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**PUBLIC SECTOR ACCOUNTING AND
BUDGETING REFORM: THE MAIN
ISSUES INVOLVED WITH SPECIAL
FOCUS ON THE ARAB WORLD**

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**PUBLIC SECTOR ACCOUNTING AND BUDGETING REFORM:
THE MAIN ISSUES INVOLVED**

With special focus on the Arab world

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With special focus on the Arab world

ABSTRACT

The last two decades have witnessed radical changes in the public sector of some countries such as New Zealand, UK and Australia. In addition, the Asia-Pacific region (especially the countries which are called as Asian Tigers such as: Malaysia, Singapore, Thailand, and Philippines) has also witnessed remarkable public sector reform initiatives in terms of changing the role of state and its impact on public sector management; state/private sector relationship; resource use and efficiency; and decentralized planning.

Even though most of the developed countries (and some of the developing countries such as: Tanzania) have followed this trend, *governments in the Arab world* are still using the traditional government accounting system (which is cash-based system) and traditional budgeting system (line item budget – input-based budget system). Those systems are no longer able to provide the information which is required by an efficient and effective government. Therefore, this paper will be devoted to research the government accounting and budgeting reform in general and, in particular, in the Arab countries. More precisely, this paper deals with the main shortcomings of the prevailing system of government accounting and budgeting in the Arab world: Cash accounting system. It outlines the need for changes in the government accounting and budgeting system. Furthermore, it discusses the link between management reform and accounting and budgeting reform. It ends with discussion of the implications of the implementation of the accounting and budgeting reform in the Arab countries.

Keywords: government accounting innovation, budgeting reform, public sector reform, accrual accounting and accrual budgeting

1- Introduction

In the second half of last century, radical changes took place in the management tools, information technology, ways of decision-making, performance measurements, accounting procedures, accounting systems etc. These changes were more transparent in the private sector in comparison with the public sector. No one would expect the private sector to manage, make decision, measure the performance, and use accounting procedures and practices as it did in the beginning of last century. In many parts of the public sector, especially central government, they are still using the management tools, accounting systems, accounting procedures, accounting standards, and performance measurements that have been used for more than a century ago. Although a few countries have implemented radical reforms in different levels of the public administration (such as: New Zealand, UK, Australia and Canada), in order to improve management efficiency and effectiveness, most of the countries do not use the new management tools, and the more informative accounting systems. The reason is that they are convinced that the new tools and the more informative accounting systems are appropriate for business organization, which aims at making profit. And this is not the aim of the public sector, which aims at serving the public interest.

On the other hand, nowadays governments are requested:

- to be fully accountable to the community for resources entrusted to them;
- to work better and cost less;
- to improve the fiscal policy;
- to do more with less;
- to realize that living on credit is not sustainable for it;
- not to leave huge burdens on future generations;
- to disclose the real financial position of the whole government. (IFAC 1997)

In short, the governments are requested to be efficient and effective. This means that there should be emphasis on strategic control of aggregate spending and priority setting; and the facilitation of greater efficiency and effectiveness through delegation of management authority with accountability for results. In order to achieve that, the decision-makers in all levels in the public sector need a more improved and useful information. This, in turn, requires from the government to perform radical changes in the public administration system. Examples of these reforms are:

- Management changes;
- Accounting changes; and
- Budgeting changes.

The management changes are essential to redefine the accountability relationship between the executive's authority members (such as ministers and chief executives). This redefinition is required for determining:

- what should be produced (the output);
- how it can be produced;
- what the responsibilities of the ministers are;
- what the responsibilities of the chief executives are; and
- what the effects (outcomes) are of that product (the product can be goods or services) on the community.

In this context, the government accounting and budgeting system needs to be innovated in order to support the management changes. Basically, accounting as an information system plays an important role in whatever reform process any government entity would want to undertake. Thus, the move from cash to accrual accounting is an important step in developing the government accounting and budgeting system. In short, cash will no longer be sine non-qua of the public sector financial management. Australian CPA, 1998, stated that “cash, in the past, was control. The one unbreakable rule was: do not spend more cash than Parliament has allocated unto you. The reform process entails a concerted move away from that mindset. The new focus is on contributing to outcomes within specified operating and capital budget”.

In addition, government should be positive and open with its public by not limiting the amount of information that reveals about its own performance. Therefore, the government should give greater attention towards developing more business-like reporting system within public sector. This in turn can contribute towards more transparent and informative public accounts and greater efficiency in the management of public resources. In this context, government accounting system has to be able to provide appropriate information for decision-making process. On the one hand, the accounting information has to be useful to politicians to choose the objectives and on the other hand, it has to be useful to managers to design the strategy in order to achieve the objectives (Gimeno 1997).

The aforementioned radical changes in the public sector were a consequence of several reasons. The challenges arising from global economic integration are one of the essential reasons underlying these radical changes. Globalization is exerting great pressure on the governments to make fundamental changes to the administrative systems, accelerate enterprise reform, and open up the financial system to foreign competition (Fulin 2001). Globalization demands a public sector that is responsive to an increasing competitive environment. It also demands that governments and public bodies harmonize their goals. Harmonization may ensure that economic development is not stifled and instead provides stimulus for the creation of improved standard living. Therefore, there is an increasing need for proper determination of how public resources are allocated and for monitoring the effective use of these resources. In short, the rapid integration of the world economy through increased trade and investment (an integration which has been fueled by new technologies, spread of information and the growing importance of knowledge-based industries) provides the potential for opening up new age for human development.

Moreover, it has become clear in the last two decades that the public sector reform has been reinforced by global economic crisis. In New Zealand, for instance, the major public sector reforms that began in 1984 were integrally linked with the economic crisis and the conditions leading to it, as well as with political change- namely the election of the labor government in 1984. Following the election in mid- 1984 the incoming government faced an economy with an extended history of slow economic growth, high fiscal deficits, high debt including substantial liabilities resulting from various guarantees given by previous governments (Scott 1990). Then, the sick economy was the impetus for reform.

And, in yet another reason is, the pressure that is exerted by the international financial institutions, such as International Monetary Fund (IMF) and World Bank (WB), on

most countries to make the required economic reform, including the public sector reform. This pressure can be more observed in underdeveloped and transitional economies where international organizations require particular accounting innovations to be effected as a sine qua non of assistance being provided (Godfrey et al.1999). Finally, increasing the international experience with respect to the public sector reform will result in stimulation of other countries, which have not started yet with the public sector reform, to follow this trend.

As a result of the aforementioned reasons, we can conclude that the public sector reform (including management, accounting and budgeting reforms) is a must. It will take place whether the countries want it or not. It is a matter of time where some countries have the ability to quickly response to the external and internal events and other countries take some time to response, but in the end they will follow. Therefore, scrutinizing where we have been certainly helps us to better know where we are headed. This is why it is essential to better understand the many types of public sector reform initiatives, how they are inter-related and the impacts they generate.

Even though most of the developed countries (and some of the developing countries such as: Tanzania) have followed this trend, **governments in the Arab world** are still using the traditional government accounting system (which is cash-based system) and traditional budgeting system (line item budget – input-based budget system). Those systems are no longer able to provide the information which is required by an efficient and effective government. So in order for the government accounting system to be relevant for an efficient and effective government, it should be an informative accounting system. Namely, it should provide the information, which can demonstrate the accountability of government for the financial affairs and resources entrusted to it, and be useful for decision-making.

Therefore, this paper deals with the public sector accounting and budgeting reform in general and particularly in **the Arab world**. More precisely, it tackles the main issues involved in this subject. So the main aim of this paper is:

- to critically analyze the main shortcomings of the prevailing system of government accounting and budgeting in the Arab world: Cash accounting system;
- to outline the need for changes in the government accounting and budgeting system;
- to discuss the link between management reform and accounting and budgeting reform;
- to discuss the implications of the implementation of the accounting and budgeting reform in the Arab world.

2- Main shortcomings of the prevailing system of government accounting and budgeting in the Arab world: Cash accounting system

Before dealing with the main shortcomings of cash accounting system, it would be useful to give a brief idea about its nature, concept and advantages in the public sector.

2.1 Cash accounting: Nature and concept

The basis of accounting is a set of rules that determine when revenues and expenditures or expenses are recognized. The cash basis of accounting recognizes transactions and events only when cash has been received or paid (IFAC 1991). This takes place independently of the time when goods and services are ordered, delivered and consumed. Goods and services, for which payments are made (labor, stores, transportation ...etc.), are considered to be consumed when suppliers are paid. This means that the cash basis of accounting shows only the volume of disbursements. Such disbursements do not reveal the amount of resources used and the value of actual work done. According to the cash basis, the statement of receipts and expenditures is prepared to disclose information about cash flows during a period and cash balances at the end of that period (IFAC 1993). Consequently, the financial statements include only three elements: cash receipts, cash disbursements, and cash balances. Cash receipts and cash disbursements represent cash inflows and cash outflows respectively, and the cash balance is the difference between cash inflows and cash outflows.

Inherent to the cash accounting, it is not possible to prepare balance sheets. Because there are no assets and liabilities in the books: “sales are only recognized when cash is received (so there are no debtors); purchases are only recognized when cash paid (so there are no creditors); there are no stock adjustments because the accounts are not concerned with recording usage, only with the fact that cash has been paid for purchases (so there is no closing stock figure). Furthermore, there are no fixed assets, for the same reasons (Jones and Pendlebury 1984)”.

So cash accounting measures financial results for a period as difference between cash received and cash disbursed and provides a comparison of actual against budgeted expenditures. Hence, the information, which can be provided to the different users, is about the sources of cash received during the period, the uses to which those funds were applied, and the cash balances at the reporting date (IFAC 1991).

But: *Why have the most sovereign governments adopted the cash accounting? In other words, what are the advantages of cash basis that made the governments adopt it?*

2.2 Advantages of cash accounting

- Cash accounting is the easiest to maintain and serves the stewardship function of accounting well by furnishing information that can assist in assessing whether resources were used in accordance with the legally adopted budgets;
- The estimates on cash basis are meeting the requirements, which are placed by the control function (Langendijk 1990);
- As a result of its widely use, it facilitates the international comparison of the budgets and accounts;
- It provides useful data that permit analysis of the monetary impact of fiscal transaction and facilitates review and assessment of the cash position (United Nations 1984);
- It produces the same data as accrual basis when expenditures are mainly for salaries, travel and for goods and services which are received, paid for and consumed within a fiscal year;
- It is simple, relatively cheap and easier to understand than accrual-based accounting and in many countries even preferred by national legislatures;

- The popularity of the cash basis in government accounting arose from the need for Parliament, or other representatives of the electorate, to monitor the collection of taxation receipts and the subsequent spending of those receipts by the government each year (IFAC1998).
- It describes over which management has full control, although it ignores resources over which full control has not been established, and it reflects legal reality associated with fiscal compliance as reflected in government budgets.
- It is more objective in comparison with the accrual basis. Cash accounting does not include the subjective adjustments that have to be made to produce balance sheets and income statements;
- It provides necessary information on receipts and expenditures made during the fiscal year, expenditures reflect that part of the acquisition of goods and services for which payments are made during the fiscal year.

Of course the essential point is not whether the accounting system is simple, easy to understand, cheap or objective; it is the extent to which it provides the required and useful information that satisfies the users needs. This will lead us to pose the following questions:

- Does cash basis, in accordance with the above-mentioned advantages, provide effective information which can lead to an effective management of government programs, activities and for result assessment?
- What are the problems that arise by the use of cash accounting in governmental entities?
- In other words, what have the governments (especially in the Arab countries) missed as a consequence of the adoption of cash accounting system in the government sector?

These questions will be answered in section 2.3

2.3 Shortcomings of cash accounting in the public sector

It has been noticed from inducing the practice that public sector entities around the world follow diverse accounting practices. However, IFAC 1998 has made some generalization by stating that most governments use cash-based information for budgeting, accounting and fiscal management. As a consequence, frequently, government activities are managed with poor quality financial information that is not reliable, not timely, or limited in its data on assets and liabilities (IFAC 98). So the main task of this section is to show the extent to which cash-based governmental accounting system provide poor quality financial information to the users. The fact that government accounts are maintained on cash basis has led to serious distortions and significant information is missed. In short, there are important shortcomings in cash-based government accounting system, especially when the following facts are taken into account:

The Hidden Liabilities

One of the main shortcomings of the cash basis of accounting is the fact that it fails to provide governments with complete information on all the total liabilities which take place in a given year (IFAC 97). Under a pure cash basis of accounting, no liabilities are recognized. Accordingly, neither liabilities due in the current period (short-term

liabilities) nor liabilities which are owed beyond the current period (long-term liabilities) are recorded in the operating accounts of that period. As a result of not recognizing the long-term liabilities (for example, pensions, compensated absences, judgements, and claims) as well as their costs are not recognized and reported, the governments do not make plans to meet these liabilities when they come due. And this, in turn, will lead to increasing the deficit in one period more than the other periods. For example, by the late 1980's, Canada's federal and provincial governments had accumulated more than \$ 30 billion unrecorded employee pension liabilities. In some provinces, the size of unrecorded liability equaled or exceeded their accumulated deficits (Hillier-IFAC 1997). The accounting bases affect the volume of the deficit. Under the cash basis most of the liabilities are hidden, and this gives the government the opportunity to manipulate the deficit amount. But the changing from cash basis to accrual basis will show the hidden liabilities and will force the government entities to suddenly show huge deficits in governmental funds. For example, the Government of Kate Carnell in the Australian Capital Territory, which has been at the forefront of accrual budgetary reform. When it came into government, it inherited a budget deficit of about \$80 million. After implementing the new accounting system, it had an accrual-operated loss of \$343 million in July 1996, despite considerable economic reforms that normally would have been expected to balance the budget (<http://www.brw.com.au/newsadmin/stories/brw/19990329/1687.htm>).

This may explain why politicians do not warm to the new basis of accounting. Because it makes budgets look less impressive as it includes liabilities previously not accounted for. So as a result of using the cash basis, a huge amount of the government's liabilities are not reported in financial statements and are not taken into account when assessing government's financial position and results, or determining its future revenues requirements. Moreover, the accrued expenses of the government are also not known at the end of the fiscal year. The all previously mentioned demonstrate how misleading is to use cash-based accounting system in the government.

No information on the earned revenues is available

Under the cash basis of accounting the revenues will only be recognized in the financial statements in the period in which cash is received. However, the cash receipts do not make distinction between current receipts and capital receipts. So an excess of receipts over payments cannot be called income because receipts might encompass capital receipts. This will result in that the revenues, which are earned in a given fiscal year, are not known. As such it is difficult to evaluate the efficiency of the collection staff, and to discover the losses during the collection process. In addition, under cash basis, receipts and revenues are identical since no difference exists between the time when they are recognized and when they are collected. But under accrual basis, the recognition of revenues is required at the time when they are earned, and the receipts occur when revenues are collected.

No information on the total cost of services is provided

The use of cash-based accounting system would result in reporting of only those costs, which involved a cash flow during the period. However, the cash disbursements do not reflect what the organization cost to run during the year, because these disbursements may also include cash flows resulting from, for example, the acquisition of assets or the

repayments of debt related to the previous years. This means that 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. As a result, there is little incentive to use current capital assets efficiently. 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). Also as a result of not capitalizing 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 cost 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 and these costs are important for performance evaluation, control, public contracts policy and price fixing policy, and to measure the efficiency and the effectiveness of the governmental entities.

The total value of stocks is not disclosed

Cash-based accounting system does not present information regarding the value of stocks that are consumed during the fiscal year or the stocks, which are still existed at the end of that year. This is because the accounts are not concerned with recording the usage; they are rather concerned with the cash outflow, which has been paid for purchases. As a consequence, there are no stock adjustments, stock valuation and stock measurement. This would result in that the real value of the stocks is not known and this in turn gives rise to the appearance of several problems such as: carrying cost problem; freezing the public money, opportunity cost of public capital. Furthermore, these stocks can be lost by a deliberate manipulation during the addition and deduction operations. It would be wrong, however, to assume that these problems are management problems rather than accounting problems. They are certainly both management and accounting problems. The output of the accounting system with respect to the stocks is considered as one of the main and important information sources that the management relies on in the decision making process. So the absence of a useful accounting information regarding the stocks would result in that the management will not be able to take the right and deliberate decision in relation to the above stated problems.

No information on the total assets is provided

The elements, which are included in the financial statements under the cash-based accounting system, are cash receipts, cash disbursements and cash balances. Accordingly, there is no information provided on the total assets (financial and physical). For example, there is no information provided about the investment in materials, supplies, equipment's and other assets, which are available for future use in carrying out of the government unit's work. No subsequent account is taken of whether the assets are still in use, have reached the end of their useful life or have been sold. Nevertheless, this information can be used in estimating how much is to be requested in each year's budget.

For proper understanding, we can give an example to illustrate the above-mentioned limitations: Assume that X government entity needs some raw materials costing

\$20,000 to use them in producing the goods and services. These raw materials are ordered in July, delivered and received in August, and paid for in September. Moreover this entity in October 2002 has sold goods in amount of \$30,000 and it has agreed with the customer to pay 50% of that amount in November and the other 50% in January 2003. In addition, in November 2002 this entity has issued \$1 million in long-term debt to cover its financial deficit.

July (Commitment)

The order is placed. The X governmental entity incurs commitment for \$ 20,000

August (Accrued Expenditure)

The raw materials are received. At this point the X government entity becomes committed to pay for them. The accounts of the X governmental entity will show accounts payable

(Liability) of \$ 20,000 and an inventory of raw materials on hand of \$20,000.

September (Payments)

Payment is due. A cheque is issued for \$20,000 and accounts payable in X governmental entity are eliminated.

October (Revenues earned)

The revenues of sold goods are earned but not yet collected. The accounts will show accounts receivable of \$30,000 and sales revenues account of \$30,000.

November (Receipts and issuing of long-term debt)

The first half of the revenues is collected. Herein the accounts receivable are reduced by amount of \$15,000.

Also the X government entity has issued \$ 1,000,000 to cover its deficit, the accounts will show a long-term liability of \$1,000,000

At this point, the accounts of X governmental entity show that the commitment incurred, the expenditure accrued, the asset acquired, the revenues earned, and it also shows the liability (short and long-term liabilities), disbursements, and the receipts.

If the above-mentioned transactions had been recorded under cash-based accounting system, the X governmental entity accounting information would provide only the payments of the bill of \$20,000 (September) and the receipts of \$1,015,000 (November), but would not have provided the following information:

- How much money others owe to the X governmental entity (accounts receivable)?
- What short and long-term liabilities have been incurred in a given year?
- How much resources have been consumed in carrying out the operations during the accounting period (operating costs)?
- How much revenues have been earned in a given period?
- What the value of inventory of the raw materials is at the end of a given period?
- What the value of the total assets is at the end of the fiscal year?

Clearly, the above stated example has shown that the cash-based accounting system provides information only on the payments and receipts and very important information is missed, and this in turn will lead to serious distortion in the decision-making process.

From all the previously mentioned, ***True and fair view about financial position of government can not be provided.*** As a result of using the cash basis of accounting, no information can be provided about the actuality of the financial position of the governmental entity at the end of the fiscal year. Moreover, the changes in the financial position are not reported. Hence true and fair view of government financial positions can not be disclosed with the governmental cash-based accounting system.

Over-spending appropriation

The balances of appropriations (the estimated expenditures) available for expenditure may not be accurately stated when determined only on the basis of cash payments. Part of the balances so determined are needed to pay for the goods and services received or ordered but not paid for. Thus, there is a strong potential for over-spending appropriated amounts when the cash basis is used (United Nations 1984).

No performance measurements are available

As illustrated in the above-stated example, important information is lacked on period revenues, expenses, long-term liabilities, amounts receivable, amounts payable, value of stocks, total cost of service produced. As a result, reliable information about the performance measurements of the government and their impact on the economy is not provided. For example, because there are no assets or liabilities, there is no measure for the net worth. Since the net worth is the difference between total assets and total liabilities, the changes in the total assets and the total liabilities will affect the net worth. So if the government increased the liabilities either by borrowing to fund the deficit or obligation to make payments in the future, such as pension; or increased the assets which would provide economic benefits to the reporting entity, these actions would affect the net worth. Similarly, because there is no information available on the total cost of services and goods, the government can not compare the total cost of the services and goods produced in a given year with the total cost of services and goods produced in the previous years. Obviously, under the cash-based accounting system, the accounts tell us about the amounts of receipts and expenditures compared with the budgeted figures. So the only measure of performance which can be yielded is the comparison of budget with actual.

The cash-based accounting is inadequate for control purposes

Cash accounting is not a complete accounting system and its internal control is very weak. Inherent to this system is not possible to control the usage of the inventories during the year or to what extent the fixed assets have been used in a right way or how much is redeemed from the total government's debt in the fiscal year. On the other hand, this system assists in fulfilling the budgetary control function. The budgetary control is concerned with ensuring that actual expenditures are in line with budgeted amounts and that the objectives and levels of activity envisaged in the budget are achieved. Therefore it is required in the governmental entities, in order to achieve the control purposes, to prepare the budget (A budget is financial plan describing the estimated expenditures and the means of financing them) as a control means on the activity of the governmental entity besides the financial regulations – restrictions. Where the budget and the financial regulations are forming the cornerstone of the

internal control system within the governmental entity. Hence, cash accounting system alone without the budget and financial regulation – restriction is inadequate for control purposes.

Cash-based accounting system is not cost effective

According to the nature of cash-based accounting, items such as fixed assets, creditors, commitments, debtors, payroll can not be integrated into one system, where this system includes only cash receipts and cash disbursements. On the other hand in order to get information on items such as creditors, debtors, and commitments, etc. there should be other separate accounts used. These accounts are generally called regular accounts or extra accounting files. These accounts are used to report on financial assets and liabilities that are not included in the cash accounting system. This is because cash accounting system can not comprise all the elements of assets and liabilities, thereby increasing double processing and reconciliation problems associated with separated systems. Theoretically, an integrated system, able to produce information on all elements, would be more efficient than separated systems. Clearly, this would result in the accounting system being cost effective. So in total, we see that cash-based accounting system is not cost effective as a result of using separate systems and the related reconciliation problems. Therefore we call upon integration in place of disparity and duplication.

It is not useful for comparison purposes

As it is clear from the nature of cash-based accounting system that it is interested in cash flows and recognizes the events and transactions only when cash has been received or paid. Therefore, it always happens that one year can be charged by costs made in other years. Accordingly, the use of cash basis results in interpenetrating of activity of the different financial years. For example, if the government entity purchased spare parts in amount of 10.000 on account in 2002 and used them in the same year but the payments will be made in 2003. The accounts in 2002 will not show the accrued costs of the spare parts and the accounts in 2003 will show only the payments and these payments are included in the total expenditures of that year although this year has not benefited from the spare parts. Consequently, the adoption of cash-based accounting system by governmental entities often makes the comparison between the results of different financial years less important and very difficult.

It gives rise to a deliberate manipulation

Finally, one of the greatest limitations of cash accounting relates to the potential for deliberate manipulation of the accounts to produce preferred results (Jones & Pendlebury 1984). For example, the real spending of a department or services might be the same under whatever system of accounting is adopted but in a given year, using cash accounting, the cash payments could be postponed by as little as twenty-four hours so that the accounts record a lower figure. Imagine a given department or service which can see that it is going to over-spend its budget. Rather than reduce its spending it maintains it, but postpones cash payments (Jones & Pendlebury 1984). This is not to say that other accounting bases, in particular accrual accounting, are not impervious to manipulation, but they are not so open to the same abuses to which cash accounting can be subjected.

In addition to the above stated shortcomings, the Public Sector Committee (PSC) of the International Federation of Accountants (IFAC) has identified in its study 1 (1991) seven objectives of governmental financial reporting. **Of the seven objectives only the first three objectives** are met by a cash-based government accounting system.

Those objectives are as follows:

- 1- “indicating whether resources were obtained and used in accordance with the legally adopted budget.
- 2- indicating whether resources were obtained and utilized in accordance with legal and contractual requirements, including financial limits established by appropriate legislative authorities.
- 3- providing information about how the government or unit financed its activities and met its cash requirements.
- 4- providing information about the sources, allocation and uses of financial resources.
- 5- providing information that is useful in evaluating the government’s or unit’s ability to finance its activities and to meet its liabilities and commitments.
- 6- providing information about the financial condition of the government or unit and changes in it.
- 7- providing aggregate information useful in evaluating the government’s or unit’s performance in terms of costs, efficiency and accomplishments.

Thus, all the previously mentioned shortcomings can lead to another question, *why are most governments still adopting the cash basis by their government accounting and budgeting systems?*

As far as this question is concerned there are four reasons as follows:

- 1- **Political reasons:** By the use of cash basis of accounting, the politicians can easily cook the books, namely, they can easily show positive results or reduce the negative results and convince the public that they are doing something different than what they are actually doing. For example, a government may want to convince people: (Hillier - IFAC 97)
- that their budgetary deficit is less than what actually is;
 - that they really haven’t exceeded spending authority granted by the legislature;
 - that the growth in their total expenditures is less than what really is;
 - that the liabilities to be met by the future generations are less than they really are;
 - that this year’s performance compares favorably with their own or a previous government’s past performance; and
 - that by comparison with other governments their performance is really quite good.

Another example, in 1993, two Dutch accountants J. Poot and C. Boer made an attempt to prepare the State balance sheet according to accrual accounting system. They found out that the central government did very defective financial reporting over its assets and liabilities. According to the data of the Dutch Ministry of Finance the net worth of the

State (assets – liabilities) is f 70 billion negative. But according to the balance sheet, which is prepared by the two accountants (based on accrual accounting system), the net worth is f 180 billion negative.

So the use of cash basis by the Dutch central government accounting system has helped the Minister of Finance to reduce the negative results from f180 billion to f 70 billion (de volkskrant 1994). So it can be inferred that even though the cash-based government accounting does not provide the required information by the politicians which can assist them in evaluating the performance, discharging the accountability and decision-making, it is serving their interest by giving them the opportunity for a deliberate manipulation. This can explain why there are no political incentives, particularly in the governments that have an interest in limiting the amount of information that reveals about their performance, to use a more informative accounting system. Self-evident the use of cash basis serves the interest of the government more than the public.

2- **Traditional reasons:** the cash accounting has been used by governments for long time till it became one of the main traditions of the central government. The government accountants are accustomed to prepare the budget on cash basis and to disclose the monetary position of the government, hence, they are not required to prepare the balance sheet and income statement. In contrast to the informative accounting system, cash accounting can help them to avoid the adjustments and evaluation problems, which are necessary to prepare the balance sheet.

3- **Resistance to change:** usually, the civil servants are not active enough and they have not the incentives that make them to bear additional work that is involved in shifting to the new accounting system. Then the fear of being burdened with the responsibility of carrying out new procedures that involve additional work, both in quantity and quality, may be the real reason for putting up such resistance

4- **Scarcity:** the scarcity of the qualified personnel with advanced knowledge in government accounting forms one of the main reasons of maintaining the cash accounting.

2.4 Cash accounting and traditional budgeting system

It was pointed out in the introduction that the Arab world is using the traditional (line item) budget. The traditional budget is designed to ensure legislative control over the expenditure of public money. However, it does not indicate the relationship between the expenditure and results, and this prohibits the formulation and execution of economically meaningful budgetary policy. Moreover, it prevents proper political choice among objectives and rational allocation of resources as well as limiting the public understanding of government activity (Wilenski 1982). This budget is a short-term process that makes rational planning more difficult. It stresses inputs rather than outputs and controls only the inputs, this in turn, results in inhibiting the ability of the managers to flexibly manage resources to achieve program objectives. In short, this budget system does not satisfy the information needs of the efficient and effective government. On the other hand, the government can overcome the shortcomings of traditional budget by shifting to the program-performance budget. The latter aims to provide a systematic method of improving the allocation process; to incorporate in planning activity recognition of costs of alternatives programs resources available; and

to provide a basis for choosing between the feasible alternative programs (Mills 87). The program-performance budget indicates the relationship between the inputs and the outputs and whether the resources have been effectively used and the target objectives have been achieved. In short, it focuses on the purposes of expenditures and the outcome of the expenditures and provides data, which can be used to evaluate this outcome. Clearly, the program-performance budget has more advantages than the traditional budget. Then, the question is: *why has the traditional budget lasted up till now?*

Some has argued that it serves a valuable purpose in government. For example:

- it limits the expenditure to the amounts and to the items voted in the appropriations;
- it makes budgeting easier and more manageable; and
- it is adaptable to all-economic circumstances and conditions (Wilenski 1982).

In addition, we see that accounting system, which is used to carry out the budget, plays an essential role in lasting one method of budgeting in comparison with the others. However, each accounting basis has a special nature and characteristic which makes it appropriate for a specific use, hence, to be consistent with one of the budgeting methods (in practice there are three methods of budgeting: line-item budgeting, program budgeting, and performance budgeting). Similarly, the use of one budgeting method can also play a fundamental role in lasting one accounting basis in comparison with the others. Namely, in the public sector there is a strong relationship between the budget system and the accounting system, where they are complementing each other.

For proper understanding we assume the following:

Assumption 1: that the budget system should be compatible with the accounting system which is used to carry out the budget, therefore, the basis on which the budget is prepared should be consistent with the basis of accounting used.

Assumption 2: that the budget reform involves accounting reform to support it. So it can be inferred that there is an interrelationship between the budget system and the accounting system, this means that any change in one of them will result in change in the other.

On the *first assumption*, when the government accounting is based on cash basis, then it provides information on whether resources were obtained and used in accordance with the legally adopted budget; whether resources were obtained and utilized in accordance with legal and contractual requirements, including financial limits established by appropriate legislative authorities; and about how the government or unit financed its activities and met its cash requirements. Typically, this is the information, which satisfies the requirements of the line item (traditional) budget. This means that the nature and requirements of the traditional budget are consistent with the concept and the implications of cash basis of accounting. Consequently, the continuity of using the cash-based government accounting would result in lasting the traditional budget in spite of its disadvantages.

Assumption 2 could make the fact more clear, when the government wants to overcome the problems of traditional budget, namely, to emphasize the output in place of input; to

provide information relevant for performance measurement, decision-making and discharge the accountability, it should develop its budget system. For example, to shift from traditional budget system to program-performance budget system. However, each budgeting method needs a relevant accounting system that is consistent with its nature and requirements. Basically, cash-based accounting system is unable to satisfy the requirements of the program-performance budget. Therefore, the accounting system should be developed too in order to provide the required information. For example, to adopt accrual accounting in place of cash accounting. In reality, the nature and the requirements of the program-performance budget are consistent with the concept and the implications of accrual accounting system.

So the development of the budget system without taking into consideration the related accounting system will not achieve the target benefits of that development. Hence, the continuity of using the cash-based government accounting would have resulted in not improving and developing the budget system. And this can explain why most of the developing countries are still using the line-item (traditional) budget. Self-evident the use of cash basis in most of the government accounting systems was/is one of the main reasons behind the lasting of traditional budget, namely, it has assisted in the postponement of the budget reform by most of the countries.

Generally, we could say, if one government wants to develop its budget system it should firstly adopt the accounting system that could be able to carry out this budget and to be consistent with its nature. Should this not take place, the development of the budget system will not have major effects on the performance of the government.

2.5 Concluding remarks

The rationale for discussion of these shortcomings is to research the extent to which cash-based government accounting system provide the required accounting information that satisfies the users needs, in particular with respect to an efficient and effective government which is required for the new millenium.

In summary, we have seen that the cash accounting system provides essential information and it is simple, easier to understand, cheap and much more objective than other alternatives. On the other hand, this system is not intended to provide information on the cost of services, earned revenues, accounts receivable, accounts payable, long-life assets, long-term liabilities, accrued interest on external debt, cost effectiveness, and property inventories. In addition, Cash-based information alone does not provide indication of long-term fiscal strength and the relationship between revenues, expenses and changes in net worth, and the trade off between the burdens of current and future taxpayers. Furthermore, cash-based government accounting does not provide the users with complete and comprehensive financial information that they need for decision-making purposes and does not assist to a great extent in discharging the accountability.

3- The Need for accounting and budgeting reform in the public sector

As pointed out in section 2, cash accounting is not an informative accounting system. Furthermore, it does not underpin the development of government accounting and

budgeting system, hence, it is not relevant for an efficient and effective government. So in order for the government accounting system to be relevant for an efficient and effective government, it should be an informative accounting system. Namely, it should provide the information that can demonstrate the accountability of government for the financial affairs and resources entrusted to it, and be useful for decision-making. In short, government accounting should disclose the total physical and financial assets, total liabilities, the net worth, expenses and revenues, and to what extent the economic resources were used in an efficient and effective way, and to what extent the fiscal policies are in the interest of both current and future taxpayers. Therefore, there is an urgent need for additional information, one of the important accounting reforms, which merits serious consideration in providing additional information for policy formulation, management and control of resources and effective audit is the use of accrual accounting. In addition to an accrual accounting system, the government would also need an accrual budgeting system so that actual results can be measured against plans and budget. The accounting system would need to be on the same basis as the budgeting system to avoid the possibility of conflicting objectives (Schick, 2001).

So in order to innovate the government accounting and budgeting system in the Arab world, there is an urgent need for:

- a- A shift from cash accounting to accrual accounting system; and*
- b- A shift from traditional (line item) budget to program-performance budget, in other words, from cash budget to accrual budget. (In short: from cash accounting and budgeting system to accrual accounting and budgeting system).*

Accordingly, section 3.1 deals with the adoption of accrual accounting and budgeting in the public sector of some of the developed countries (such as: New Zealand, UK and Australia). In reality, in this section, we shall attempt to explore the challenges and problems (main reasons/considerations), which prompted reforms in those countries. Namely, the shift from cash accounting to accrual accounting and from input-based budget to output based budget (accrual budget). In addition, it illustrates whether these challenges and problems (main considerations) are also valid for the **Arab world** or not.

Furthermore, section 3.2 discusses the challenges and main considerations (main reasons) that will make the Arab countries to follow the international trend regarding the public sector accounting and budgeting reform.

3-1 Main considerations for the adoption of accrual accounting and budgeting in the government sector: An international perspective

Until the end of 1980s governmental accounting had not received the study and reforms it warrants. In the late of 1980s and early of 1990s some countries made an attempt to improve their governmental accounting systems and to make them efficient, such as New Zealand, UK and Australia. These countries have reformed their accounting and budgeting systems by shifting from cash-based accounting system to accrual-based accounting system, from cash-based budget to accrual-based budget system and moving from the separate accounting reporting to consolidated financial statements. This section outlines the background (main considerations) to the adoption of accrual accounting and budgeting across the New Zealand, UK and Australia public sector. In other words, it

explores what the main reasons were for the adoption of accrual accounting and budgeting in the public sector of these countries.

3.1.1 The New Zealand Experience

New Zealand government, like other countries over the past two decades, has been concerned with the growth of public expenditure and the necessity to search for ways to increase the effectiveness of the use of resources which are available for the governmental entities. Prior to 1984, the New Zealand governments had made various attempts to improve public sector operations. Following the election in mid-1984 the incoming government faced an economy with: an extended history of slow growth; very high deficits; high debt including substantial liabilities resulting from various guarantees given by previous governments; and highly sheltered private sector (MacCulloch & Ball 1992).

In addition, Richardson (IFAC 1997) stated that the imperative for change in New Zealand was three fold:

- Sick economy – one of the worst performance in the Organization for Economic Co-operation and Development (OECD)
- Sick public institutions – lack of efficiency and effectiveness in government agencies
- Sick social policy – neither fair nor affordable.

Richardson has also added that New Zealand suffered from two deficits:

- Financial deficit – in continuous deficit for two decades (70s and 80s) pushing net public levels up from 5% of Gross Domestic Product (GDP) to over 50% of GDP
- Performance deficit – while public expenditure levels climbed from 30% of GDP to over 42% of GDP over those two decades the standard and quality of performance in our public institutions and agencies dropped (IFAC 1997).

As it is clear from the aforementioned, New Zealand was suffering from an economic crisis. This in turn induced the government to undertake a program of economic reforms one element of which was public sector reform. The public sector reform has taken place by introducing three major changes:

- 1- Separating commercial operations from other government production
- 2- Strengthening lines of ministerial and executive accountability
- 3- Designing budget and financial management systems to improve measurement of the public sector performance.

The last reform includes:

- a- shifting from an input-based budget to an output-based budget system
- b- changing from cash to accrual accounting
- c- and creating different forms of appropriations for different types of government activities. (Goldman & Brashares 1992).

Herein, we are not intended to discuss the above stated reforms. The aim here is to discuss the main reasons for the adoption of accrual accounting and budgeting in the New Zealand public sector (Ouda, 2002):

Before the public sector reform took place, particularly in the early 1980s, the New Zealand government's management system was based on a program budgeting, but was in fact dominated by centralized input controls, such as the requirements for

government departments to use centralized monopoly suppliers for accommodation, vehicles, computers and office services. All public money was required to be paid into a consolidated bank account. In accordance with treasury instructions, departments submitted vouchers for payment to treasury offices which organized payment, and reported on the transactions in the “Public Accounts”. (IFAC 1996). Budgeting was formalized in a set of appropriations for cash payments for loosely designed purposes (programs). The appropriations could be expressed in terms of the recipient, the government activity, or the type of payment (e.g., a grant or a capital payment) (Ball & Bradbury 1998).

Furthermore, in this environment, accountability was seen mainly in terms of compliance with written rules aimed at limiting discretion, the absence of corruption, and the avoidance of mistakes or political embarrassment. In this environment, the New Zealand government accounting and financial system was suffering from a number of deficiencies, which have led to accounting and budgeting changes. In other words, these deficiencies were the main reasons for the adoption of accrual accounting and budgeting in the New Zealand public sector. These deficiencies are:

- Accountability is unclear.
- Assets levels are poorly maintained, and changes in value or depreciation are not required to be recorded.
- Goals and performance requirements of government departments are poorly specified.
- Losses, long-term liabilities, and future revenues are obscured by modified cash-based accounting system.
- Incentives often encourage dysfunctional behaviour (for example, year-end spending).
- Responsiveness to changing circumstances is slow.
- Global competitive forces that demand efficiency for survival are often ignored in designing governmental financial systems. (Ball et. al 2000, http://www.rppi.org/privatization/ps_258.html).

In addition to these deficiencies, there are other reasons that made the New Zealand government to shift to accrual accounting and budgeting:

a- Problems with Cash Accounting and Current Financial-management Practices

Cash accounting provides information, which satisfies the annual compliance interest of legislators, but unfortunately has a number of serious limitations and drawbacks (see section 2). These drawbacks and limitations were the main reasons behind the adoption of accrual accounting in the New Zealand public sector.

b- Owner – Purchaser Distinction

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 (output) which are delivered by the departments, and this inevitably requires the adoption of accrual accounting. On the other hand, cash accounting is inadequate for satisfying that purpose because some cost elements are not fully allocated to outputs. Furthermore, the purchase’ interest was also one of the main reasons of budgeting reform. Namely, the shift from input to output-based budget. The new budget reform moves from appropriations for each input used to produce goods and services towards appropriations for classes of outputs that will be purchased by the government. Once again in order to meet the information that would satisfy both the owner’s and purchaser’s interests the use of accrual accounting and budgeting in the New Zealand public sector was an imperative.

c- World-wide Market Competition

As it has been seen in the last two decades the forces of internal and international competition have increased, because of unsustainable fiscal commitments of the governments. Consequently, many countries have attempted to reform and reinvent government activities in an effort to reduce government size and improve efficiency. New Zealand was subjected to these pressures earlier than many other governments, and answered in part with accounting reform (Ball 2000). Moreover, some writers expect that it is likely that the same global market forces will make the adoption of accrual accounting by other governments inevitable in the next two decades.

d- Intergenerational Equity

Intergenerational fairness is important in fiscal policy. Cash accounting allows the government to hide both their liabilities and real state of their finances. Accordingly, traditional government accounting enables the governments to pass off the present costs to the future generations. On the other hand, accrual accounting recognizes the short and long-term liabilities and provides a longer-term perspective for judging the impact of policies. For example, without the use of accrual accounting, decisions on pensions that create pension liabilities may not fully consider the impact of the liabilities on future budgets.

e- Public-Private Competition and the Costing of Outputs

As previously noted, cash accounting does not provide information on the total cost of goods and services delivered by the governmental entities. Hidden costs make the prices of public goods and services artificially lower than the same goods and services provided by the private sector. In other words, cash accounting makes government appear to deliver services more cheaply than the private sector, which is forced to include non-cash expenses as depreciation in its account. This is not true because the taxpayer subsidizes the difference. In order for the governmental entities to be able to provide competitive goods and services, all costs must be allocated to these goods and services. Accrual accounting and output-based budget let’s all costs be allocated to an

output. This was also another reason for adoption of accrual accounting and budgeting in the New Zealand public sector.

In addition, the New Zealand financial reforms have resulted in that:

- Budgeting, accounting and appropriations are now all done on an accrual basis;
- There is a charge for the use of capital;
- All budgeting and management is done according to outputs not inputs;
- Accountability is now clear;
- Managerial discretion is significantly greater than in other nations.

Bear in mind that these financial reforms did not occur in isolation. They were part of a movement to make the New Zealand economy more competitive as well as to make the government more competitive and accountable. In other words, the New Zealand approach with respect to the public sector reform is consistent and comprehensive framework, which comprises all the mechanisms of accounting, reporting, budgeting, parliamentary appropriations, performance specifications and monitoring, rather than dealing with accrual accounting and budgeting as a separate issue. (Ball & Bradbury 1998).

After having discussed the main considerations for the adoption of accrual accounting and budgeting in the New Zealand public sector, we would like to discuss an issue, which is often raised by some opponents. This issue is that the New Zealand has successfully reformed their public sector, namely the implementation of accrual accounting and budgeting in the public sector, because:

- It is a small country; and
- It was suffering from an economic crisis.

This has led to the following questions:

- Can an economic crisis and the size of the country be considered as the only main reasons for making public sector reforms?
- Do England and Australia (in making their public sector reform) have the same economic crisis as that of the New Zealand?
- Are England and Australia small countries like the New Zealand?

Answering these questions will bring us to UK and Australian case.

3.1.2 The England experience

In November 1993, the Chancellor of the Exchequer announced the proposed introduction of Resource Accounting (RA) (1) to UK central government departments. This was followed by a consultation paper (Green Paper) in July 1994, which specified that resource accounting would be implemented in the majority of government departments by 1 April 1997 and in all departments by 1 April 1998. Subsequently, White Paper was published in July 1995, which described the progress that had been made in developing Resource Accounting and the Government's proposals to introduce

(1) Resource Accounting: resource accounting comprises a set of accruals techniques for reporting on the expenditure of central government and a framework for analysing expenditure by departmental aims and objectives, relating these to outputs where possible.

Resource Budgeting (RB) (1), moreover, it stated that the first published accounts would be in respect of 1999-2000 (HMSO 1995). These proposals can be seen as a further step in a process of government financial management reform that laid down in 1982 in the Financial Management Initiative (FMI), focusing on value for money and improved accountability. Also the introduction of accrual-based resource accounting underpin other initiatives taken since 1982, including Next Steps. As part of the Next Steps initiatives, accrual accounting has already been adopted for executive agencies within central government; building on well established principles from commercial accounting procedures. These proposals aimed at applying the resource accounting coherently to the whole of central government, and not just its executive agencies.

The adoption of resource accounting in the UK central government implies:

- identifying outputs and the processes by which are produced;
- charging for all resources consumed including the use of capital assets, central services and non-cash items;
- classifying and valuing all assets;
- compiling and publishing a balance sheet showing assets, depreciation, stocks, debtors and creditors;
- reconciling resource flows and cash funding.

From the above-mentioned, the key feature of resource accounting can be summarized as follows: using of accrual accounting techniques to provide a more accurate measurement of resource consumed; accounting for the use of capital and current resources consistently, in terms of resource consumed; a financial reporting structure to match resources used to departmental objectives, and linking these objectives to quantified measures of output and performance; provision of essential cash accounting information; and a coherent accounting framework to fulfil a range of requirements from low level management information to high level financial reports (Green Paper 1994).

In addition, resource budgeting comprises two elements: managing the Public Expenditure Survey (PES) on a resource accounting basis; and presenting Supply Estimates to Parliament on a resource accounting basis.

As previously noted, UK has proposed two papers (Green Paper 1994 and White Paper 1995) with respect to the introduction of resource accounting and budgeting (RAB). The main reason for introducing the resource accounting and budgeting was the improving of the efficiency and effectiveness of the public sector. Moreover, resource accounting and budgeting was envisaged in the White Paper as a milestone in modernizing the state by:

- focusing more on resources consumed and not just on cash spent;
- treating capital and current expenditure in a way which better reflects their economic significance;
- encouraging the discipline of a greater emphasis on outputs and the achievement of aims and objectives.

(1) Resource Budgeting: resource budgeting covers planning and controlling public expenditure on a resource accounting basis.

In addition to improving the efficiency and effectiveness of public sector, there were a number of reasons that have entailed the adoption of resource accounting and budgeting (RAB) in UK central government:

- There was in UK government dissatisfaction with the use of cash accounting (especially in decisions about capital);
- There was an increasing focus on the objectives and outputs delivered, performance measurement and value for money (rather than cash inputs). This was a natural consequence of the Financial Management Initiative (FMI) which was designed to encourage departments to produce better information on objectives, output and performance.
- The UK government wanted to make the changes that would provide information for better management decisions so that government departments can improve the use of resources to fulfil their objectives;
- Fiscal control: Control of public sector finance has also contributed to the development of public sector accrual accounting in the UK. From its inception, it was envisaged that the change to an accrual accounting basis in central government would have impact on the presentation of public sector plans (HM Government, 1994). However, the new budgeting framework could only be introduced once the new accounting systems were in place (Ellwood 1999).
- The continuing interest in reducing avoidable difference between public expenditure survey and the parliamentary processes; (Likierman 1998)
- The departmental ability to exercise financial control, and to plan and to structure their resources will be enhanced by implementing the resource accounting and budgeting;
- The UK government believes that resource accounting will help promote better management by government departments of the resources and assets made available to them by parliament;
- But the most significant reason is the increasing use of accrual-based accounting in the other parts of the UK public sector (such as, the NHS, Local authorities and executive agencies within central government departments) and in other countries such as New Zealand, which has moved furthest in introducing accruals accounting and budgeting, linked closely to financial management reforms including output-based performance contracts. In addition, other countries (for example Australia, Iceland, Canada, USA and Sweden) are moving in a similar direction;
- In addition, the UK government believes that the accounting and budgeting changes will provide benefits not only for individual departments, but for the public sector as a whole and for the economy more generally as follows:

For the Department: there is the provision of improved management information, especially on costs and assets. This will open up the opportunity for the making of better-informed decisions on the allocation of the resources, especially on capital and on comparison between internal and external providers. And will assist managers in planning and controlling the use of resources within departments.

For the public sector as a whole: the accounting changes provide also for the public sector as a whole a number of benefits:

- improvements in the way in which government conducts its public expenditure planning and control procedures at all levels;

- facilitating the development of cash control at a higher level than hitherto, whilst keeping tight control of public spending as a whole ; and
- in line with other initiatives, contributing to the further development of a strategic approach to managing the Civil services, in line with the principles of the Financial Management Initiative. (Green Paper 1994)

For the economy as a whole: there will be better information for formulating economy policy and preparing National Accounts on the value and use of fixed assets and capital consumption in the public sector; and the possibility of a reduction in the public sector's call on funds by promoting better use of resources. (Green paper 1994).

3.1.3 The Australian experience

As in other countries, the poor economic performance of the 1970s led to a reassessment of the role of the Australian public sector and its management. The Australian public sector was suffering from the lack of a system of performance measurement, the absence of incentives to encourage greater efficiency and the lack of competition as a pressure for improved performance (Mascarenhas 1984). This led to generating pressure for reform, focussing on improving efficiency, effectiveness, responsiveness and accountability. The Financial Management Improvement Program (FMIP), which launched in 1984, was an umbrella under which other administrative reforms were undertaken (e.g. running cost, devolution responsibility, program management and budgeting, user charging, contracting out, corporate planning, and commercialization) (Guthrie 1998). FMIP was concerned as much with effectiveness as with efficiency. In fact, the major concern was to improve the links between programs outcomes and the resources required for achieving them. Hence, the key feature of the FMIP were:

- the development of budgetary and regulatory processes which encourage efficient and effective management practices in departments;
- identifying and promoting techniques and systems that help departmental and agency managers focus on results; and
- changing administrative procedures and practices to give managers more incentive to manage and greater awareness of resource costs (Department of Finance 1988, 5)

Although FMIP focused on the budget – dependent sector, FMIP principles have been a driving force for commercialization of the common services of government and for reform of government enterprises (Keating and Holmes 1990).

This general shift towards a more commercial ethos has highlighted the need for a more commercial style of accounting, involving a move from cash accounting to a full accrual basis of accounting. Consequently, the administrative reforms in the name of improved efficiency, effectiveness, responsiveness and accountability were one of the most important reasons for the adoption of accrual accounting and budgeting in the Australian public sector. The National Commission of Audit (NCOA) in March 1996 said that a full accrual accounting framework was an essential complement to the structural and cultural change the Government was seeking by way of a more competitive, efficient and effective public sector. So it can be inferred that the adoption

of accrual accounting and budgeting in the Australian public sector was a response to management reforms.

In addition, the need for a more transparent and accurate picture of government spending and the use of resources was recognized as far back as the 1970s and early 1980s. Since then other significant pressures have been developed that require governments to have a clear understanding of their use of resources, their whole-of-government financial position and, basically, how to get the best value out of every tax dollar (<http://www.dofa.gov.au/budgetgroup/pressroom/speeches/cpaspeech.asp>). This recognition has also required the adoption of the accrual accounting in order to achieve these objectives.

Moreover, there were other factors which created a climate for an explosion of discussion about the application of accrual accounting to the public sector, such as: various state governments were hit by the emergence of serious fiscal problems, as well as the failure of two major state banks (Guthrie 1998).

Furthermore, the lack of cash accounting to provide the new required information, by managers as a result of management reforms, has also generated pressure for shifting to accrual accounting. Guthrie 1998 said that as commercialization and contracting out reforms started to impact government agencies, new information sets were required to help managers engage with these reforms; these included pricing of goods and services for cost recovery; cost control; liability containment; asset management; evaluating contracting out and leasing options; and workplace bargaining. As in other countries such as New Zealand and UK, the drawbacks of cash accounting was one of the main considerations for the adoption of accrual accounting in the Australian public sector.

Based on the aforementioned, we can answer the previously posed questions under the New Zealand experience. Frankly speaking, the UK and Australia experience has revealed that the two countries have reformed their public sector without having the same economic crisis like the New Zealand. However, the reform of the public sector (including the accounting and budgeting reform) in the name of improved efficiency, effectiveness, responsiveness and accountability does not require per se an economic crisis to be started and achieved. In fact, there are other reasons or considerations, which create a pressure for reforming the public sector as it has been seen from the UK and Australian and also from the New Zealand experience. On the other hand, the size of the country can make the reform process easier especially for the small countries in comparison with the big countries, but it is not a condition for starting a public sector reform. As it is known the size of the UK and Australia is bigger than that of the New Zealand. Yet, the two countries have successfully revamped their public sector. Therefore, it can be concluded that the economic crisis and the size of the country are one of many considerations but they are not the only main considerations for starting and achieving the public sector reform.

In addition, the ideas underlying the New Zealand, UK and Australia reforms apply to any government, including developed and developing countries. They represent good management practices-what one would expect to see in any well-managed organization, public or private. The experience of New Zealand, UK and Australia shows the extent to which accounting, budgeting and financial-management reforms can be successfully applied in the public sector, provided that they are part of a well-designed system. Ball

(2000) said: *if a government can be run in this fashion, why would we continue with outmoded conventional practices?*

In conclusion, the main considerations/reasons for the adoption of accrual accounting and budgeting in the public sector whether for developed and developing countries can be summarised as follows: (Ouda 2002)

- *Management reforms*: it is evident from the experience of New Zealand, UK and Australia that the adoption of accrual accounting and budgeting in their public sector was a response to managerial reforms. The movement to expand the focus beyond inputs towards a “performance-based” or “output-based management, to improve the efficiency, effectiveness and accountability of the public sector, and to increase the managerial discretion which gives managers incentive to manage and greater awareness of resource costs, has led to major changes in the public sector accounting system. In other words, these management reforms entailed the adoption of accrual accounting and budgeting in the public sector of New Zealand, UK and Australia. Furthermore, they will make the adoption of accrual accounting and budgeting inevitable by other governments, which confirmed their intention to make such managerial reforms in the next decades.
- *Problems, shortcomings and drawbacks of cash accounting*: as earlier noted there was in UK and New Zealand (also in other countries) dissatisfaction with the use of cash accounting. This is because cash-based government accounting does not provide the users with complete and comprehensive financial information that they need for decision-making purposes and does not assist to a great extent in discharging the accountability. On the other hand, accrual accounting seems to provide this information and it can to a great extent overcome the shortcomings and drawbacks of cash accounting.
- *Serious fiscal and economic problems*: the New Zealand experience has revealed that New Zealand was suffering from an economic crisis. This crisis induced the government to undertake a program of economic reforms, one element of which was public sector reform (including accounting and budgeting changes). The Contingency Model (Luder 1992) has specified the serious financial problems as driving forces for accounting changes.
- *Harmonizing the government accounting system*: by inducing the practice, we found out that many countries such as France, the Netherlands, Spain and Sweden are using the accrual accounting in the local government. In addition, some parts of the central government such as agencies have also used the accrual accounting system. Then, the use of accrual accounting will bring the accounts of the central government into line with the other parts of the governmental sector, where the accrual accounting is in place.
- *World-wide market competition*: as previously pointed out, the global market forces have led to the adoption of accrual accounting in the public sector in the last two decades and it will make the adoption of accrual accounting by other governments inevitable in the next two decades.

- *Intergenerational Equity and Net Worth*: intergenerational fairness and net worth became important measures for fiscal policy. Intergenerational equity reflects the degree to which the government today is paying the costs of services today, as opposed to shifting costs to other periods. Net worth represents the net assets after subtracting the liabilities. Changes in net worth would give an indication of whether the government follows a deliberate fiscal policy or not. Only accrual accounting provides the financial information required for measuring and judging the impact of fiscal policies.
- *Increasing the international interest in, and experience of, accrual accounting and budgeting in government*: in addition to the New Zealand, UK and Australia experience, accrual accounting has also been introduced in a number of other countries such as Sweden, Finland and the USA (Hansen et al, 1998). In Sweden, government agencies moved to accrual accounting approach between 1991 and 1994, as a development from the new management system of comparing outputs with resources consumed in the public sector. In Finland as part of the new public management reforms, accrual accounting was adopted in local government in 1997 and in central government in 1998. In the USA, the federal government made a commitment to full accruals accounting following statements on federal accounting issued by the Federal Accounting Standard Advisory Board, but accrual accounting was only introduced in 1998 and the approach adopted does not capitalize military and heritage assets (Ellwood 1999). Also the Netherlands adopted accrual accounting in local government (municipalities and Provinces) in 1985 and in central government agencies in 1994.
- *Its benefits in comparison with its costs*: discussion about whether to apply accrual accounting and budgeting system in the public sector should be approached in terms of costs and benefits of such application. As we have seen from our earlier study (Ouda 2002) and from other international publications in this regard, if the benefits of the application of accrual accounting and budgeting in the public sector are weighed against the costs of such application, the cost/benefits analysis has no doubt a positive balance.

In fact, these considerations in all cases apply to any developed and developing country. This means that these considerations will make all the Arab countries sooner or later to adopt the accrual accounting and budgeting in their public sector. On the other hand, we see that the global market forces, as one of the reasons for the adoption of accrual accounting in the public sector, are more applicable in the developed countries than the developing countries. Even though the costs of the production factors are low in developing countries, these countries are not in a position that enables them for competition with the developed countries. Therefore, global market forces can be applied in the developed countries more than the developing countries (especially in the Arab countries).

3.2 The main considerations that can stimulate the adoption of accrual accounting and budgeting in the government sector of the Arab countries

In addition to the previously mentioned challenges and considerations which are also deemed to be fundamental and vital for the Arab countries, we see that there are other

specific reasons, which will make the Arab countries (as an example of the developing countries) to adopt the accrual accounting and budgeting in their public sector. These reasons are as follows:

- *Fighting of the corruption and fraud:* without exception, all developing countries (including the Arab countries) are suffering from the corruption and fraud, since there are serious weaknesses in the internal operations of the government sector in the fiscal field. These weaknesses penetrate into the heart of every government transaction. The government accounting system is outmoded and cumbersome. It does not indicate what was accomplished with the money spent in the year past. The budget system does not indicate accurately what the costs of each activity will be over the coming year. Therefore, the weaknesses of the budgeting, accounting and internal control systems within the governmental sector have resulted in increasing the corruption and fraud. Consequently, improving the accounting and budgeting systems, by the adoption of accrual accounting and performance budget, will aid to some extent in reducing the corruption and fraud phenomena.
- *Response to the international organizations pressure:* nowadays, the international organizations such as the International Monetary Fund (IMF), World Bank (WB) and other aids donors are practicing some pressure on many countries to make changes in social, economic and political fields. Particularly, in underdeveloped and transitional economies, the international organizations can have a major impact, both directly and indirectly, on setting the agenda for innovation (Godfrey et al 1999). Thus, this impact can be more observed in developing countries, where the international organizations require particular accounting and budgeting innovation to be effected as a sine qua non of assistance being provided (Godfrey et al 1999). In fact, this kind of pressure has already been practiced by the international organizations on Egypt in 1991, where the IMF and WB have required economic liberalization and privatization of State owned enterprises as a result of giving Egypt a structural adjustment loan.
- *Harmonizing the budget bases within the government sector:* for example, in Egypt there is a general budget that is prepared for the country as a whole. According to the Budget Act 53 of 1973, the general budget should be divided into current budget and capital budget. The latter comprises investment budget and capital transfer budget. By virtue of the Government Accounting Act NR. 27 of 1981, the cash basis is applied on the current budget with respect to expenditures and revenues and the accrual accounting is applied on the investment budget concerning the investment projects. This means that Egypt uses different budget bases which in turn makes the accounting and budgeting process more difficult for the accounting staff. Thus, the adoption of accrual accounting will bring the current budget into line with investment budget. In other words, the use of one budget basis within the governmental sector will facilitate the budgeting process and make the budget system compatible with the accounting system, which is used to carry out the budget.
- *Lack of integration, synergy and co-ordination:* In the many Arab countries, the process of strategic planning and prioritization, financial planning and resources allocation, and performance management have tended to be discrete processes with very little integration and synergy. This has resulted in policies which were

unconnected with budgetary provision, and thus prone to implementation failure. In addition, an agreed set of priorities in the form of a clear, integrated statement of overall public sector goals and outcomes has often been lacking. Furthermore, the horizontal fiscal co-ordination across ministries and departments tend to be very poor. Thus, the use of accrual accounting and budgeting system can, to a great extent, assist in overcoming these problems.

- *The missing link*: in most of the Arab countries, if not all, there is a missing link between the national vision and the annual departmental priority setting and budgeting process. In addition, there is frequently little or no link between budgeting and the macroeconomic framework, together with the absence of detailed estimates of revenues over the medium term. Accordingly, improving the financial management system that aims at linking the strategic planning, budgeting, accounting and performance management system to each other will assist in creating the required link.
- *Excessive reliance on central control*: in most of the Arab countries, there is emphasis on tight central control of the details of the budget execution, including a pre-audit function. But the centralized financial control seems to have absolved departmental managers from accountability for performance (managers in effect "administered" their budgets, they did not "manage" them). This means that the primary focus is on the central control and compliance with regulations rather than the promotion of the accountability and the achievement of results. However, it is notable in the Arab countries that a very high degree of central control has not stopped fiscal crises from emerging at various points of time. Where this system is focused on line item control and appears not to be accompanied by a parallel capability for control at the strategic level of expenditure management.

4- The link between administrative reform and budgeting and accounting reform

The previous section has demonstrated the challenges and considerations which have prompted the accounting and budgeting reforms from the international and national (in the Arab countries) perspective. One of these challenges/considerations is the management reform. This can lead to the following questions:

- 1- Are the management reforms important in order to implement the accrual accounting and output-based budgeting (accrual budgeting) in the public sector and to fulfil the target benefits of that implementation?
- 2- In other words, to what extent are the management reforms required for the implementation of accrual accounting and output-based budgeting in the public sector?

As mentioned in section 2, the Arab countries are using the *Traditional Government Accounting and Budgeting System (TGABS)* (which is based on cash accounting and input-based budget). In addition, all the Arab countries are also using the *Public Administration System (PAS)* (bureaucratic system). This system focuses on a blind-following of the instructions and a compliance with written rules and regulations aimed

at limiting discretion. It rewards compliance and creates incentives to avoid risk, having little freedom and less accountability. And it is a highly centralized management system. So the main feature of the traditional government accounting and budgeting system and public administration system is the focus on the input and cash flows instead of output. Under those systems: there is no relationship between the input and the output, hence, the total cost of the output is not important and even it can not be obtained from those systems. Managers are not completely responsible for their departments; the expenditures are more important than the costs (expenses); there is lack of a performance measurement system; the incentives to encourage efficiency and effectiveness are absent.

Furthermore, under the public administration system, the role of the managers is limited to the following of the instructions. They have no effective role in improving the efficiency of their departments and their evaluation is not based on the following points: the output, results, total costs, relationship between the input and output (efficiency) and the relationship between the output and outcome (effectiveness).

Consistent with the above-stated public administration philosophy, cash accounting is widely used. However, the system of funding government expenditure based on annual cash appropriations does not provide the right incentives for public sector managers to make the best use of the resources available. Nor does it encourage them to provide information on the full cost of activities or the outputs achieved using available resources. In addition, cash-based accounting does not provide a full and accurate account of activities, especially when capital assets are used; it does not take accounts of future commitment, or of guarantees and other liabilities; it controls the inputs purchased rather than the output produced; and it fails to provide information on the government's financial condition. A cash-based system distorts incentives by encouraging managers to underestimate the cost of programs; bid for incremental allocations rather than evaluate the use of resources already at their disposal; enter into unbudgeted commitments for future years; spend their full annual appropriation; and to conceal costs by promoting non-cash resources and interventions, such as tax expenditures and regulations (Schick :<http://www.ssc.govt.nz/Spirit/Transforming.asp>).

Accordingly, the available information is limited and there is a limited scope to use this information. Then, improving the financial information (as a result of an adoption of accrual accounting in the public sector) has no or little meaningful value under the above-mentioned public administration philosophy. Where this information may not be used as it should be, or the scope which is available to use this information is very limited. In other words, the use of accrual accounting will provide information on the total costs of the output and can assist in measuring the performance in terms of efficiency and effectiveness and assessment of results. However, the information on the outputs, results, efficiency and effectiveness is not required or they are not the main focus under the public administration system. Warren (IFAC 1996), has argued that "accounting is important and exciting when it generates information that is used by decision makers. Conversely, without decision-makers demanding and using accrual information, the implementation effort is far less likely to succeed". Frankly speaking, the public administrators who spent their lives to administrate rules and regulation and formalize procedures are not accustomed to use improved information.

Consequently, the implementation of accrual accounting in the public sector will provide superfluous information that will not be used and the costs of producing this

information can not be justified. Hence, the target benefits from its implementation will not be fulfilled under the public administration system. *So logically, before talking about producing improved information, we should create the scope which allow for using this information and to find the right person who can efficiently and effectively using it.*

On the other hand, the shift from input-based budget to output-based budget requires the determination of the output, which will be used as a basis for allocating the appropriations. In the context of the public administration philosophy, this output is not determined and it is also not known who is going to determine this output. Basically, the determination process of the output is originally technical and management issues more than accounting and budgeting issues; namely, the management (operationally and politically) is essentially responsible for specifying the output. *Similarly, before we talk about the shift from input to output-based budget, we should firstly specify this output.* Consequently, any change in accounting and budgeting system can be justified as a result of its contribution in fulfilling the target benefits from that change.

Therefore, the government should shift from the Public Administration System (PAS) to the Public Management System (PMS); (*this also called New Public Management*). The latter focuses on output instead of input, increasing the individual responsibility, giving the managers extensive discretion in the use of resources, measuring the performance in terms of efficiency and effectiveness. Furthermore, the evaluation of the managers is based on the results; and it is a decentralized management system. Keeling (1972) distinguished administration from management. He characterized administration as being associated with time-intensive, risk-avoiding behaviour which focused on adherence to procedure. It was also associated with long organizational hierarchies and limited delegations. By contrast, he characterized management as being associated with short (flat) hierarchies, maximum delegation, and time-sensitive and risk-accepting behaviour, the focus on results, not procedures (Ball 1998). Moreover, Aucoin (1990) has argued that "the very term "Management" is one that derives from private experience denoting as it does a concern from the use of resources to achieve results in contrast to the assumed focus of "Administration" as the adherence to formalized processes and procedures". Public sector bureaucrats in this comparison are perceived essentially as administrators of rules and regulations and thus are considered inferior to their private sector equivalents who "manage their organizations to achieve results (Holmes & Shand 95). Furthermore, OECD Member countries have distinguished a number of key features of the public management reforms: (OECD 1995:28)

- Devolving authority, providing flexibility;
- Ensuring performance, control and accountability;
- Providing responsive service to citizens;
- Developing competition and choice;
- Improving the management of human resources;
- Exploiting information technology;
- Improving the quality of regulation;
- Strengthening steering functions at the center.

Public management means, in short, the focus on performance in terms of efficiency and effectiveness rather than compliance with rules and regulations, greater confidence in market mechanism, and linking resources with results. In addition, public management has often been described as "Let the managers manage" and "Make the

managers manage”, and it aims to change the incentives acting on managers so that they support the changing process rather than oppose it. In other words, public management is grounded on a simple principle: managers cannot be held responsible for results unless they have freedom to act, that is, to spend and hire within agreed budgets as they see fit, to make their own choices respecting office accommodation and other purchases to run their organizations free of ex-ante control by outsiders (Schick :<http://www.ssc.govt.nz/Spirit/Transforming.asp>).

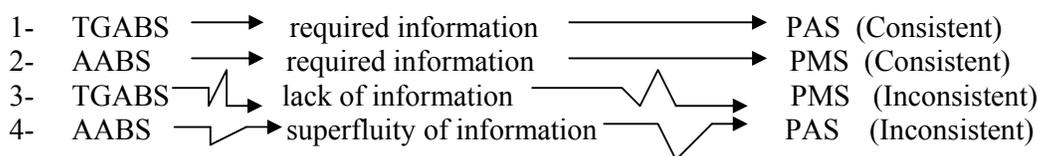
As it is apparent from the above stated, the main feature of public management is the greater emphasis on efficiency and effectiveness. In order to attain a greater level of the efficiency and effectiveness it is necessary to develop the accounting and budgeting system (through the introduction of the Accrual Accounting (AA)) which provides the required information for measuring the performance in terms of efficiency and effectiveness.

From UK, Australia and New Zealand experiences, it has been found out that the implementation of accrual accounting and budgeting in the public sector was a response to the management changes. Yet the UK researchers (for example, Gray and Jinkins 1986 and Humphery et al., 1993); New Zealand researchers (Ball, 1990, 1992, and McCulloch, 1990); and Australian researchers (Guthrie 1994, Parker and Guthrie 1990) all argue that public sector accounting and budgeting changes are “underpinned” by a “managerialist” philosophy (Ryan 1998). Moreover, Warren (IFAC 96) has argued that “ while the demand for accrual accounting information is likely to increase as *public administration* trends towards *public management*, development of accrual information should be seen as an integral element of this reform and not a stand-alone exercise”. The management changes in New Zealand have required that the managers should shift from processes to results and focus on the output instead of the input and they should be completely responsible for the management of their departments (I. Ball – Arthur Andersen 94). This, in turn, required that the managers need an accounting system which can provide them with meaningful information about the economic resources and the total costs of the output. This, in turn, sets forth that the management changes are very related to the accounting and budgeting changes.

Based on the above-mentioned, we could drive the following facts: (Ouda 2001)

- 1- The traditional government accounting and budgeting system (TGABS) fits well with the public administration system (PAS). Whereas the TGABS provide information about cash flows, input and the compliance with rules, and this information is consistent with the philosophy of the PAS.
- 2- An informative accounting and budgeting system (Accrual Accounting and Budgeting System AABS) fits well the public management (philosophy) system (PMS) which requires improved information.
- 3- The use of TGABS with the PMS will lead to lack of information.
- 4- The use of AABS with PAS will lead to superfluity of information.

In short:



So it can be concluded that in case 3 and 4 the target benefits of the changes (whether they are accounting and budgeting changes or management changes) will not be achieved.

In addition, one of the common themes for the management, accounting and budgeting changes is discharging of the accountability. Accountability is closely associated with the new public management and the application of the accrual accounting in the public sector since enhanced accountability has been one of the explicit aims of all management and accounting reforms. The purely instrumental new public management view of the accountability- one that focus on results – will promote accountability mechanisms that pay close attention to the purpose of the public action (Martin, 1997). The ensuing accountability mechanisms will be compatible with the basic ideas of performance management that include the task of establishing expectations of performance, the reporting of valid and reliable information on what was achieved, the need to evaluate whether pre-determined expectations have been met, and the necessity to give feedback on the performance achieved and to maintain responsiveness through positive incentives or negative sanctions (Ormond and Loffler: <http://www.clad.org.ve/ormond.html>). Accordingly, the implementation of accrual accounting and budgeting in the public sector will not effectively assist in discharging of the accountability unless parallel management changes have been also made.

Note that there is a strong relationship between the management changes and the accounting and budgeting changes. Generally, the changes in management, accounting and budgeting in the public sector are not isolated processes. The failure to recognize this relationship and the interdependence between them has held back the implementation of accrual accounting in the public sector in many countries. For example, Egypt has attempted to partly apply the accrual accounting in the government accounting system (according to the general budget act NR 53, section 12, 1973) (Z. Noufal 1989). But this attempt failed because it did not recognize that the implementation of accrual accounting can not succeed without making the required changes such as management changes and to qualify the persons who are going to take part in the implementation process. So we can say that making accounting and budgeting changes without making the required management changes or vice versa, may not fulfil the target benefits from those changes because these changes must be consistent with each other. Moreover, it has been argued that any accounting reform will succeed only if the attention of the reform-makers is focused on the consistency of accounting with other elements of the public government, rather than simply on accounting alone (Eugenio Caperchione 1995).

Based on the above-mentioned, we can answer the two questions that are stated in the beginning of this section.

Herein, we can say that without making internal management changes in the public sector departments, which focus on the output instead of the input, and on a more strategic or results-oriented (efficiency, effectiveness and service quality) approach to decision-making, and on the linking of resources with results, and on the replacement of a highly centralized management system by a decentralized management environment; the implementation of accrual accounting and budgeting in these departments has no or little meaningful value. Whereas the improved information which is produced by an accrual accounting system may not be used as it should be. Therefore, the management

changes can be considered as a cornerstone for successful implementation of the accrual accounting and budgeting in the public sector and carrying through the target benefits which are aimed from that implementation (Ouda 2001).

Furthermore, it can be concluded from the experience of different countries such as New Zealand, United Kingdom, Australia, and Spain that the accrual accounting and budgeting system can really work in the public sector only if parallel management changes are made, too. Should this not take place, the implementation of accrual accounting and budgeting will not have major effects on the performance of the public sector.

5- Implications of the implementation of the budgeting and accounting reform in the Arab countries

While the potential returns to accounting and budgeting reform are substantial, so too are the consequences of reform failure. Therefore, before embarking on accounting and budgeting reform process, the factors which could undermine the reform process need to be managed. Accordingly, the implementation of the accounting and budgeting reform requires from the Arab countries to introduce some significance changes in the public sector, which in turn underpin and create climate fit for the reform process. Briefly, these include:

- Legislative changes

The legislative changes are essential in any change process, because they make clear the purpose and philosophy of the changes, as well as the technicalities. In the light of this, it is desirable to obtain the enactment of laws for any substantial accounting and budgeting reforms that have to be put into practice. Thus, the introduction of accrual accounting and budgeting needs to be supported by adequate legal provision (Ouda 2001). As empirical evidence, the New Zealand government's experience had demonstrated that the legislation of the following acts was necessary to start and to accomplish the reform process. So the New Zealand legislative initiatives fall into three main categories:

1- Improving public sector performance:

- State-Owned Enterprises Act-1986 – corporatizing of state business.
- State Sector Act 1988 – securing accountability of state sector managers.
- Public Financial Act 1989 – a true government balance sheet

2-Improving private sector performance:

- Employment Contracts Act 1991- securing flexible labour markets.

3- Securing Macro-economic performance:

- Reserve Bank Act 1989
- Fiscal Responsibility Act 1994.

Ball (2000) has made clear the role that these acts had played in sustaining the New Zealand reform process, for example, he argued that the Public Finance Act of 1989 embedded firmly in legislation the concepts developed in the policy design stage. These included changing the nature of appropriations from an amount of cash able to be spent on a particular program, to an accrual-based measure of resources consumed in the

production of a specific set of outputs. In addition, State Sector Act 1988, involved the legislative changes that are required to redefine the accountability relationship between the Ministers and Chief Executives and to afford managers the necessary flexibility over recruitment and procurement procedures, and the provision of guidance and support to enable the managers to exercise their decentralized powers efficiently and effectively. The fact that the concepts were captured in the legislation signalled to departments that the government was serious about implementing changes. Result: very little resistance to the reforms.

- **Management reform**

The management reform is considered to be a prerequisite to the implementation of accrual accounting and budgeting reform (as demonstrated in section 4). Pallot (1996), stated that it is extremely important, however, to appreciate that accounting was always seen as an integral part of overall management reform in New Zealand and it is impossible to discuss accounting matters in isolation from more general public sector changes. Similarly, Guthrie (1998), stated that the adoption of accrual accounting and budgeting techniques has been part and parcel of broad public sector reform, whereby old discourse ideals and methods of management have been gradually superseded by new managerialism, contracting, and market-based activities.

As previously pointed out in section 4, the management reform is essential to redefine the accountability relationship between the executive's authority members (such as ministers and chief executives). This redefinition is required for determining:

- what should be produced (the output);
- how it can be produced;
- what the responsibilities of the ministers are;
- what the responsibilities of the chief executives are; and
- what the effects (outcomes) are of that product (the product can be goods or services) on the community.

However, in most of the Arab countries, if not all, the expected output and outcomes are not defined, no indicators of success or failure are in place, and as a result the real outcomes of the public administration policies are not regularly evaluated. And hence, it is difficult to apply the accrual accounting and budgeting and the output-outcome framework in the government sector of the Arab world. Accordingly, the implementation of accrual accounting and budgeting system will require from the governments in the Arab countries to:

- Specify the quantity, quality and price of the outputs they will deliver, where outputs are defined as goods and services produced by governmental entities on behalf of the government and directed to the external organizations or individual.
- Describe planned outcomes to which outputs contribute, where outcomes are defined as results, impacts or consequences of actions by the governments.
- Specify the performance information required to monitor, manage and account for output delivery and achievement of actual outcome; and
- Report performance accordingly, noting that outcomes and outputs may be grouped for reporting to Parliament and the public at levels higher than required for internal management purposes.

Basically, these changes enhance and promote greater responsibility and accountability for results. This takes place through the introduction of incentives and controls, such as performance-related contracts, to ensure that greater managerial responsibility and autonomy is matched by accountability for the achievement of centrally-established goals and priorities. The management reforms also involve the move towards an output, outcome, program-based and results-oriented approach to budgeting, rather than the traditional input-based approach. In short, the management reforms are significant in the context of the accounting and budgeting reforms. On the one hand, they are essential for determination of the output, which should be used as a basis for allocating the appropriations, hence, emphasizing on the linkage between the input and output and indicating whether the appropriations have been effectively used and the target objectives have been achieved. On the other hand, they assist in creating the scope, which allows for using the improved information.

- Setting the required accounting standards

Unlike the private sector, the public sector entities follow widely diverse financial reporting practices, and in many countries, there are no authoritative standards for the public sector. In some countries where standards do exist, the body of standards may be either at an early stage of development or limited in application to specific types of entities in the public sector (IFAC May 2000). This conclusion of IFAC can be sustained through inducing the practice, where it has been noticed that the public sector throughout the world is using a variety of accounting methods, ranging from cash, modified cash, modified accrual to full accrual accounting. Countries that are using or moving rapidly towards full accrual accounting in the central government include New Zealand, United Kingdom, Australia, and Canada. The countries that are moving towards modified accrual accounting in the central government include the Netherlands and the United States. Most of the rest of the world would be between cash and modified cash, including most Continental European countries, Asian countries, African and South American countries. The pure cash basis is probably not really used by any one (Morphett 1998). The widely diverse financial reporting policies and practices have usually been developed in an ad hoc manner around the need for short-run budgetary control and the need to assess the impact of the cash deficit on the economy (Ball and Bradbury 1998). Therefore, the prescribing of accounting standards, principles and practices (accounting policies) that are consistent with the public sector context is an essential step for successful transition to accrual accounting in the public sector. This is because accrual accounting is more judgmental than cash accounting and requires a more sophisticated regulatory framework. Furthermore, the early focus on accounting policies is significant as accounting policies can have an impact on the requirements of information systems, training strategies, and communications strategies (IFAC 2001).

- Development of an integrated approach to financial management reform over a period of years:

In addition to the accounting and budgeting reform, this approach should involve:

- the introduction of effective aggregate expenditure control framework to promote greater fiscal discipline and macro-economic stability;
- the development of systems and mechanisms aimed at forging closer links between strategic planning, budgeting, financial management and performance management systems; and

- the introduction of right-sizing measures to reduce consumption pending, release resources for productive investment, and in particular to achieve optimal allocation of resources in line with government priorities.

- **Changes in the information technology capability**

In the era of information technology, the reform process should involve an increasing use of computerized information systems as a key component of budgeting and financial management. In addition, more complex information technology systems will be required to adopt accrual accounting than those associated with a traditional cash system. For instance, the accrual general ledger would differ from that of the cash system in four main areas:

- it would have additional balance sheet (e.g. depreciation accounts) and different reporting options (e.g. depreciation per category of asset);
- the accruals general ledger would contain a feature for the creation of template batches (skeleton journals) which would be set up to deal with regular accruals and prepayments;
- it would link to the assets register and shows the depreciation charges for the various assets and associated Cost Centers;
- miscellaneous suspense accounts would be grouped in similar categories, (e.g. due to State, during the transfer process. (Treacy et al. 1996)

Generally, there are two options for development of new computerized system:

- maintaining and expanding the current system, or
- moving to an entirely new software system.

Which option should be used, this depends heavily on the situation of each country. However, in most of the Arab countries, the accounting system is not computerized and they are still doing the accounting work manually. In that case, the second option will be the most suitable one.

- **Establishing an appropriate communication strategy**

While the communication efforts are important in the developed countries to convey a common understanding of the key principles of the accounting and budgeting changes, they are considered to be an imperative means in the Arab countries to increase the people grasp and awareness regarding the change process. Especially, these communication efforts will be directed towards people who are primarily non-technical, often uninformed and unsophisticated in financial matters. Moreover, persuasion of such people by the significance and benefits of the new accounting and budgeting systems will certainly be difficult and requires more communication efforts in comparison with the same situation in the developed countries. Accordingly, the communication strategy should be planned and designed more carefully in order to take into consideration the environmental variables and the level of accounting sophistication of financial information users in the Arab countries. In addition, the domination of the bureaucracy philosophy will make the behaviour change towards the

change process more complex. And this, in turn, requires very targeted communication content and careful selection of media by which the behaviour can be influenced.

- **Building skills and capacity for budgeting and accounting**

Generally, the developing countries (including the Arab countries) are suffering from a serious shortage of qualified accountants. This due to the fact that their accounting personnel is merely literate at the basic level which in turn can not manage the accounting changes successfully. Therefore, a major investment in human resources development needs to take place in line with reform process. This will be essential to ensure that necessary skills and capacity are built for the new systems of accounting and budgeting. Therefore, the implementation of accrual accounting and budgeting requires the recruitment of new qualified staff and training the old staff.

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