its very beginning, it is from a year 1994, the Accounting Act assumed more important solutions from IAS, however limiting the reporting model to the balance sheet, the profit and loss account, and the cash flow statement, as well as considered solutions from the IV and VII EEC Directives (78/660/EEC and 83/349/EEC), in 2000 deepened the convergence with the provisions of both Directives, and – with pattern of contemporary IAS conceptual frameworks and IAS1 – entered the definitions of financial statements elements (assets, liabilities, net assets, income, expenses) and accepted the full reporting model, widening the ternary model by adding the statement of changes in equity. At present this act includes 2013/34/EU Directive requirements and is appealing to IAS/IFRS in the version published in the UE Official Journal.

Both acts, the Public Finance Act and the Accounting Act, aren't directly referring to the International Public Sector Accounting Standards - IPSAS. The Accounting Act includes solutions from these standards to extend they are similar to IAS/IFRS, in addition excludes from directly applying in the public finance sector of the IAS/IFRS reporting model.

5. Possible approach towards public finance sector accounting reshaping in Poland

In Poland it is possible to consider an approach towards the public finance sector accounting and reporting reshaping from the theoretical side and from the practicality. From the theoretical side the approach is being illustrated by the general model of the change in the accounting of the sector of the public finance, introduced on Schema 3. The schema implies that in the case of EPSAS the implementation will be a consequence of the diffusion of innovation and outside influences and effects resulting from outside political coalitions. Both political actors and administrative actors must be committed to this implementation. In addition it is necessary to take into account at least such barriers of change as the way of thinking, the ways and contents of accountability, the legal system, the system of education, and the state of the information and communication technology (ICT). Feedbacks will be taking place through consequences which the EPSAS implementation will trigger in the real world.
From the practicality, determining areas which are supposed to be transformed is an important issue. Components of the infrastructure of public finance sector accounting and reporting will be critical areas of the change. Generalizing global experience model of this infrastructure was formulated in 2005-6 years through the World Bank. It is introduced on Schema 4.
Today, it is necessary to extend the range of this model by adding budgetary accounting and reporting, and information and communication technology. After implementing these elements the infrastructure of public finance sector accounting and reporting includes:

1) financial accounting and reporting standards,
2) budgetary accounting and reporting standards,
3) statutory framework,
4) monitoring and enforcement,
5) education and training,
6) accounting profession and ethics,
7) auditing standards.
8) information and communication technology

The World Bank suggests beginning the implementation of international accounting and reporting standards from estimating the quality of the framework of the functioning of the infrastructure of the national system of accounting and financial audit. This framework embraces (Hegarty, 2006 b, p. 2):

- economic context,
- legal and framework,
- accounting practice,
- audit practice.
Estimating should concern stating the actual state of the frames, and identifying a functioning way of thinking about them (of their dominating perception). The effectiveness of the implementation will be conditioned with both changes in the actual state of the frames, and changes in a way of thinking on them. The actual state of the frameworks, and a dominating way of thinking about them should become a point of departure for conversions in the accounting and reporting infrastructure. Changes should embrace the entire infrastructure of the public finance sector financial and budgetary accounting and reporting. Appropriate transformation and strengthening of each of the components of this infrastructure are a condition of the effectiveness of international standards local implementation (Hegarty, 2006b, p.3). In addition, they require the particular attention three from these elements, that is: the statutory framework, monitoring and enforcement, and education and training. Slowing down and negligence in these areas will cause the breakdown of the entire infrastructure what was illustrated on Schema 5.

Schema 5

Statutory framework has aspects instrumental and institutional. Both require taking into account. In the instrumental aspect a mechanism of granting the international standard the local force of law and coupling the standard with the tax law and the public finance sector entity law (public finance law) is important. In Poland, the mechanism of granting EPSAS of the force of law and harnessing them together with the law of public finance sector entity functioning will be dependent on the way of introducing EPSAS on the level of EU – by the EU directive or by the EC regulation (EC order). So, the statutory framework instrumental aspect will be relatively simple. The institutional aspect of statutory framework can turn out to be area very much of substantial changes. One should consider and convert the system of national institutions of creating, interpreting, monitoring and enforcing regulations of accounting. It would concern, among others, the role in this system of the Ministry of Finance, national Committee of Accounting Standards, Accountants’ Association in Poland, and the National Chamber of Statutory Auditors. Perhaps establishing the new institution of the public supervision would be needed. By such direction of changes, one should keep the cohesion of formal-legal frames, avoiding parallel systems and promoting accepting the general platform of the financial
reporting with the scope limited to the minimum of necessary arrangements between the general purpose report and the reports of public finance law and tax law (also see: Hegarty, 2006b, p.5).

The issue of monitoring and enforcing applying standards by entities will be compounded and gentle matter. Observation of the compliance of financial statements with standards is unfeasible from the point of view of the user not having sufficient power for extorting information needed for him from the reporting entity. In this regard it is necessary to rely on bodies about the recognized reputation. The trouble is that in world internationally recognized patterns of the good practice and models of such bodies are missing. There are no acknowledged instruments of their legitimization and generally accepted methodology of action, as well. The current world practice is also pointing to arising problems in monitoring and enforcing, because special organs of monitoring usually aren't directly interested in the general purpose financial reporting. Probably problems of harmonization of standards being based on principles with a natural tendency to the execution being based on rules will be a distinct issue. It is possible also to predict that the effectiveness of monitoring and enforcing will be conditioned with the span and the scope of the government regulation, the effectiveness of monitoring bodies and the judiciary, and the way of ruling the country. One should suppose that statistical surveys of the features of the population of elements of real financial statements and of their compliance with standards will become essential. These kinds of examinations can become a meaning type of academic research, what in many countries - also in Poland - would indicate the qualitative change in the profile of the research on accounting kept on universities in field. However, it would require proper preparing researchers.

As regards to the education and training in accounting and auditing, it seems that the education system currently functioning in Poland is able relatively easily to absorb EPSAS. However, one should expect increasing training actions in the reference to accountants working in the public finance sector entities and with reference to statutory auditors. It will require early preparing of both academic and non-academic teachers and instructors, and suitable textbooks and training materials. They will be processes taking quite a lot of time.

An information and communication technology will require the separate remark, as well. In particular it concerns the costly standardizing and streamlining computer systems of the extensive central government subsector of public finance.

6. Conclusion

EPSAS are suitable for Polish accounting, and Poland is quite well prepared for the EPSAS implementation. It has reaching the second-half of 1940s tradition of applying in the public sector the accrual basis of accounting and the double record. It has a quite well-developed present system of financial and budgetary accounting and reporting, as well. All the not less, described in the paper models of the theoretical and practical approaches towards the EPSAS implementation can legitimize early taking preparations for the implementation, and these preparations structuralize.
Bibliography


Towards a common conceptual framework for Public Sector Accounting in Europe? - A comparative study of the IPSAS framework and the conceptual approach applied by the German federal state of Hessen

Andreas Glöckner, Hessian Court of Auditors, Germany *

Abstract

In Europe the discussion about the implementation of accrual accounting in the public sector, based on so called harmonised European Public Sector Accounting Standards has just started. Obviously, there are controversial ideas and expectations how Public Sector Accounting should look like. In order to reach compromises it is important to understand the competing positions. Therefore, the paper compares the opposing conceptual bases of the International Public Sector Accounting Standards Board (as stated in its first own 2014 framework) and the German federal state of Hesse (as guided by the German Commercial Code). Obviously, this discussion about accounting harmonisation in the European Union seems like a flashback. It reminds us of the harmonisation process of the Union in private sector accounting, accomplished by the accounting directives and the IAS-regulation as well as the compromises found at that time. Consequently, the paper also addresses the discussion about “conservatism” versus “neutrality” and contributes to the discussion if the purpose of Public Sector Accounting rather is the provision of information or the protection of stakeholder groups.

1. Introduction and research questions

When implementing an (accrual) accounting system, conceptual decisions have to be made. Currently, conceptual questions are raised internationally again. One reason for this is that the International Public Sector Accounting Standards Board (IPSASB) published its first own conceptual framework for financial reporting. Furthermore, the European Union (EU) discusses the possibility to harmonise Public Sector Accounting (PSA) that is applied by its member states and therefore also has to take conceptual topics in consideration first. The IPSAS are intended being used as first reference of specific European accounting standards for the public sector (so called European Public Sector Accounting Standards, abbreviated to EPSAS).

In order to reveal the implicit and explicit conceptual decisions by the IPSASB, included in the IPSAS framework (IPSAS-F), an object of reference is useful. Thus, the paper belongs to the academic field of Comparative International Governmental Accounting Research: The conceptual decisions made by the IPSASB within the IPSAS-F (chapter 2) will be analysed in comparison with those equivalents made by the government of the German federal state of Hesse (chapter 3). According to Lüder (2013b), the state of Hesse (a federal state of Germany) must be considered an innovator in German terms because for the implementation of accrual accounting it developed and implemented its own reform steps and accounting rules and therefore also had to solve conceptual problems. Hence, the Hessian model is worth being analysed and compared with the work of the IPSASB. Lüder conducted an “in-depth-study” of the completed reform process in Hesse and the specific Hessian “legal-political-economic context”. This paper is therefore completing the Hessian case study by focusing on the outcome of this reform process: notably the current accounting model in Hesse, the overall conceptual direction of the accounting rules and certain practices that are applied there.
The paper is focusing on four fields of conceptual differences: 1. the different governance structure, 2. the significance (function and authority) of the conceptual basis, 3. the objectives determined and users assumed or given by law, and 4. the basic accounting principles. The research questions (chapter 4) are as follows: Do both conceptual models have things in common and which are the main differences? According to the Hessian experiences, is the IPSAS-F precise enough for being applicable in practice? By answering these questions, the paper is of high importance in the current discussion in Europe. Since all conceptual questions raised above are covered in chapter 1, 2, and 3 of the IPSAS conceptual framework, the author will focus mainly on these. The aim of the paper is to show the theoretical alternatives of conceptual decisions when intending to harmonise PSA and their practical implications. The final chapter 5 contains concluding remarks and suggestions. To sum up, the study is a theoretical, comparative study of the conceptual basis of different accounting models.

2. The IPSAS framework - the conceptual basis of (future) standards

2.1 The historic background and the scope of the IPSAS framework

The idea of conceptual frameworks encompasses that objectives, qualitative characteristics and principles for recognition, measurement and presentation are derived from a catalogue of weighted user interests. According to Jones/Pendlebury, a framework is defined as “a constitution of fundamental principles from which the more specific accounting standards can naturally follow or draw on”iv. Over many years it used to be seen as an old-fashioned, even inferior attitude of “good old accounting Europe” (mainly by Anglo-American scientists and practitioners, supporting the idea of “positive accounting”) to work on a sound normative (deductive) conceptual basis for accounting. Starting from the 1980s, the Anglo-American accounting world rather followed a positive accounting research view, applying an empirical focus on accounting. However, nowadays it is widely accepted that principle-based accounting provides an advantage regarding consistency in the development and application of standards – also within the Anglo-Saxon accounting environment. This is why there is a world-wide revival of the development of normative accounting frameworks. In the past, both dominating accounting standards boards in private sector accounting, the IASB and the FASB, co-operated in order to develop a common framework. However, due to unbridgeable conceptual differences between both boards, the project failed. This experience proves the importance to deal with conceptual issues first, before developing a set of accounting standards. In September 2012 the IASB restarted its framework project without any partnerv and in 2015 published an exposure draft of a new framework for the International Financial Reporting Standards (IFRS)vi.

The lack of a specific conceptual framework for the public sector used to be a permanent source of criticism of the work of the IPSASB.vii Consequently, also the IPSASB worked for some years at its first ownviii, public sector specific conceptual framework (“Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities”; hereinafter abbreviated to IPSAS-F). It was published in October 2014. The IPSAS-F might be of high importance also for preparers and users of financial reports of public sector entities in Europe if the European legislators follow the suggestion of the European Commission using IPSAS as (first) reference base for developing EPSAS.ix

During the development of the IPSAS-F there was a public discussion about its scope. As it is shown in section 2.3 of this paper, the IPSASB pursues a rather broad multiple-user approach. Different users have different information interests and needs and therefore also claim for specific accounting information. As a consequence, the framework “reflects a scope for financial reporting that is more comprehensive than that encompassed by financial statements”ix. The board clarifies that “information presented in financial statements remains at the core of...
financial reporting\textsuperscript{xii}, but beside this “primary focus”\textsuperscript{xiii} there should be “additional information that enhances, complements, and supplements those statements”\textsuperscript{xiii}. To sum up, the broad area of application of the IPSAS-F comprises the presentation of non-financial, prospective and sustainability information in addition. This exceeds the narrow focus of a presentation of ex post, accrual accounting data that can be found in financial statements.\textsuperscript{xiv} At the same time, the IPSASB also refuses a scope that might be too comprehensive and therefore states that there is a limitation “to matters that assist users to better understand and put in context the information included in those statements”\textsuperscript{xv}.

2.2 Function and binding authority of the IPSAS conceptual basis

The questions of function and authority of the IPSAS-F are answered in its first chapter. Following the Anglo-Saxon accounting tradition, one primary function of conceptual frameworks is to establish legitimacy for the work of private standard-setting bodies. The IPSASB – established by the accounting profession and still working under the auspices of the International Federation of Accounting (IFAC) – is such a private standard-setting institution and therefore neither has the right to set legally binding standards, nor does it have enforcement power. The board consists of accounting experts who are developing accounting standards, guidelines and recommendations (“recommended practice guidelines” – abbreviated to RPGs) that preparers might follow on a voluntary basis. At the same time, legislators might 1. Use them as professional source of guidance for developing own legal accounting regulations, accounting standards and/or practical accounting guidelines (the latter might be understood as a kind of very detailed, descriptive “accounting cookbooks”), 2. Adapt them in a way so that they fit to the specific national legal and social environment, or 3. Approve them unmodified (“endorsement”), providing the missing legally binding status.

In terms of PSA, the legislators normally make use of the first two options, due to reasons of sovereignty. It is common practice that they decide to cut back options given by the IPSASB, to exclude parts of standards or entire standards from the application and to work on adaptations. This is why there is a huge variety of nationally or regionally adapted IPSAS. Consequently, from a global perspective, the development of regional-specific “E”PSAS by the EU would be nothing unique. The IPSASB used a consultation process in order to involve as many stakeholders worldwide as possible. During this process controversial opinions and perspectives on conceptual PSA matters were received and taken into consideration.

By developing a conceptual framework, a standard-setter establishes a solid but rudimentary conceptual basis that it would like to build the standards on.\textsuperscript{xvi} “The Conceptual Framework identifies the concepts that the IPSASB will apply in developing IPSASs”\textsuperscript{xvii}. However, the Anglo-Saxon tradition of rules-based standards does not allow the framework to override regulations given by particular standards or guidelines.\textsuperscript{xviii} Likewise, the IPSASB does not consider the framework being binding for its own work either, and declared that it is also not mandatory for preparers who are applying IPSAS. It “does not establish authoritative requirements”\textsuperscript{xix}. In short, the binding authority of the conceptual framework is rather weak. It is nothing more than a statement of intent that could be discarded by the IPSASB, whenever considered necessary. However, even though the focus lies on a non-binding conceptual guidance of the standard-setting body, the IPSASB confirms that there is an additional assisting function for preparers of financial reports\textsuperscript{x}: it can bridge gaps of regulation by “provid[ing] guidance in dealing with (…) issues not dealt with by IPSASs or RPGs”\textsuperscript{xiii}. In this context, it is important to point out that in democratic societies the legislator has the final say, also in terms of accounting regulation. Private standard-setting bodies depend on the acceptance of their work
(or at least on a lack of objection) by the legislator. In short, objectives and principles always have to be derived from the accounting law, based on the decisions of the legislator.

2.3 Objectives determined and users assumed

The IPSAS-F defines objectives and users in the second chapter. Content of this chapter is the traditional Anglo-Saxon idea that the only feasible objective of accounting is the provision of information. The historic reason for this “puristic” view is that – unlike the situation in continental Europe – there are no immediate financial consequences connected to financial statements in the Anglo-Saxon countries. For purposes such as the measurement of profit for tax purposes, the payout to owners/shareholders, or creditor protection, special single purpose statements are prepared or contracts signed. Some of these contracts even contain binding conditions for accounting. Consequently, financial reporting could develop there free from any other than informational claims. In addition, there was a strong influence of the capital markets and the informational demands of (potential) investors. One proof for that is that in the US the supervisory authority of the stock market, the Securities and Exchange Commission, plays a dominant role in standard-setting.

The central orientation of an accounting system that completely follows an informational objective is given by the first question: To whom should the information be provided implicitly or explicitly? This is the addressee (or assumed user) perspective of accounting. “The objectives of financial reporting are therefore determined by reference to the users of GPFRs, and their information needs.” According to the opinion of the IPSASB, information should be provided to two collective groups, the resource providers and the service recipients. According to the IPSAS-F, the informational needs and interests of these two quite extensive groups should be in the center of standard-setting. There is no hierarchy in interests, both user groups are of equal importance. Both groups should be protected by the provision of information, at least from an informational asymmetry. This can be put in another way by saying that they should be enabled to protect themselves by meeting their information needs and expectations. However, the IPSASB further specifies the anticipated user-ship of financial reports that were prepared according to IPSAS. It is the “information outsiders” that should receive the information needed. Thus the reports should address “users who are unable to require the preparation of financial reports tailored to meet their specific information needs.” “Information insiders” may use the information if they think the information is useful to them, too. Nevertheless, the reports are not prepared to primarily respond to their specific information wishes. In addition, the IPSASB also enlarges the group of users again by adding the representatives of resource providers and service recipients, “when acting in their capacity” and interest. In the end “the primary users (…) are service recipients and their representatives and resource providers and their representatives”.

The second question raised is that of why there is the need of informational provision. This is the question about the purpose of accounting. And this is also where the usefulness approach comes in. Financial reporting should only provide useful information. But this leads to another question: what is the definition of “usefulness”? The IPSASB answers it in two ways: Information is useful if it contributes to accountability and decision-making purposes. The assumption is that information which was provided for accountability reasons also serves the decision making purpose in a following step. In one way or the other, a decision could be the result of the information provided. One could say that basic accountability supports or even enables decision making. Therefore, the IPSASB also emphasises that “the notion of accountability reflected in this Framework is broad”.
The following figure 1 presents an overview of the conceptual basis given in the IPSAS-F.

Figure 1: Objective-purpose hierarchy of the IPSAS (according to the IPSAS-F)

2.4 The trade-off between the “qualitative characteristics”

In the third chapter the IPSAS-F also includes the definition of “qualitative characteristics”. Literally, the term expresses that the application of this kind of principles is supposed to ensure a high quality of accounting information. “Qualitative characteristics are the attributes that make the information provided in financial statements useful to users.”xxxiv According to the IPSASB, accounting information with these attributes also matches the claim of usefulness and will contribute to achieve the objectives which were mentioned above.xxxv The IPSASB declares that there are six characteristics: “relevance, faithful representation, understandability, timeliness, comparability, and verifiability”xxxvi.

The standard-setting body believes that there should be no fixed hierarchy (unchangeable “sequence of their application”) in the relationship between those characteristics.xxxvii The IPSASB explained that any classification and a permanent hierarchy would not be “appropriate”xxxviii. In contrast, it states that there is a need for balancing them, because “all qualitative characteristics may not be fully achieved” at the same time. This “balance or trade-off”xxxix should be reached by “professional judgment” from case to case. That means that each characteristic is of “relative importance” – depending on the specific accounting problemxl, the circumstances, the environment and the kind of information that is needed.xli Such an “appropriate balance” should guarantee that the objectives are achieved, too.xlii The common work of all characteristics makes sure that the information that is provided is useful.xliii In that sense the area of application of the qualitative characteristics includes all kind of information: financial, non-financial, historic, prospective and explanatory.xliv

However, from a theoretical point of view, one might disagree with the IPSASB and distinguish between what can be called “material” principles and “formal” principles. As a matter of fact, the formal characteristics are common to all accounting systems: understandability, timeliness, comparability, and verifiability. By contrast, the material principles specify the broad conceptual orientation of the accounting system. Therefore, they are also called “meta rules”. The latter encompasses faithful representation and relevance. The IPSASB admits that there were also comments during the consultation process for the IPSAS-F exposure draft that were exactly expressing such a view. These respondents asked for a clear order of application, using the expressions “fundamental” and “enhancing”xlv qualitative characteristics.xlvi It is the aim of this paper to analyse the conceptual differences of two PSA models. Therefore, the author agrees with these comments and believes that it is necessary to focus on those principles that are not common to all accounting systems. These are the principles that are classified as “material” because they indicate the particular features of a PSA system. Consequently, it is the terms relevance and faithful representation and their interrelations that will be taken into consideration in the following:
Relevance is defined as “capable of making a difference in achieving the objectives”\textsuperscript{xlvii}. According to the IPSASB, this is the case if accounting information is either confirmatory or predictive – and sometimes it is both\textsuperscript{xlviii}. Information is classified as “confirmatory” if it “confirms or changes past (or present) expectations”\textsuperscript{xlix}; information is “predictive” if it assists to anticipate the future and to develop expectations about the financial and nonfinancial situation of the entity.\textsuperscript{l}

Faithful representation comprises three sub-principles: completeness (no omission of information\textsuperscript{li}), neutrality (“absence of bias” and of the “intention of attaining a particular predetermined result”\textsuperscript{lii}) and freedom from material error (including individual or collective materiality in both, the information and the process of its gathering\textsuperscript{lii}). In addition, the substance over form rule (more priority is given to the economic substance of a transaction than the legal form) is mentioned.\textsuperscript{lv} At the same time, the IPSASB is expressing that no “absolute completeness or neutrality” or “total freedom from error” could be expected in terms of estimates. As a consequence, the application of the three sub-principles is limited by the concept of practicability.\textsuperscript{lvii}

The IPSASB also points out that other principles that are common in Anglo-Saxon accounting literature such as “sincerity, true and fair view, credibility, and transparency” cannot be seen as individual characteristics. They are classified as important “overarching qualities” which the unity of the financial reports should strive for to achieve by applying all IPSAS standards and the conceptual framework.\textsuperscript{lvii}

3. The conceptual approach applied by the German federal state of Hesse

3.1 The historic and legal background - the application of the German Commercial Code in the public sector

The legal basis for the implementation of accrual accounting on states level in Germany was given by the “Act for the further development of the budgetary law” (HRFEG) in 1997.\textsuperscript{lvi} With this act the existing law on budgetary principles from 1969 that applies to the Federal government of Germany and the German federal states (“Haushaltsgrundsätzegesetz” – HGrG) was modified. After the modification it was permitted to operate an accrual accounting system “in addition”. This means that accrual accounting was possible on an optional basis. However, it was still mandatory to maintain the traditional cash based (“cameral”) accounting system on states level in Germany. Furthermore, a reference model was determined: state accrual accounting in Germany should follow the German principles of orderly accounting (“Grundsätze ordnungsmäßiger Buchführung”, abbreviated to GoB). It was added that these principles should be applied in analogy with the German Commercial Code (“Handelsgesetzbuch”, abbreviated to ComC).\textsuperscript{lx}

Hesse was one out of three German federal states that implemented accrual accounting on states level in the following years.\textsuperscript{lx} First, the legal requirements mentioned were voluntarily transferred into the Budgetary Code of the state of Hesse (“Landeshaushaltsordnung Hessen”, abbreviated to LHO HE).\textsuperscript{lxii} As a consequence, the state accrual financial reports were based on the existing ComC as close as possible. But the ComC was developed for private sector accounting. Therefore, the most difficult task was to solve accounting problems that were not covered by the ComC. In fact, Hesse was forced to develop own solutions to public sector specific problems, based on the ComC conceptual framework. These rules cover specifications, necessary amendments and additions to the ComC that are caused solely by public sector specifics (e.g. heritage assets, tax revenues, and social policy obligations). They are laid down in a handbook (“Kontierungshandbuch des Landes Hessen”) and their application is mandatory for the state ministries and their subordinate units in Hesse. It was also said in the LHO HE that the
The Hessian Ministry of Finance and the Hessian Court of Auditors will agree on the regulation of these further details. One might say that the Court of Auditors served (and still does until today) as advisor of the Hessian government and a kind of “quality auditor” for the development of the Hessian accounting rules.

At the time when the Hessian government started the reform project, IPSAS were not sufficiently elaborated. Especially the public sector specific standards and the framework that could have been helpful as reference for solving public sector specific problems did not exist. Therefore, Hesse was forced to develop its own conceptual public sector specific approach in order to solve all problems on its own. The only helpful guideline (or better compass) that existed was the rule that the evolution of the Hessian state accounting system should strictly follow an analogous application of the ComC. The entire project of implementing full accrual accounting in Hessen then took about ten years: starting with the cabinet decision in 1998/1999 and finally finishing by publishing the first annual accrual accounts for the state of Hesse in 2009/2010.

In 2009 another act to modernise the law on budgetary principles (“Haushaltsgrundsätzegesetzmodernisierungsgesetz” – HGrGMoG) was adopted, allowing the federal states in Germany to run an accrual accounting system on a stand-alone basis. Until today the German federal states have the right to choose between cameral and accrual accounting, as long as they meet the common statistical requirements. According to para. 7 HGrG [headlined “Grundsätze der staatlichen Doppik”], state accrual accounting should be based on the ComC and the GoB. As a consequence, if the German federal government or the federal states decide for accrual accounting, they are obliged to apply these “principles of state accruals”. In the reasoning of the HGrGMoG it was said that there is a need to clarify to what extent the “structures, rules and procedures” of private sector accounting will be transferred to the public sector. Therefore, it was mentioned in the HGrG that specifications of (especially how to exercise existing ComC options) and deviations from the ComC due to public sector specifics will be addressed by a common committee of the German federal government and the federal states. In fact, the committee consists of representatives of the 17 ministries of finance in Germany. The result of their work is the set of the German “standards of state accruals” (“Standards staatlicher Doppik”, abbreviated to SSD).

Until now, Hesse has not yet modified its Budgetary Code again and therefore still runs a leading cameral accounting system and an additional accrual accounting system in parallel. According to the preface of the SSD, these German PSA standards should be applied by all state governments that already have an accrual accounting system by 1st of January 2015. As a result, the state of Hesse also started to revise its handbook, based on the SSD. However, the Hessian Ministry of Finance and the Hessian Court of Auditors agreed that some regulations that can be found in the SSD violate the ComC and the GoB. In case of a conflict between the existing rules, the LHO HE and the HGrG override the SSD, because they hold the status of nothing more than drafts of administrative instructions. As a consequence, the state of Hesse is still applying an accounting model that is strictly based on the ComC. Hesse proved that the conceptual basis of the ComC does also match the necessities of a state accrual accounting system.

3.2 The significance of the conceptual basis (conceptual and practical reasons)

With the accounting regulation explained in section 3.1, the federal state of Hesse is strictly following the German tradition of a principle-based accounting system. That means that the abstract conceptual base (including the objectives and principles) may overrun concrete,
detailed individual rules and regulations. In the first hand, the financial statements of the state of Hesse have to be coherent with the conceptual basis. To meet the conditions of detailed accounting regulations is a secondary, subordinate obligation. However, due to the principled-based approach, there is also a tight alignment of the rules and the conceptual basis.

Because Hesse strictly applied the conceptual base, the rules, and the principles of the ComC (provided that they are feasible), it is sometimes described as “imitator”\textsuperscript{lxvii}. However, due to the first-time implementation of accrual accounting on states level in Germany and the composition of own public sector specific accounting rules and the development of an own public sector specific conceptual basement, Hesse must considered being an “innovator”\textsuperscript{lxviii} in terms of PSA in Germany at the same time. Why decided Hesse to apply the ComC as reference model in such a strict way from the very beginning (apart from the reason that there were legally no alternatives)? There are basically five reasons and advantages (the first two are conceptual, the last three are rather practical ones):

– First, the ComC proved to be a conservative and therefore rather stable and reliable system. The compact set of ComC objectives and principles is consistently applied.\textsuperscript{lxix} Even with nothing more than a basic understanding of the core objectives and principles it is possible to solve specific accounting problems within the ComC-system. The abstract nature of the GoB makes them quite flexible for adaptions across diverse accounting problems but also across sectors.\textsuperscript{lxx} Therefore, some scientists even consider the ComC as a competitive advantage of Germany.\textsuperscript{lxxi} This makes the ComC a very useful reference model for an adaptation in a completely different sector because the preparers there will not have well-established solutions to particular accounting problems and therefore need \textit{conceptual guidance} how to solve problems on their own. Especially, one may assume that the transition to accrual accounting would be more difficult if a rather less principles-based accounting system (e.g. a rules-based-system with an extensive catalogue of complex standards) is applied. However, from a consistency point of view the principles have to be accompanied by consistently derived rules\textsuperscript{lxxii} because “for reasons of comparability, enforceability and objectivity of financial reporting information, it is important to have specific (internally consistent) accounting requirements that limit managers’ judgments in the application of accounting standards to ideally only one possible accounting method.”\textsuperscript{lxxiii} In the end, there is a need for principles \textit{and} rules – both are offered by the ComC system or the latter at least provides the conceptual foundation to develop rules, if there are none.

– Secondly, unlike international standards, the core set of ComC objectives, methods and principles are not often modified by the legislator and if so usually they are only slightly changed. For instance, between the BiRiLiG-reform in 1985 and the BilMoG-reform in 2009 there was a period of almost 25 years of \textit{regulative stability} in private sector accounting. And also the BilMoG only slightly shifted the ComC in the direction of a stronger orientation on informational needs (cf. section 3.3).

– In addition, even though capital-market-oriented enterprises and corporations apply IFRS, the majority of German enterprises and especially government business enterprises (GBEs) apply the ComC. Accounting according to IFRS for SMEs was considered too costly and complex. One initial argument for implementing accrual accounting in the public sector was that there is a need of \textit{consolidation}.\textsuperscript{lxxiv} This is especially true since in the last couple of years there was a strong tendency in Germany of outsourcing major parts of the state and municipal core administration into GBEs. Most of these new enterprises belong to the SME category and are neither capital-oriented nor do they have a differentiated ownership structure. Therefore, they usually apply the ComC accounting rules. Due to comparability and consolidation reasons,
there is a need for a common conceptual basis of public and private sector accounting. The transfer of the proven ComC system enables a consolidation of public and private sector entities within the same conceptual system.

- Next, the already existing, **high quality audit standards** that exist for ComC financial statements could also be applied in the public sector. This is why Hesse has annually audited and published financial statements, comparable to the statements that capital-market oriented corporations are obliged to prepare and publish. The state of Hesse is the only state entity in Germany that has annual accounts that are audited and certified according to the same standards that also apply to corporations that have a ComC accounting system. For this reason the Court of Auditors also appoints public auditors as technical experts.

- Some also argue that by using the ComC as a reference model, there might be a facilitated **exchange between the labor markets of the private and the public sector**. In fact, this is a miserable argument. The public sector is usually not able to pay the higher salaries that are offered to employees in the private sector. Therefore, the public sector often faces a lack of professionals with a business administration background, unless these individuals have other than monetary (such as intrinsic) motives. But since this is an argument that is often used by proponents of IPSAS, it is fair to add it to the list of the ComC advantages.

The promoters of the ComC in the public sector in Germany always claim that the conceptual basis of the ComC fits both sectors. The next section will show that this is feasible.

### 3.3 A glimpse into the conceptual basis of the ComC-reference model

Since the Hessian model is strictly based on the conceptual foundations of the ComC, it is necessary to shortly describe the latter first. In the following, it is then easier to understand the Hessian model.

The ComC does not explicitly state any objective of private sector accounting in Germany. Instead, the objective is given by the legislator in two ways: 1. Implicitly, in single accounting norms and 2. Explicitly, in the comments within the legislative acts that created the current ComC. Source of this kind of comments is mainly the Act on accounting principles (“Bilanzrichtliniengesetz” – BiRiLiG), the law that transferred the 4th, 7th and 8th accounting directives of the European Community into German law in 1985. Furthermore, in 2009 there was the Act to modernise commercial accounting law (“Bilanzrechtsmodernisierungsgesetz” – BilMoG) that intended to adapt the BiRiLiG-ComC in a way that it could better compete with IFRS. These are the two main acts that formed the current ComC. It is important to distinguish between the “traditional” ComC after the transfer of the EC accounting directives in 1985 and the ComC after the light opening towards IFRS in 2009.

In order to completely understand the ComC one has to go back to its roots. For the purpose of this paper, however, it seems sufficient to say that the “core idea” of the ComC was generated by diverse experiences that the German legislator made in the first decades of a unified private sector accounting in Germany, starting from 1861. In addition, one should beware that accounting law in Germany was shaped by European developments from the very beginning. Economic crises, fraudulent bankruptcies, balance sheet scandals, cases of fraud, and continuing disputes of stakeholder groups for information and money were guided by the development of different, conflicting accounting theories. This paper phrases seven basic characteristics that result from this rich accounting history and tradition. The following points reflect the
decisions of the legislator and the prevailing opinion formulated by the courts of finance and recognised scientists when interpreting the ComC and its underlying idea.

1. It is not possible to develop regulations for the preparation of financial statements that serve the interests of multiple stakeholder groups equally. Even though there is the possibility that accounting information might be useful for more than one stakeholder group, the German prevailing accounting theory points out that there is the need to focus on the interests of some. Accounting cannot consider the interests of multiple groups of users at the same time in the same way (at least in terms of the distribution of cash flows). When shaping an accounting system, it is necessary to decide on a priority of interests. As a result, the term “objective” has to be understood in ComC accounting as the protection of the interests of somebody or something. From a German point of view, there is solely the legislator that can decide on binding hierarchies of interests and it is about the courts of justice to finally settle disputes by interpreting the legislator’s intention and clarifying which accounting procedure fits best to reach the objectives given.\(^{lxxxviii}\) The main intention of the 1985 ComC (after the BiRiLiG) was the protection of the interests of creditors.\(^{lxxix}\) However, in the history of accounting in Germany, the legislator also thought about the protection of interests of minor share owners, the financial sustainability of the reporting entity itself and the public taxation (the cash inflow of the treasury by raising taxes).

2. There are two dimensions of accounting: the information that accounting produces and – based on the hierarchy of interests given (see point 1) – the distributional effects that it has.\(^{xc}\) From a private sector perspective, the term “distributional effects” includes all kind of capital flows that are based on accounting information (such as the distribution of income to shareholders, the building up of open or hidden reserves, or the payment of taxes and other public obligations). According to the two dimensions, protection of stakeholder groups might be reached either by a steering of information or of capital flows. The latter was the preferred way when preparing financial statements according to the 1985 ComC.\(^{xci}\) Since accounting is the basis of tax measurement and shareholder politics in Germany, the legislator intended to affect the flow of financial resources via conservatism accounting (see point 4). The intention was a combination of preserving capital within the enterprise\(^{xcii}\) and measuring capital outflows in a way that protects creditors (both are part of the capital flow protection and “supplement each other” – “[b]oth aim at the safeguarding of the company against the uncontrolled removal of assets by the owner”\(^{xciii}\)). At the same time, there was the intention of providing accountability (informational protection). The accounting theory that the ComC is based on is called “static outflow theory” (“Ausschüttungsstatik”)\(^{xciv}\) which shows that the focus has been on the protection via a conservative measurement of capital flows. In the US this mechanism of protection is called “legal capital”.\(^{xcv}\) Especially the measurement of the “profit which is understood as feasible outflow”\(^{xcvi}\) was important compared to the protection via the provision of information.

3. The German legislator, the courts and accounting scientists learned to clearly distinguish between both dimensions and that it is possible to make use of them in precise ways by “uncoupling” the two. This requires on the one hand to develop Generally Accepted Accounting Principles (GAAP) which focus solely on the measurement of income that should be distributed in the interest of the primary stakeholder (therefore called “distributional GoB”; see point 5).\(^{xcvii}\) They apply to the financial statements. However, providing additional information can satisfy multiple groups at the same time. Therefore, on the other hand, there is an additional, partly different set of principles that applies to the additional elements of financial reports (see point 6) and that resembles the set of qualitative characteristics given by the international standard-setter (“informational GoB”).\(^{xcviii}\)
4. For reaching the purpose of ComC accounting (see point 2), there is a need to preserve capital within an entity. Therefore, the content of the ComC regulations show that the legislator’s intention was to implement an accounting system that is determined by the conservatism principle. This principle serves the protection of creditors and the long-term financial stability of the entity. It is important to define what “conservatism” means. There is an excellent definition by Alexander/Nobes: “The most famous bias in accounting is prudence, or conservatism. There is still some room for this, despite the (...) requirement for neutrality. Full-blown conservatism (...) protect[s] certain users (including creditors) from the risk of making financial statements look too good, particularly given the excessive optimism of some businessmen. Recognizing that a number of estimates are involved in accounting, an accountant, according to this convention, should ensure the avoidance of overstatement by deliberately setting out to achieve a degree of understatement. This requires that similar items, some of which are positive and some of which are negative, should not be treated symmetrically. The lack of symmetry which is intentionally striven for (in the German ComC implemented as the “imparity-principle” because of the missing parity in the treatment of revenues and expenditures) is also the key element of another famous definition of “conservatism” by Basu. According to his “interpretation of conservatism, earnings reflects bad news more quickly than good news. For instance, unrealized losses are typically recognized earlier than unrealized gains.” To sum up, in concrete accounting terms, “conservatism” means a rather early booking of losses and late registration of profits, the definition of assets according to the fulfilment of requirements that ensures its stability of value, and the reporting of contingent liabilities also for many internal reasons in order to be prepared for worst-case-conditions. In Anglo-Saxon understanding this method that indisputably leads to hidden reserves/values is seen as “distortion” or “bias”. However, the idea is to maintain financial resources within the company in order to prevent (major) capital owners from distributions of income that has not yet realised and therefore the harming of those interest groups that cannot ensure the protection of their interests.

5. In accrual financial statements there are three elements: the balance sheet, the income and the cash flow statement. All of them provide a different perspective on the entity. Even though financial statements usually contain all these elements, one perspective has to be the dominant. In other words, in the history of the ComC it was realised that there has to be a clear hierarchy in the relationship between the different tasks that financial statements can potentially fulfil. The ComC has the primary focus to measure the income that is distributable. For that reason there is a need to recognise and measure the assets in a conservative and objective way.

6. In the additional elements of financial reporting (such as notes, management commentary, and segment reporting) there is explanatory, but also prospective and subjective information that is not provided in the financial statements. This is called the “uncoupling-proposition”. According to the prevailing opinion in Germany, financial statements and the additional elements have to be seen as a unity (the financial reports). The “distributional GoB” applies to the elements of financial statements (especially the calculation of the distributable income); the “informational GoB” applies to the disclosure of additional information in the additional elements. The advantage of this kind of uncoupling and the combination of different elements that are serving different purposes is that the financial reports can fulfil two tasks simultaneously and therefore match multiple needs: the measurement of distributable income in the financial statements and the provision of missing (but maybe useful) information in the additional elements (notes) of the financial reports.

7. Due to the negative experiences described above, the ComC legislator asks for an accounting system that is objective and therefore reliable (lack of subjective judgement). The
principle of objectivity is interpreted in a strict way. In general, the ComC is a principle-based accounting system. Therefore, it is the definition of material accounting principles that completes the conceptual accounting basis. The characteristic attribute of these principles is that their content exceeds the requirements of qualitative characteristics that are common to each accounting system. They define the income measurement of the year and translate the abstract objectives into definite, precise accounting terms. Within the ComC, such specific principles (stated in para. 252 (1), number 4 ComC) are a) the “conservatism principle” that demands the reporting of a rather lower than higher value of assets and revenues, while the contrary applies for liabilities and expenses, b) the “realisation-principle” including the principle of measurement at cost and the realisation of revenues at the moment of market transaction, c) the “imparity-principle” (see point 4) which claims that risks related to revenues and expenditures are disparately treated, and d) the “objectivity-principle” because only objective accounting data can protect the information of a third party. By following these principles, the ComC objectives and the requirement of objective and reliable information are transferred into accounting items.

Bearing these seven points in mind, it is easier to understand the conceptual logic of the “traditional ComC”.

Then, in 2002 the European legislators decided that capital market oriented enterprises have to publish its consolidated accounts according to IAS/IFRS. The reason for this was to protect European capital markets, to better compete with US-GAAP (the US private sector accounting standards) regulation and gaining back influence on standard setting in private sector accounting. Ever since, the idea of Anglo-Saxon based IFRS also gained support in Germany and there is also a capital-market driven tendency of implementing systematic-foreign elements into the ComC where it is reasonable and adequate in order to make it a more attractive alternative to IFRS. In 2009 the federal parliament passed the BilMoG. The aim of this legislation was to “ensure that the proven, inexpensive and straightforward accounting law of the Commercial Code will be retained in future and strengthened for competition with international accounting standards.” It was said that this should be reached by “enhancing the qualitative validity of annual financial statements drawn up under commercial law”. According to the BilMoG, the ComC should be adapted according to international regulations and requirements where this is reasonable and adequate in order to improve the informative value of the ComC financial statements. This means that the intention also was to enhance the status of the informational objective in accounting (described as “moderate convergence”). However, the legislator added that this goal is to be achieved without entailing the existing disadvantages of the international accounting standards at the same time. He confirmed the traditional objectives (esp. the measurement of distributable profits) and the set of mandatory GAAP. The “lessons learned” above were not condemned in the 2009 ComC (after the BilMoG), but the idea of the “provision of information” as autonomous objective of accounting was set aside the traditional objective of creditor protection. Traditionally, the provision of information was not seen as objective on its own in the ComC. It was argued that the provision of information is an elementary function of each and every accounting system. The partly inconsistent mixture of accounting practices in the 2009 ComC was intentionally agreed on with the aim to guarantee a better functioning of capital markets but to preserve conservatism at the same time. Therefore, the opening of the traditional ComC-conception was market-driven. With the BilMoG there has also been a strong increase in the meaning of accountability. However, since the German legislator also wanted to secure the traditional understanding in the 2009 ComC, the accountability now stands equally at the same conceptual level as the capital flow protection. Moxter evaluates the consequences...
of the BilMoG as “purely ostensible fundamental qualification” of the existing ComC accounting system.

3.4 Objectives according to the Hessian concept and users stated by law

All public sector entities in Germany that implemented accrual accounting used the ComC as reference model (see section 3.3). The Hessian model of accrual accounting followed the reference model completely and therefore is closer to it than any other accrual PSA model in Germany. The underlying concept of the Hessian model is that the ComC conceptual basis (the “static outflow accounting theory”) may and should be applied as far as possible. According to the Hessian opinion, the ComC system also fits to the public sector specific objectives or rather ideally serves them. The former president of the Hessian Court of Auditors explained it like that: “There is only a need for public administration specific accounting principles if there is no sensible possibility to transfer the accounting principles for private sector enterprises to the conditions given in the public sector administration.” This means that the Hessian model does not claim that the ComC could be applied unmodified in the public sector. However, according to the regulation in the HGrG, there should be only differences between public and private sector accounting if there are sector-specific characteristics that can justify those. The Hessians asked themselves why “to reinvent the wheel” if there is an elaborated accounting system that is trusted by the legislator, tax authorities, resource providers, the association of public auditors and which has proved to provide reliable data for many years? Why comparable accounting questions should be answered in a different way simply because the reporting entity belongs to another sector? Figure 2 presents an overview of the implicit conceptual framework in Hesse.

Objective = intergenerational equity (implicit „protection“ of future generations and financial sustainability of public sector entity)

Figure 2: Objective-purpose hierarchy according to the Hessian model

Based on the ComC reference model, the Hessian understanding of the term “objective” includes the protection of somebody or something. However, due to differences within the group of stakeholders in the two sectors, the person or entity to be protected is different. It is not the protection of creditors but the protection of future generations (of citizens) that is (implicitly) strived for in the accounting system. By analogy with creditors in the private sector, it is mainly the future generations that have no influence on the maintenance of capital within the reporting entity. In a private business enterprise it is the (main) owners that might have an interest to distribute income or to pull out capital. In doing so, they can potentially harm creditors that have an interest to receive repayments and interests in a reliable manner. The ComC based PSA model considers that there might be such a clash of interests in the public sector between future generations (of citizens) on the one hand and current stakeholder groups on the other hand. In particular, it is the present generation of citizens that benefits from current public sector services. Therefore, the intention is to reduce public spending if money is not used for long-term investments but for expenditures in favour of present generation consumption. Today’s generation should “not live on the costs of their children” and “waste” the financial
substance of the public sector entity. There should be a kind of periodic matching of revenues and expenditures (“inter-period equity”). Each generation should pay for the resources that were consumed by it. Or in other words: Each generation should be able to hand over the assets received from former generations to the following one(s). At the same time, they should also not be asked to hand over more than that. In that sense also the current generation is protected and the objective of PSA in Hesse is in fact intergenerational equity. In Hesse, it is intended to use PSA as a steering tool to achieving the goal of sustainable public sector financial resources. To sum up, the Hessian model is supporting the idea of intergenerational justice. However, due to existing incentives, it is argued that there is a need to primarily prevent that the present generation is exploiting future generations. This happens if one generation is spending the existing financial resources of the entity or if it is perhaps even spending additional, future financial resources by getting into debt. According to the Hessian model, the objectives of accounting are different in the private and public sector: in the private sector it is the protection of creditors respectively the financial sustainability of the enterprise and in the public sector it is the protection of future generations respectively the financial sustainability of the public sector entity. But both objectives also have in common that they aim to reduce incentives for the spending of financial resources, to protect groups that have a stake in keeping financial resources within the entity, and to improve the long-term financial stability of the entities. Moxter states that in the public sector the temptations for accounting policy are quite obvious – especially due to the political dimension that is included there. Therefore, the Hessian model reveals that – even though the objectives are different from the private sector – the conceptual arrangement of the accounting system must be the same. As a consequence, the ComC reference model is seen as applicable and appropriate for serving public sector needs. To put it in a nutshell, both the ComC and its Hessian public sector adaptation are conservative accounting models.

In this context it is also important to explain that the Hessian concept implicitly distinguishes between stakeholders and users of accounting information. The stakeholders are the different generations of citizens. The accounting system is adjusted according to the interests of current and future generations so that intergenerational equity is achieved. However, the legislator (the Hessian parliament) in its role as representative of citizens is stated as the primary user of accounting information by Hessian law (para. 114 (1) LHO HE). The information is provided by the government so that the parliament may control and formally approve the activities of the Hessian government. In addition, it is the task of the Court of Auditors, assigned to it by law (e.g. in Hessen: para. 88 (1) LHO HE), to audit financial statements of the state governments. If information in the financial statements is not according to law (para. 90 LHO HE) the Court has to indicate that to the government (para. 96 LHO HE) and the parliament (para. 97 LHO HE). The Court of Auditors in Hesse fulfils this task based on its professional judgment and with judicial independence.

Also on the second conceptual level – the means by which the legislator would like to reach the objectives (the purposes) – the 1985 ComC and the Hessian model have things in common. Since both are conservative accounting models, the steering of flows of financial resources (hereinafter also described as “distributional effects”) is the preferred way and therefore the first purpose of accounting. It is indisputable that the steering of flows of financial resources in the public sector is carried out by ex ante budgeting and not by ex post accounting. Nevertheless, also from a public sector perspective, accounting may have distributional consequences including all kind of capital flows that are influenced by accounting or are based on it (either during the execution of the current budget or in the next round of budgetary negotiations). In PSA, such “distributional effects” may include e.g. the public claim for a provision of additional public services to present generations if the financial situation is
presented too positive or the building up of open or hidden reserves in order to protect future generations and the financial sustainability of the entity. Compared to an informational protection, it is a rather direct way of protection. Both, the preservation of capital (or in Hesse: the public sector assets) and the measurement of capital outflows (in Hesse: the “surplus” in the income statement, in comparison with the budget), should be analogously transferred to the public sector.\textsuperscript{cxxxiii} However, the Hessian model admits that there is an important difference between public and private sector entities: the first are seeking profits and distributing (parts of) the income, the latter is not. However, according to the Hessian concept, the public sector entities do maybe not strive for profit but have an interest to seek a balanced income statement. In the private sector, profits are defined as add-on on prices that are realisable on markets. The analogous definition in Hesse is that of an ex post “surplus” when using public sector budgets in an economic manner. The profit in the private sector can be distributed to the owners. The “surplus” in the public sector is distributed in another way: by using the financial resources for providing more or enhanced current consumption of public sector goods (to current generations). And by doing that, there is the possibility of the government to consider current generations’ interests.\textsuperscript{cxxxiv} The origins of financial sustainability in private and public sector might be different. For a business enterprise it is a matter of financial survival: a company is insolvent if it has no more financial resources available and is no longer considered as creditworthy. According to German law, a public sector entity cannot be insolvent. But financial sustainability in the public sector ensures that the entity is able to provide the public goods demanded by citizens, also in the long run. According to the Hessian concept, sustainability is interpreted as maintenance of the public sector assets. Profit is defined in a sector-similar way to the ComC. It is the amount of capital that can be pulled out of the institution/that can be distributed so that the institution is not in danger of being bankrupt (private sector) or in danger of being unable to deliver necessary public goods or services (public sector).\textsuperscript{cxxxv}

Compared with the measures of distributional protection, the informational protection plays a minor role in the Hessian model. However, there is the possibility of providing information in the additional parts of the financial report (such as the notes and management commentary) that are prepared without the bias caused by conservatism that is applied in the financial statements. This is the preferred way to close informational gaps.\textsuperscript{cxxxvi} As a consequence, the second purpose of Hessian financial reports is also stewardship, the provision of information to the pseudo-owner (the citizens) and their elected representatives.\textsuperscript{cxxxvii} The changes in the ComC that were caused by the BilMoG have been transferred also to the Hessian PSA model. This led to a slight increase in the meaning of stewardship. However, the traditional understanding of monetary protection is still prevailing, just like it is the case in the ComC (see section 3.3).

To conclude, in order to transfer the abstract objective intergenerational equity into definite accounting terms there is a need of a mandatory annual balance of the income statement.\textsuperscript{cxxxviii} This would be more efficient in terms of a protection of future generations than adopting debt brakes by law with the same intention. Except for the city state of Hamburg, the existing debt brakes in Germany are cash based. Even though being considered an innovator in German terms, Hesse is still on the way to complete its reforms on PSA. There are discussions to pass an act that will adapt the present Budgetary Code of the state of Hesse and implement an “accrual debt brake”, too.\textsuperscript{cxxxix}

3.5 The hierarchy of material principles

The Hessian model decided to follow the principled-based approach of the ComC. This means that the abstract conceptual basis is converted into accounting terms by a small number of principles that are mandatory to apply. This is to avoid an extensive set of very detailed rules. However, as stated in section 3.1 and claimed for in section 3.2, there are also rules in Hessen
that are consistently derived from the principles and which in that sense complete the accounting system. They are put together in the Hessian PSA handbook. In the LHO Hessen it was said that the Hessian accounting model should adhere to the accounting principles of the ComC. These principles contain qualitative characteristics as well as “material principles” (cf. section 2.4). Following the Hessian approach (that there should be only differences between public and private sector accounting if there are sector-specific characteristics), the ComC principles are reinterpreted from a public sector specific point of view.

Comparable with the private sector reference model, it is important to distinguish between financial statements and financial reports when talking about the set of principles applied in Hesse. Financial, historic information is subject to the financial statements. Moreover, non-financial, prospective, and explanatory information should be addressed in separate reporting elements (such as notes, management commentary, and segment reporting – cf. section 3.4). According to the ComC reference model, the set of principles that is applied to this additional reporting follows principles that are comparable to those applied according to IFRS or IPSAS. In these additional elements there are no restrictions according to conservatism, objectivity – and partly this is also the case for reliability. However, concerning the financial statements, the Hessian accounting model entirely follows the concept of conservatism (cf. section 3.3, point 5).

Moxter points on the importance of objectivity and conservatism for public sector financial statements. The colloquial understanding of being conservative means having traditional attitudes and being aware of values that were handed down. Being conservative from an accounting point of view is somehow connected to this understanding, because it used to be the traditional behavior of an honorable merchant not to overstate the own assets but to recognise and measure them with caution. That means that conservative preparers of financial statements should calculate the income so that the financial situation is not presented in a better way than it is realistic (and they pretend not being “richer” than they actually are). The application of objectivity – on the other side – prevents the preparer from presenting a situation in the financial statements that is too positive (“dressing” of the balance sheet). The need of professional judgment and the connected influence of subjectivity should be reduced to the maximum extent and options should be eliminated completely. Usually, especially on the asset side, both concepts – conservatism and objectivity – work smoothly in the same direction. However, Moxter also explained that in case that there is no satisfying application of the objectivity principle due to public sector specific situations, conservatism may need to override or simply replace objectivity in its function described above. For that reason it is also accepted that assets are rather under- than overstated and the contrary applies to liabilities – with the consequence that there might be hidden reserves also in the financial statements of public sector entities. Knowing that in fact there is no truly “true and fair view” in accounting and provided the alternatives of over- and understatement of the financial situation, the latter is seen as the necessary, the lesser evil. The Hessian model believes that the application of the conservatism concept (including the sub-principles: the “imparity-principle” and the “realisation-principle”) is the only way to reach the objective of intergenerational equity. In order to protect the interests of future generations and to maintain the long-term financial solvency of the public sector entity, it is seen as essential that the accountant tries to be as objective as possible.

Opponents of this conceptual alignment argue that not all the necessary information is given in such an accounting system. However, as stated before, the ComC reference and the derived Hessian model showed that additional information may be given in the attachments to the financial statements (the transfer of the “uncoupling proposition” to the public sector). The ComC based “holistic view” of financial accounting says that the necessary information has to
be given by the financial statements “as a whole”, not by the single elements separately. Therefore, in Hesse the elements of the financial reports are also seen as “informational unit”. However, it is the financial statements that have ex post distributional effects (in addition to the ex ante distributional effects of the budgetary planning). Therefore, in order to protect future generations and the financial sustainability of the entity, it is these financial statements that must be paid attention to concerning the financial consequences aspired. Also the Hessian model counters critics of information incompleteness by providing additional information provided in the notes to the financial statements or the management commentary.

The measurement of possible capital outflows in a way that balances stakeholder interests and that ensures the matching with the protection objective is the most relevant information that could be provided by financial statements. Therefore, the model indirectly accuses the opponents of conservatism (that is basically the proponents of the “true and fair view” concept) of not providing the relevant information themselves. By doing this, the criticism of an incomplete and false presentation of information is turned back.

To sum up, the set of mandatory GAAP described above makes the ComC a “compact” alternative to the extensive sets of standards that are developed by the IASB and the IPSASB. Therefore, it is clear that the German ComC is still based – regardless the BilMoG – on the concept of conservatism: “In particular the conservative principle, the realisation principle and the end-of-period principle keep their present significance.”

4. An analysis of the common items and differences of both conceptual approaches

In the following, the two accounting concepts that were described in chapters 2 and 3 will be compared with the aim to emphasise the common items and differences. The author is aware of the useful explanations of “Anglo-Saxon”-accounting being a myth by Alexander/Archer. However, they also stated that “[i]t is important not to underestimate the strength and importance of this shared history and parallel development. In terms of a general emphasis on the investor and the needs of capital markets, and an increasing emphasis on openness and transparency, the UK and the US show a long-standing and significant similarity.” By using the simplifying expression “Anglo-Saxon”, the author wants to point out exclusively this similarity of a (capital) market-information driven accounting tradition, in contrast to the one that is strongly financial-stability driven. The ComC and the ComC-based Hessian model belong to the second group of accounting systems. The author is aware that there is not a monolithic appearance of Anglo-Saxon accounting but accounting systems with Anglo-Saxon origin feature common characteristics which separates them from their continental European equivalents. There are common features of Anglo-Saxon concepts (such as the usefulness claim or the informational objective) that are to some extent described below.

First, there are some differences in the governance and authority of the two accounting concepts. The IPSAS-F was developed by the IPSASB, a private standard-setting body. One major role of the framework is to provide legitimacy to the IPSAS-standards and the standard-setting body itself. For that reason, a broad-based consultation process has been applied in order to develop it with a maximum support of different stakeholder groups. By developing and publishing a conceptual framework, the IPSASB follows an Anglo-Saxon tradition. Usually, these frameworks deal with the statement of objectives, the assumption of users, and the definition of qualitative characteristics (and the clarification of questions concerning elements and recognition as well as measurement and presentation matters). However, the conceptual basis is non-binding – neither for the standard-setting bodies, nor for the preparers of financial
statements. The IPSASB’s decision on the non-overriding status of the framework was criticised by many respondents to the framework consultation. For instance the Institute of Public Auditors in Germany (IDW) suggested that “[i]f an IPSAS currently in effect conflicts with the Conceptual Framework, the IPSASB should review that IPSAS and, applying the due process for standard setting, revise it.” The European Financial Reporting Advisory Group (EFRAG) and some national private sector standard-setting bodies (the French Autorité des Normes Comptables, ANC; the Accounting Standards Committee of Germany, ASCG; the Organismo Italiano di Contabilità, OIC; and the Financial Reporting Council of the United Kingdom, FRC) suggested in a common bulletin, commenting the IASB 2013 framework discussion paper, that “any new IFRS requirement and guidance developed by the IASB and the Interpretations Committee should be derived from the objectives and concepts of the Framework.” In addition, it was said: “Generally inconsistencies between the Framework and individual standards are undesirable. (…) Hence, departure from the Framework should be exceptional and requires strong justification.” These general suggestions are transferable to the public sector, especially since the IPSAS are based on IFRS. The Hessian model follows the legal approach of continental European accounting and therefore does not have an explicit conceptual framework. It is based on the private sector ComC. Therefore, it was developed by the German federal legislator and simply transferred to the public sector by the Hessian legislator (according to federal law). Consequently, legitimacy is given by law and there is no need for an explicit conceptual framework for that reason. The necessary public sector driven adaptations were developed by the Hessian Ministry of Finance in agreement with the Hessian Court or Auditors, as a result of an analogous application of the ComC. The implicit conceptual foundation of the ComC is binding for the preparers of financial statements and for the two institutions that have to agree on ComC-adaptations in Hesse when developing practical public sector specific accounting guidelines. These guidelines in the Hessian handbook strictly follow the conceptual ideas of the ComC. If there is any specific PSA problem, the solution is chosen that fits best to the conceptual basis of the ComC. Therefore, the underlying conceptual framework of the ComC has an overriding status within the Hessian concept.

Different stakeholders have different interests in the provision of information and financial resources. In a multiple-user setting (and that is what reality is) not all interests can be met at the same time and to the same extent. As a consequence, it is inevitable that there are distributional effects. Hence, when developing a conceptual framework, the first step is to make a decision on the hierarchy of existing interests. Provided this decision as starting point of establishing an accounting system, one could argue that the term “objective” is defined in accounting terms as the protection of interests. Even though the IPSASB also declares that intergenerational equity is an important objective, the accounting system outlined in the framework is not set precisely enough in a way to reach this objective. In the IPSAS context, the anticipated users are resource providers and service recipients – in other words: (almost) everybody. Both groups describe conglomerations of users with highly controversial interests. As a matter of fact, it seems impossible to balance all of those different interests. “[I]t remains questionable as to whether it is really possible to identify and respond to common needs in GPFRs.” The IPSASB simply ignores this fact and assumes that information could be provided that is useful for multiple users. One may agree with Jones/Pendlebury who drew the general conclusion on frameworks that they “have offered no way to reconcile any expected differences. In this sense, also the IPSAS-F lacks a clear decision which interests will have priority in case of a probable clash of interests. The reason is obvious and understandable from a private standard-setting body perspective: It is the intention of the IPSASB not to give any kind of hierarchy, so that the framework (and the standards) might be applied by entities with completely different multiple cultural as well as social environments and backgrounds.
However, this means that the content of the IPSAS-F also stay vague. According to the Hessian concept, a balance of interests of the current and future generations (of citizens) is right in the center of the accounting model. Objectives, hierarchy of interests (of implicit assumed users) and principles are given by the legislator. Interpretations are added by the courts of finance, scientists and prevailing commentaries. According to the Hessian concept, accounting also has a focus on distributional protection. In fact, by striving for a truly intergenerational equity, it is the “protection” of future generations (or even of the current generation in few years time) and the protection of financial sustainability of the public sector entity that has priority in Hesse. The stakeholder group of future generations is seen as endangered of being “robbed” by the present generation (of politicians) when deciding on further debts simply because the present generation might claim for an additional consumption of public services. In the end, the hierarchy of interests can only be given by the (national) legislators and the IPSAS-F is a kind of quarry that national legislator could make use of. However, if the latter decides on different hierarchies, the attempt of harmonising PSA stays on a shallow level. As a result, there would be no possibility to compare financial statements of Hesse, Navarra or Alabama, even if all of them had an IPSAS-compatible accounting system. In this sense, it is not easy to compare the IPSAS-F with the elaborated Hessian conceptual basis. Due to missing decisions in controversial conceptual issues the IPSAS-F needs further decisions for practical implementation or guidance. And in the end there is the need for a definite decision by the legislator: “certain reports may simply respond to the information needs of specific users or classes of users, rather than really common information needs applicable to all users”.

Next, there is also a different understanding of the dimensions that accounting should include. As a consequence of this, there are also differences in the objectives that both accounting systems want to reach: the provision of information for IPSAS versus intergenerational equity in the Hessian concept. On the one side, the IPSAS-F is solely focusing on information. According to the Anglo-Saxon belief, the provision of information is the only legitimate objective of accounting. However, it is possible to argue that this provision is not an objective for its own sake because there should be no circular argument. For instance, Moxter made clear that the provision of information is nothing unique of one particular accounting system but is common to all systems. Building up on his position, one might argue that defining the provision of information as objective is somehow meaningless. Also the IPSASB explained that “[f]inancial reporting is not an end in itself.” On the other side, the Hessian model considers the distributional effects that accounting automatically has or may have, in addition. From an Anglo-Saxon point of view, intergenerational equity should be regarded as a consequence of accounting but not as the starting point and facing distributional effects is considered a conflict to “neutrality” (a sub-principle of “faithful representation” in the IPSAS-F). In that context, it is interesting that the IPSASB noted in its framework that “to require information included in GPFRs to be neutral does not mean that it is not without purpose or that it will not influence behavior.”

Below the level of objectives is the level of purposes (the specification why and also how to reach the objectives). There are also differences in the understanding of the purposes of accounting. As mentioned before, the provision of information to external addressees is something that may be seen as connected with the “nature” of accounting. Accounting is the activity of editing the information provided by the bookkeeping system and presenting it to an addressee. So the accountability purpose is included in the definition of accounting. The private sector standard-setter IASB recently deleted the term “stewardship” in its framework and is now solely using the term “accountability” for describing such a purely informational purpose. This decision caused many controversial discussions and is still not supported by all European standard-setting bodies. The IASB justified this step with “difficulties translating the term
‘stewardship’ into other languages. However, the concept of stewardship has a very characteristic meaning: it is the mandatory provision of information to the owner of an entity (who provided the equity). In other words, the reporting entity owes the information to the capital providers. Information about stewardship is important for resource providers who have the ability to vote on, or otherwise influence, management’s actions. Contrary to that, accountability has a rather broad focus of a (partly voluntary) provision of information to several addressees. In addition, as the IASB states, accountability could be mistaken “to focus more on the needs of short-term (…) rather than on the needs of longer-term investors.” This means that accountability and stewardship do not have the same meaning. The primary purpose of PSA in democracies should be the provision of information to the pseudo-owner (the citizens) and their representatives. It is a matter of fact that the government or other reporting entity has to address the members of parliament or comparable elected institutions: “Most governments and other public sector entities operate within spending mandates and financial constraints established through the budgetary process. Monitoring implementation of the approved budget is the primary method by which the legislature exercises oversight, and citizens and their elected representatives hold the government’s management financially accountable.” As the IDW agrees on, the best term to describe this relation is “stewardship”: “The very word stewardship refers to the office, term or duties of a steward – one who is entrusted with the management of property, finances or other affairs not his or her own. By definition, stewards are accountable to owners, which means that they are liable to being called to account by those owners and are therefore responsible for an accounting to those owners. The provision of such an accounting goes beyond just the provision of information useful to users in relation to stewardship: it means that stewards must be in a position to support such information that they have provided to owners. This goes to the very heart of the meaning of accountability and accounting. Therefore, in a framework for PSA, it is necessary to focus primarily on stewardship (which does not exclude other parts of accountability in a second step). The reason for this is that democratic control over revenue (mainly taxation) and expenditure (for the provision of public services) of a public sector entity via PSA (and its auditing) is a basic element of parliamentary sovereignty. Therefore, also the Hessian concept is based on that elementary assumption and the roles and procedures given by law. Consequently, in Hesse one purpose of accounting is stewardship. By contrast, the IPSASB took over the controversial decision by the IASB. Therefore, the IPSAS-F does not mention the term stewardship at all but uses the more comprehensive term accountability instead, which is the logic consequence of the assumption of a multitude of users and possibilities of uses. The IPSASB declares: “The IPSASB is of the view that the legislature or similar governing body is a primary user of GPFRs in its capacity as a representative of service recipients and resource providers.” However, it does not agree that “the public, citizens or legislature should be identified as the primary or most important users of GPFRs of public sector entities, because it does not want to exclude any other user group. To conclude, the IPSAS-F simply presents precisely, in a comprehensive way all possibilities and extensively describes all kind of relations in PSA. As it was explained before, taking a decision on priorities of particular user groups would be incompatible with the multicultural/national nature of the IPSAS. In addition, following the multiple-purpose-and-user approach in the IPSAS-F is chosen not to restrict the more specific standards in any way. The IPSASB is aware of this target of possible critics: It “recognizes that it is unlikely that GPFRs will provide all the information that service recipients and resource providers need for accountability and decision-making purposes” and therefore “accepts that, in developing IPSASs and RPGs, it will need to consider and, in some cases, balance the needs of different groups of primary users.” As a consequence, the balance of interests in the standards and guidelines is decided on a case-by-case basis. This
definitely does not support the idea of an accounting system that is providing the degree of comparability, objectivity and coherence that is needed in a PSA system.

Apart from accountability, the IPSAS-F also defines another purpose for the provision of information, which is “decision making”. According to the Anglo-Saxon accounting tradition, decision-usefulness used to be the major qualitative criterion. As a consequence, there is also a special Anglo-Saxon interpretation of “decision-useful” information that is rather determined by the criterion of relevance instead of the criterion reliability. Following the needs of the capital markets, it is a kind of information that is rather prospective (and therefore necessarily subjective) than ex-post oriented (and more objective). However, there are also voices in the Anglo-Saxon world who “have argued the superiority of an accountability framework over a decision usefulness one in accounting” c.xvii. Generally speaking, decision-making is common to the activities of planning, steering and control that are the basic functions of accounting and therefore also common to all accounting systems. c.xviii In Hessian terms, the purpose of decision-making is specified by the steering of flows of financial resources. As a result, another difference in the two PSA concepts is the understanding and usage of the accounting dimensions. The steering of flows of financial resources in Hesse is contrary to the Anglo-America idea of “neutrality”, which is defined as “absence of bias”. c.xlix This neutrality-argument is quite catching in public discussions because “bias” is seen as something negative in itself. The IPSASB expresses that financial reporting should not been presented “with the intention of attaining a particular predetermined result” c.xcx. In contrast, according to the Hessian concept, it is seen as necessary to intentionally steer monetary flows in order to reach the protective objectives of PSA. Consequently, applying the principle of conservatism could be negatively understood as “bias” by the Anglo-Saxons. Contrary to that, from a traditional Continental European point of view, it is seen as something positive, even a strength of the own PSA concept, in order to reach financial stability and sustainability. c.xcii

The hierarchy of interests that was explained above has to be considered separately from the determination of anticipated users of accounting information. For understanding the differences between both PSA concepts, it is also important to understand that there might be a difference between the terms “user” and “stakeholder”. c.xciii On the one side, if accounting has a distributional impact on a person but this individual is not using the financial reports anyway, we are talking about a stakeholder, not a user. On the other side, a person could use financial reports without being (personally) influenced by them. This person is a user, not a stakeholder. Usually, there will be an overlap between the user and the stakeholder category. The IPSASB exclusively uses the user term. By contrast, the Hessian concept uses both terms by implicitly differentiating between stakeholders (current and future generations of citizens) and anticipated users. According to Hessian law, it is assumed that mainly the budgetary legislator in its role as representative of current and future citizens, and public sector auditors are using PSA information. This means that the Hessian accounting system is adapted to the stakeholder needs and their dominating interests, even though it is used by a different group of users. The primary user, the (budgetary) legislator, has to balance the interests of the generations. The primary stakeholders who are in fact protected by the PSA system in Hesse are the future generations of citizens. In addition, the conceptual difference in the terms used (stakeholder vs. user) is connected with an opposite understanding of the dimensions of accounting. If a standard-setter supports the idea that accounting has solely an informational dimension, then there should be no difference between “user” and “stakeholder”. However, if it is accepted that accounting also has the function to steer monetary streams, the two terms must deviate in their meaning.

There is also a clear difference concerning the classification of the accounting principles and the order of their application:
a) Even though both PSA concepts claim that they want to reach **objectivity** in financial reporting, there are differences in the definition of this principle. On the IPSAS side, there is no hierarchy and only “relative importance” is attached to all qualitative characteristics. Their value is considered case-by-case. It is mentioned in the IPSAS-F that professional judgement is needed for deciding on that “trade-off”: “[T]he extent to which the qualitative characteristics can be achieved may differ depending on the degree of uncertainty and subjective assessment or opinion involved in compiling the financial and non-financial information.” cxciii However, this means that there is no constant application of the characteristics and accounting problems are not solved based on objective assessments. Also Anglo-Saxon accounting strives after “objectivity” in the financial reports. However, it is seen as reachable only by subjective assessments there. To sum up, literally there is no “meta rule” but a dominant sense of subjectivity in the IPSAS-F. However, one has to take into consideration that also parts of the Anglo-Saxon accounting literature agree on the position that faithful representation and relevance are dominant characteristics, as the consultation on the IPSAS-F showed. cxciv On the Hessian side, the conservatism principle and reliability (via objectivity in the decision about recognition and measurement in financial statements) are the superior, “material” principles that strongly influence the entire Hessian accounting system. These “meta rules” convert the abstract objectives and purposes into real accounting practices. They are further elaborated by the principles of realisation and imparity. According to Moxter, there is a constant consideration of conservatism and objectivity. Most often, the results of their application has the same effect. However, in case of a conflict, the conservatism principle prevails. cxcv From an international point of view, Moxter/Engel-Ciric described that conservatism is on retreat. cxcvi During a discussion about the development of a draft EPSAS-F the author experienced himself that some proponents of the IPSAS-F argued that it contains all necessary principles and concepts. It was said that one should not introduce a new concept called “conservatism” in the discussion. The author cannot see that there is something new about the conservatism principle that cannot be found in well-known undergraduate Anglo-Saxon accounting text books. There is a longstanding conservative accounting tradition, theory and experience in continental European countries. The Hessian PSA concept, which is derived from the German ComC, is based on this tradition.

b) The other **“qualitative characteristics”** (understandability, timeliness, comparability, verifiability) are common to all kind of accounting systems. Thus, they are not unique for IPSAS and therefore do not play a significant role for the material orientation of the IPSAS-F. The qualitative characteristics that are classified as “non-material” can also be found in ComC-based accounting literature. cxcvii Furthermore, there are three considerations that both accounting concepts have in common. Both the Hessian conceptual as well as the IPSAS-F models are based on accrual accounting. In addition, both are aware of the **restriction in the kind of information** that ex post oriented accounting can provide. So there is a realistic assessment agreed by both concepts that the focus of financial statements has to be on historic accounting information. Non-financial and prospective information should be addressed in the attachments. Another common item is that – compared to e.g. US-GAAP – both IPSAS and the Hessian model is **principled based**. Due to the strong overriding function of the conservatism principle, the Hessian model has to be regarded as stronger principled based. The reason for this assessment is that within the IPSAS-F there are expressions such as “information should be as complete, neutral, and free from error as is possible” cxcviii or “best available information” cxcix. From a positive point of view, one could argue that these terms show that the IPSASB has a realistic perspective. However, from a negative point of view, expressions like these also show two weaknesses of the IPSAS-F: 1. its informational-oriented, qualitative characteristics are hard to prove or audit; 2. its subordinate
position. But a conceptual work should express definite, binding and ultimate positions. Therefore, one should not expect that the IPSAS-F will contribute to reliability and objectivity. If requirements are qualified and non-binding, it is the responsibility of the preparers to decide on the extent that they are willing to meet these requirements. Frameworks “are all statements of the policymakers about what financial statements ought to be. In contrast, the associated accounting standards are statements about what is, in the hope that the standards will be fully complied with in practice”cc. Consequently, it seems fair to say that the IPSAS-F is no exception from this rule.

Table 1 presents an overview of the conceptual differences found.

<table>
<thead>
<tr>
<th>Topics of difference</th>
<th>IPSAS-F</th>
<th>ComC-based Hessian conceptual model</th>
</tr>
</thead>
<tbody>
<tr>
<td>Governance</td>
<td>Set by private standard-setting body (legitimacy via application of a broad-based consultation process)</td>
<td>Set by ComC legislator; analogous application of the ComC; public sector driven adaptations by Hessian Ministry of Finance and Hessian Court of Auditors</td>
</tr>
<tr>
<td>Accounting tradition</td>
<td>Anglo-Saxon</td>
<td>Continental European</td>
</tr>
<tr>
<td>Significance of the conceptual basis</td>
<td>Non-binding – neither for standard-setting bodies nor for preparers</td>
<td>Binding for preparers – overriding of individual rules</td>
</tr>
<tr>
<td>Hierarchy of stakeholder interests</td>
<td>No hierarchy given</td>
<td>Priority of the interests of future generations (of citizens) in order to reach the objective</td>
</tr>
<tr>
<td>Objectives</td>
<td>Providing information that is useful for multiple users</td>
<td>Intergenerational equity (“protection” of future generations and ensuring financial sustainability and stability of the reporting entity)</td>
</tr>
<tr>
<td>Dimension of steering</td>
<td>Information</td>
<td>Information and distributional effects of financial resources</td>
</tr>
<tr>
<td>Kind of information</td>
<td>Priority: financial information; in addition: non-financial and prospective information</td>
<td>Financial information – purely ex-post oriented and objective; in attachments: additional non-financial and subjective information; (“uncoupling-proposition”)</td>
</tr>
<tr>
<td>Purposes</td>
<td>Decision making and accountability</td>
<td>Stewardship and steering of flows of financial resources</td>
</tr>
<tr>
<td>Anticipated users of accounting information</td>
<td>Resource providers and service recipients</td>
<td>By law, priority of the budgetary legislator (in its role as representative of citizens); not excluding other users, especially interested citizens</td>
</tr>
<tr>
<td>Principles-/rules based</td>
<td>Rather principles-based (but achievement depends on subjective assessment of preparers)</td>
<td>Strongly principles-based</td>
</tr>
<tr>
<td>“Material” principles (“meta rule”)</td>
<td>In letter: none (equal value of all characteristics); however, in fact: faithful representation and relevance</td>
<td>Conservatism principle / reliability</td>
</tr>
<tr>
<td>Additional/Sub-Principles</td>
<td>Qualitative characteristics (understandability, timeliness, comparability, verifiability)</td>
<td>Objectivity, realisation and imparity principle; in addition: qualitative characteristics</td>
</tr>
</tbody>
</table>

Table 1: Overview of the conceptual differences between the IPSAS-F and the Hessian conceptual model

Source: Own table.
The IPSAS-F provides an extended list of information that is assumed to be needed and therefore required by the stipulated users (such as information about non-financial sustainability, service delivery achievements, the meeting of operating objectives etc.). Information about financial position, financial performance, and cash flows mirror the three elements of financial statements. However, needs for explanatory, prospective and non-financial information cannot be satisfied by ex-post-oriented financial statements. Moreover, according to the characteristics of German accounting theory (see section 3.3), it is even impossible (the adjective that is traditionally used for striving for incompatible tasks in accounting is “unscientific”) to serve these three informational needs equally at the same time. One conceptual idea to solve these problems and that both analysed accounting concepts have in common is what is called the “uncoupling-proposition” in Germany (see section 3.3).

The IPSASB and the German legislator (in the position as ComC standard-setter) are both aware that the kind of information that could be provided by public sector financial statements is primarily retrospective/ex-post oriented. Therefore, both argue for reporting additional information in the notes or other instruments of reporting. For these additional elements of public sector reporting, the IPSASB is developing so called “Recommended Practice Guidelines (RPGs)” The IPSAS-F also applies as basis for the RPGs. The IDW suggested that “non-financial information (…) ought to be subject to separate reporting”, too. Moxter even argued for a second balance sheet containing elements, that would be considered as not “objective” and “reliable” (such as the reporting of self-generated intangible assets) in both the IPSAS and the ComC based Hessian State financial statements. The IPSASB admits that even then there might be information that is not provided in financial reports but needed by users and that these therefore have to be received “from other sources.”

In short, one might say that there is neither a hierarchy of interests nor a hierarchy of principles in the IPSAS-F. It “contain[s] contradictory objectives and qualitative characteristics as well as conflicting general concepts and principles.” From a positive point of view, this makes the framework a work that is open to be applied in different socio-economic-cultural environments. From a negative point of view, however, one might say that the concept lacks important determinations that would be needed when transferring the abstract concept into real accounting terms. Therefore, it is also not easy to criticise the IPSAS-F. If these important conceptual points are open to the decision of national preparers, we might end up with a situation where harmonisation is nothing else than hollow words. There is a high probability that the result of current efforts on harmonisation is a world where every public sector entity applies some kind of IPSAS but in fact national or regional differences make it impossible to easily understand, compare or consolidate the accounting data of different entities. If this is the case, one would have to raise the question of cost and benefit. Both international conceptual frameworks by IPSASB and IASB do not contain conservatism because from their point of view it is seen as something negative, something that leads to a misrepresentation in the reports. The opposite is the case for the Hessian concept. At the time when Hesse implemented accrual accounting, there was a need to answer basic accounting questions and therefore it was a matter of necessity also to make decisions on conceptual issues. One of these decisions was to agree on conservatism in PSA. In ComC-based PSA-systems, conservatism is regarded as something positive and even necessary to achieve the objectives of PSA. The bias that indisputably exists and that is always criticised by the Anglo-Saxons is explicitly intended because it opens the way to protect future generations and to maintain the financial stability/sustainability of the reporting entity.
5. Conclusion and suggestions

To sum up, the differences and discussions about conceptual issues in PSA follow the well-known paths that one might remember from harmonising private sector accounting in the EU in the 1980s and again from standardising the capital-market oriented parts of private sector accounting around the year 2000. However, there is one important difference compared with the situation in the past. When you have a look at the 1989 framework of the International Accounting Standards Committee (IASC), which is the previous version of the current IASB-F, the difference and development is obvious. The authors of this former framework laid stress to some extent on prudence and reliability. Moxter/Engel-Ciric assume “that at that time one could not agree on a less indefinite statement, because some persons involved were still part of an accounting world where ‘conservatism’ was regarded as self-evident”\textsuperscript{ccxvi}. The other controversies are partly the same as today, now we are discussing reforming PSA in the EU. In that sense it seems that history repeats. Since IPSAS are IFRS based and the Hessian model is based on the ComC, many arguments that were exchanged in that past discussion about the harmonisation and standardisation of private sector accounting via the accounting directives or the IAS-regulation are valid also today, in the discussion about EPSAS. However, this does not mean that the answers are necessarily the same, because the stakeholders involved and the interactions between them are different in the public sector.\textsuperscript{ccxvi} There is a good point in saying that some public sector entities, such as a federal state or a big city, are comparable to corporations in terms of the balance sheet total, the number of employees etc. However, there are also major differences that result from the necessity to fully align PSA to the needs of a public sector entity. In the public sector, there are different stakeholders and users of accounting and different processes of using accounting information. In addition, there are also small and medium public sector entities and due to good reasons there is still no mandatory, IFRS-based, harmonised private sector accounting for small and medium-sized entities in the EU. As a consequence, it is also necessary to consider what small and medium-sized entities in the public sector could accomplish, also avoiding the risk of overextending them.

Pallot stated concerning the theoretical framework for PSA: “Logically, it is possible to create as many different classifications for a universe of elements as there are criteria for distinguishing among their traits. The potential arbitrariness is constrained and guided by two factors: underlying world view or assumptions and the practical purpose to which the classification is to be put.”\textsuperscript{ccxvii} This means that there is also not only one possible solution to accounting problems. Depending on the traditions, assumptions and objectives/purposes strived for, accounting and its underlying conceptual model necessarily looks different. It is important to get into a thorough but open-minded, fair and unbiased discussion\textsuperscript{ccxviii} about conceptual considerations before a decision is made on the future direction of PSA in Europe. This also includes the integration of experiences made with the usefulness of the usefulness concept, the need of conservatism and reliability in PSA and the primary purpose of stewardship in the sense of “democratic control over the use of funds”\textsuperscript{ccxix} From a German perspective, it seems that the proponents of conservative accounting participate more actively in the discussion than they used to do in “the last round”.\textsuperscript{ccxxi} It would be a bad advice to speed up in standard-setting efforts, not having these essential conceptual discussions. The IPSAS-F is a good point to start these discussions from.\textsuperscript{ccxii} However, due to missing hierarchies, lacks of decisions and simply ignored or deleted concepts and approaches that are relevant especially to constituents with a continental European accounting background, it cannot be more than that. At the end of a reform that aims at harmonising PSA in Europe, there should be truly “complete, reliable and comparable”\textsuperscript{ccxiii} information – otherwise it would be wiser not to start at all.
A sound knowledge about conceptual issues is highly relevant in terms of understanding the background of the current discussion. Even though the idea of developing frameworks is traditionally connected with the Anglo-Saxon accounting tradition, it is possible to express the conceptual ideas of continental Europe also in such a document. For the current discussion it is therefore tempting to develop an alternative PSA framework expressing ideas such as stewardship, conservatism, reliability and objectivity in order to facilitate the necessary comparison with the IPSAS-F that was started in this paper. Jones/Pendlebury pointed to the fact that “[a]lthough their purpose was to provide a constitution for individual standards”, frameworks “were increasingly developed after a set of accounting standards”ccXXIV. Let us see if, provided that the European legislators agree to harmonise European PSA, EPSAS can do better?

References


Notes

* The author expresses his personal view in the paper. The comments of conference participants at the 15th Biennial CIGAR Conference at the University of Malta in 2015 are gratefully acknowledged.


ii The federal state of Hesse is located in the center of Germany. Major cities are Wiesbaden [capital], Frankfurt (Main), Kassel and Darmstadt. According to the Hessian statistical office, the state has a size of about 21.115 km² and 6.1 million inhabitants (cf. www.statistik-hessen.de/themenauswahl/bevoelkerung-gebiet/landesdaten/bevoelkerung-allgemein/laeche-bevoelkerung-und-bevoelkerungsdichte/index.html). The Hessian GDP is 250.494 million Euro (as of 2014, according to the European System of National and Regional Accounts 2010; cf. http://www.vgrdl.de/VGRdL/tbls/tab.asp?rev=RV2014&tbl=tab01&lang=de-DE). According to the German Federal Ministry of Finance, Hesse is one of currently four federal states that are contributors in the federal financial equalisation system. This system is redistributing financial resources with the aim to provide all German “Länder” with an appropriate level of funding (about 1.755 million € in 2014 by Hesse; cf. http://www.bundesfinanzministerium.de/Content/DE/Standardartikel/Themen/Oeffentliche_Finanzen/Feodrliche_Finanzbeziehungen/Laenderfinanzausgleich/Vorlaufige-Abrechnung-Laenderfinanzausgleich-2014.pdf?__blob=publicationFile&v=1).

iii Cf. Lüder (2013b), p. 240; for the term “in-depth-studies” see p. 296. The paper was also translated in English and presented at the 14th CIGAR Conference 2013 in Birmingham, cf. Lüder (2013a).


v Cf. IASB (2013).


viii The IPSASB pronounced in its 2014 handbook that “the IASB’s Conceptual Framework for Financial Reporting is a relevant reference for users of IPSASs” (IFAC-IPSASB (2014a), p. 21, Preface, para. 14, s. 1).

IPSAS-F, chapter 2, para. 2.29, s. 2. Also see IPSAS-F, BC2.18, s. 1.

IPSAS-F, chapter 2, para. 2.30, s. 1 and IPSAS-F, BC2.25, s. 2.

IPSAS-F, BC2.25, s. 2.

IPSAS-F, chapter 2, para. 2.29, s. 3. Also see IPSAS-F, BC2.22, s. 2.

Cf. IPSAS-F, BC2.17, s. 2.

IPSAS-F, BC2.22, s. 3. The IPSASB confirms that there were concerns during the IPSAS-F ED consultation process saying that its focus might be too broad. Cf. IPSAS-F, BC2.25, s. 1.

Cf. IPSAS-F, Preface, para. 1.

IPSAS-F, chapter 1, BC1.1, s. 1.

Cf. IPSAS-F, chapter 1, para. 1.2, s. 1.

IPSAS-F, chapter 1, para. 1.2, s. 1.

Cf. IPSAS-F, chapter 1, BC1.1, s. 1.

IPSAS-F, chapter 1, para. 1.3, s. 1.

Cf. IPSAS-F, chapter 2, para. 2.1.

IPSAS-F, chapter 2, para. 2.2, s. 3.

Cf. IPSAS-F, chapter 2, para. 2.3, s. 2, para. 2.8, s. 1. Also see ibid., BC2.4, s. 3, point 1 (for accountability) and chapter 2, para. 2.9, s. 1 (for decision-making). The “service recipients” are further described as “those that depend on them to use those resources to deliver necessary services” (ibid., chapter 2, para. 2.3, s. 2). IPSAS-F, BC2.9, s. 2 et seq. gives examples of both groups: citizens = service recipients; donors, lenders = resource providers.

Cf. IPSAS-F, BC2.9, s. 2 et seq.

Kübler expressed it in a similar way. He says that there is a difference in the understanding of what creditors are able to do: According to the ComC there is the assumption that creditors need paternalistic protection by the state. However, the Anglo-American idea is that creditors are able to make rational decisions in order to protect themselves if they are enabled via the provision of precise information. Cf. Kübler (1995), p. 365.

IPSAS-F, chapter 1, para. 1.4, s. 2. Cf. also IPSAS-F, chapter 2, para. 2.4, s. 1.

IPSAS-F, chapter 2, para. 2.4, s. 2 (also literal quotation). There, also an example of a common representative for both groups is given: “[t]he legislature (or similar body) and members of parliament (or a similar representative body)” (ibid.).

IPSAS-F, chapter 2, para. 2.4, s. 3. Cf. also IPSAS-F, BC2.9, s. 1.

Cf. IPSAS-F, chapter 2, para. 2.2, s. 2.

Cf. IPSAS-F, chapter 2, para. 2.1. Cf. also IPSAS-F, preface, para. 2, s. 3 and IPSAS-F, BC2.14, s. 3 (for the statement of purposes without the connection to usefulness).

IPSAS-F, chapter 2, para. 2.10, s. 1.

IPSAS-F, BC2.16, s. 2.


IPSAS-F, chapter 3, para. 3.1, s. 2 (also literal quotation).

IPSAS-F, chapter 3, para. 3.2.

IPSAS-F, BC3.28, s.3, point 2, s. 3 (also literal quotation).

IPSAS-F, BC3.28, s.3, point 2, s. 3 (also literal quotation).

IPSAS-F, chapter 3, para. 3.4, s. 2 (both quotations above).

IPSAS-F, chapter 3, para. 3.42, s. 2 (also both quotations above). Also see IPSAS-F, BC3.28, s.3, point 2, s. 2.

IPSAS-F, BC3.28, s.3, point 2, s. 3.

IPSAS-F, chapter 3, para. 3.42, s. 3 (also literal quotation).

IPSAS-F, chapter 3, para. 3.4, s. 1 and IPSAS-F, BC3.28, s.3, point 2, s. 1.

IPSAS-F, chapter 3, para. 3.5, s. 1.

IPSAS-F, BC3.27, s. 1 (both quotations).

IPSAS-F, BC3.27, s. 2.

IPSAS-F, chapter 3, para. 3.6, s. 1 or IPSAS-F, BC3.7, s. 1.

IPSAS-F, chapter 3, para. 3.6, s. 2.

IPSAS-F, chapter 3, para. 3.7, s. 1.

IPSAS-F, chapter 3, para. 3.8, s. 1 and s. 3 in combination with IPSAS-F, BC3.7, s. 1

IPSAS-F, chapter 3, para. 3.12, s. 1.

IPSAS-F, chapter 3, para. 3.13 (both quotations). In addition, it is said in ibid., para. 3.14, s. 1: “Neutral information faithfully represents the economic and other phenomena that it purports to represent.”

IPSAS-F, chapter 3, para. 3.16, s. 2.

IPSAS-F, chapter 3, para. 3.10, s. 2.

IPSAS-F, chapter 3, para. 3.10, s. 3.

IPSAS-F, BC3.9 (literal quotations in s. 2).
lvii  Cf. IPSAS-F, BC3.6; both literal quotations above in s. 2.
lxi  Cf. para. 71a, s. 1 LHO HE.
lxii  Cf. para. 71a, s. 2 LHO HE. As a consequence, the role of the Court of Auditors of Hesse was to contribute its knowledge by remarks and requests for change so that by the end of the development the legal requirements were fulfilled.
lxv  At 14 July 1998 the decision of the Hessian government to introduce accrual accounting was made; at 2 June 1999 then came the decision for a whole-of-government implementation by the year 2008.
lxvi  At 20 November 2009 the consolidated opening balance sheet of the state of Hessen was presented, based on the data from 1 January 2009. Then, at 2 November 2010 the first consolidated financial statements as at 31 December 2009 were published.
lxvii  Cf. para. 7a (1), s. 1 HGrG.
lxviii  Cf. para. 7a (2), HGrG. Also see Eibelshäuser/Rüdinger (2011), pp. 35-43, mn. 25-42.
lxx  Cf. Breidert (2013), p. 80. On ibid., pp. 78-79 there are more details about the work of the SSD committee.
lxxii  Cf. para. 49b HGrG. Also see Nowak/Ranscht-Ostwald/Schmitz (2012), p. 22, mn. 79.
lxxiii  Cf. para 7a (1), s. 1 HGrG. Also see Breidert (2013), p. 77.
lxxvi  Cf. para. 7a (2), HGrG. Also see Eibelshäuser/Rüdinger (2011), pp. 35-43, mn. 25-42.
lxxix  Cf. Breidert (2013), p. 80. On ibid., pp. 78-79 there are more details about the work of the SSD committee.
lxxxiii  Cf. e.g. Moxter (1995a) or Hüther (2014), p. 6. Hüther states that long-term orientation and stability are characteristic attributes for the German economic culture. According to his opinion, conservatism in accounting (he mentions the lower-of-cost-or-market-price principle which is a sub-principle of conservatism) is an element of this culture.
lxxxv  Wüstemann/Wüstemann (2010), p. 16.
lxxxix  Moxter describes the development of ComC, especially focusing on those accounting theories that had the status of paradigms, in Moxter (1993), pp. 64-79.
xc  Cf. Moxter (2003), pp. 219-336 and Ballwieser (2009), pp. 20-22, mn. 73-83. E.g. there is the user-orientation and decision-usefulness-approach (mn. 73), the principle of neutrality and the explicit insignificance of conservatism for the reason of a provision of additional information (mn. 75), but also – just like in the set of measurement-income GAAP – the reliability principle (mn. 81).


cx Cf. Ballwieser (2009), pp. 9-13, mn. 30-42. Also see Moxter (2003), pp. 41-54.


international accounting standards.

cxiv In Deutscher Bundestag (2008), p. 34, 3. a) it is mentioned that the BilMoG is the reaction of informational requirements by
capital markets.

cxv Federal Ministry of Justice (2008) (both literal quotations above). In Deutscher Bundestag (2008), p. 34, 3. a) it is explained
as „raising of the level of information“.

cxvi Deutscher Bundestag (2008), p. 34, 3. a).


and for a more detailed analysis of the effects that the BilMoG had on public sector accrual accounting see Glöckner (2009),
pp. 10 et seq.


cxxiv Eibelshäuser (2006), p. 618 (translation from German). Remark: in that context, public administration is to be
understood as public sector.

cxxv This is also the argument why the IPSASB is still running the convergence-programme with the IASB.

cxxvi For more detailed information about the Hessian concept cf. the description of the section about the “Frankfurt school of


cxxxx Wüstemann/Wüstemann refer to it as the steering of the economy and the fiscal policy and state that there is a tight


mn. 96.


cxxxxx Cf. Moxter (2013), p. 308. See also Nowak/Ranscht-Ostwald/Schmitz (2012), pp. 27-28, mn. 95 and mn. 97. For the

cxxxxxi Cf. Glöckner (2014), pp. 331-337. An explanation of the difference between the term “True and Fair View” (used in
the United Kingdom) and “Fair Presentation” (used in the United States) is given in Alexander/Archer (2000), pp. 545-549.

21.


For the ANC it is the only (primary) objective and the ASCG/the OIC support the decisions made by IASB (cf. EFRAG, ANC, ASCG, OIC, and FRC (2013a), p. 10, para. 31).

This does not exclude the possibility of a provision of information also to other users.

This was – as explained before – the reasoning for the BilMoG in 2009. And in IPSAS-F, BC2.19, s. 1 it is said: “Consequently, the performance of public sector entities in achieving their financial and service delivery objectives can be only partially evaluated by examination of their financial position at the reporting date, and financial performance and cash flows during the reporting period.”

In IPSAS-F, BC2.19, s. 3 the IPSASB suggests "separate reports" and in ibid, s. 4 it is said that “[i]n some cases” additional information could also be provided in the notes.

The definition of RPGs given in the IPSAS-F is as follows: “RPGs are pronouncements that provide guidance on good practice in preparing general purpose financial reports (GPFRs) that are not financial statements. Unlike IPSAS, RPGs do not establish requirements.” (IPSAS-F, p. 2). The motivation of developing RPGs and an analysis of the RPGs 1 and 2 as well as RPG 3 (ED 54) is analysed by Blab/Haller (2014), pp. 1251-1260.

The definition of RPGs given in the IPSAS-F is as follows: “RPGs are pronouncements that provide guidance on good practice in preparing general purpose financial reports (GPFRs) that are not financial statements. Unlike IPSAS, RPGs do not establish requirements.” (IPSAS-F, p. 2). The motivation of developing RPGs and an analysis of the RPGs 1 and 2 as well as RPG 3 (ED 54) is analysed by Blab/Haller (2014), pp. 1251-1260.

According to Kübler, the traditional ComC see the creditors as potential “victims” who have to be protected by the state, whereas the Anglo-American understanding is that creditors are rational acting market participants. He concludes that both pictures are not realistic. Cf. Kübler (1995), p. 371. However, in PSA it might be a different situation: Future generations (of citizens) cannot act on their own or use (PSA) information to protect themselves, they depend on the voluntary protection by others or that others are forced (e.g. by binding accounting regulations that have distributional effects) to protect them. Cf. also Glückner (2014), p. 491.

There is a brilliant example of such a discussion: EFRAG and some national standard-setter that were discussing the role of prudence and could not agree on a common position, however they were unanimously of the opinion that prudence cannot simply be ignored: "In this Bulletin, we have described that prudence, although widely accepted as a concept, continues to give rise to diverse views, since not everyone today exercises the degree of “caution” in the same way. This variety of views plays a role in the decisions to be made, in the context of the revisions of the Conceptual Framework, about recognition, measurement, presentation and disclosures. Therefore, it is in our view useful that, in making these decisions, the role of prudence is explicitly considered.” (EFRAG, ANC, ASCG, OIC, and FRC (2013b), p. 12, para. 38). Also see EFRAG (2014), p. 2.

E.g. it is the decision on stewardship, reliability and prudence that EFRAG did not agree on in its comment letter in response to IASB (2013). Cf. EFRAG (2014), p. 1. Nevertheless, exactly these controversial decisions from IASB where simply taken over by the IPSASB when developing the IPSAS-F.

The German Federal Audit Office also asks the federal government to “participate actively in the EPSAS-process already at an early stage” (Bundesrechnungshof (2014), p. 14, Nr. 5, s. 1).


Jones/Pendlebury (2010), p. 125 (both quotations above).
Technical Challenges Facing the Implementation of Performance Budgeting and Accrual Budgeting

Prof. Dr. Hassan A. G. Ouda,
German University in Cairo (GUC)
E-mail: hassan.ouda@guc.edu.eg

Abstract

A great part of the Organization for Economic Co-operation and Development (OECD) countries has made fundamental changes in public financial management (e.g. reforming public sector accounting and budgeting). These changes are characterized under the rubric of implementing accrual accounting, performance budgeting and accrual budgeting. This paper has attempted to explore a number of the technical challenges that can face the implementation of performance budgeting and accrual budgeting in the public sector. In order for governments to successfully implement both performance and accrual budgeting, these technical challenges must be identified and tackled before any attempt to implement both of them in the public sector. In addition, it has been made clear that the implementation of performance budgeting face a specific technical challenges that are different from the specific technical challenges that face the implementation of accrual budgeting. In the first place, the paper concludes that the implementation of performance budgeting will face the following technical challenges: specifying the outcomes; specifying the output; and linking outcomes to outputs. In the second place, the paper concludes that the implementation of accrual budgeting will encounter the following technical challenges: Appropriations for non-cash items; treatment of capital charging in the budget; and cash Management systems. It is concluded that there are two models that can be used to tackle the technical issue of appropriation of non-cash items, these are cash-in-hand-model and no-cash-in-hand model. Moreover, the paper has tackled in detail the following challenges that are related to capital charge: How can government determine the capital charge rate? How to compute a net asset base on which to apply the rate? How can the capital charge be treated in the budget? Finally, the paper concludes that the nature of the appropriations is intrinsically linked to the cash management system that the government uses, and therefore, the interface between cash management and appropriations differs depending on the extent of decentralization of the appropriation system.

Key Words: Accrual Accounting, Performance Budgeting, Accrual Budgeting and Technical challenges.

1- Introduction

A great part of the Organization for Economic Co-operation and Development (OECD) countries has made fundamental changes in public financial management (e.g. reforming public sector accounting and budgeting). These changes are characterized under the rubric of implementing accrual accounting, performance budgeting and accrual budgeting. Performance-based budgeting aims to improve the efficiency and effectiveness of public expenditure by linking the funding of public sector organizations to results they deliver, making systematic use of performance information (Robinson, 2009b). In comparison to traditional line item budgeting that stresses inputs rather than outputs and controls only the inputs and inhibits the ability of the managers to manage resources flexibly to achieve program objectives, the performance budgeting allows for more flexible use of fiscal resources and transforms focus from inputs to results, as it focuses on the results to be achieved. Accrual budgeting means that spending ministries are given budgets which are
defined in terms of accrual concepts—and, in particular, that the budget sets quantitative limits on the expenses which they incur rather than the cash payments they make (Robinson, 2009a). In other words, accrual budgeting is defined as the specification of budgetary expenditure authorizations and revenue estimates in terms of accrual accounting measures—that is, measures which are specific to the accrual system of accounting (Robinson, 2009a). This in turn means that the appropriations have to be allocated in the budget including both cash and non-cash items.

While accrual budgeting is not considered as a prerequisite to the implementation of performance budgeting, notwithstanding, accrual budgeting can assist in the implementation of performance budgeting because it provides measures of costs of services/output in budgetary documentation (Marti, 2010). It underpins the allocation of costs to outputs and outcomes. In fact, the pioneer countries such as New Zealand, UK and Australia have adopted both performance budgeting and accrual budgeting as result of adoption of accrual accounting in their public sectors. An earlier paper (Ouda, 2010) has suggested a framework for implementation of the performance budgeting. The suggested framework has identified the following components that can facilitate the implementation of performance budgeting:

- Shifting from public administration/bureaucratic system to performance management (managing-for-results). Government cannot budget for results unless it manages for results;
- Introducing and using of performance information into budget process will facilitate the implementation of performance budgeting;
- Changing the budgeting format and structure towards a more performance-oriented approach;
- Shifting to a multi-year budget framework (a Medium-term expenditure framework);
- Shifting from Bottom-up budgeting approach to Top-down budgeting approach;
- Modernizing the governmental accounting system (shifting to accrual accounting system); and
- Developing an appropriate performance measurement system.

However, the practical experiences of the OECD countries have proved that while the aforementioned suggested framework can facilitate the implementation of performance budgeting, the technical challenges and problems that are encountered when implementing the performance and accrual budgeting can preclude that implementation. Therefore, the potential technical challenges must be identified and tackled before any attempt to implement performance and accrual budgeting in the public sector. This in turn can assist in reducing the implementation risks and avoiding the implementation failure. In fact, the identification of the technical challenges gives a clear and comprehensive picture about both volumes of work and financial means required to successfully managing the implementation of performance and accrual budgeting. Furthermore, the well-identified and articulated technical challenges will profoundly affect the nature and speed of the implementation process. Therefore, exploring and tackling the technical challenges can be considered as a complement to the earlier suggested framework (Ouda, 2010), as both can create appropriate conditions for successful implementation of performance and accrual budgeting and putting them into practice.

Accordingly, this paper aims at exploring the technical challenges that can be encountered when implementing performance and accrual budgeting in the public sector. In fact, while both developed and developing countries are incrementally moving towards performance and accrual budgeting, for most countries the implementation of both performance and accrual budgeting is in its early stages of development. Consequently, exploring the technical
challenges and problems can assist in successful transition to both accrual and performance budgeting. So this paper raises the following questions:

1- Are performance budgeting technical challenges really different from the technical challenges of accrual budgeting? If so
2- What are the technical challenges that are encountered when implementing the performance budgeting?
3- What are the technical challenges that are encountered when implementing the accrual budgeting?

2- Performance Budgeting and Its Technical Challenges

2.1 Introduction

The OECD (2002) has defined performance budgeting as budgeting that links the funds allocated to measurable results. Shah and Shen (2007) have defined the performance budgeting as a system of budgeting that presents the purpose and objectives for which funds are required, costs of programs and associated activities proposed for achieving those objectives, and outputs to be produced or services to be rendered under each program. Performance-based budgeting aims to improve the efficiency and effectiveness of public expenditure by linking the funding of public sector organizations to results they deliver, making systematic use of performance information (Robinson, 2009). In comparison to traditional line item budgeting, performance budgeting allows for more flexible use of fiscal resources and transforms focus from inputs to results, as it focuses on the results to be achieved.

Consequently, the performance budgeting has shifted the focus from input-focused budgeting to output- and outcome-focused budgeting. In other words, it has shifted the focus from how much resources, staff, facilities, etc. are made available for a programme or ministry to what products and services (outputs) can be delivered by these resources and what is the impact that these products and services will have on the community (outcomes). In order the performance budgeting to work efficiently and effectively, some of the OECD countries (e.g., Australia) have developed the outcomes and outputs framework which can assist in determining and linking the outcomes to outputs (Australian Government, 2000). This framework works as follows:

- the Government specifies, via outcome statements, the outcomes it is seeking to achieve in given areas;
- these outcomes are specified in terms of the impact government is aiming to have on some aspect of society, e.g., defence and education;
- Parliament appropriates funds, on a full accrual basis, to allow the government to achieve these outcomes through administered items and departmental outputs;
- items such as grants, transfers and benefit payments are administered on the government's behalf by agencies, with a view to maximising their contribution to the specified outcomes;
- agencies specify the nature and full accrual price of their outputs and manage them to maximise their contribution to the achievement of the Government's desired outcomes;
- performance indicators are developed to allow for scrutiny of effectiveness (i.e. the impact of the outputs and administered terms on outcomes) and efficiency (especially in terms of the application of administered items and the price, quality and quantity of outputs); and
- agencies discuss in their annual reports their performance against their performance indicators.
The outcomes and outputs framework is essentially designed to assist in implementation of the performance budgeting. In fact, the outcomes and outputs form the basis of the budgetary framework and documentation. Outcome statements determine the purpose of appropriations in the Budget Bills, and these outcomes have to be translated into outputs that should be produced and delivered to the community to achieve the targeted outcomes.

Accordingly, the new performance budgeting structure, for example, in the Netherlands and Australia is designed to give answer to the following questions:

1- what does government want to achieve?
2- what actions is government going to undertake to achieve it?
3- what may those actions cost?

This new budgeting structure has entailed that there should be a new structure for the financial reporting that should give answer to the following questions:

1- did government reach its goals as set in the budget?
2- has government done what it was going to do?
3- did the cost of actions remain within the limits previously set in the budget?

So in addition to the earlier suggested framework for implementation of the performance budgeting (Ouda, 2010), the successful implementation of performance budgeting in the public sector will encounter some technical challenges which need to be overcome before implementing the performance budgeting. Based on the experience of OECD countries (e.g.,
New Zealand, Australia, UK, etc.), the potential technical challenges can be identified as follows:

- **Specifying the outcomes**
- **Specifying the output**
- **Linking outcomes to outputs.**

### 2.2 Performance Budgeting Technical Challenges

#### 2.2.1 Specifying the outcomes

Outcomes are the consequences for the public resulting from the outputs and activities of government. Australian Government (2000) defined the outcomes as the impact sought or expected by government in a given policy arena. It also added that the focus is on change and consequences: what effect can government have on the community, economy and/or national interest. In other words, the outcomes are the results, consequences or impacts of Government actions. In addition, the outcome statements must articulate Government objectives, describe the purposes of appropriated funds and serve three main purposes within the financial framework (Australian government, 2009):

- To explain the purposes for which annual appropriations are approved by the Parliament for use by agencies/governmental entities;
- To provide a basis for budgeting and reporting against the use of appropriated funds; and
- To measure and assess agency and program non-financial performance in contributing to Government policy objectives.

Basically, the outcome statements must describe the broad goals of government and its entities. All ministries and governmental entities within the general government sector must have at least one Outcome Statement. The output of these ministries and governmental entities must contribute – directly or indirectly – to the realization of a specific outcome. However, the determination of the outcome is not an easy task, as the outcomes have to be determined at the level of government as a whole and hence at the level of each ministry and governmental entity. In addition, there should be consistency among those outcomes at the aforementioned levels. This is due to the fact that the outcome statements also perform a specific legal function by articulating the purposes of appropriated funds. Consequently, there are some technical challenges with respect to: How to determine/specify the outcomes? How can the government measure the achievement of outcomes? Who will be held accountable for achieving outcomes? How can the government translate these outcomes to appropriate outputs? How can the government define and achieve outcomes that are cross-ministry in nature?

#### Determining the outcomes

The outcome statements should reflect the strategic priorities of the country. This means that the government must specify its broad strategic priorities for the upcoming budget; its fiscal intentions (e.g., for the next three years); and its long-term fiscal policy objectives (e.g., for the next ten years). However the question is: who is or should be responsible for determining/defining outcomes and identifying indicators? Is it the president of country, the parliament, the cabinet collectively, the minister responsible for program, the program’s executive or manager, career government officials; or should outcomes be defined jointly by several of these parties? (Kristensen et al, 2002). In fact, several parties should participate in determining the intended outcomes. For example, the government can specify the outcome
statements through consulting with Parliament, all ministries and governmental entities and
surveying the public to know what their needs are for the upcoming years. An outcome
should not be so general as to lack meaning; nor should it be so specific and operational as to
fail to articulate the actual impact desired by Government (Australian Government, 2000).
has determined the factors that should be taken into account when determining an appropriate
outcome level as follows:

- The degree and nature of the Government’s policy interest in the area, particularly as
  expressed by the portfolio minister(s).
- The breadth of the agency’s policy responsibilities (e.g., the Department of the Treasury is
  likely to have broader outcome statements than the Australian Broadcasting Authority).
- Whether the agency is making use of intermediate outcome statements to provide a
  managerial and information link to a higher, over-arching outcome.

**Example: Outcome Statement Reflecting Government Policy Interests**

*An efficient and equitable labour market that links people to jobs and promotes the transition
  from welfare to work*

Department of Employment, Workplace Relations & Small Business, Outcome One, 2000-2001

**Examples: Outcome Statements Reflecting Breadth of Responsibilities**

*Well-functioning markets*

Department of the Treasury, Outcome Three, 2000-01

*An accessible, diverse and responsible broadcasting industry*

Australian Broadcasting Authority, 2000-01

**Source:** The Outcomes & outputs framework guidance Document, November 2000.

In addition, an outcome statement should exactly be specified and focused. This in turn leads
to identifying the intended results of the ministries and governmental entities and specifying
the activities that should be undertaken by the ministries and governmental entities in order
to contribute to the achievement of the intended results. Furthermore, the outcome statement
should be written precisely to ensure that the underlying purpose is clear and should not
include multiple purposes nor use technical and difficult language (Australian Government,
2009).

- **Measuring the achievement of outcomes**

Having determined the outcomes, the next step is to determine the performance indicators
that help in assessing the degree of achievement of those outcomes. Also outcome statements
should be formulated in a form that facilitates their measurement. As one of the more
difficult aspects of specifying outcomes is ensuring that they are amendable to measurement,
particularly in terms of the effectiveness of the relevant administered items and/or
governmental entities outputs in contributing to the outcome (Australian Government, 2000).
The Australian experience shows that the performance indicators specified by agencies fall
into two categories: indicators for effectiveness and indicators for efficiency. Effectiveness
indicators should be designed to identify as clearly as possible the causal relationship
between the outcome and the outputs and administered items in place to achieve it.
Efficiency indicators provide information on the productivity of a given output in terms of
combined and independent effects of its quality, quantity and price (Kristensen, et al, 2002).
The following is an example of an outcome statement and effectiveness indicators in Australian government:

**Example: Outcome Statement & Effectiveness Indicators**

* A stronger, sustainable and internationally competitive Australian industry, comprising manufacturing, resources and service sectors

* **Department of Industry, Science & Resources** Outcome One for 2000-01

The Department's five effectiveness indicators for achievement of this outcome (as specified in its Portfolio Budget Statement for 2000-2001) include:

- **Production**: Changes in Australia's per capita gross domestic product relative to its major international trading partners and trading competitors, at purchasing power parities;
- **Exports**: Trend in exports from the manufacturing, resources and services sectors; and
- **Productivity**: Trends in labour productivity and multi-factor productivity in the manufacturing, resources and service sectors.

**Source:** The Outcomes & outputs framework guidance Document, November 2000.

In addition, the Canadian experience shows that in the fall, Department Performance Reports are tabled in Parliament along with the president of the Treasury Board’s annual overview of government performance. In these reports, departments and agencies chart progress made towards achievement of their Key Results Commitments (outcomes). The performance reports describe to what extent the intended outcomes and outputs of a department and an agency have been achieved, the resources used, and how departmental activities contributed to the department’s strategic direction and to government-wide commitments (Kristensen, et al, 2002).

- **Accountability for achieving outcomes**

In fact, there is no consensus among countries about who is accountable for achieving the outcomes, as this depends on how the budget and accounting documents are being structured whether around the outcomes or the outputs. For instance, in Australia and the Netherlands, the main budget and accounting documents are now restructured around the outcomes. This restructuring is accompanied by plans to change the focus of budget negotiations. In New Zealand, the budget is structured around the outputs. Agencies in Australia are directly responsible and accountable for the delivery of outcomes identified in the appropriation bills and receive appropriations based on their outcomes (OECD, 2002). There should be relationship between the ministry outcomes and the outcomes of each agency related to that ministry. This means that the agencies develop an outcome statement in conjunction with the portfolio minister. Based on these outcomes, the appropriations can be allocated. The outcome statement then requires the endorsement of the Minister of Finance.

So the accountability for achieving the outcomes is strongly related to the specific government structure of each country and the structure of the budgeting and accounting systems and documents.

Finally, government has to ensure that the outcome statement is specified enough to form a valid appropriation, however, it should not be so abstract as to be without meaning.

**2.2.2 Specifying the outputs**
Outputs are the goods or services which government entities provide for citizens, business and/or other government entities/agencies. The Outcomes & outputs framework guidance Document (Australian Government, 2000) defined the outputs as they are “engine room” of the outcomes and outputs framework. They are actual deliverables - goods and services – governmental entities produce to generate the desired outcomes specified by government. These outputs (goods and services) can be used by different users such as members of parliament, general public, industries, sectors, ministries and other governmental entities. In addition, an output-focus to management and budgeting typically describes public functions in terms of goods or services and calculates how many services are being delivered, or products produced (Kristensen, Groszyk and Bühler, 2002)

In order for governmental entities to be able to carefully specify its outputs, they should consult with major stakeholders, such as client groups, related governmental entities/agencies and the relevant legislation committee within the parliament. Moreover, these outputs must be approved by the relevant minister. In fact, the Outcomes & outputs framework guidance Document (Australian Government, 2000) has determined the requirements for output specification. As it requires that the outputs should:

- describe a good or service provided to individuals or organizations external to the governmental entity/agency;
- be effective in terms of their contribution to the specific outcome;
- be expressed in terms of what it is (nouns or noun phrases) rather than how it is performed (verbs);
- be within the control of the agency, whether through direct delivery or contractual arrangements with third parties;
- identify what government is paying for, including being measurable in terms of price, quantity and quality;
- be amendable to comparison between actual or potential suppliers (especially through price analysis);
- collectively cover all of the agency’s activities, including overheads or shared resources allocated across outputs or output groups; and
- specified so that the agency’s organizational structure and management systems can be mapped to its outputs.

Basically, there must be a strong relationship between the outputs and outcomes, as the outcomes cannot be achieved without producing the related outputs. Accordingly, there is a causal-relationship between an outcome and output(s). The governmental entities are required to maximize the contribution of their outputs to the specified outcome. However, the governmental entities will encounter the problem of:

*How can they report the outputs in the budget?*

*How can they measure the impact of an output on both outcomes?*

In other words, shall the governmental entities report at the output level or output groups’ level. In fact, the experience of the Australia has indicated that while the governmental entities are still required to report at the output level, grouping outputs can allow aggregated reporting at a business or program level (Australian government, 2000). Output groups tend to reflect the more business-specific aspects of a governmental entity’s operations, while
outputs within output groups tend to be more generic in nature. The following is an example business-specific output groups and generic outputs:

<table>
<thead>
<tr>
<th>Business-Specific Output Groups &amp; Generic Outputs</th>
</tr>
</thead>
<tbody>
<tr>
<td>In 2000-01 the Department of Education, Training &amp; Youth Affairs (DETYA) had three outcomes. The first of these was 'School systems provide their students with high quality foundation skills and learning outcomes'. Under that outcome there are three output groups—1.1 Infrastructure funding for the schools system 1.2 Assistance for school students with special needs and 1.3 Enhance the quality of teaching and learning—Under each of these output groups there are four generic outputs:</td>
</tr>
<tr>
<td>1. Administration;</td>
</tr>
<tr>
<td>2. Policy Advising;</td>
</tr>
<tr>
<td>3. Ministerial &amp; Parliamentary Services; and</td>
</tr>
<tr>
<td>In addition, output group 1.2 includes a fifth generic output, Service delivery.</td>
</tr>
<tr>
<td>By defining generic outputs under specific output groups, DETYA is more likely to be able to manage across outputs in a consistent manner. It also enhances the scope for benchmarking and price comparisons within the Department and with benchmarking partners.</td>
</tr>
</tbody>
</table>


Furthermore, the governmental entities will face a significant issue which is, in case that an output contributes to more than one outcome: How can they measure the impact of an output on both outcomes? Basically, the outputs should be specified so that they contribute to an outcome; however, there are some circumstances where an output may influence a second outcome as well. A governmental entity focused on environmental policy may, for example, have an outcome aimed at enhancing community knowledge and understanding matters affecting environment, and another aimed at supporting green environment. While the environment-oriented output(s) will contribute considerably to the knowledge and understanding outcome, it could also have impact on the supporting green environment. Accordingly, there should be relevant performance information that enables the governmental entities to measure the impact of an output on more than one outcome.

Finally, the governmental entities should carefully specify the outputs and overcome the related problems in order to facilitate the link between appropriated funds and outputs in the performance budgeting.

2.2.3 The link between outcomes and outputs

As aforementioned, the outcomes are the impact sought or expected by government in a given policy arena. In other words, the outcomes are the results, consequences or impacts of Government actions on the community. Outputs refer to products and services provided with government appropriation funding, and outcomes are the impacts of those outputs. Accordingly, the link between outcomes and outputs ensures that governmental entity activities fit with the Government's policy agenda. Under this framework Ministers must articulate policy agenda in terms of the outcomes they wish their agencies to achieve (Australian government, 2000). The relevant governmental entities then can set about producing outputs required to achieve the specified outcomes. The main aim of linking outcomes and outputs is to allow Parliamentarians and the public to see the real cost of providing government services. The real cost includes indirect costs such as corporate overheads, depreciation and maintenance, and the opportunity cost of capital. The purpose of linking outcomes with the full costs of outputs demonstrates a clear and accountable
contribution to policy formation and service delivery on behalf of the government (Australian government, 2000).

The following figure illustrates the links between outcomes and governmental entity/agency outputs and administered items.

![Diagram of outcomes and outputs framework](source: Department of Finance and Administration (Australian Government))

Accordingly, the ministries/departments and governmental entities objectives flow from the Outcomes and Outputs Framework, through which resources are applied for the purposes for which Parliament approves appropriations. The ministries/departments and governmental entities measure their performance in terms of effectiveness in contributing to and achieving the specified outcomes and efficiency in delivering outputs in terms of quality, quantity and price.
The Australian government has given a good example on how government can make link between the outcomes and outputs as follows:

**Outcomes and Outputs Framework 2006-07**

**Outcome 1: SCHOOL EDUCATION**

**Individuals achieve high quality foundation skills and learning outcomes from schools and other providers**

Administered by: Schools Group, Indigenous and Transitions Group

<table>
<thead>
<tr>
<th>Output 1.1</th>
<th>Output 1.2</th>
<th>Output 1.3</th>
<th>Output 1.4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Funding for schools</td>
<td>Assistance for individuals, including those with special needs</td>
<td>Assistance for quality teaching and learning</td>
<td>Assistance for transition through and from school</td>
</tr>
</tbody>
</table>

**Outcome 2**

**Individuals achieve relevant skills and learning outcomes from post-school education and training**

Administered by: Higher Education Group, Indigenous and Transitions Group, Industry Skills Development Group, National Training Directions Group, Strategic Analysis and Evaluation Group

<table>
<thead>
<tr>
<th>Output 2.1</th>
<th>Output 2.2</th>
<th>Output 2.3</th>
<th>Output 2.4</th>
<th>Output 2.5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Funding for vocational education and training</td>
<td>Australian Apprenticeships</td>
<td>Assistance for skills and career development</td>
<td>Funding for higher education</td>
<td>Assistance for post-school students, including those with special needs</td>
</tr>
</tbody>
</table>

**Outcome 3**

**Australia has a strong science, research and innovation capacity and is engaged internationally on science, education and training to advance our social development and economic growth**

Administered by: International Education Group, Higher Education Group, Innovation and Research Systems Group, Science Group, Questacon

<table>
<thead>
<tr>
<th>Output 3.1</th>
<th>Output 3.2</th>
<th>Output 3.3</th>
<th>Output 3.4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Research infrastructure</td>
<td>Assistance for science collaboration and innovation</td>
<td>Support for the Australian education and training export industry and international relationships</td>
<td>National leadership in engaging people in science and technology</td>
</tr>
</tbody>
</table>

**Departmental Outputs**

The following enabling areas provide support to all of DEST:

Audit and Investigations Branch, Finance, Property and Planning Group, Information Services Group, People, Communications and Network Group, Procurement, Assurance and Legal Group, Strategic Analysis and Evaluation Group

*Source: Department of Finance and Administration (Australian Government)*
3- Accrual Budgeting Technical Challenges

The experiences of pioneer OECD countries such as the New Zealand, UK and Australia have proved that the implementation of performance budgeting should be accompanied by implementation of accrual budgeting. The main aim of performance budgeting is to link the resources (inputs) to the results (outputs). In that case, it is necessary to know the actual costs of output that include both cash and non-cash items. In fact, the use of cash basis would result in allocation of only those costs that involved a cash outflow during the period. In addition, cash disbursements do not reflect what the governmental entities costs to run during the year, because these disbursements may also include cash outflows resulting from, for example, the acquisition of assets or the repayments of debt related to the previous years. This means that the cash-based accounting system makes no difference between expenditures and disbursements, and generally no distinction between current and capital expenditure. Capital purchases are treated in the same manner as personnel expenses with no recognition that they are productive for years.

Accordingly, under the cash basis of accounting, it is difficult to know how much resources have been consumed in carrying out the operations during the accounting period (operating costs) (Ouda, 2006). Also as a result of not capitalization of the fixed assets and not recognizing of the long-term debts, the depreciation and interest costs are not accounted for. And this, in turn, results in that the costs of producing the services in the governmental entities, and the total cost of the programs and activities, which take place in a given period, are also not known. Consequently, it is difficult to get the right information about the total cost of services and goods produced during the year. Therefore, the adoption of accrual budgeting is essential for allocating the appropriation including both cash and non-cash items in order to know the total actual cost of the outputs.

In fact, the use of accrual budgeting enables the government to report on the true cost of its programs and activities. Moreover, under accrual-based accounting, it is known how much resources have been consumed in carrying out the operations during the accounting period (operating costs). Then the total cost of the services produced by the government entities and the total cost of government programs and activities, and the matching of those costs with the output can only be provided by the accrual-based accounting system (Ouda, 2003). Accordingly, accrual budgeting can provide better information concerning the total resources consumed in the provision of the output (goods and services) and better reflect the cost of capital, thus encouraging better assets management. This means that the accrual budgeting is a useful tool to encourage more efficient and effective use of resource management by providing better analytical base and incentives for assessing performance and managing costs. In addition, the experiences of pioneer countries have proved that accrual-based cost information contributes to improved resource allocation and program management decisions.

For example, New Zealand officials argued that the cost information provided by accrual-based budgeting has led to efficiencies and better resources allocation decisions. New Zealand attributed the cost information provided by accrual-based budgeting as helping them identify where and how to cut spending to put the country on a more sound fiscal footing in the early 1990s. Several of the countries have attributed specific improvements on the departmental level to accrual budgeting. For example, under accrual accounting, the cost of a loan includes the subsidy cost—the cost of lending below market rates and provisions for bad debt. When New Zealand recently made student loans interest free, the cost of the subsidy was taken into consideration during the policy debate. The United Kingdom also reported the more complete information on student loans directly affects lending decisions at the Department of Education and Employment (Carlin, 2003).
In addition, other countries such as the Netherlands perceived that accrual budgeting can facilitate comparisons between the public sector and private sector. For example, the OECD reported in 2005 that both agencies and core ministries in the Netherlands were content with the results from accrual budgeting at the agencies. Agencies, which now receive a budget for the full cost of their activities, like the flexibilities under accrual budgeting, while core ministries value the output and price information they receive from the agencies. The ministries also reported that agencies’ use of accrual budgeting enables them to consider the performance of the agencies relative to alternatives (i.e., decentralization to subnational government or contracting out). At the same time, the availability of the alternatives enabled ministries to put more pressure on agencies to improve cost efficiency and to reduce prices (Schick, 2007).

Moreover, accrual budgeting helped policymakers recognize the full cost of certain programs at an earlier point and make decisions that limited future cash requirements. For example, as reported in 2000, both New Zealand and Iceland credited accrual budgeting with highlighting the longer-term budgetary consequences associated with public sector employee pension programs. In Iceland, accrual budgeting showed the consequences of wage negotiations on future public sector employee pension outlays. The full costs of these agreements were not fully realized by the public until the adoption of accrual budgeting. Similarly, New Zealand officials decided to discontinue the defined benefit public employee pension program after pension liabilities were recognized on the balance sheet and the expense incurred was included in the budget.

Also United Kingdom officials argued that accrual budgeting helped highlight the full cost of pension liabilities and forced the debate on pension reform to happen sooner. Furthermore, accrual budgeting has also changed the information available for insurance programs, veterans benefits, and environmental liabilities. For example, Canadian officials attributed accrual information with leading to recent changes in veterans benefits. The use of accrual accounting requires Veterans Affairs Canada to record the full cost of veteran benefits in the year they are earned rather than paid. Therefore when considering changes to veteran’s benefits, Veterans Affairs Canada considered the effect of future cash flows in discounted terms. Consequently, the implementation of accrual budgeting can lead to efficient and effective use of public resources and provide better information with respect to the full cost of services provided by governmental entities. However, the implementation of accrual budgeting will create new technical challenges and problems that did not exist when allocating the appropriations using the cash basis. In order to assure the successful implementation of accrual budgeting, these technical challenges must be identified and tackled before starting the implementation process. The potential technical challenges can be identified as follows:

- Appropriations for non-cash items;
- Treatment of capital charging in the budget; and
- Cash Management systems.

These challenges will be tackled in details in the following section.
3.1 Appropriations for non-cash items

Unlike cash basis of budgeting, accrual basis of budgeting recognizes expenses when they are incurred rather than when cash is paid or received. This also means that several accrual expenditures are non-cash in nature. These comprise depreciation, post-employment benefits (pension, health care), interest payable on government debt, employee leave entitlements (annual leave, long-service leave), revaluations of assets (downwards) and liabilities (upwards), and payables and year end (Blondal, 2005). There is one aspect of accrual appropriations which is of special note: appropriating cash for non-cash items.

The question is: how such non-cash items should be treated under an accrual appropriations framework?

In fact, the experiences of the pioneer OECD countries have led to development of the following two approaches:

1- **Cash-in-hand model**: Cash is appropriated for the full accrual amounts, comprising non-cash items such as depreciation. According to this model, the governmental entity would receive cash for both the cash required during the year and for the non-cash items such as depreciation, interest payable on government debt, etc. This means that the cash appropriations would reflect the total operating costs of the governmental entities (Blondal, 2005). The advantage of using the cash-in-hand model is that it has led to major changes in management of the government. Before using this model the main focus was on the immediate cash requirement, but now the full costs of government become the main focus of the operating budget. This in turn requires from the governments to develop ways of how effectively manage the cash appropriated for non-cash items such as depreciation. In fact, the governmental entities can use the accumulated depreciation for funding the replacement of capital assets.

However, the lack of transparency regarding the appropriation and use of these funds can lead to criticism that the provision of cash in excess of immediate needs provides a pool of funds which can be used for other purposes. So if the governmental entity is given cash to fund depreciation expense, there is a risk that the money may be used for other purposes than replacing the capital assets. For example, a standing committee of the Australian Senate has expressed concern that accrual-based appropriations have led to a loss of transparency in the management and use of funds appropriated for accrual expenses (Parliament of Australia, 2007b). As part of Operation Sunlight, the new government is considering options for resolving these challenges. Accordingly, the implementation of accrual budgeting requires from the governments to set clear criteria for the use of cash appropriations for non-cash items, for instance, the use of accumulated depreciation to replace capital assets and not for other purposes. In addition, when the governmental entities switch to accrual budgeting will face another problem which is that no appropriations were given for accumulated depreciation on the day of the switch to accruals, meaning that governmental entities would almost always need to have a separate appropriation to replace assets, this problem should also be tackled before switching to accrual budgeting, i.e. to fund the accumulated depreciation at the time of switching to accrual budgeting (at the first year of switching) and after that it can only fund the annual depreciation.

2- **No-cash-in-hand model**: Cash is appropriated for only the cash component of full accrual amounts. This in turn means that non-cash items – such as depreciation- would not receive a cash appropriation. These items would be recognized in the budget as approved by the
parliament (Blondal, 2005), which means that the budget would include both the full accrual costs and the cash required.

“The financial statements of the governmental entities would report the total accrual amount as revenue on their operating statement – in the same manner that all expenses are treated on an accruals basis. The difference between the cash requirement and the total full cost appropriations would be treated as accounts receivable in the balance sheet. This would give formal recognition to these non-cash items” (Blondal, 2005).

The main advantage of the no-cash-in-hand model is that it is achieving the benefits of accrual budgeting without making big changes of current cash-based appropriation arrangements. While the appropriation will continue to be on cash basis, the total amount recorded in the budget would also include the non-cash items (Blondal, 2005). This model can to a great extent overcome the aforementioned problems of the cash-in-hand model as it can avoid the risk of using the cash received for other purposes and enhance the parliament’s control over capital acquisition. In addition, it will avoid the financial problem that can take place as a result of funding the accumulated at the first year of switching to accrual budgeting.

However, the disadvantage of this model is that it will not lead to culture change with respect to the management of money received for non-cash items, as the old cash-based appropriation system will continue. In addition, it will open the door for the governmental entities to manipulate the accounts receivables recorded in their balance sheets.

3.2 Treatment of capital charging in the budget

- **Rationale**

  The capital charging is designed to capture the financing cost associated with government assets (Ball, 2002). In fact, Capital charge is a cost levied on the government’s investment in each governmental entity. It reflects the opportunity cost of governmental capital investment. Namely, it reflects the cost to the government of investing in a governmental entity versus other use of that money. Similar to the private sector, governments do pay interest on borrowed funds. While the borrowing costs are significant costs to the government as a whole, they may not obvious to an individual governmental entity and may have no impact upon the governmental entity financial statements (Ball, 2002). This is due to the fact that governmental borrowing is usually undertaken by a central borrowing agency and then allocated to governmental entities at no cost. This prevents governmental entities from seeing the true cost of their financing and also makes it less likely that they will be motivated to better manage the public assets.

  Accordingly, the introduction of capital charging aims to identify explicitly the full costs of services and to provide a way for capital to be efficiently allocated and used, and hence making the governmental entities to be aware of their actual financing cost. In fact, the capital charging is introduced in New Zealand and other pioneer countries alongside accrual output based budgeting. In addition, there are important incentives behind the introduction of capital charging in the public sector, as it has positive impact on decision-making in the following areas: (OECD, 2002)

  1- Assets management decisions: Capital charging can result in more efficient asset management for following reasons: a- the full cost of holding assets is highlighted; b- complete information on assets held is available; and c- governmental entities can reduce the capital charge through more efficient asset management (e.g. by disposing of surplus assets).
2- Output production decisions: By the introduction of capital charging, the governmental entities will be able to see the full cost of producing their goods and services. This can in return facilitate make or buy decisions and encourage resource switching. This will lead to reduced assets holdings and therefore a reduced charge.

3- Capital investment decisions: In fact, a government entity should be able to generate more value from its net assets than the capital charge it is required to pay to the government. The presence of a capital charge can assist in choosing the appropriate discount rates and investment selection techniques.

4- Output purchase decisions: By the introduction of capital charge, governments will be able to make better cost comparison between private and public sector providers, or between alternative public sector providers. In addition, some governmental entities provide goods and services to the private sector. In the absence of a capital charge, such goods and services is being subsidized by the taxpayers.

In addition to the rationale behind the capital charge, the following challenges are important for its application:

- How can government determine the rate?
- How to compute a net asset base on which to apply the rate?
- How can the capital charge be treated in the budget?

These challenges will be tackled as follows:

- **How can government determine the capital charge rate?**
  The governmental entities receive the appropriations from the treasury at no cost (free of charge). This makes the governmental entities not to be aware of the actual cost of their financing and also makes it less likely that they will be motivated to better manage the public assets. The main objective of the capital charge is not making revenues but making the governmental entities to be aware of their financial costs and hence be motivated to manage their assets efficiently. In other words, the motivation for capital charging has been to persuade the managers to get rid of unnecessary assets. The capital charge is levied on the governmental entity which neither pays interest nor provides a return on owners’ capital. Accordingly, the capital charge should be designed to be substitute for interest and a return on capital (OECD, 2002). In other words, it should reflect the cost to the government of investing in a governmental entity versus other uses of that money. Ball (2002) argues that the capital charge should, as a minimum, cover the government’s cost of borrowing. Similar to private sector, governments face risk when conducting their activities. The capital charge should comprise a risk premium in addition to the borrowing cost. In order to determine the appropriate risk premium, we can use Capital Asset Pricing Model (CAPM) or Arbitrage Pricing Theory (APT). Bear in mind that CAPM and APT are used to calculate the cost of capital from equity sources and not from debt sources. As it is aforementioned, the capital charging rate should include both interest and return on capital. The rate will vary depending upon the way in which it is calculated and the countries in which it is operating, but usually be in the region of 5-15% (Ball, 2002). In private sector, the cost of capital is composed of the weighted average of two components: 1- the cost of capital from equity sources and 2- debt sources, adjusted for tax effects as follows:
\[ K = Ke(1 - L) + kd(1 - T)L \]  
(1)

Where \( ke \) is the cost of equity, \( kd \) the cost of debt, \( T \) the statutory tax rate, and \( L \) the financial leverage. In the private sector, the cost of equity is equal to the expected dividend yield and the expected percentage increase in stock price; whereas, the cost of debt is represented by the after-tax interest rate to the firm. Each factor – equity and debt- is weighted by the proportion they contribute to the capital of the firm, and thus, the weights \((1-L)\) and \(L\).

However, the governmental entities do not pay corporate tax. Therefore, the cost of capital must be adjusted to be valid for the government application. The absence of a tax on governmental entities means that the cost of debt is not net of a tax deduction. In addition, the cost of equity must be adjusted to reflect the absence of corporate taxes. So the following equation represents these tax adjustments for governmental entities: (Lally and Smith, 1997)

\[ Kg = \left[ \frac{ke}{(1-t)} \right] (1-L) + kd(L) \]  
(2)

Where \( kg \) is the cost of capital to the government; \( ke \) is the cost of equity, \( t \) represents the effective rate of corporate taxation; \( kd \) is the cost of debt without a tax effect, and \( L \) represents leverage.

In addition, Hartman (1990) states that as government activities displace private investment the marginal pre-tax rate of return on private investment should be used as a discount rate. New Zealand experience has also proved that the effective pre-tax rate is used to adjust the cost of equity and to maintain competitive neutrality between the government and tax-paying, private sector entities. Lally and Smith (1997) argue that without the use of a pre-tax cost of capital, government organizations have unfair advantage in pricing their outputs, and competing with private sector businesses.

Moreover, a capital charge may be expressed in either real (excluding inflation) or nominal (including inflation) terms. The cost of capital should be expressed in real terms rather than nominal terms, therefore, the cost of capital should be adjusted by subtracting the projected rate of inflation in the consumer price index for the coming year \(i\) as follows:

\[ Kg = \left[ \frac{ke}{(1-t)} \right] (1-L) + kd(L) - I \]  
(3)

In order to calculate the cost of equity \((ke)\), the Capital Asset Price Model (CAPM) is used. Herein, three separate parameters must be estimated: (1) \(R_f\), the risk free rate of interest; (2) \(R_m - R_f\), the market risk premium, and \(B\), the beta of equity, which measures the risk of a particular private sector firm’s equity. These three parameters are used in the equation 4 to determine the cost of equity \((ke)\):

\[ Ke = R_f + (R_m-R_f) B \]  
(4)

Accordingly, the equations (3) and (4) can be used to calculate the capital charge rate. Bear in mind that when a capital charge is first introduced within a jurisdiction, a lack of requisite information or skills may mean that a uniform charge is applied to all governmental entities (Ball, 2002). Over time, the governmental entities which consider that a uniform rate is too high may be able to obtain information regarding the cost of capital for comparable private sector activities and present a case for a lower rate. Similarly, the Ministry of Finance might make a case for a higher rate if the investment risk warrants it (OECD, 2002).
• How to compute a net asset base on which to apply the rate?
A capital charge usually consists of a rate levied on an asset base. The asset base upon which the charge is levied could be: (OECD, 2002)
• Total assets;
• Fixed assets;
• Total assets less current liabilities; or
• Total assets less all liabilities.
As a result of using the cash basis in the governmental accounting system of most governments, there is no information available on government assets and the value of those assets. It is necessary before a capital charge can be introduced to have complete information on assets held and the value of those assets. As a pre-requisite to the introduction of accrual accounting and the application of capital charge, the United Kingdom government has compiled two registers: in November 1997 a National Assets Register was published, giving, for the first time, details of what was owned by the central government. Also in the course of year 1998-1999 a Departmental Assets Register was published which gave full information on the departmental assets. The information, which is provided by the two registers, enables the politicians and departmental management to make more informed decisions and to improve the management of these assets (Likierman, 1998). The effective management of such assets requires sufficient records to identify the existence of assets and the costs of holding and operating these assets. The question here is, on what basis should assets be valued or revalued?
In fact, the historical cost accounting convention has traditionally been used as basis for preparing accounts because of its underlying simplicity and certainty, derived from original bookkeeping records. But in a period where the prices rise, the historical cost accounting suffers from a number of drawbacks. Aiken (1982) argues that it is widely accepted that in a period of inflation, historical cost accounts conceal the true position of a business because they:
- overstate profits by charging against revenues an inadequate measure of the true cost of assets sold or used up;
- understate capital employed, by stating assets at historical rather than current costs;
- overstate return on capital employed, by compounding the distortion of the last two cases; and
- distort the information on which decisions are made about the allocations of resources, pricing policy, cost control, distributions and gearing.
Also, the fall in the value of money during a period of inflation has serious implications for accounting. Unless the effects of these implications are taken into consideration, the reported data will be based upon monetary units with different purchasing powers, depending on the value of money at the date of each relevant transaction.(United Nations, 1984). As a consequence of the drawbacks of the historical cost, the New Zealand and United Kingdom (as pioneer countries in public sector accounting and budgeting reform) have preferred to use some form of current cost (i.e., inflation-adjusted) accounting for the public assets. In National Health Service of UK, the Depreciated Replacement Cost (DRC) has been used as basis for valuing the fixed assets. Whereas the consolidated financial statements of the New Zealand government reported that land and buildings are recorded at Net realizable Value.
(NRV), military equipment is recorded at Depreciated Replacement Cost (DRC), and plant and equipment is recorded at its historical cost (New Zealand, 1993). The experience of the New Zealand and the UK appears to favor a market-based perspective to capital maintenance. While the New Zealand’s Crown recognizes NRV where it is most significant, i.e., with buildings and land, the Tertiary Capital Charge Feasibility Study Task Force (Task Force, 1993) recommends the higher of NRV or the Optimized Depreciated Replacement Cost (ODRC) for valuation of fixed assets as surrogates for market value. Also the UK public sector, including the National Health Service, adopts the Depreciated Replacement Cost (DRC). So the governments can use one or mix of the aforementioned valuation methods. However, it is important that initial valuations are established in a manner which enables them to be accepted by all governmental entities. It is also necessary to consider the impact of future revaluations as a capital charge may prove a disincentive to revalue assets, where revaluations are accepted accounting practices (Ball, 2002).

- **How can the capital charge be treated in the budget?**

There was a fear from governmental entities side that the introduction of capital charging can result in budget deficit. In fact, the experience of New Zealand, UK and Australia has proved that the impact of the implementation of capital charging on governmental entities has been budget neutral. As the governmental entities were compensated for the charge; their appropriations were increased by an amount equal to the charge.

From the experience of New Zealand, UK and Australia, we can see that there are two models can be used for funding the capital charging as follows:

1- **Full Reimbursement Capital Charging Model:**

The three pioneer countries (New Zealand, UK and Australia) have adopted the accrual output based budgeting model. Under accrual output based budgeting model, cash and non-cash items are funded in each governmental entity’s annual appropriations. Thus the increase in expense (as a result of including the capital charging) has been exactly matched, for each governmental entity, by an increase in appropriations. This model is generally referred to as a full reimbursement capital charging model (each governmental entity is given additional funds exactly equal to the capital charge) (Heald and Scott, 1996, Heald and Dowdall, 1999 and Carlin, 2003).

However, the adoption of full reimbursement model without to have an efficient public management system, will not achieve the target benefits from its application. If a governmental entity’s appropriations were increased by an amount equal to the capital charge without comparing its output cost with other competitive entities, it will not be motivated to use the available resources efficiently. In fact, deriving maximum benefit from the capital charging requires a prior redesign of the management process. For example, the public sector reform has resulted in that the New Zealand ministers 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. The ownership interest is concerned with how effectively resources are being maintained and used. This requires the same types of financial reporting, as are generally accepted practices in the private sector (Ball 94). This includes distinguishing of capital and current expenditure, notion of capital maintenance, and hence, the use of accrual accounting, without accrual accounting there is no reliable basis for measurement.
As “purchaser” of services from the departments, the government is looking for quality of goods and services at the best competitive price. Herein, the purchaser wants to know the full cost of services which are delivered by the departments. The capital charging is considered as an important cost item of the goods and services provided by each department. In addition, the cost of these goods and services is compared with private sector. Accordingly, the implementation of the capital charging in the government should be done with a framework that makes the governmental entities to use their resources efficiently.

2- Weighted Capitation Model:

Under this model, the governmental entities are compensated for the capital charge they incur on the basis of certain socio-economic characteristics of the population base they serve (Heald and Dawdall, 1999). This in turn means that a governmental entity might be compensated for anywhere between 0% and 100% of the capital charges it incurred. A governmental entity (e.g., School) which served a privileged socio-economic demographic might, for example, be compensated on the lower end of that range, while a school which served an underprivileged demographic would be compensated at the upper end of the possible range (Carlin and Guthrie, 2001).

In such model, capital charging becomes as much a tool for economic redistribution as for improved internal governmental entity management (Carlin and Guthrie, 2001).

The international experience prefers to use the weighted capitation model. For example, the UK started with the application of the full reimbursement model and overtime changed to weighted capitation model. So when capital charges were first introduced in the UK National Health Services, they were neutral, in the sense that each purchaser received an additional allocation equal to the actual charges incurred by the provider and passed it on to the latter. Over time, they were gradually made to bite more, as the allocation became more dependent on weighted capitation and less on the characteristics of individual providers, bringing more pressure to bear on high-cost providers. Consequently, it might be right in the beginning to use the full reimbursement model but overtime, the capital charge must be bite through the movement to application of weighted capitation model.

3-3 Cash Management systems

In order a government to be able to budgeting and forecasting the cash required for appropriations in right way, management cash systems at the whole-of-government level need to consolidate a range of information relating to taxation receipts, asset sales, loan repayment schedules, transfer payments and individuals government entity/agency operating flows and capital requirements. In addition, the cash management systems need to be linked with debt management systems to ensure current interest and principal obligations can be met (Ball, 2002). Thus, the main aim of cash management is to ensure that the government is able to fund its expenditures on timely basis and to meet its obligations when fall due. Even though the cash management is a very important dimension for effective management for budgeting appropriations, it is not very well covered in the public financial management literature. The well covering cash management should include, in fact, several subjects such as cash budgeting and cash forecasting; collection of cash receipts; disbursement of funds/payment mechanisms; identification and investment of surplus funds; obtaining short-term funds and cash appropriations management, this is in addition the degree of centralization of cash management system and the structure of bank accounts (Ball, 2002). However, the main focus here is not on discussing all the aforementioned subjects but on the accrual budgeting technical challenges related to the cash appropriations management. As Blondal (2005) argues that the nature of the appropriations is intrinsically linked to the cash
management system that the government uses, and therefore, the interface between cash management and appropriations differs depending on the extent of decentralization of the appropriation system. Based on the experience of pioneer countries such as New Zealand, UK and Australia, there are four approaches for appropriations, as the appropriations may be designated as being for: (Blondal, 2005)

1- The cash expenditure made by agencies;
2- The cash provided to agencies;
3- The costs incurred for the production of outputs by agencies and
4- The price paid to agencies for the production of outputs.

These four approaches are related to the above described models (no-cash-in-hand model and cash-in-hand-model). As the first approach (and in some cases, the second approach), represent the no-cash-in-hand-model where the appropriations are allocated to governmental entities including only cash required for their operations in a given year. The last two approaches, and sometimes the second approach, represent the cash-in-hand-model, where the appropriations are allotted to governmental entities including both cash and non-cash items.

Accordingly, the government has two options, firstly, it can allocate only cash requirements for a given year to governmental entities, secondly, it can allocate cash required for the given year in addition to cash required for replacement of fixed assets in the future (e.g. accumulated depreciation). In effect, cash management system would be used to transform the cash-in-hand-model in the no-cash-in-hand-model. Blondal (2005) argues that the non-cash items would be a national amount in the bank accounts of the governmental entities-i.e. as receivables.

In all above options, there should a strong control on cash and how it is used. In fact, there are two broad models of cash balance management and control that can be derived from country practices. The control task of cash management can be performed by centralized system or decentralized system. The centralized system can be performed by the Central Bank, Ministry of Finance or both Central Bank and Ministry of Finance. The decentralized system can be performed by governmental entities/agencies themselves. In case the Central Bank is the government’s de facto cash manager and controller, the total net cash flows of government are managed passively, through the central bank. A cash surplus is put on deposit at the central bank, while a deficit is covered by an overdraft or through operations conducted by the central bank. This situation applies whether the central bank has direct responsibility for cash management or operates as agent for the government. In practice in this model, cash management operations form part of the central bank’s liquidity management operations. This model is appropriate in those countries (particularly developing and emerging-market economies) where the ministry of finance lacks the technical capacity to accommodate the transaction flows and also manage the financial and operational risks that are associated with transactions with the market. Alternatively, the ministry of finance may be an active cash manager. In this model, the ministry of finance, through the state treasury or debt management office, manages the government’s overall net cash flows directly with the market, by investing a cash surplus or securing funds to cover a deficit.

There may be hybrid solutions, however, in this model, the ministry of finance, through the state treasury or debt management office, manages the government’s overall net cash flows both directly with the market and via the central bank. This situation may manifest itself in two ways. From the perspective of the ministry of finance, the central bank may be an
optional counterparty, in that the ministry of finance has the option to pass responsibility for any end-of-day cash surplus or deficit to the central bank.

Under the decentralized model, the governmental entities would receive the cash in their account for the full amount of the non-cash items of their appropriations. The governmental entities would be responsible for the management of this part of their appropriations. However, in order for the governmental entities to manage the non-cash items effectively, the ministry of finance has to set some limits for each governmental entity for using the appropriations for non-cash items and all amounts in excess could require the approval of the ministry of finance (Blondal, 2005).

4- Conclusion

While both developed and developing countries are gradually moving towards adopting the performance budgeting and accrual budgeting, for most countries the implementation of performance budgeting and accrual budgeting is not an easy task and at an early stage. Nevertheless, the accrual and performance oriented budgeting, if fully implemented, could bring radical changes to structure and format of the government budgets and to budgetary decision making processes. This paper has explored a number of the technical challenges that can face the implementation of performance budgeting and accrual budgeting. In order for governments to successfully implement both performance and accrual budgeting, these technical challenges must be identified and tackled before any attempt to implement both of them in the public sector. In addition, this paper has made clear that the implementation of performance budgeting face a specific technical challenges that are different from the specific technical challenges that face the implementation of accrual budgeting. In the first place, the paper concludes that the implementation of performance budgeting will face the following technical challenges: specifying the outcomes; specifying the output; and linking outcomes to outputs. With respect to specifying the outcomes, the paper has tackled the following technical challenges: How to determine/specify the outcomes? How can the government measure the achievement of outcomes? Who will be held accountable for achieving outcomes? How can the government translates these outcomes to appropriate outputs? How can the government define and achieve outcomes that are cross-ministry in nature?

Regarding the specifying the outputs, it is concluded that while the governmental entities are required to maximize the contribution of their outputs to the specified outcome. The governmental entities will encounter the problem of: How can they report the outputs in the budget? How can they measure the impact of an output on both outcomes? This is in addition to how can government link the outcomes to outputs.

In the second place, the paper concludes that the implementation of accrual budgeting will encounter the following technical challenges: appropriations for non-cash items;

Treatment of capital charging in the budget; and cash Management systems. It is concluded that there are two models that can be used to tackle the technical issue of appropriation of non-cash items, these are cash-in-hand-model and no-cash-in-hand model. Moreover, the paper has tackled in detail the following challenges that are related to capital charge: How can government determine the capital charge rate? How to compute a net asset base on which to apply the rate? How can the capital charge be treated in the budget? Finally, the paper concludes that the nature of the appropriations is intrinsically linked to the cash management system that the government uses, and therefore, the interface between cash management and appropriations differs depending on the extent of decentralization of the appropriation system.
References


The Development of Public Sector Accounting and Financial Reporting in Sri Lanka

Nagalinagm Nagendrakumar,
Department of Business and Management Studies, Faculty of Communication and Business Studies, Trincomalee Campus, Eastern University, Sri Lanka, nagendrakumarn@esn.ac.lk

Mangala Fonseka,
Department of Accounting, Faculty of Management Studies and Commerce, University of Sri Jayewardenepura, Sri Lanka, bhatiyamangala@yahoo.com

Kumudinie Dissanayake,
Department of Management & Organization Studies, Faculty of Management & Finance, University of Colombo, Sri Lanka, kumudisa@mos.cmb.ac.lk

Abstract

Accrual accounting practices in private sector and cash accounting practices in public sector are unconsciously institutionalized. However, in the recent past the Association of Public Finance Accountants of Sri Lanka, which became the public sector wing of the Institute of Chartered Accountants of Sri Lanka in 2012, has initiated accrual accounting practices to the public sector in the country. Authors, adopting Institutional Theory as theoretical lens and using semi-structured interviews, attempt to explain the recent developments in Public Sector Accounting and Financial Reporting Practices in Sri Lanka. The study finds that mimetic practices played a dominant role and the normative and coercive practices seemed poor in making the accrual accounting practices a success in the public entities and further the study concludes that the Public Sector Accrual Accounting Practices are still open to debate and research.


Introduction

The primary role of the classical accounting system was concentrated almost exclusively on financial transaction, events, and conditions and on the preparation of the financial statements for external users (Nagendrakumar, 2006). To the extent that the organizations accumulate and process the data which are of interest to management, the accounting system plays a second role, that is, management support. However, this second role was considered incidental and peripheral (Nagendrakumar, 2006).

Recent developments in the accounting field, however, demonstrate that the accounting profession, acting as a whole, has realized that governmental accounting is an area that is important, meaningful and critical to the continuing growth of a nation. All the Public Sector Accounting and Financial Reporting (PSAFR) reforms will not succeed unless the central, provincial and local governments invest their resources in better accounting and financial reporting practices. They must understand and recognize that appropriate accounting principles are the only instrument for true and fair disclosures. The appropriate accounting principle would be a matter to be chosen on the Continuum of Accounting Practices (CAP). CAP demonstrates all possible alternative accounting practices available for an organization: One extreme of the spectrum is cash accounting practices and on the other extreme is accrual accounting practices and several possible alternative accounting practices are available in between. Adherence to meaningful accounting principles enhances fiscal discipline, provides more relevant information for better decision making, fosters system efficiencies and lessens the likelihood that scare resources are dissipated because of poor controls.
Drawing attention to the need for research in Public Sector Accounting, Dean (1989) states that the field remains neglected in many countries. Therefore, several changes have to be made in the government accounting system in order to make public sector organizations more accountable for their performance (Mulgan 1997; Sinclair 1995; Hood 1995) and making the required changes in the Government Accounting System is possible only through sound research (Nagendrakumar, 2006).

The purpose of this study is to understand and explain the recent developments in Public Sector Accounting and Financial Reporting (PSAFR) in Sri Lanka. Institutional theory has been proved appropriate in similar kinds of investigations in previous studies (Oulasvirta, 2014; Jacobs, 2012). Accordingly, the concepts of organizational field and isomorphism are used in the present study for enquiry.

The rest of the paper deals with the literature review, methods, results and discussion, and conclusions. The literature review focuses on an early review of PSAFR in developing country perspectives, availability of a conceptual framework and standards for PSAFR, the debate on PSAFR reforms, and emphasis on New Public Financial Management. The methods section reveals the data collection and analysis of this study. Under results and discussion section the findings of this study are highlighted and finally the study states its conclusions.

**Literature review**

The main focus of the literature review is to highlight recent developments in PSAFR reforms which are underway all over the world.

**Accounting: An early view**

The American Accounting Association defines accounting as the process of identifying, measuring, and communicating economic information to permit informed judgments and directions by users of the information (Raymond, 1991). Thus, accounting data summarizes primitive transactions or events through accounting policies and standards with the purpose of preserving value-relevant information about the firm (Olson, Guthrie, & Humphrey, 1999).

Financial accounting is broadly divided into two categories: cash accounting and accrual accounting. Cash accounting records the transactions once the cash is received or paid whereas accrual accounting records the transactions, events and conditions as and when they occur irrespective of cash flows. It is interesting to note that both private and government sectors were used to adopting cash-based accounting practices until the 16th century with a focus on the single entry system (Al-husaini & Gowda, 2008). The basic requirements for presenting accounts to shareholders were almost unknown before 18th century and became common only from the 1820s, usually in the form of cash-based receipts and payments accounts, which enabled investors to determine the legitimacy of the dividend payments and enabled them to calculate a cash-based version of the rate of return (McCartney & Arnold, 2012).

Under the traditional model of public administration cash-based accounting practices were initially considered as being more appropriate for the public sector. The emphasis was on compliance with rules and regulations and one of the results of this system is the budget out-turn report which was primarily designed to contribute to increased control of public money (Monsen, 2010). The budget out-turn report in Sri Lankan practice is the ‘Annual Appropriation Account”. The cash basis of accounting has served almost all governments well for at least the last two hundred years. This could be conveniently proved since the International Federation of Accountants (IFAC) and its Public Sector Committee on Public Sector Accounting:
International Public Sector Accounting Standards Board (IPSASB), at the initial stage issued the standard on the cash basis of accounting (Wynne, 2003).

While the government sector remained on a cash basis, the private sector moved on to the generally accepted accounting principles (GAAPs), which emphasized the adoption of accrual accounting practices (Al-husaini & Gowda, 2008). IFAC has commented extensively on 12 positive corners of accrual-based accounting for organizations. The arguments for using accrual-based accounting in place of cash-based accounting often resonate with ideas relating to such issues as better information for decision-making and more accurate costs (Al-husaini & Gowda, 2008). The effectiveness of the budget at the macro level and the programme and performance budget at the micro level essentially depends upon the adoption of accrual based accounting practices, which is at the heart of the GAAPs (Al-husaini & Gowda, 2008).

**Public Sector Accounting and Financial Reporting (PSAFR): Developing Country Perspectives**

The purpose of PSAFR is to provide useful financial information (Christensen, 2010) and it should be regarded as a financial management information and reporting system for use of Parliament, public sector management, and the general public as the key stakeholders (Barton, 2005). Information can be useful only when it satisfies certain criteria and is appropriate for the functions and roles of the accounting entity and as a result, the qualitative aspects of financial reporting become significant, namely, relevance, reliability, comparability and understandability (Barton, 2005). Financial reporting might be internal: presented to management for specific purposes, or external: presented to stakeholders for general purposes.

This paper concentrates on General Purpose Financial Reporting (GPFR) in the public sector since accrual accounting practices are brought in through the public sector accounting standards to improve external reporting. The requirement of GPFR is to meet the needs of the people interested in public sector activities (Miah, 1991). Users of GPFR want an annual financial report, including what the government owes and what it owns, where its revenue came from and where they were spent, and including a report on the full cost of the programmes (Jones, 1992). Accordingly, Chan (2003) claims that government accounting has three purposes: its basic purpose is to safeguard the public treasury by preventing and detecting corruption and graft; the intermediate purpose is to facilitate sound financial management; and the advanced purpose of government accounting is to discharge public accountability. Further, taking a wider perspective, accounting also provides inputs for budget policy formulation and decisions (Ellwood & Newbury, 2006).

The literature reports inadequacies in public sector accounting and financial management performance in the developing world (Blondal, 1998; Craner & Jones, 1990; Dean, 1988; 1989; Ghartey, 1985). Very often poor countries are poor in financial management performance, which has made financial management decision-making unrealistic and inconsistent (Blondal, 1988). Proper accounting data and interpretation thereof is very much needed for sound, economic and proper management decisions (Gujaratli & Dean, 1993). Many studies point to the deficiency in accounting systems as an important weakness in the management of the public sector of most, and especially, developing countries (Blondall, 1988; Craner & Jones, 1990; Deen 1988; 1989; Ghartey, 1985). Further deficiency in accounting systems is the main reason for improper, inaccurate and delayed financial information communication. Monitoring the performance of the public sector entities are viewed as a problem in both developed and developing countries (Deen, 1989) owing to internal and external politics and socio-cultural influences. ‘Deficiency’ in public sector accounting and financial management has been identified as a characteristic of socio-economic underdevelopment (Enthoven, 1988; Craner &
Jones, 1990). Further, poor countries generally have poor governmental accounting and financial management systems (Dean, 1989).

Financial information is the foundation of financial accountability which is produced through PSAFR (Miah, 1991). In order to satisfy fully and effectively the financial accountability function of public sector entities attention should be given not only to the quantity but also to the quality of information provided to users (Miah, 1991). The efficient use of financial resources is particularly important in public entities because of their significant impact on a nation’s overall social and economic life (Miah, 1991). Thus, the public accounting profession’s appreciation of the need for separate financial reporting standards for the public sector because of their unique operating environment is well accepted by the world (Miah, 1991).

Further, remarkable pressure was exerted by supra-nationals such as WB and IMF on adopting the accrual accounting practices in developing counties since they always depend on funding by supra-nationals. These pressures are imposed through International Financial Reporting Standards (IFRSs) and International Public Sector Accounting Standards (IPSASs) and it is argued that introducing true and fair view accounting, like IFRS, that relies on difficult-to-verify information, may not be suitable for improving accounting information quality in the context of a weak corporate governance system (Kaserer & Klingler, 2008). Moreover, it is argued that the corporate governance system of developing and less developed countries is poor and IPSASs are supported by IFRS. As a result, the application of IPSASs to weak corporate governance countries is always questionable.

**Conceptual framework and standards for PSAFR**

The Federation of Accounting Standards Board (FASB) defines a conceptual framework for accounting as a constitution, a coherent system of interrelated objectives and fundamentals that can lead to consistent standards and prescribes the nature, function and limits of financial accounting and financial statements. Though some consideration of both conceptual frameworks and implementation is evident in the public sector, the debate as to whether generic approaches, especially private sector-based, are relevant and possible and thus how to regulate financial reporting in the public services remains unanswered (Mayston, 1992 & 1993).

Accounting standards are the principles that guide and standardize accounting practices and they are a significant part of accounting practices since the financial statements become meaningful and harmonized only when they are applied across a wide variety of organizations. The recent past has seen a global movement towards the development of comprehensive international accounting and auditing standards for financial reporting by public and private companies and non-business organizations (Bewley, 2008). Accordingly, a new movement to internationally standardize PSAFR started in 2000 and was led by IFAC (Oulasvirta, 2010). The special committee of IFAC named IPSASB has published 32 public sector accounting standards for all public sector entities, whether central governments or provincial or local governments. Accounting researchers advocate that increased accounting harmonization can only become efficient only when all countries interpret the standards in the same way (Sjolander, 2009) and the possibility of applying the same set of standards for all nations is highly questionable considering various political, social and economic factors.

IFAC, in fact, has in recent years become an integral player in global financial governance (Oulasvirta, 2010). IFAC declares that its aim is to serve the public interest and to contribute to the efficiency of the global economy (Oulasvirta, 2010). The objective of IPSASB of IFAC is to serve the public interest by developing high-quality accounting standards for use by public-sector entities around the world in the preparation of general-purpose financial statements (GPFS) (Oulasvirta, 2010). A general goal to develop GPFS in the public sector can hardly raise
any protests. The IFAC has recommended that public sector entities should distance themselves from traditional cash-based accounting and move to accrual-based accounting regulated by IPSASB (Oulasvirta, 2010).

**The debate**

It is argued that a cash-based system does not provide information about the total cost of government activities (Al-husaini & Gowda, 2008). In addition, a failure to recognize an allocated cost of capital assets makes it more difficult to understand the ongoing financial implications of maintaining a given level of public service (Buhr, 2012). According to Soverchia (2012), cash accounting could not fit in with public resource management control, not being able to highlight the connection between resource consumption and the achieved results in the public sector.

Thus, lack of information makes it more difficult to make decisions about expanding or contracting public programmes (Buhr, 2012). There are issues related to public sector liabilities. Prior to the implementation of accrual-based accounting, many governments were building up pension liabilities and liabilities for other social benefits that went unrecorded in the financial statements (Buhr, 2012). As discussed earlier, cash-based accounting has its dominant financial statement - a budget out-turn report - that shows cash spent against budget expenditure. However, critics of cash-based accounting argue that this does not give an accurate picture of all the costs, or show the actual use made of capital assets and provide a complete record of what is owed and what is due. As a result, the information is incomplete and often undermines the ability of decision makers to make decisions that lead to effective and inefficient outcomes (Al-husaini & Gowda, 2008). Therefore, cash-based accounting practices are always said to not reflect the true state of affairs.

There has been widespread adoption of Public Sector Accrual Accounting Practices (PSAAPs) and though recently voices have been raised about its impacts (Barton, 2005; Carlin, 2005), those impacts are largely unknown (Christensen, 2010). Only some initial assessments of the impact of PSAAPs have been made to date (Barton, 2005; Dhanani & Connolly, 2012). The debate on the crucial subject of cash-based accounting and accrual-based accounting in the public sector is still open (Carlin, 2005; Grossi & Soverchia, 2011). Moreover, recent literature in the public sector accounting has critically questioned the claimed benefits of accrual reports for government organizations when it comes to actual implementation (Carlin, 2005; Christensen, 2010; Christiaens & Rommel, 2008; Dhanani & Connolly, 2012; Harun & Kamase, 2012).

The debate on the implementation of PSAAPs arose mostly when New Public Financial Management came into existence (Soverchia, 2012) since the modes of operation of governments and of the business sector are very different and further it was argued that accounting standards must be tailored to suit the specific information needs of each sector (Barton, 2005). On a larger scale, the very nature of the indicators in accrual financial statements differs between the private sector and the public sector because the public sector does not exist to maximize profits and further, the logic of interpreting a government’s operating results is more complicated. Several authors (Carnegie & Napier, 2011) have commented on problems regarding the reliability and usefulness of applying accrual accounting concepts from business to capitalize public sector resources such as libraries and heritage assets.

Much tension is observed in countries where accrual accounting has been adopted (Buhr, 2012). Initially, Australia adopted business-based accounting standards with a few modest extensions covering the public sector. However, first, there was much controversy over the displacement of cash-based accounting and budgeting systems by accrual-based accounting and second,
whether the Australian Accounting System was appropriate for the public sector (Barton, 2011). Further, with the adoption of IFRS, the underlying International Accounting Standards Board’s (IASB) conceptual framework presented real challenges to New Zealand’s standard-setters (Casey, 2006). A key challenge is that IASB’s conceptual framework is driven solely by the reporting needs of profit entities and, at this stage, IASB ignored their applicability to public sector organizations (Casey, 2006).

In developing economies, government-owned institutions are dominant economic forces and as such require an efficient and effective government financial management system (Jallow, 2008). Often the accounting systems installed in those countries were often too sophisticated for local requirements because they were imported from developed jurisdictions to underdeveloped ones (Jallow, 2008). Moreover, even though accrual accounting was adopted by many countries, the nature of the accrual accounting adopted and the way in which the accrual accounting was adopted played out differently (Buhr, 2012). This was due, in large part, to differences in the timing and speed of change required by government, as well as the role played by the profession (Buhr, 2012).

Although there is already significant work in the area of PSAFR, there is still insufficient contextually rooted consideration of the technical and conceptual nature of the accounts to be produced (Broadbent & Guthrie, 2008). The basic question for researchers with regard to the conceptual framework and accounting standards is whether the needs of shareholders in the private sector and stakeholders in public services are the same (Broadbent & Guthrie, 2008). Therefore, it could be argued that governments make an effort to introduce private sector techniques in PSAFR but practical implementation is a very long and difficult process (Bikiene, 2011). As a result, a formal adoption of accrual-based accounting would not automatically produce the intended outcomes as officially planned (Harun & Kamase, 2012). Thus, after some years of enthusiastic adoption of new tools and techniques, an increasing body of literature has highlighted the fact that reforms do not always lead to the expected results (Olson, Guthrie, & Humphrey, 1999; Lapsley, 1999; Helden, 2005). The key factors (macro and micro) in the reform process have varying effects between countries (Grossi & Soverchia, 2011) and for example, Governmental accounting in Europe diverges between countries and within countries. This diversity ranges from fundamental differences in recording systems to different measurement rules and disclosure requirements (Jones & Abraham, 2007).

A conceptual pattern has not yet been identified and followed when institutionalizing the Public Sector Accrual Accounting Practices (PSAAPs) reforms, resulting in an uncritical and misleading transferring of business practices to the public sector (Broadbent & Guthrie, 1998; Barton, 2005; Christiaens and Rommel, 2008, Grossi & Soverchia, 2011). Though the international harmonization of Public Sector Accounting Standards (PSASs) appears to be inevitable, little evidence exists regarding whether harmonizing accounting standards will result in the actual harmonization of accounting practices since IFAC and its special board IPSASB are private sector bodies and IFAC had failed to do a thorough assessment and development of a conceptual framework for public sector accounting and financial reporting. It is good to note at this juncture that IPSASB has come out with the draft conceptual framework particularly for the public sector in 2015 which is very much similar to the accounting framework for IFRS. Further, IFAC recommends applicability of the whole set of standards. But most developing countries adapt partial standards and try to subordinate the traditional system to a partially incorporated system.

Cash-based accounting is a simple, robust and well-tried and tested approach to accounting in public sector organizations whereas accrual-based accounting is a complex, well-tried and tested
approach in the private sector. Even on its own terms for accrual-based accounting to account adequately for governments it must prove its relevancy for the government’s unique aspects of transactions before putting it into operation. For many countries, especially transitional and underdeveloped countries the adoption of accrual-based accounting in their public sector organizations may not be appropriate and certainly should not be considered to be a high priority (Wynne, 2003).

**New Public Financial Management Emphasis**

The discussion so far shows that no endeavor in PSAFR has attracted more attention and criticism than the effort to create a comprehensive set of concepts for theory and practice (Miller, 2012). Developing countries have taken various measures to reform their economic and developmental policies and to integrate themselves with the world economy (Al-husaini & Gowda, 2008). Various exogenous factors have accelerated the pressure for reforms: the demands made by supra-nationals, the establishment of the World Trade Organization (WTO), the partnership agreements made with groups of countries (e.g., EU) (Al-husaini & Gowda, 2008). This pressure was due to the movement of New Public Management (NPM) which was initiated during the latter part of the 1970s. NPM simply means making the public sector accept and adopt private sector practices in the public sector. Accordingly, the nations were thinking about how PSAFR could be improved in line with the NPM movement and that gave rise to New Public Financial Management (NPFM), where the public sector is encouraged to accept and adopt the private sector accounting and financial reporting practices in public entities.

In fact, during the 1980s many politicians, academics, citizens and representatives from the private sector criticized the public sector because of its inefficiency and ineffectiveness. This critique resulted in Traditional Public Financial Management disappearing and NPFM emerging (Olson, Guthrie, & Humphrey, 1999; Helden, 2005). Under the traditional model, the emphasis is on control but under the NPFM model the emphasis is on efficiency and so the private sector style of financial statements under the accrual concept are recommended for introduction (Wynne, 2003). As a result, professional accounting standards have been applied in the public sector around the world as part of the process of adopting accrual-based accounting.

The application of modern business type accrual accounting practices is becoming common in the public sector all over the world. However, the application patterns and the modalities differ from country to country. The debate on the suitability of the PSAAPs is also another point of tension which has cropped up from the very beginning of the reforms initiatives. Thus, the developing countries need to show special care and diligence in accepting or rejecting the PSAAPs reforms in their respective countries.

**Theoretical background**

Institutional theory is the theoretical basis of understanding and explaining the present research issue. Institutional theory focuses on the deeper and more resilient aspects of social structure. It considers the processes: cognitive, normative and regulative by which structures, including schemes, rules, norms, and routines become established as authoritative guidelines for social behavior (Scott, 2014). Mimetic practices are copying the common beliefs and shared logic of action. Normative practices are certification and accreditation activities of the organizations. Regulative practices are rules, laws and sanctions imposed by the government.

Recent developments in PSAFR become the organizational field of this study. An organizational field, according to Di Maggio and Powell (1983), constitutes a set of organizations that, in the aggregate, forms a recognized area of institutional life comprising key suppliers, resource and product consumers, and other organizations that produce similar services and regulatory
agencies. Thus, this study questions whether recent developments in the public sector are due to mimetic or normative or regulatory practices, which have been informed as the three important forces in the institutional environment (Scott, 2014).

**Methods**

The present study covers the period from independence to date to track recent developments in PSAFR in Sri Lanka and since it is related to recent developments in PSAFR, it is assumed that top level financial management is empowered to take such development decisions. As a result, the data requirements for the study could be rich at top-level management and therefore purposive sampling was selected. The sample comprised three types of agencies, which are initiating agencies: the Institute of Chartered Accountants of Sri Lanka (ICASL) and the Association of Public Finance Accountants of Sri Lanka (APFASL), the implementing agency: Eastern Provincial Council (EPC), and the controlling agency: the Treasury and the divorce voice: Chartered Institute of Management Accountants (CIMA) (Appendix 1). The EPC was purposively selected as the implementing agency since the earlier studies revealed that the financial reporting of the EPC is poor (Nagendrakumar, 2014, 2014a & 2006). Data for this study was gathered through 26 semi-structured interviews. Chartered Accountants, Accountants from the Sri Lanka Accountants Service and CIMA Accountants were interviewed. The interview lasted 45 minutes on average. The questions were framed based on mimetic, normative and regulatory practices in recent developments in PSAFR. The data was coded using NVivo and then thematic analysis was carried out. Thematic analysis is a method for identifying, analyzing, and reporting patterns (themes) within the data (Braun & Clarke, 2006). Themes were found by familiarizing ourselves with the data set, transcribing verbatim, generating initial codes, searching for themes, reviewing the themes, and defining and naming the themes.

**Results and Discussion**

Sri Lanka favours following whatever good things found in the international arena. This is claimed by IA/01 as,

"Good thing we can [do] anything any ahh( smiles) it is better to follow the good things from borrowed or something. It is better no. (smiles)…"

It was found that recent developments in PSAFR practices in Sri Lanka are based on mimetic practices. IA/07 claims this as,

"Earlier we borrowed the old FR and now we [have] borrowed the modern accounting standards"

Often Sri Lanka is used to mimic international best practices in other disciplines as well. IA/08 claims this as,

"All are coming like that. Think about these things. If you take the Law it is based on decided cases. Someone might have given solution to a problem at that time [and] based on that only the practice of Law has come. We [accounting] also same like that (smiles). In total international wise they have started. Someone need to start, no”?

Sri Lanka in recent years has introduced changes in public sector financial management especially the introduction of accrual-based accounting practices in public entities which has created a new trend in public sector accounting (Nagendrakumar, 2014). This has been done through mimicking international best accounting practices. This is claimed by DV/02 as,

"The world over the trend was public sector accounting standards. So if you want to keep up the best with the rest of the world then you have to introduce it."
This is true for private sector accounting practices as well and this is claimed by InA/04 as,

“We adopted same IFRS in Sri Lanka also to be followed by the Sri Lankan quoted and non-quoted public companies. So what we adopt is the system which is already been issued and announced by the UK based authorities. So we just with some modifications adapt to Sri Lankan accounting environment. That’s all. Basically, we follow which is suitable for us. We adopt the accounting standards and the auditing standards based on the suitableness. Basically they are mother organizations”.

As a result, mimicking is the force by which developments are brought into the private and public sector accounting field. The same footage of international best accounting practices for the public and private sector has been claimed by InA/03 as,

“But if you look at the source for IPSAS [International Public Sector Accounting Standards] it is nothing but IFRS [International Financial reporting Standards] and if you look at SLAS [Sri Lanka Accounting Standards] the source is also the same. So whether it is IPSAS or SLAS the source is IFRS and therefore there is no conflict. So it is almost on the same footing. Financial accounting and reporting principles are the same. Of course now the IPSAS board is trying to have a separate [accounting] framework [for the public sector]. But if you ultimately look at the framework that also will be identical [with IFRS]”.

Sri Lanka benchmarks the best international accounting practices since the private and the public sector have not come out with their own set of accounting practices. InA/03 put this as,

“But so far to my knowledge although the different schools of thoughts have different views there is no system [particularly to the public sector] that has immerged which can be acceptable to the public sector. If there is an alternative then of course we can think of whether that will suit the requirement [but the alternative is not there]”.

As a result, Sri Lanka is unable to develop its own set of national accounting practices. InA/01 explains this as,

“Even we are going for preparing our own standards, I don’t know how it is worth full because we have good product right? We have good car from japan. If you can make a good car with technical sound car from Sri Lanka, that is good. Until we do it, what to do? So we have to accept the reality”.

The main reason why Sri Lanka is not in a position to initiate its own accounting practices is that it does not have skilled public sector accounting experts; it cannot afford the cost involved in doing research; there is ignorance among the academia about this particular area (Guthrie, 2008). This is partly claimed by InA/01 as,

“So we can’t say we need only locally created standards. There are no such standards anywhere in the world to my knowledge. All follow IFAC standards. All the institutes are members of the IFAC [and] because those are advanced, those are well developed. There were lots of researches before adopting those standards by the IFAC. There was lots of research. There are lots of experts. That’s how those standards have been formulated. So we simply got those standards and do some modifications and apply. Nothing wrong so those are good standards”.

And it is partly claimed by IA/19 as,

“We do not have experts in the field”

And, it is partly claimed by InA/03 as,
“But that also if you look at even the professional bodies all over the world they are not doing their own research and development. They are all picking up the international best practices because they are also part of it no”?  

So it is very clear that the country is well exposed to mimicking the best accounting practices and of course with slight changes to suit the Sri Lankan context. This is claimed by DV/01 as,  

“It is a kind of mirror. So [it is] your image. You take as it is. Do whatever minimum modification to and apply as it is. It is coming actually imported from UK”.  

One camp argues that a standard setting process is expected to accommodate local law, regulations, and political institutions, so that the establishment of unique national standards provides higher net social benefits than international standards (Wynne, 2003, Oulasvirta, 2010&2014). Further, fundamental differences between the public sector and the commercial sector require the reporting framework to be designed specifically for the sector, not a minimalist revision of a commercial framework (Newbury, 2006). However, it is argued that SLPASs are based on International Public Sector Accounting Standards (IPSASs). IPSASs are not supported by the conceptual framework and further, it is argued that there are many flaws in the IPSASB’s standard setting work (Oulasvirta, 2010). Therefore, it is argued that the PSAAPs reforms based on IPSASs operates with many flaws.  

Almost many setters of conceptual framework are the professional bodies in the relevant field (Jones,1992) and it is substantially true for the private sector accounting profession in Sri Lanka since ICASL is empowered to set accounting standards for private sector and government business organizations. However, Sri Lanka’s public sector accounting profession has not been successful in standing as an institutionalized set up for their profession. It does not mean that they did not take steps to organize themselves into a logical institutional pattern, instead, during the 1990s the public sector profession came under one umbrella called the Institute of Public Finance and Development Accountancy (IPFDA). This institute implemented the major part of the Asian Development Bank and Ministry of Finance - Financial Management Training Programme during the 1990s. Further, IPFDA endeavoured to incorporate itself as the distinct public sector accounting professional body by passing an Act of Parliament. However, the effort failed because of some political, economic and institutional barriers. Yet, IPFDA did not give up the effort to reform public sector accounting and recently it was incorporated as APFASL and it became the public sector wing of ICASL. As a result, ICASL joined the public sector PSAAPs reforms and officially issued ten Sri Lanka Public Sector Accounting Standards (SLPSASs).  

The enforceability SLPSASs is another aspect that matters in reforming PSAFR (Jones, 1992). Enforceability could be provoked by moral governance and legitimization (Scott, 2014). Moral governance is achieved by incorporating the normative practices of the profession (Scott, 2014). Normative practices are the product of professional standards and accreditation practices (Dimagio and Powell, 1983). ICASL is a member of IFAC and APFASL has been accredited by ICASL and the Chartered Institute of Public Finance Accountants (CIPFA) London. Yet the effort to make SLPSASs morally governed is not conducive since ICASL does not have enforcing ability of SLPSASs to the public sector. This is spelt out in the preface to the SLPSASs as follows:  

“Standing alone, ICASL has no power to require compliance with SLPSASs. The success of the ICASL’s efforts is dependent upon the recognition and support for its work from many different interested groups acting within public sector”.  

IA/13 claims this as,
“It [APFASL] is not [legally] created. They should come within this [Treasury hierarchy]. It is not within the Treasury. APFA has joint with ICASL and they develop this [SLPSASs] and they are directly asking us to do. What they do is they operate as a semi government separately. They need to become as a government institution”.

ICASL is governed by the Accounting and Auditing Standards Act No: 15 of 1995 and it has been authorized to regulate the accounting practices of the business activities in the country. However, it reserves the right of establishing the accounting standards and guidelines for financial reporting to the public entities to the government. This is spelt out in the preface to the SLPSASs as follows:

“The ICASL acknowledges the right of Sri Lanka government to establish accounting standards and guidelines for financial reporting in public sector”.

It is worth noting that, as spelt out above, there is no specific legally binding push for SLPSASs by the Sri Lankan government. However, the circulars of the Ministry of Finance apparently support the reforms process and the Secretary to the Treasury has positively commented on the adoption of SLPSASs in Public Enterprises in his message to the Volumes 1 & 11 of the SLPSASs. Yet it is argued that circulars and positive commendations by the top officers could not make the final result binding but instead they had to be legally enforced. The legal enforcement of any matter depends on the institutional capacity of the social domain in which it is going to be instituted.

Institutional capacity is paramount in reforming PSAAPs reforms (Nagendrakumar, 2014). In a government organization, institutional capacity can be defined as the organization’s ability to identify problems, to develop and evaluate policy alternatives, and to operate the government’s programmes (Eggleton, 2012). Thus in an organizational context, the level of the institutional capacity of an organization would depend on the technical capacity and the human resources capacity (Harun & Kamase, 2012). PSAFR occurs in social and economic enterprises and it is influenced by the political enterprise. Therefore, it is argued that the institutional capacity with regard to PSAFR reform is vital. However, the institutional capacity of the Sri Lanka PSAFR environment is not conducive (Nagendrakumar, 2006, 2014 & 2014a).

Institutional capacity is strengthened by combining the technical capacity and human resource capacity with respect of PSAFR (Nagendrakumar, 2014a). Technical capacity could be conceptualized as the ability of an institution to decide on and pursue its goals, to perform tasks, and to improve performance constantly. Technical capacity of PSAFR is strengthened by combining the accounting system capacity, internal control system capacity and regulatory mechanism capacity (Nagendrakumar, 2014a). The old Sri Lankan PSAFR has been unconsciously institutionalized. Most accountants in the public sector perceive FR as the conceptual framework for accounting even after introducing the PSAAPs reforms. Further, SLPSASs are not supported by a conceptual framework for PSAAPs but it is common in private sector accounting standards. However, the preface to the SLPSASs pinpoints that it is appreciable if the private sector conceptual framework for accounting is adopted in the public sector. It is again a complication which makes Public Sector Accountants get away from the SLPSASs since they are not professionally qualified Chartered Accountants.

Human resource capacity is strengthened by training and development and job satisfaction of the accounting staff of the public sector (Nagendrakumar, 2014a). Human resource availability is one of the most important factors that determine the extent to which institutional capacity of an organization can successfully implement a new accounting reform (Christensen, 2010; Harun & Kamase, 2012). Despite the PSAAPs reforms unfortunately the Sri Lanka Accounting Service has already lost two important accounting support services, viz. Sri Lanka Bookkeeper Service.
and Sri Lanka Storekeeper Service and further, some of the accountant cadres have been revoked by the Cadres Commission. This is claimed by IA/13 as,

“Cadre commission has removed three Accountants cadres. The Sri Lanka Book Keeper Service and Sri Lanka Store Keeper Service were there earlier and since they have also been demolished we [Accountants] rely on ordinary staff and trained them to do”.

Another important aspect which contributes to the development of PSAFR is the minimization of the contest between the responsible organizations. One of the issues raised in the public sector accounting literature is the “contest” between the accounting profession regulators (e.g., ICASL) and public sector regulators (e.g., Treasuries), for control of the policy formulation process (Ryan, 1999). APFASL (formerly IPFDA), which has been highly interested for a long time in the development of the public sector accounting, does not have the authority to issue, experts to set, and authority to enforce SLPSASs. ICASL who are the experts in setting SLPSASs does not have the power to issue and enforce them in the public sector. The Ministry of Finance and Treasury who are empowered to issue and enforce SLPSASs do not have experts in the field. InA/03 claims this as,

Claim-1

“That is what I mentioned. Now once it is brought into the part of the law then it becomes mandatory. Currently it is a Treasury direction. So to the some extent they are mandatory because Auditor General can qualify the accounts if they [public sector] do not comply. So to that extent they are compulsory. But it becomes legally mandatory once the Act is amended to incorporate these requirements”.

Claim - 2

“Circular instructions have been already given by the Treasury. So it becomes legally required only once the law is passed. Then people can go to courts also for noncompliance and things like that. That will come later”.

InA/02 explains this as,

“Now SL accounting and auditing standards Act No: 15 of 1995 empowers the charted institute to issue the SLASs. Now treasury has issued instructions to Sri Lanka Accounting and Auditing Monitoring Board to amend the Sri Lanka accounting and auditing standards Act to enable the charted institute to issue the public sector accounting standards also”.

PSAFR has not been regulated and it is not compulsory for government departments in Sri Lanka. Unless it is made compulsory by the top the developments will not be adopted by the bottom level and the financial statements will not be based on accrual accounting principles. For that, incorporating a separate body for public sector accounting would be a much better option to go ahead with the reforms. InA/04 explains this as,

“So having considered the public sector development and public sector accountants, another body is necessary because that has to come from the what do you call incorporation of Act and government regulations are important and parliamentary Act is important”

The effort to incorporate a separate body for the public sector was attempted several times but without success. This is explained by InA/02 as,
Many times our efforts were in wane in the last movement. So sometimes we have even drafted the Act even. We have gone to that extent, but these all totally pushed away”.

Public sector organizations had already been required to adhere to the Financial Regulations (FR). It has been in operation and followed for a long time in history from independence in Sri Lanka. Further, the preparation and submission of budget are also compulsory for all government departments. It was suggested that PSAFR has to be made the same as FR and budget by passing an Act of Parliament. InA/04 explains this as,

“Enactment is coming. Those enactments are very important to bind the people in the public sector. So that there has to be separate public body through this enactment like budgetary Act and other things. Otherwise it [implementation] is an option. So people are on both sides. That option; some are with adoption and some are without adoption because options is there”.  

Government has realized the importance of the PSAFR reforms and they have pledged support for it. The Auditor General’s Department has agreed to conduct the government audit based on accrual accounting practices. However, the government has other priority areas of concern in its agenda and thus, the developments in PSAFR are getting delayed. InA/02 explains this as,

“Even the government has accepted the need for the PSAFR reforms; government’s blessing is also there. Only thing is government is having the other priorities. That is very reason that they are not giving priority to this”.  

The Treasury has not issued circulars instructing the PEs to implement accrual accounting practices. This is claimed by InA/02 as,

“That is fine obviously, that has to be really done by the treasury through the circulars. So far treasury has not issued circular. In fact, the Treasury problem is treasury has no competent people to do. Today even to draft the circular there is no competent people in the public entities. There are no charted accountants in the treasury. All charted accountants are transferred out. Only one or two are there, no people. So there is a practical difficulty to implement that is the problem we having really”.

Further, the Treasury has not issued a guideline for adopting accrual accounting practices in PEs. InA/02 puts this as,

“So, for that [implement] they government have to provide the necessary facilities such as the circular instructions and how to do it and those things they have to guide which should come from the Treasury and also sometimes incentives for them[accounting staff]
Taking all the points above the enforceability of the recent developments in PSAFR could be illustrated in Table 1 as follows:

**Table 1: Present situation of institutional dimensions of PSAFR developments**

<table>
<thead>
<tr>
<th></th>
<th>Mimetic practice</th>
<th>Normative practice</th>
<th>Coercive practice</th>
</tr>
</thead>
<tbody>
<tr>
<td>APFASL-Pool of Public Sector Accountants</td>
<td>YES</td>
<td>NO</td>
<td>NO</td>
</tr>
<tr>
<td>ICASL-Pool of Private Sector Accountants</td>
<td>YES</td>
<td>NO</td>
<td>NO</td>
</tr>
<tr>
<td>MOF and Treasury- Regulating body for public sector accounting</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>

*Source: Interview data*

Since complex problems prevail in the country with respect of PSAAPs reform, it is urged that the associated parties must develop sound and effective negotiations among themselves. It is understood that negotiations among some of the members of the ICASL, APFASL and Treasury are poor and as a result there is a continuing lack of progress in government accounting and financial reporting. This is attributable partly to the lack of interest in and understanding the issues related to public sector accounting among newly empowered electors and successive governments have been reluctant to push hard for accounting reforms, not least because improved accountability poses a significant threat to politicians’ and bureaucrats’ overall income levels (Harrun, 2007). Therefore, even though Sri Lanka has stepped into PSAAPs still it is argued that the progress of the system is not conducive due to political, institutional and economic reasons. IA/17 put this as,

“They [related parties] should be educated. Call each level individually and educate them. When we get ready to implement if the CEO [Chief Executive Officer] of the province i.e. the CM [Chief Minister] is not giving us the fullest support we cannot go ahead. Therefore each and every group must be given knowledge about the importance of this”.

Therefore, this research identifies first, that the accounting profession in Sri Lanka is used to mimic the international best accounting practices for the PSAFR from its inception, second, that Sri Lanka has developed tight enforcement practices for FR for public sector accounting, and third, that the modern PSAAPs reforms in Sri Lanka have not been well supported by the regulatory dimension of Institutional Theory.

**Conclusion**

It is argued that PSAAPs reforms must be logically enforced. The mimetic practices in relation to PSAFR are effective in Sri Lanka. However, the normative practices and coercive practices are lacking in rigour in implementing the reforms in the public sector. Therefore, the normative practices should be strengthened among the government accounting staff and those normative practices must be backed by specific regulative practices by the government (i.e., enactment of laws). Regulative enforcement is possible in three ways: either ICASL could be empowered by amending the existing Act of Parliament or APFASL could be legally enacted as the separate
public sector accounting professional institution or a new institution could be legally established under the Treasury which may reduce the conflict of interest among the actors and delays in PSAAPs reforms. Further, a positive attitude from political actors is very important if Sri Lanka is to realize the positive consequences of PSAAPs reforms.

The present study employs Institutional Theory as a theoretical lens for Public Sector Accounting research in Sri Lanka. Further, the findings of this research may alert the public sector higher officials and other parties to make correct policy decisions with regard to PSAAPs reforms. However, the basis of accounting which is to be adopted should be decided in the context of the overall priorities of the reform process and not just on the basis of the perceived superiority of one basis of accounting over another. Therefore, accrual accounting may facilitate PSAAPs reforms but it is not an end in itself (Wynne, 2003). Consequently, the appropriateness of PSAAPs for Sri Lanka is open to debate and further research.

Further, research in the field of PSAAPs seems somewhat behind and it is a serious omission on the part of the academic community (Broadbent & Guthrie, 2008). This is a fact applicable to Sri Lanka as well. Especially in developing countries there are many technical and institutional problems that the authors believe could potentially hamper the government's efforts to reform public sector accounting for improved efficiency (Harun & Kamase, 2012). Therefore, it is high time to consider the need for rich and rigorous research in the field and deploy the resources and effort needed to bring prosperity to the public sector in Sri Lanka. Prospective researchers can think of exploring the same idea through a quantitative approach and come out with generalizable findings. Further, the same phenomenon could be looked at through some other relevant theories such as Actor Network Theory. Some researches could focus on incorporation of liberal ideas in the country and their impact on national identity.

The coding and thematic analysis required the authors to interpret the data in explaining the recent developments in PSAFR in Sri Lanka. Thus, the generalizability of the findings becomes a major limitation of this study. Hence, the findings are confined to the Sri Lanka and PSAAPs reforms context. The information gathered from top management is highly sensitive. Thus, some respondents reserved their opinion. This is claimed by InA/02 as follows:

“Ya, ya, ya. Now off the record I will tell (Omitted)”

Thus, the findings are subject to those reservations and omissions.
References

Appendix 1: Sample

<table>
<thead>
<tr>
<th>Name of the Respondant</th>
<th>Source</th>
<th>Name of the Respondant</th>
<th>Source</th>
<th>Implementing Agency (cont’d)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initiating agency</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chartered Accountant</td>
<td>Internals/ InA 01</td>
<td>Sri Lanka Accountants Service</td>
<td>Internals/IA 15</td>
<td></td>
</tr>
<tr>
<td>Chartered Accountant</td>
<td>Internals/ InA 02</td>
<td>Sri Lanka Accountants Service</td>
<td>Internals/IA 05</td>
<td></td>
</tr>
<tr>
<td>Chartered Accountant</td>
<td>Internals/ InA 04</td>
<td>Sri Lanka Accountants Service</td>
<td>Internals/IA 16</td>
<td></td>
</tr>
<tr>
<td>Chartered Accountant</td>
<td>Internals/ InA 03</td>
<td>Sri Lanka Accountants Service</td>
<td>Internals/IA 17</td>
<td></td>
</tr>
<tr>
<td>Implementing Agency</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sri Lanka Accountants Service</td>
<td>Internals/ IA 08</td>
<td>Sri Lanka Accountants Service</td>
<td>Internals/IA 18</td>
<td></td>
</tr>
<tr>
<td>Sri Lanka Accountants Service</td>
<td>Internals/ IA 09</td>
<td>Sri Lanka Accountants Service</td>
<td>Internals/IA 07</td>
<td></td>
</tr>
<tr>
<td>Sri Lanka Accountants Service</td>
<td>Internals/ IA 10</td>
<td>Sri Lanka Accountants Service</td>
<td>Internals/IA 19</td>
<td></td>
</tr>
<tr>
<td>Sri Lanka Accountants Service</td>
<td>Internals/ IA 20</td>
<td>Sri Lanka Accountants Service</td>
<td>Internals/IA 01</td>
<td></td>
</tr>
<tr>
<td>Sri Lanka Accountants Service</td>
<td>Internals/ IA 04</td>
<td>Sri Lanka Accountants Service</td>
<td>Internals/IA 02</td>
<td></td>
</tr>
<tr>
<td>Sri Lanka Accountants Service</td>
<td>Internals/ IA 11</td>
<td><strong>Controlling Agency</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sri Lanka Accountants Service</td>
<td>Internals/ IA 12</td>
<td>Sri Lanka Accountants Service</td>
<td>Internals/T 01</td>
<td></td>
</tr>
<tr>
<td>Sri Lanka Accountants Service</td>
<td>Internals/ IA 13</td>
<td><strong>Divorce Voice</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sri Lanka Accountants Service</td>
<td>Internals/IA 14</td>
<td>CIMA-Accountant</td>
<td>Internals/ DV 01</td>
<td></td>
</tr>
<tr>
<td>Sri Lanka Accountants Service</td>
<td>Internals/IA 03</td>
<td>CIMA-Accountant</td>
<td>Internals/ DV 02</td>
<td></td>
</tr>
</tbody>
</table>

*Note: Names of the respondents are maintained private and personal to the research.*
The Influence of Budget Transparency on Quality of Governance

Bassam A. Albassam, Ph.D.,
Institute of Public Administration, Riyadh, Saudi Arabia, Email: bassamb@ipa.edu.sa

Abstract

Public budget is the engine that drives any economy; thus, budget transparency contributes to shaping the political process and government performance. The current study examines the relationship between budget transparency (measured by Open Budget Index (OBI)) and governance quality (measured by Worldwide Governance Indicators (WGI)). The study covers four years – 2006, 2008, 2010, and 2012 – where OBI data are available. Furthermore, the role of the human development level of nations in shaping this relationship is tested.

While the result of the analysis shows a significant relationship between budget transparency and governance quality, which is inconsistent with the literature, the findings indicate minimal influence of the human development level of nations on this relationship. This result confirms the influence of budget transparency in the adoption of good governance practices by governments and increased quality of governance. Future research can examine the relationship between human development and quality of governance in the process of understanding factors that contribute in enhancing the governing process.

Keywords: budget transparency, governance quality, human development

Introduction

Aaron Wildavsky (1961), in his masterpiece Political Implications of Budgetary Reform, stated “The budget is the life-blood of the government, the financial reflection of what the government does or intends to do” (p. 184). The budgetary system and the public budget process have impacts on the way government operates. Thus, the cornerstone of developing financial systems in countries starts with the development of the public budget. Also, the public budget contributes to human development, economic growth, and governing. Therefore, international organizations, donors, and civil society organizations advocate budget transparency and accountability toward better governance.

Conversely, good governance has been introduced as a tool to work toward better service for citizens, political stability, and government effectiveness. Furthermore, good governance is connected to fighting corruption and holding bureaucrats and politicians accountable for their actions. Consequently, good governance practices by governments are a prerequisite of financial and nonfinancial aids from donors to countries in need of assistance.

The main theme of the current article is to study the influence of budget transparency on good governance. The open budget index (OBI) as a measure of budget transparency, as well as the worldwide governance indicators (WGI) (Voice and Accountability (VA), Political Stability and Absence of Violence (PS), Government Effectiveness (GE), Regulatory Quality (RQ), Rule of Law (RL), and Control of Corruption (CC)) as a measure of good governance, have been used in studying the relationship between budget transparency and good governance. The study covers 2006, 2008, 2010, and 2012, where OBI data are available.

In addition, the current study will explore the influence of human development in shaping the relationship between good governance and budget transparency. The human development index (HDI), which will be used in the current study as a measure of human development, classifies countries into four groups (very high development, high development, medium development,
and low development). The three dimensions used in constructing HDI are health, education, and living standards.

Where most prior studies on this subject have concentrated on one aspect of governance, the current article is exploring the influence of budget transparency on all six indicators of good governance, which will enhance the knowledge regarding the relationship between budget transparency and quality of governance. Also, studying the relationship between budget transparency and governance on a global scale (compared to the regional or country level) allows for studying the relationship in a variety of political and governmental systems. In addition, the current study will explore the influence of human development on the relationship between good governance and budget transparency, thus filling the research gap in exploring this issue.

While the result of the analysis shows a significant relationship between budget transparency and quality of governance, the analysis concludes that the human development level of nations has a minimal influence in shaping the relationship. This result confirms the influence of budget transparency on governments’ adoption of good governance practices and increasing quality of governance. In contrast, although human development significantly moderates the relationship between budget transparency and regulatory quality and between budget transparency and government effectiveness, it did not moderate any other relationships.

**Budget Transparency**

The theme of transparency has been addressed through numerous studies in many fields (e.g., political, economic, and social sciences). Kosack and Fung (2014) argue that the notion of transparency has been adopted by governments and international organizations based on the promise that “disclosure of information about government institutions, policies, and programs empowers citizens to hold officials responsible for their spending and performance, thereby reducing corruption and mismanagement of public resources and leading, eventually, to more accountable, responsive, and effective governance” (p. 65). Thus, transparency is argued to be an important tool for better governing.

Public budget, on the other hand, is the engine that drives the economy and government’s work. The structure of the budget, the budget process, and the way it is executed play a significant role in economic growth and sustainable development (Acosta, 2013; Ellis & Fender, 2006), political stability and political turnout (Benito & Bastida, 2009; Zucolotto & Teixeira, 2014), controlling corruption (Kosack & Fung, 2014; Santiso, 2006), and human development (Carlitz, Renzio, Krafchik & Ramkumar, 2009; de Renzio, Gomez & Sheppard, 2005). In addition, the impact of public budget goes beyond the public sector to influence private sectors’ performance and financial market (Hameed, 2011).

Distinguishing between budgets and budgetary systems is a critical point that many previous researchers have mentioned. Whereas the budget refers only to the documents within which financial proposals are contained, the budget system refers to the relationship between the stages to be followed in order to compile the budget documents (Lee, 2012; Shah, 2007). In addition, the public budget generally reflects the policy of the government with regard to economic policies.

Over the years, many definitions of budget transparency have been introduced. Premchand (1993) defines budget transparency as “the availability of information to the public on the transactions of the government and the transparency of decision-making processes” (p. 17). The Organization for Economic Co-operation and Development (OECD) defines budget transparency as “the full disclosure of all relevant fiscal information in a timely and systematic
manner” (OECD 2002, p. 1). The definition of open budget initiative that will be utilized in the
current paper explicates details in defining budget transparency: “transparency means all of a
country’s people can access information on how much is allocated to different types of
spending, what revenues are collected, and how international donor assistance and other public
resources are used” (IBP, 2010, par. 4).

Accordingly, budget transparency movements are motivated by the assumption that
“enhancing transparency and accountability in the budget process will lead to improved
democratic and developmental outcomes” (Carlitz, 2013, p.s53). In contrast, the length and
complexity of the public budget makes it difficult for the average citizen to understand; thus, it
has been argued that too much budget transparency can do more harm than good (Persson,
Rothstein & Teorell, 2010; Kolstad & Wiig, 2009). On the contrary, Carlitz (2013) stated that
“access to budget information and budget processes clearly has the potential to empower
citizens and make their governments respond in ways that may improve their lives” (p. s63).

**Good Governance**

Evaluating public sector performance and people’s participation in political and governmental
decision-making processes are subjects that have dominated research in many fields (e.g., public
administration and political science) (Birkland, 2006; Rhodes, 2007). In addition, many theories
and models have been introduced, such as new institutionalism theory (North, 1990; DiMaggio
& Powell, 1991) and public choice theory (Tullock, Seldon, & Brady, 2002), which study how
governments perform their work and how politicians and bureaucrats behave in the policy
process.

The governance model is characterized by a change in the role of government from the only
player to one of many players. Governance is marked by a change in government’s role in
society, where nongovernmental actors (e.g., citizens and non-profit organizations) participate
in the decision-making process and where democratic principles are applied by giving the
majority of people the right to participate in the governing process (Denhardt & Denhardt, 2007;
de Ferranti, Jacinto, Ody, & Ramshaw, 2009). According to Neumayer (2003), governance is
defined as “the way in which policy makers are empowered to make decisions, the way in which
policy decisions are formulated and implemented and the extent to which governmental
intervention is allowed to encroach into the rights of citizens” (p. 8).

Accordingly, good governance is the standard used to determine the quality of governing by
countries and international institutions providing political, administrative, and financial support
and advice to other countries. Also, international financial institutions (e.g., the IMF and the
World Bank) and donor countries (e.g., the United States and the United Kingdom), use good
governance as a standard to evaluate countries’ affairs and systems. This evaluation contributes,
in part, to the decision of whether or not to provide aid to those countries (Mimicopoulos, Kyj,
and Sormani, 2007; Santiso, 2001).

Good governance is defined as “the ability of government to develop an efficient, effective and
accountable public management process that is open to citizen participation and that strengthens
rather than weakens a democratic system of government” (Riddell, 2007, p. 374). In addition,
international organizations deem that good governance is a condition for economic development
and efforts to fight corruption. The United Nations has introduced eight major characteristics of
good governance that define and articulate good governance practices by governments: “[good
governance is] participatory, consensus oriented, accountable, transparent, responsive, effective
and efficient, equitable and inclusive, and follows the rule of law” (UNESCAP, 2009, p. 1). In
addition, good governance is characterized by respecting human rights and adopting democratic
principles by governments (e.g., citizen participation and transparency) in decision-making processes (Denhardt & Denhardt, 2007; Kosack & Fung, 2014).

Therefore, indices have been developed by organizations to measure quality of governance, and each index is structured and calculated differently (Arndt & Oman, 2006; Mimicopoulos et al., 2007; Thomas, 2008). While some are regionally based (e.g., measuring quality of governance among African nations), other indices have expanded annually by covering more countries. Other measures of quality of governance concentrate on one or two aspects of the governing process, such as the corruption perceptions index (CPI), which measures nations’ corruption levels. Arndt and Oman (2006) argue that, although “the perfect governance indicator will undoubtedly never exist” (p. 11), some indicators have more validity and credibility than others. The number of sources used to structure an index, the comprehensiveness with which the governing process is covered, and the accuracy of the results are all factors that make one index more credible than others among users (Arndt & Oman, 2006; Mimicopoulos et al., 2007).

The worldwide governance indicators (WGI) project defines good governance as “the traditions and institutions by which authority in a country is exercised,” including:

(a) the process by which governments are selected, monitored and replaced; (b) the capacity of the government to effectively formulate and implement sound policies; and (c) the respect of citizens and the state for the institutions that govern economic and social interactions among them (Kaufmann, Kraay, & Mastruzzi, 2009b, p. 1).

Because they cover the most important aspects of the governing process (Arndt & Oman, 2006; Mimicopoulos et al., 2007), the worldwide governance indicators (WGI) will be adopted as a measure of good governance, in the current study. Unlike other indices, the WGI contain an indicator for each aspect of the governing process, affording researchers and policy-makers a better understanding of the political process (de Ferranti et al., 2009; Kaufmann, Kraay, & Mastruzzi, 2009a; Thomas, 2008). Thus, the design of the WGI, coupled with the fact that it covers all member nations of the UN, helps to provide a clear understanding of the relationship between quality of governance and budget transparency.

**Transparency and Good Governance: Previous Studies**

Many studies have been conducted to examine the relationships between budget transparency and government’s performance and activities; budget transparency and countries’ development (Alt & Lassen, 2005; Gaventa & McGee 2013); budget transparency, fiscal performance, and political turnout (Benito & Bastida, 2009; Stiglitz, 2002); and transparency and good governance (Acosta, 2013; Kolstad & Wiig, 2009). The positive influence of government work’s transparency on a country’s development and quality of governance is a common finding among most of these studies.

Benito and Bastida (2007) study the relationship between budget transparency on one side and economic development and fighting corruption on the other. Even though every country has a different culture and political system, which might affect the way each country applies public budget transparency standards, the authors find a strong relationship among budget transparency, economic development, and efforts to fight corruption in all countries included in the research. Additionally, the study concludes that budget transparency increases a government’s accountability and improves the decision-making process. In addition, Benito and Bastida (2009) study the relationship between budget transparency based on the availability of information from governments and citizen participation in the political process. After admitting the difficulty of measuring political participation by using one only aspect of it (voting), the
study nonetheless finds a positive relationship among budget transparency, fiscal performance, and political turnout.

Renzio, Gomez, and Sheppard (2009) study the relationship between budget transparency and human development in resource-dependent countries – that is, countries that depend on natural resources (e.g., oil or minerals) as their main source of income. Using open budget initiative data collected in 2006, they compare these scores with the UN Human Development Index (HDI) for each country. While they find that resource-dependent countries suffer from a lack of budget transparency, Renzio et al. (2009) find no clear relationship between budget transparency and a country’s level of development.

In contrast, Zucolotto and Teixeira (2014) study the influence of budget transparency on corruption, accountability, quality of legislature institutions, and democracy in countries. The study concludes that “countries that are more transparent have more and better accountability mechanisms and, consequently, a greater level of democracy and less corruption, all of which points to the importance of transparency in the process of democratic consolidation” (Zucolotto & Teixeira, 2014, p. 96).

Although the literature has reached mixed conclusions in connecting transparency and budget transparency to good governance, there has been increasing interest in the potential of transparency to improve quality of governance (Relly & Sabharwal 2009; Schmidt-Hebbel, 2012). According to Masud (2011), “budget transparency has emerged as a key component in governance reform, particularly since citizens around the world frequently lack at least some of the most basic information about government decisions and actions at every stage of the budget process” (p. 43).

In summary, while budget transparency has been connected to good governance practices by governments, information access by the public has not played the role of an end in itself but rather a tool toward better governance. Thus, to have an effective and efficient system and to benefit from budget transparency, the public (e.g., citizens and non-profit organizations) must have the capability to monitor authorities and hold them accountable for their actions. In their study of the effect of budget transparency on the performance of resource-rich countries, Kolstad and Wiig (2009) argue that budget transparency in and of itself cannot be the only solution to reduce corruption and maintain sustainable development unless combined with improved quality of institutions and policies (financial and otherwise), citizen empowerment, and human development level. Similarly, Lindstedt and Naurin (2010) stated, “Reforms focusing on increasing transparency should be accompanied by measures for strengthening citizens’ capacity to act upon the available information if we are to see positive effects on corruption” (p. 301).

**Human Development**

Human development has been associated with quality of governance (Grindle, 2007; Sagar & Najam, 1998), economic growth (Adams & Mengistu, 2008; Smith, 2007), and sustainable development (Alkire, 2010; Ndulu & O’Connell, 1999). In addition, human development shares some principals with good governance practices by governments, such as supporting free speech, upholding human rights, and improving public services’ quality (Grindle, 2007; Sagar & Najam, 1998). Therefore, Pradhan and Sanyal (2011) argue that good governance practices (e.g., rule of law and transparency) are conditions for high levels of education and health systems; thus, high quality of governance results in more efficient and effective government work that leads to high levels of human and economic development.
Similarly, Alkire (2010) thinks that human development (e.g., high-quality education and health systems) supports the productivity of an economy by providing healthy and highly trained individuals. To this end, human development requires both economic growth and good governance practices by governments. According to The United Nations Development Program (UNDP) (2000), “resources generated by economic growth have financed human development and created employment while human development has contributed to economic growth” (p. 7).

Consequently, governments need to adopt balanced development of the governance process, economic and human development in order to enhance the well-being of citizens and increase the effectiveness of the government’s work. The current paper will test whether the state’s level of development influences the relationship between quality of governance and budget transparency. In addition, having four groups of human development as human development index (HDI) constructed (very high development, high development, medium development, and low development) will help in enhancing our understanding of the influence of nations’ human development levels on the relationship between budget transparency and quality of governance.

**Theoretical Framework: New Institutionalism Theory**

The new institutionalism framework has shaped studies in many fields, including public policy and public administration. According to Lane and Ersson (1999), new institutionalism focuses on non-policy factors, such as economic and social factors, that affect the composition and functioning of institutions. New institutionalism theory argues that the quality of institutions is related to their governance quality (North, 2009; Powell, 2007). In addition, new institutionalists stress the important role of institutions in shaping individuals, political processes, and economic outcomes (March & Olsen, 1984; Weaver & Rockman, 1993), while individuals and society likewise influence institutions (Hall & Taylor, 1996; Scott, 2003). According to Powell (2007), “organizations are deeply embedded in social and political environments [suggesting] that organizational practices and structures are often either reflections of or responses to rules, beliefs, and conventions built into the wider environment” (p. 1).

Thus, there is a two-way relationship between governance and the structure and design of institutions (North, 2007; Stoker, 1998). Governance is a means of including all social and political actors in the decision-making process, while institutions can be seen as the rules of the game, controlling how the governance process takes place (Stocker, 2010; Williamson, 1998). According to Bell (2011), “institutions are important, because, as entities, they form such a large part of the political landscape, and because modern governance largely occurs in and through institutions” (p. 1). In addition, Hall and Taylor (1996) argue that the quality of political outcomes and governance depends on improving human development factors (e.g., socioeconomic factors, education levels, and standard of living). Therefore, new institutionalism theory contributes to the debate over the role that individuals play in influencing an institution’s outcomes.

Additionally, both governance and new institutionalism assert the importance of both formal and informal arrangements (Lane & Nyen, 1992; North, 2009). According to North (1991), “institutions are the humanly devised constraints that structure political, economic and social interaction. They consist of both informal constraints (sanctions, taboos, customs, traditions, and codes of conduct), and formal rules (constitutions, laws, property rights)” (p. 97). Thus, since public budget is “the life-blood of the government” (Wildavsky, 1961, p.184), we could argue that public budget transparency plays an important role in enhancing the quality of governance, government performance, and human development (DiMaggio & Powell, 1991; Ndulu & O’Connell, 1999). Accordingly, the current paper examines whether the public budget transparency levels of nations affect governance (i.e., quality of institutions).
Methodology and Data Sources

Although many studies have addressed governance throughout history, little has been said regarding the relationship between budget transparency and governance. The current paper attempts to fill this gap by studying the relationship between budget transparencies from 2006 to 2012. Thus, the first research question is: Is there a relationship between budget transparency (independent variable) and quality of governance (dependent variable)? Furthermore, the current study will explore whether the relationships between budget transparency and each governance indicator vary based on a country’s level of development. Thus, the second research question is: Does the relationship between budget transparency and quality of governance vary from country to country based on each country’s level of development?

Measuring Budget Transparency

Many indices and guidelines have been introduced in an effort to measure and evaluate the application of budget transparency by governments (e.g., open budget index (OBI), best practices for budget transparency by the Organization for Economic Co-operation and Development (OECD), and guidelines for public expenditure management by the International Monetary Fund (IMF)). Although it is based on data collected through surveys sent to institutions and civil society organizations – which raises some concerns regarding the accuracy of the results, since most of the data collection is based on the subjectivity of the participants rather than fact-based analysis (de Renzio et al., 2005; Hameed, 2011) – the open budget index (OBI) is nonetheless considered by many scientists and organizations to be the most reliable and credible tool available for measuring the application of budget transparency by governments (Carlitz, 2013; Santiso, 2006; Wehner & de Renzio, 2013). OBI “assesses whether governments provide their citizens with timely, comprehensive, and useful budget information; whether oversight institutions, including the legislature and external auditors, are effectively performing their role; and whether the public has opportunities to participate in the budget process” (Masud, p. 43).

OBI is a product of the open budget initiative, which is part of the International Budget Partnership’s (IBP) program, which is founded by the Center on Budget and Policy Priorities. The first index of OBI was issued 2006, and it has been issued every two years since. OBI collected data from 100 countries in 2012 (International Budget Partnership, 2012). In the current paper, the open budget index is used as a measure of budget transparency. According to International Budget Partnership (2012):

The Open Budget Index (OBI) assigns each country a score from 0 to 100 based on the simple average of the numerical value of each of the responses to the 95 questions in the questionnaire that assess the public availability of budget information. A country’s OBI score reflects the timeliness and comprehensiveness of publicly available budget information in the eight key budget documents (p. 45).

Measuring Governance

While there are many governance indices, most specialize in measuring certain aspects of the governing process, while few attempt to comprehensively cover all aspects of governance. The World Bank Group’s set of worldwide governance indicators (WGI) is considered by many scholars to be “the most comprehensive publicly available set of governance indicators” (Arndt & Oman, 2006, p. 28).

The current paper will use the worldwide governance indicators (WGI) as a measure of the quality of governance for several reasons. The WGI includes six indicators, each of which measures one aspect of the governing process. Unlike other indices, the WGI contains an
indicator for each aspect of the governing process, affording researchers and policy-makers a better understanding of the political process (de Ferranti et al., 2009; Langbein & Knack, 2010). Accordingly, in the current research, each indicator will be used as a separate, unique variable in order to reach a better understanding of the relationship between each aspect of the governance process and budget transparency.

In addition, 31 sources of data were used to construct the WGI indicators, thus enriching their quality (Kaufmann et al., 2010, 2009a). The WGI, which used more than 441 variables in formulating and measuring the six indicators of governance, covers more than 213 countries and territories, making this the only set of indicators to cover all member states of the United Nations (Arndt & Oman, 2006). The WGI has been an annual indicator since 2004; however, it was biannual from 1996-2003. Accordingly, a scale of low to high quality of governance (-2.5 to +2.5), will be adopted in the current paper. Six dimensions are used in measuring the level and quality of governance as part of the Worldwide Governance Indicators (WGI): 1) Voice and Accountability (VA), 2) Political Stability and Absence of Violence (PS), 3) Government Effectiveness (GE), 4) Regulatory Quality (RQ), 5) Rule of Law (RL), and 6) Control of Corruption (CC) (Kaufmann et al., 2009a).

**Measuring Human Development**

Many studies have found a strong correlation between governance on the one hand and economic growth and human development on the other (Kaufmann & Kraay, 2002; Ranis, Stewart, & Samman, 2006; Smith, 2007). Thus, a nation’s human development level is used in this study to analyze the relationship between governance and budget transparency. Many indices and reports have been issued for measuring and evaluating countries’ human development level, including the human development index (HDI), human rights index (HRI), and human development reports (HDRs) (McGillivray, 1991; Ranis et al., 2006; Streeten, 1994). HDI has been adopted in the current study because it has been recognized as a well-designed index that captures and measures the majority of human development aspects in a credible and valid way (Haq, 1995; Noorbakhsh, 1998; Ranis et al., 2006).

HDI is a product of the United Nations Development Program (UNDP) and has been published annually since 1990. HDI is an index that ranks countries based on their human development level relative to other countries. Three dimensions – adult literacy, life expectancy at birth, and standard of living – are used in calculating HDI (UNDP, 2010). According to UNDP (2010), gross national income (GNI) is used to measure the standard of living, life expectancy at birth is used to measure level of life expectancy at birth, and mean years of schooling and expected years of schooling are used to measure level of adult literacy. For every human development component, there is a mathematical formula, and there is an aggregate formula that includes all three formulas to construct HDI (UNDP, 2010). HDI can range from 1.0-0.0, where scores of the final formula divides countries as follows: 1.0-0.79 (very high development), 0.78-0.698 (high development), 0.69-0.52 (medium development), and 0.51-0.28 (low development) (UNDP, 2010). For the current paper, the 2006, 2008, 2010, and 2012 issues of HDI will be used.

**The Relationship between Budget Transparency and Good Governance**

The first research question sought to determine whether there was a relationship between budget transparency (as measured by the open budget index) and good governance (as measured by Voice and Accountability, Political Stability, Government Effectiveness, Regulatory Quality, Rule of Law, and Control of Corruption). Since all the variables were measured using an interval scale, correlation procedures were conducted. As most of the variables were highly
skewed and not distributed normally, non-parametric Kendall-Tau correlation tests were utilized.

**Budget Transparency and Good Governance in 2006**

The findings in Table 1 reveal that the Open Budget Index (OBI) was positively associated with the six indicators of good governance in 2006. Therefore, increased levels of budget transparency were significantly associated with increased levels of Voice and Accountability (VA), Political Stability (PS), Government Effectiveness (GE), Regulatory Quality (RQ), Rule of Law (RL), and Control of Corruption (CC).

**Table 1: Kendall Tau Correlations between Budget Transparency and Good Governance in 2006 (N = 98)**

<table>
<thead>
<tr>
<th>Variables</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
</tr>
</thead>
<tbody>
<tr>
<td>Open budget index</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Control of corruption</td>
<td>.44***</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Government effectiveness</td>
<td>.47***</td>
<td>.71***</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Political stability</td>
<td>.23***</td>
<td>.48***</td>
<td>.41***</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rule of law</td>
<td>.42***</td>
<td>.77***</td>
<td>.75***</td>
<td>.49***</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Regulatory quality</td>
<td>.51***</td>
<td>.69***</td>
<td>.77***</td>
<td>.41***</td>
<td>.70***</td>
<td></td>
</tr>
<tr>
<td>Voice and accountability</td>
<td>.56***</td>
<td>.56***</td>
<td>.51***</td>
<td>.46***</td>
<td>.53***</td>
<td>.55***</td>
</tr>
</tbody>
</table>

* p < .05. ** p < .01. *** p < .001.

**Budget Transparency and Good Governance in 2008**

The findings in Table 2 show that the OBI was positively associated with the six indicators of good governance in 2008. Therefore, increased levels of budget transparency were significantly associated with increased levels of VA, PS, GE, RQ, RL, and CC.

**Table 2: Kendall Tau Correlations between Budget Transparency and Good Governance in 2008 (N = 91)**

<table>
<thead>
<tr>
<th>Variables</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
</tr>
</thead>
<tbody>
<tr>
<td>Open budget index</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Control of corruption</td>
<td>.42***</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Government effectiveness</td>
<td>.41***</td>
<td>.58***</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Political stability</td>
<td>.26***</td>
<td>.33***</td>
<td>.29***</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rule of law</td>
<td>.37***</td>
<td>.59***</td>
<td>.54***</td>
<td>.37***</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Regulatory quality</td>
<td>.49***</td>
<td>.58***</td>
<td>.54***</td>
<td>.37***</td>
<td>.57***</td>
<td></td>
</tr>
<tr>
<td>Voice and accountability</td>
<td>.51***</td>
<td>.40***</td>
<td>.34***</td>
<td>.28***</td>
<td>.38***</td>
<td>.39***</td>
</tr>
</tbody>
</table>

* p < .05. ** p < .01. *** p < .001.
Budget Transparency and Good Governance in 2010

As shown in Table 3, the OBI was positively associated with five of the indicators of good governance in 2010. Increased levels of budget transparency were significantly associated with increased levels of VA, GE, RQ, RL, and CC but not PS.

Table 3: Kendall Tau Correlations between Budget Transparency and Good Governance in 2010 (N = 82)

<table>
<thead>
<tr>
<th>Variables</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
</tr>
</thead>
<tbody>
<tr>
<td>Open budget index</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Control of corruption</td>
<td>.32***</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Government effectiveness</td>
<td>.35***</td>
<td>.51***</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Political stability</td>
<td>.14</td>
<td>.30***</td>
<td>.27***</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rule of law</td>
<td>.30***</td>
<td>.59***</td>
<td>.60***</td>
<td>.35***</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Regulatory quality</td>
<td>.39***</td>
<td>.45***</td>
<td>.59***</td>
<td>.34***</td>
<td>.56***</td>
<td></td>
</tr>
<tr>
<td>Voice and accountability</td>
<td>.46***</td>
<td>.36***</td>
<td>.37***</td>
<td>.31***</td>
<td>.35***</td>
<td>.42***</td>
</tr>
</tbody>
</table>

* p < .05. ** p < .01. *** p < .001.

Budget Transparency and Good Governance in 2012

As shown in Table 4, the OBI was positively associated with five of the indicators of good governance in 2012. Once again, increased levels of budget transparency were significantly associated with increased levels of VA, GE, RQ, RL, and CC but not PS.

Table 4: Kendall Tau Correlations between Budget Transparency and Good Governance in 2012 (N = 57)

<table>
<thead>
<tr>
<th>Variables</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
</tr>
</thead>
<tbody>
<tr>
<td>Open budget index</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Control of corruption</td>
<td>.30***</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Government effectiveness</td>
<td>.46***</td>
<td>.48***</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Political stability</td>
<td>.14</td>
<td>.25***</td>
<td>.25***</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rule of law</td>
<td>.40***</td>
<td>.63***</td>
<td>.58***</td>
<td>.32***</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Regulatory quality</td>
<td>.48***</td>
<td>.45***</td>
<td>.53***</td>
<td>.32***</td>
<td>.55***</td>
<td></td>
</tr>
<tr>
<td>Voice and accountability</td>
<td>.43***</td>
<td>.34***</td>
<td>.41***</td>
<td>.27***</td>
<td>.41***</td>
<td>.42***</td>
</tr>
</tbody>
</table>

* p < .05. ** p < .01. *** p < .001.

The Moderating Effect of Human Development on the Relationship between Budget Transparency and Good Governance

The second research question sought to determine whether the relationship between budget transparency (as measured by the OBI) and good governance (as measured by VA, PS, GE, RQ, RL, and CC) varied across nations’ levels of human development. The independent variable, budget transparency, was transformed into a binary variable, with the top 50 countries categorized into the highly transparent group and the bottom 50 countries assigned to the less transparent group. The moderator, human development, was transformed from a four-category
variable into a two-category variable with the Very High and High categories collapsed into a single group and the Medium and Low categories collapsed into another group. Because the indicators of good governance were highly skewed (and transformations did not correct for skewness), the six indicators were coded into binary variables based on their medians. Since the dependent variables were binary, logistic regression procedures were conducted. The product of the independent and moderator variables, the interaction term, was evaluated at an alpha of .05.

Results for 2006

Control of corruption. The findings in Table 5 indicate that human development did not moderate the relationship between budget transparency and CC scores in 2006, \( B = .07, p = .949 \). Rather, human development had a main effect on CC scores, \( B = -2.16, p = .001 \). In comparison to countries that were highly transparent, the likelihood that countries that were not as transparent would have higher CC scores dropped by .12.

<table>
<thead>
<tr>
<th>Variables</th>
<th>B</th>
<th>SE</th>
<th>OR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Control of corruption</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High vs. low human development (HD)</td>
<td>-2.16</td>
<td>.54</td>
<td>0.12</td>
</tr>
<tr>
<td>High vs. low budget transparency (BT)</td>
<td>-0.78</td>
<td>.54</td>
<td>0.46</td>
</tr>
<tr>
<td>HD x BT</td>
<td>0.07</td>
<td>1.08</td>
<td>1.07</td>
</tr>
<tr>
<td>Government effectiveness</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High vs. low human development (HD)</td>
<td>-2.90</td>
<td>.67</td>
<td>0.06</td>
</tr>
<tr>
<td>High vs. low budget transparency (BT)</td>
<td>-0.12</td>
<td>.67</td>
<td>0.89</td>
</tr>
<tr>
<td>HD x BT</td>
<td>-1.78</td>
<td>1.35</td>
<td>0.17</td>
</tr>
<tr>
<td>Political stability</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High vs. low human development (HD)</td>
<td>-0.85</td>
<td>.50</td>
<td>0.43</td>
</tr>
<tr>
<td>High vs. low budget transparency (BT)</td>
<td>-0.06</td>
<td>.50</td>
<td>0.95</td>
</tr>
<tr>
<td>HD x BT</td>
<td>-0.64</td>
<td>.99</td>
<td>0.53</td>
</tr>
<tr>
<td>Rule of law</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High vs. low human development (HD)</td>
<td>-1.58</td>
<td>.52</td>
<td>0.21</td>
</tr>
<tr>
<td>High vs. low budget transparency (BT)</td>
<td>-0.60</td>
<td>.52</td>
<td>0.55</td>
</tr>
<tr>
<td>HD x BT</td>
<td>-0.63</td>
<td>1.03</td>
<td>0.53</td>
</tr>
<tr>
<td>Regulatory quality</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High vs. low human development (HD)</td>
<td>-2.99</td>
<td>.71</td>
<td>0.05</td>
</tr>
<tr>
<td>High vs. low budget transparency (BT)</td>
<td>-0.81</td>
<td>.71</td>
<td>0.44</td>
</tr>
<tr>
<td>HD x BT</td>
<td>-3.16</td>
<td>1.43</td>
<td>0.04</td>
</tr>
<tr>
<td>Voice and accountability</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High vs. low human development (HD)</td>
<td>-0.50</td>
<td>.55</td>
<td>0.61</td>
</tr>
<tr>
<td>High vs. low budget transparency (BT)</td>
<td>-1.85</td>
<td>.55</td>
<td>0.16</td>
</tr>
<tr>
<td>HD x BT</td>
<td>1.09</td>
<td>1.10</td>
<td>2.98</td>
</tr>
</tbody>
</table>

\* \( p < .05 \). ** \( p < .01 \). *** \( p < .001 \).
**Government effectiveness.** Likewise, human development did not moderate the relationship between budget transparency and GE scores, $B = -1.78$, $p = .187$, but it did have a main effect on GE scores, $B = -2.90$, $p = .001$. In comparison to countries that were highly transparent, the likelihood that countries that were not as transparent would have higher GE scores dropped by .06.

**Political stability.** Human development did not moderate the relationship between budget transparency and PS scores, $B = -.64$, $p = .520$, nor did it have a main effect on PS scores, $B = -.85$, $p = .088$.

**Rule of law.** Human development did not moderate the relationship between budget transparency and RL scores, $B = -.63$, $p = .542$, but it did have a main effect on RL scores, $B = -1.58$, $p = .002$. In comparison to countries that were highly transparent, the likelihood that countries that were not as transparent would have higher RL scores dropped by .21.

**Regulatory quality.** Human development significantly moderated the relationship between budget transparency and RQ scores, $B = -3.16$, $p = .027$. Post-hoc procedures reveal that within countries scoring high on human development, there was no relationship between budget transparency and RQ scores, $B = .77$, $p = .502$; however, within countries scoring lower on human development, there was a relationship between budget transparency and RQ scores, $B = -2.39$, $p = .003$. In particular, in comparison to countries that were highly transparent, the likelihood that countries that were not as transparent would have higher RQ scores dropped by .09.

**Voice and accountability.** Human development did not moderate the relationship between budget transparency and VA scores, $B = 1.09$, $p = .322$, nor did it have a main effect on VA scores, $B = -.50$, $p = .367$.

**Results for 2008**

**Control of corruption.** As shown in Table 6, human development did not moderate the relationship between budget transparency and CC scores in 2008, $B = 1.00$, $p = .340$. Rather, human development had a main effect on CC scores, $B = -.25$, $p = .017$. In comparison to countries that were highly transparent, the likelihood that countries that were not as transparent would have higher CC scores dropped by .29.

**Government effectiveness.** Similarly, human development did not moderate the relationship between budget transparency and GE scores, $B = -.05$, $p = .963$, but it did have a main effect on GE scores, $B = -1.77$, $p = .001$. In comparison to countries that were highly transparent, the likelihood that countries that were not as transparent would have higher GE scores dropped by .17.

**Political stability.** Human development also did not moderate the relationship between budget transparency and PS scores, $B = 1.46$, $p = .141$, nor did it have a main effect on PS scores, $B = -.57$, $p = .253$. 
<table>
<thead>
<tr>
<th>Variables</th>
<th>B</th>
<th>SE</th>
<th>OR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Control of corruption</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High vs. low human development (HD)</td>
<td>-1.25</td>
<td>* 0.52</td>
<td>0.29</td>
</tr>
<tr>
<td>High vs. low budget transparency (BT)</td>
<td>-1.29</td>
<td>* 0.52</td>
<td>0.27</td>
</tr>
<tr>
<td>HD x BT</td>
<td>1.00</td>
<td>1.04</td>
<td>2.71</td>
</tr>
<tr>
<td>Government effectiveness</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High vs. low human development (HD)</td>
<td>-1.77</td>
<td>*** 0.53</td>
<td>0.17</td>
</tr>
<tr>
<td>High vs. low budget transparency (BT)</td>
<td>-1.01</td>
<td>0.53</td>
<td>0.37</td>
</tr>
<tr>
<td>HD x BT</td>
<td>-0.05</td>
<td>1.06</td>
<td>0.95</td>
</tr>
<tr>
<td>Political stability</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High vs. low human development (HD)</td>
<td>-0.57</td>
<td>0.50</td>
<td>0.57</td>
</tr>
<tr>
<td>High vs. low budget transparency (BT)</td>
<td>-0.37</td>
<td>0.50</td>
<td>0.69</td>
</tr>
<tr>
<td>HD x BT</td>
<td>1.46</td>
<td>0.99</td>
<td>4.32</td>
</tr>
<tr>
<td>Rule of law</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High vs. low human development (HD)</td>
<td>-0.89</td>
<td>0.50</td>
<td>0.41</td>
</tr>
<tr>
<td>High vs. low budget transparency (BT)</td>
<td>-0.53</td>
<td>0.50</td>
<td>0.59</td>
</tr>
<tr>
<td>HD x BT</td>
<td>0.63</td>
<td>0.99</td>
<td>1.88</td>
</tr>
<tr>
<td>Regulatory quality</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High vs. low human development (HD)</td>
<td>-2.40</td>
<td>*** 0.58</td>
<td>0.09</td>
</tr>
<tr>
<td>High vs. low budget transparency (BT)</td>
<td>-1.20</td>
<td>* 0.58</td>
<td>0.30</td>
</tr>
<tr>
<td>HD x BT</td>
<td>-0.87</td>
<td>1.16</td>
<td>0.42</td>
</tr>
<tr>
<td>Voice and accountability</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High vs. low human development (HD)</td>
<td>-0.29</td>
<td>0.56</td>
<td>0.75</td>
</tr>
<tr>
<td>High vs. low budget transparency (BT)</td>
<td>-2.04</td>
<td>*** 0.56</td>
<td>0.13</td>
</tr>
<tr>
<td>HD x BT</td>
<td>1.47</td>
<td>1.13</td>
<td>4.36</td>
</tr>
</tbody>
</table>

*p < .05. **p < .01. ***p < .001.

**Rule of law.** Human development did not moderate the relationship between budget transparency and RL scores, $B = .63$, $p = .524$, nor did it have a main effect on RL scores, $B = -.89$, $p = .072$.

**Regulatory quality.** Human development did not moderate the relationship between budget transparency and RQ scores, $B = -.87$, $p = .450$, but it did have a main effect on RQ scores, $B = -2.04$, $p = .001$. In comparison to countries that were highly transparent, the likelihood that countries that were not as transparent would have higher RQ scores dropped by .09.

**Voice and accountability.** Human development did not moderate the relationship between budget transparency and VA scores, $B = 1.47$, $p = .192$, nor did it have a main effect on VA scores, $B = -.29$, $p = .603$.

**Results for 2010**
Control of corruption. The findings in Table 7 indicate that human development did not moderate the relationship between budget transparency and CC scores in 2010, B = .87, p = .425. Rather, human development had a main effect on CC scores, B = -1.53, p = .005. In comparison to countries that were highly transparent, the likelihood that countries that were not as transparent would have higher CC scores dropped by .22.

Government effectiveness. Likewise, human development did not moderate the relationship between budget transparency and GE scores, B = -0.82, p = .501, but it did have a main effect on GE scores, B = -2.37, p = .001. In comparison to countries that were highly transparent, the likelihood that countries that were not as transparent would have higher GE scores dropped by .09.

Political stability. Human development also did not moderate the relationship between budget transparency and PS scores, B = 1.44, p = .144, nor did it have a main effect on PS scores, B = -0.72, p = .144.

Table 7: Logistic Regression Results for Good Governance in 2010 (N = 73)

<table>
<thead>
<tr>
<th>Variables</th>
<th>B</th>
<th>SE</th>
<th>OR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Control of corruption</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High vs. low HD (HD)</td>
<td>-1.53</td>
<td>**</td>
<td>0.22</td>
</tr>
<tr>
<td>High vs. low BT (BT)</td>
<td>-1.41</td>
<td>**</td>
<td>0.24</td>
</tr>
<tr>
<td>HD x BT</td>
<td>0.87</td>
<td>1.08</td>
<td>2.38</td>
</tr>
<tr>
<td>Government effectiveness</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High vs. low HD (HD)</td>
<td>-2.37</td>
<td>***</td>
<td>0.09</td>
</tr>
<tr>
<td>High vs. low BT (BT)</td>
<td>-1.67</td>
<td>**</td>
<td>0.19</td>
</tr>
<tr>
<td>HD x BT</td>
<td>-0.82</td>
<td>1.22</td>
<td>0.44</td>
</tr>
<tr>
<td>Political stability</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High vs. low HD (HD)</td>
<td>-0.72</td>
<td></td>
<td>0.49</td>
</tr>
<tr>
<td>High vs. low BT (BT)</td>
<td>0.16</td>
<td></td>
<td>1.17</td>
</tr>
<tr>
<td>HD x BT</td>
<td>1.44</td>
<td>0.98</td>
<td>4.20</td>
</tr>
<tr>
<td>Rule of law</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High vs. low HD (HD)</td>
<td>-1.09</td>
<td>*</td>
<td>0.34</td>
</tr>
<tr>
<td>High vs. low BT (BT)</td>
<td>-0.74</td>
<td></td>
<td>0.48</td>
</tr>
<tr>
<td>HD x BT</td>
<td>0.49</td>
<td>1.00</td>
<td>1.63</td>
</tr>
<tr>
<td>Regulatory quality</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High vs. low HD (HD)</td>
<td>-2.05</td>
<td>***</td>
<td>0.13</td>
</tr>
<tr>
<td>High vs. low BT (BT)</td>
<td>-1.64</td>
<td>**</td>
<td>0.19</td>
</tr>
<tr>
<td>HD x BT</td>
<td>0.75</td>
<td>1.18</td>
<td>2.11</td>
</tr>
<tr>
<td>Voice and accountability</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High vs. low HD (HD)</td>
<td>-1.99</td>
<td>**</td>
<td>0.14</td>
</tr>
<tr>
<td>High vs. low BT (BT)</td>
<td>-3.26</td>
<td>***</td>
<td>0.04</td>
</tr>
<tr>
<td>HD x BT</td>
<td>-0.08</td>
<td>1.48</td>
<td>0.92</td>
</tr>
</tbody>
</table>

* p < .05. ** p < .01. *** p < .001.
Rule of law. Human development did not moderate the relationship between budget transparency and RL scores, $B = .49, p = .623$, but it did have a main effect on RL scores, $B = -1.09, p = .029$. In comparison to countries that were highly transparent, the likelihood that countries that were not as transparent would have higher RL scores dropped by .34.

Regulatory quality. Human development did not moderate the relationship between budget transparency and RQ scores, $B = .75, p = .527$, but it did have a main effect on RQ scores, $B = -2.05, p = .001$. In comparison to countries that were highly transparent, the likelihood that countries that were not as transparent would have higher RQ scores dropped by .13.

Voice and accountability. Human development did not moderate the relationship between budget transparency and VA scores, $B = -.08, p = .956$, but it did have a main effect on VA scores, $B = -1.99, p = .007$. In comparison to countries that were highly transparent, the likelihood that countries that were not as transparent would have higher VA scores dropped by .14.

Results for 2012

Control of corruption. As shown in Table 8, human development did not moderate the relationship between budget transparency and CC scores, $B = 1.87, p = .178$, nor did it have a main effect on CC scores, $B = -1.12, p = .108$.

Government effectiveness. Human development significantly moderated the relationship between budget transparency and GE scores, $B = 3.47, p = .048$. Post-hoc procedures reveal that within countries scoring highly on human development, there was a relationship between budget transparency and GE scores, $B = -4.09, p = .008$; in particular, in comparison to countries that were highly transparent, the likelihood that countries that were not as transparent would have higher GE scores dropped by .02. However, within countries scoring lower on human development, there was no relationship between budget transparency and GE scores.

Political stability. Despite increasing the number of iterations to 50, a final solution could not be found. Cross-tabulations revealed that there were no countries that could be categorized as high on human development with minimal budget transparency and high PS scores. It is thus possible that the result is an indication of failure of estimation.

Rule of law. Human development did not moderate the relationship between budget transparency and RL scores, $B = 1.82, p = .222$. Human development also did not have a main effect on RL scores, $B = -.37, p = .619$. 
Table 8: Logistic Regression Results for Good Governance in 2012 (N = 53)

<table>
<thead>
<tr>
<th>Variables</th>
<th>B</th>
<th>SE</th>
<th>OR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Control of corruption</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High vs. low human development (HD)</td>
<td>-1.12</td>
<td>0.70</td>
<td>0.33</td>
</tr>
<tr>
<td>High vs. low budget transparency (BT)</td>
<td>-0.51</td>
<td>0.70</td>
<td>0.60</td>
</tr>
<tr>
<td>HD x BT</td>
<td>1.87</td>
<td>1.39</td>
<td>6.49</td>
</tr>
<tr>
<td>Government effectiveness</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High vs. low human development (HD)</td>
<td>-1.62</td>
<td>0.88</td>
<td>0.20</td>
</tr>
<tr>
<td>High vs. low budget transparency (BT)</td>
<td>-2.36</td>
<td>**</td>
<td>0.09</td>
</tr>
<tr>
<td>HD x BT</td>
<td>3.47</td>
<td>*</td>
<td>32.14</td>
</tr>
<tr>
<td>Rule of law</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High vs. low human development (HD)</td>
<td>-0.37</td>
<td>0.75</td>
<td>0.69</td>
</tr>
<tr>
<td>High vs. low budget transparency (BT)</td>
<td>-1.35</td>
<td>.750</td>
<td>0.26</td>
</tr>
<tr>
<td>HD x BT</td>
<td>1.82</td>
<td>1.49</td>
<td>6.17</td>
</tr>
<tr>
<td>Regulatory quality</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High vs. low human development (HD)</td>
<td>-1.27</td>
<td>0.83</td>
<td>0.28</td>
</tr>
<tr>
<td>High vs. low budget transparency (BT)</td>
<td>-2.49</td>
<td>**</td>
<td>0.08</td>
</tr>
<tr>
<td>HD x BT</td>
<td>1.73</td>
<td>1.65</td>
<td>5.63</td>
</tr>
<tr>
<td>Voice and accountability</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High vs. low human development (HD)</td>
<td>-1.32</td>
<td>0.88</td>
<td>.270</td>
</tr>
<tr>
<td>High vs. low budget transparency (BT)</td>
<td>-2.78</td>
<td>**</td>
<td>.06</td>
</tr>
<tr>
<td>HD x BT</td>
<td>0.23</td>
<td>1.75</td>
<td>1.26</td>
</tr>
</tbody>
</table>

* p < .05. ** p < .01. *** p < .001.

**Regulatory quality.** Human development did not moderate the relationship between budget transparency and RQ scores, B = 1.73, $p = .296$, nor did it have a main effect on RQ scores, $B = -1.27, p = .125$.

**Voice and accountability.** Human development did not moderate the relationship between budget transparency and VA scores, $B = .23, p = .895$, nor did it have a main effect on VA scores, $B = -1.32, p = .132$.

**Discussion**

In regard to the research question of whether there was a relationship between budget transparency and good governance, the answer found in this study is yes. Budget transparency was positively associated with increased levels of governance indicators in 2006 and 2008. In 2010 and 2012, OBI was related to all indicators except political stability. This result confirms the influence of budget transparency in the adoption of good governance practices by governments and increased quality of governance.

Conversely, while the result of the analysis shows the importance of budget transparency in improving quality of governance, the analysis concludes that, while the human development level of nations has an influence in shaping the relationship between budget transparency and quality of governance, this influence is not entirely significant. Thus, regarding the second research question of whether the relationship between budget transparency and good governance...
varies across levels of human development of nations, the answer varies across variables and years. While human development significantly moderated the relationship between budget transparency and regularity quality in 2006 and the relationship between budget transparency and government effectiveness in 2012, it did not moderate relationships in any other years.

To conclude, while the result emphasizes the importance of budget transparency in improving institutional quality, human development has minimal influence on the relationship between budget transparency and good governance. The length and complexity of the public budget makes it difficult for the average citizen to understand, and this could be a reason for the minimal influence of human development on the relationship. Also, the result confirms a significant influence of human development on the relationship between budget transparency on one hand and regulatory quality and government effectiveness on the other, which can be interpreted in terms of people devoting more attention to those factors that have a direct influence on their daily lives (e.g., regulatory quality and government effectiveness) than to the rest of the factors.

Furthermore, other factors that might maximize the influence of public budget transparency on institutional quality (e.g., political and social factors) have not been included in the analysis. Also, the current study covers only four years, whereas including more years in the analysis might give us better understanding of the effect of the human development level of nations on the relationship between budget transparency and quality of governance.

Conclusion

Public budget is the engine that drives any economy; thus, budget transparency has an influence in shaping the political process and government performance. The result of the analysis shows a significant relationship between budget transparency and quality of governance, which is inconsistent with the literature. Thus, budget transparency contributes to reducing corruption, improving government performance, and holding bureaucrats and politicians accountable for their actions. Hence, the budgetary system and the public budget process have impacts on the way government operates.

Conversely, while the human development level of nations significantly moderated the relationships between budget transparency and regularity quality and between budget transparency and government effectiveness, it did not moderate any other relationships. Future research should examine the relationship between human development and quality of governance in the process of understanding factors that contribute to enhancing the governing process.
References


ABOUT IJGFM
The *International Journal on Governmental Financial Management* (IJGFM) is a peer-reviewed and open access journal and aims to provide a forum for practitioners and academics to discuss the many disciplines involved with governmental financial management. These include accounting, auditing, budgeting, performance measurement, debt management, information technology, tax management and treasury management.

We publish articles and comments which will:

- encourage collaboration among professionals, academics 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 in identifying their own solutions to common challenges.

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

EDITORIAL TEAM

*Editor*
Prof. Dr. Hassan Ouda, German University in Cairo, Egypt

*Editorial Board*

- Femi Aborisade, The Polytechnic, Ibadan, Nigeria.
- Pawan Adhikari, University of Essex, UK (from Nepal).
- Hugh Coombs, University of Glamorgan Business School, Wales, UK.
- Jérôme Dendura, Consultant in Public Financial Management (from France).
- Jesse Hughes, Old Dominion University (retired), Virginia, USA.
- Pratap Jena, National Institute of Public Finance and Policy, India.
- Harika Masud, Consultant in Public Financial Management (US Based).
- Fred Mear, de Montfort University, UK.
- Mohamed Moindze, Consultant in Public Financial Management, National School of Administration, Madagascar.
- Patrizio Monfardini, University of Siena, Italy.
Norvald Monsen, Norwegian School of Economics and Business Administration, Norway.
Ayodeji Ogunyemi, National Audit Office, UK (from Nigeria).
Eddy Omolehinwa, University of Lagos, Nigeria.
Joseph Onumah, University of Ghana.
Michael Parry, Independent Public Financial Management Consultant, UK.
Zakiah Saleh, University of Malaya, Kuala Lumpur, Malaysia.
Carlos Santiso, Inter American Development Bank, US.
Stewart Smyth, Queen's University Belfast, UK.
Sylvia Temu, University of Dar es Salaam, Tanzania.
Daniel Tommasi, Independent Public Financial Management Consultant, France.
Mathew Tsamenyi, University of Birmingham, UK (from Ghana).
Nidhi Walia, Thapar University, India.
Zbyslaw (Peter) Dobrowolski – Editor, Professor, Jagiellonian University, Institute of Public Affairs, Poland.
Owen Zhang, China National Audit Office.

AUTHORS’ GUIDELINES
Manuscripts should be sent as an email attachment to the editor, Hassan Ouda - icgfm.ijeditor@icgfm.org and be copied to icgfm@icgfm.org

Structure of the Manuscripts/ Format and Style

The title should be short, clear and informative, but does not exceed 15 words.
Author's names and institutions. The author's names should be accompanied by the author's institutions and an email account, without any academic title. It should be placed below the title. For a joint paper, one of the authors should be notified as the corresponding author.
Count of pages should not exceed 20 single spaced pages or 10,000 words.
An abstract not exceeding 150 words - it should summarize the purpose, methodology, and major conclusions of the article. The key words should be of 3 to 5 words.
Authors should write in a non-sexist and non-discriminatory style, using, for example, "her/him"; or "s/he"
limited use of abbreviations to improve ease of reading, 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 and others, 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, et al, ibid or op cit should be avoided.

Bibliography

A bibliography should be included at the end of the text containing details of all books, articles papers, etc. which have been referenced 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:


Charts, Diagrams, Figures and Tables

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

Copyright

Material published in the Journal may be reproduced without the consent of the editor or the consortium and reproduction, translation and distribution is encouraged.
PUBLICATION ETHICS AND PUBLICATION MALPRACTICE STATEMENT

The role of the editor is to evaluate the suitability of submitted manuscripts for the International Journal on Governmental Financial Management. This evaluation includes: (a) the quality of the manuscript, (b) whether it meets the Aims and Scope of the journal, and (c) the originality of the work. The editor will not disclose information about a submitted manuscript to anyone other than the author(s).

Below is the expected ethical behavior for our potential authors and the peer reviewers based on Elsevier publishing ethics and COPE’s guidelines.

**Ethical Guidelines for Peer Reviewers**

- Reviewers are expected to be objective; avoiding any personal criticism of the authors.
- Reviewers are expected to treat the work of the authors fairly as if it is their own.
- Reviewers should avoid any personal biasness related to the nationality, religious or political beliefs or gender.
- Reviewers are asked to ensure declaring all potential competing, or conflicting, interests.
- Reviewers should express their views clearly with supporting arguments.
- Reviewers are expected to report any potential ethical issues in the paper with respect to research and publication ethics do let the editor.
- Reviewers must not share the review or any information about the paper.
- Any communication with the authors should be through the editor.
- Reviewers are expected to respond to the editor within the agreed-upon time frame.

**Ethical Guidelines for the Authors**

- Authors must warrant that the work does not infringe upon any existing copyright and does not contain material of a libelous or scandalous nature.
- By submission of a paper to the Journal, the author indemnifies the publisher and editors against any breach of such warranty or copyright restrictions.
- Authors of reports of original research should present an accurate account of the work performed as well as an objective discussion of its significance.
- Authors may be asked to provide the research data supporting their paper for editorial review and/or to comply with the open data requirements of the journal.
- The authors should ensure that they have written entirely original works, and if the authors have used the work and/or words of others that this has been appropriately cited or quoted and permission has been obtained where necessary.
Proper acknowledgment of the work of others must always be given. Authors should cite publications that have influenced the reported work and that give the work appropriate context within the larger scholarly record.

Plagiarism takes many forms, from ‘passing off’ another’s paper as the author’s own paper, to copying or paraphrasing substantial parts of another’s paper (without attribution), to claiming results from research conducted by others. Plagiarism in all its forms constitutes unethical behaviour and is unacceptable.

An author should not in general publish manuscripts describing essentially the same research in more than one journal of primary publication. Submitting the same manuscript to more than one journal concurrently constitutes unethical behaviour and is unacceptable.

Information obtained in the course of confidential services, such as refereeing manuscripts or grant applications, must not be used without the explicit written permission of the author of the work involved in these services.

Authorship should be limited to those who have made a significant contribution to the conception, design, execution, or interpretation of the reported study. All those who have made substantial contributions should be listed as co-authors.

When an author discovers a significant error or inaccuracy in their own published work, it is the author’s obligation to promptly notify the journal editor or publisher and cooperate with the editor to retract or correct the paper if deemed necessary by the editor. If the editor or the publisher learn from a third party that a published work contains an error, it is the obligation of the author to cooperate with the editor, including providing evidence to the editor where requested.