

**LOCAL GOVERNMENT ACCOUNTING
IN PORTUGAL
IN COMPARATIVE-INTERNATIONAL
PERSPECTIVE**

by

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ABSTRACT

Local government accounting in Portugal has been through a radical transformation since 1999. As additions to the traditional cash-based budgetary accounting, the system now includes accrual-based financial accounting and reporting, as well as cost accounting.

The keystone for the changes was the Chart of Accounts for Local Government, issued in 1999 as a consequence of a wider reform process (comprising administrative, financial management and accounting issues) started in 1990 for the whole Portuguese Public Administration.

This thesis describes how the Portuguese local government accounting system currently works, specifically addressing budgetary, financial and cost accounting techniques.

Using Lüder's Financial Management Reform Process Model, it also explains the current innovations in the Portuguese governmental accounting, and presents the context within which the reforms have been taking place. The same framework is used to predict the conduciveness to future developments, providing some insights into the probability of further reforms.

Finally, it offers an inductive theory of Portuguese local government accounting in comparative-international perspective, in comparison with the United Kingdom. In the process, this shows that, despite the similarities in the form and content of the reports produced, differences still remain as to their aims and purposes.

*I dedicate this thesis to my parents
for all their support and encouragement
during the most difficult moments.*

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LIST OF ABBREVIATIONS

- AARF-PSASB – Australian Accounting Research Foundation – Public Sector Accounting Standards Board
- AICPA – American Institute of Chartered Public Accountants
- APS – Administrative Public Sector
- ASC/B – (British) Accounting Standards Committee/Board
- CALG – Chart of Accounts for Local Government
- CAPA – Chart of Accounts for Public Accounting
- CICA-PSAAC – Canadian Institute of Chartered Accountants – Public Sector Accounting and Auditing Committee
- CIGAR – Comparative International Governmental Accounting Research
- CIPFA – Chartered Institute of Public Finance and Accountancy
- FAF – Financial Accounting Foundation
- FASAB – Federal Accounting Standards Advisory Board
- FASB – Financial Accounting Standards Board
- FEE-PSC – *Fédération des Experts Comptables Européens* – Public Sector Committee
- FEF – Financial Equilibrium Fund
- FMR – Financial Management Reform (Process Model)
- GAAP – General Accepted Accounting Principles
- GASB – Governmental Accounting Standards Board
- IASC/B – International Accounting Standards Committee/Board
- ICAEW-ASSC – Institute of Chartered Accountants in England and Wales – Accounting Standards Steering Committee
- IFAC-PSC – International Federation of Accountants – Public Sector Committee
- INTOSAI – International Organisation of Supreme Audit Institutions
- IPSAS – International Public Sector Accounting Standard
- MBF – Municipal Basis Fund
- MCF – Municipal Cohesion Fund
- MFOA – Municipal Financial Officers Association
- MGF – Municipal General Fund
- MPS – Managerial Public Sector
- NCGA – National (Committee) Council on Governmental Accounting
- NCMA – National Committee on Municipal Accounting
- NZSA – New Zealand Society of Accountants
- PAASC – Public Administration Accounting Standardisation Commission
- PFF – Parishes Financing Fund
- PRC – Portuguese Republic Constitution
- RCC – Regional Commission of Coordination

CHAPTER I

INTRODUCTION

The local government accounting system in Portugal is what could be said to be typical of Continental Europe.

While it has been for many years traditional cash-based budgetary accounting, essentially set within Administrative Codes of Law, it went recently through a radical transformation, as part of a more embraceable reform of the whole Portuguese Public Administration.

This process (including administrative, financial management and accounting issues) was labelled as the State Financial Management New Regime, and started in 1990 with the issuance of the Public Accounting Basis Law, complemented by other related regulations passed in the following two years. The major innovation brought by this legislation was to require financially and administratively autonomous governmental bodies, though under the State Budget, to develop along with the existent budgeting system an accounting system following the model used for business accounting. Several charts of accounts were subsequently passed, reflecting the diversity of public services: Public Health Services, Public Institutions of Social Security and Public Institutions of Higher Education. Yet, notwithstanding that all of them were based on the Chart of Accounts for Business Accounting, each had its own particularities. Therefore, comparisons were difficult to make and, above all, the lack of uniformity made it impossible to obtain consolidated financial information for the Public Administration as a whole. Accordingly, in 1997 the first Chart of Accounts for Public Accounting (CAPA) was passed, setting an important “landmark” in Portuguese governmental accounting, inasmuch as an integrated system, comprising budgetary (cash-based), financial and cost accounting (both accrual-based), was for the first time uniformly defined for the whole Portuguese Public Administration. The system goes beyond the objectives of the traditional Portuguese governmental accounting (demonstrating legal and budgetary execution, the whole system being totally subordinated to the budget), providing an accounting information system that allows analysis of public expenditures not only according to legal criteria, but to economy, efficiency and effectiveness criteria as well, hence increasing clarity and transparency in the management of public resources.

Consequently, the CAPA became the basis for other sectional charts of accounts, including the Chart of Accounts for Local Government (CALG) passed in 1999 (though Portuguese Local Government is independent from the State Budget).

Even before the CALG, the second Local Finances Law passed in 1987 had already recognised local government accounting as an instrument to support economic and financial management, besides assessing the budget execution. This law, along with a general regime of accounting (budgetary, single-entry and modified cash-based system) in force for municipalities, parishes, metropolitan areas, municipalities associations and other similar entities, set an exceptional accounting regime, applied only to the so-called “Municipalized Services” (autonomous and business oriented units within the municipalities, providing services at a local level) and federations of municipalities. This exception to the general rules was a double-entry accrual-based accounting system, similar to that used in the business sector.

Despite the exceptional regime, local government accounting continued to be essentially cash-based, single entry and budget oriented. The budget simply recorded information on receipts and payments, and the annual monetary variations were the only ones that could be perceived. The entities’ financial and economic situation continued to be a secondary matter, until the third Local Finances Law passed in 1998. This law, already under the existence of the CAPA, created the bases for the issuance of the CALG, clearly stating that the Local Government accounting regime should aim for uniformity, standardisation and simplification, so as to be a financial and economic management tool, as well as allowing the complete knowledge of the local government entities property (assets and liabilities) book value, and the analysis and valuation of the economic annual net result of its activities.

The main sources of inspiration for the CAPA, and consequently for the CALG, were on one hand the 1989 Portuguese Chart of Accounts for Business Accounting, and on the other hand, the same framework developed for the Spanish system of governmental accounting for the first time in 1984, and already revised in 1994. This system was adapted to the Spanish local government in 1990. In the last instance, arguments might also be presented for a strong influence of the Franco-German tradition of using charts of accounts, as well as of the Codified Roman Law and Napoleonic Codes of Law in the sense that all accounting rules are in the form of detailed compulsory legal requirements, having the governmental accounting reform

process followed a strong centralising tradition (top-down approach aiming at homogeneity and uniformity of the whole governmental accounting system).

Compared to systems of other Continental European countries, namely with the Spanish one from which the Portuguese governmental accounting system could be said to be derived, this is newer. In particular for the Local Government, though the Portuguese system is already more advanced than the Spanish one, it is still being implemented, and it is difficult to empirically analyse the benefits it is yielding.

Consequently, there is still no empirical study about what has been happening in terms of governmental financial management and accounting innovations in Portugal.

On the other hand, there is no literature in English that describes the “how” or explains the “why” of the Portuguese local government accounting system; the literature in Portuguese concentrates on procedures and the “how” of the accounting technique.

The main purpose of this thesis is to offer some explanations for the “why” of local government accounting system in Portugal, in a comparative-international perspective, and especially in terms of the system in the United Kingdom.

These explanations towards what could be called a theory are meant to elucidate why Portuguese local government accounting is as it is and has evolved as it has, while explaining what the budgeting/accounting system is in fact doing. Apart from being positive, this theory is also intended to be inductive, inasmuch as from the Portuguese case we propose some explanations that might eventually be generally accepted to explain international differences among governmental accounting systems. Furthermore, the theory is going to be a technical one, one that is not a function of environmental factors.

The importance of researching in the direction of such a theory relies on the fact that the lack of theory is widely acknowledged to be one of the barriers to the scientific development of accounting in general. Governmental accounting in particular seems to be even more seriously affected by this problem, inasmuch as research in this field is very recent.

A general theory of accounting could be defined as a set of common elements and concepts present in every accounting system, thus underlying and being converted in possibly different applications. Accordingly, an accounting theory would allow a clear separation between the theory itself and its practical expressions, creating a reference for placing the accounting discipline. Moreover, it would help explaining the

fundamental why of possible different practices/manifestations extracted from one common theoretical framework that is supposed to be the base for developing every accounting system.

On the other hand, as Hendriksen and Budge (1974, p.1) explained:

The objectives of accounting theory are to provide a frame of reference by which accounting practice can be evaluated, and to guide and direct accounting practice in new situations. Through theory, accounting procedures must be tested for consistency, logic and usefulness.

Notwithstanding, as the authors acknowledged, theories in accounting have not been developed enough to fulfil those objectives in all situations. Hence, accounting has been charged with several serious shortcomings, which may be addressed if more attention is given to theoretical developments.

Regarding governmental accounting in particular, only a few attempts at theory have been made, namely by the GASB, the FASAB and the INTOSAI, mainly following the traditional normative approach of *a priori* theorising, formulating hypotheses on the basis of assumptions/postulates.

Yet, that methodology portrays what accounting ought to be, not what it is. For this it is of seminal importance a positive approach involving observation of real facts.

One underlying objective of this research is to bring the Portuguese local government accounting case to the international literature, English in particular.

The main questions this research intends to answer are:

- How has the Portuguese local government budgeting and accounting system been developing?
- What the current system of cash-based budgeting and accrual-based financial and cost accounting (with double entry bookkeeping method) added compared to the previous cash-based single entry budgetary accounting?
- How does the current system work?

The answers for these questions are provided through a description and analysis both of the historical development and of the “how” of local government accounting in Portugal.

The research then addresses the following:

- Why the system witnessed recent changes?
- Which environmental factors were involved and how they affected the recent (local) governmental accounting innovations process in Portugal?
- Is the current system likely to change (again)?
- In what way a change towards accrual budgeting might add or subtract from the current system?

Answers to these questions are going to be provided by extending the Lüder Contingency/Financial Management Reform Process (FMR) Model to include the Portuguese case. The model explains which factors have been involved in the recent reform process and how they have been interacting to create a context favourable to governmental accounting innovations in Portugal (towards a more informative accounting system).

As well as making a contribution to the understanding of the (local) governmental accounting system within the country, we also contribute to a wider knowledge of the model itself, towards possible improvements.

Additionally, using the model to predict offers a contribution to the possibilities of future changes in the current Portuguese (local) government accounting system.

Further questions are:

- What are the main differences between the Portuguese and the British local government accounting systems?
- Are the Portuguese and the British local government accounting systems fundamentally different, justifying their international classification in separate governmental accounting spheres?
- Why the local government accounting system in Portugal is as it is, compared to the United Kingdom?

This is going to be a substantial contribution, since, as it will be emphasised in the literature review, there is still no theory for explaining and describing the governmental accounting systems in a comparative way.

In spite of the existence of governmental accounting conceptual frameworks on national bases, International Public Sector Accounting Standards (IPSASs), and Lüder's Contingency/FMR Model, none of these addresses the "why" of governmental accounting systems. Even if some explanations (theoretical contributions) for that "why" might be offered, they focus on Anglo-American accounting systems usually different in form from those of Continental Europe. Accordingly, it is difficult to use that Anglo-American literature to explain Continental European accounting systems such as the Portuguese one, where the budget still has the dominant role.

The thesis is organised in six chapters, including this Introduction (**Chapter I**).

Chapter II is a Literature Review aiming at showing what is known in the literature on the "why" of governmental accounting systems, focusing specifically on local government accounting when possible. It embraces four topics:

- International literature on Portuguese governmental accounting
Some literature, both in English and in Spanish, on Portuguese (local) governmental accounting, is described here. The main points highlighted concern its limited and outdated nature, as well as the fact that it only roughly explains the “how” not the “why” of Portuguese local government accounting.
- Governmental accounting conceptual frameworks
Some theory on governmental accounting – also valid for local government – that has been developed in the Anglo-American context, is presented here. Several issues regarding governmental accounting conceptual frameworks are addressed, namely history, notion, need and importance, functions, and main components and features. Questions related to the need for a governmental accounting conceptual framework to be different than that for business accounting are also discussed. Once objectives and functions of budgeting and accounting are acknowledged as important components of a governmental accounting conceptual framework, these are addressed within an approach of the information users/beneficiaries and their needs. Conceptual framework studies commissioned by standard-setting bodies are distinguished from others developed by academics, while presenting some (for national, state and local governments) that have been developed for governmental accounting in several countries.
- International Public Sector Accounting Standards (IPSASs)
This section addresses IPSASs, mainly briefly describing its history and contents, as well as how they have been based on the International Accounting Standards (IASs) for business accounting. Some IPSASs advantages and drawbacks are also emphasised, followed by an introduction to the controversy of governmental accounting international harmonisation.
- Comparative international governmental accounting research (CIGAR) and the Contingency Model
In here the only comparative-international government accounting theory – “the Contingency Model”, as it is currently designated – is addressed. A critical presentation of the model is done, from its first to the last version – the Financial Management Reform Process Model. The fact that it is a model addressing the governmental accounting and budgeting innovations process, and not the accounting systems themselves, is highlighted together with other criticisms. Strong points of

the approach are also emphasised. A summary of some problems believed as still existent in the contingency approach of governmental accounting innovations (despite its revisions) is also presented, with an extension to CIGAR itself.

Chapter III comprehensively presents an explanation of how the Portuguese local government accounting system currently works, mainly addressing the “how” of the budgeting and accounting technique. After a brief characterisation of the Public Sector in Portugal, with special focus on the local government, an overview of the Portuguese governmental accounting is presented. In here the main steps of the evolution of the Portuguese governmental budgeting and accounting systems are summarised, highlighting the recent and most important innovations. Notwithstanding the focus on local government accounting system, some information is also presented for central government, inasmuch as the recent reform has been conducted following a top-down approach. The utmost point of the recent innovations in local government accounting was the issuance of the Chart of Accounts for Local Government (CALG) in 1999, which is now being implemented. Accordingly, this framework is first generally presented, being developed later in three sections concerning the three accounting sub-systems that it integrates: Budgetary Accounting, Financial Accounting and Cost Accounting. An outline of the Portuguese governmental accounting standard-setting process is briefly presented as well.

In **Chapter IV** with the help of the latest version of the Contingency Model – the Financial Management Reform Process Model, some explanations for the recent innovations still happening in the Portuguese governmental accounting are offered, at the same time as the context within which this reform has been taking place is described. From the overall assessment of the contextual effects on conducting to the first stage of the reform, some insights are provided on the probability of further steps, using the same model to predict the conduciveness to future developments. The analysis mainly focuses on the central government situation, since the reform has been following a top-down approach. Still, some particularities of the local government accounting innovations process are also addressed. Subsequently, the Contingency Model is for the first time applied to the Portuguese case, and critically reviewed considering this application. Finally, taking into account the similarities between the governmental accounting reform processes, as well as the innovations diffusion given the regional proximity, an adaptation of the model is suggested to explain governmental accounting innovations that have been happening on the Iberian countries.

Chapter V steps forward in the direction of a theory explaining the “why” of the Portuguese local governmental accounting system, in a comparative-international perspective, by comparing with the one from the United Kingdom. The theory is intended to be positive-inductive as well as technical, inasmuch as it is not a function of environmental factors.

The chapter is organised in four main sections. Starting with a presentation of the background for the theory building (some arguments both from business and governmental comparative international accounting eventually important for the explanation to be offered here), it continues providing an overview of both the Portuguese and the British local government accounting systems through a comprehensive, though summary, comparative description. This aims at showing if the systems are in fact considerably different as it is generally argued, including them in separate international spheres of governmental accounting: Continental European v. Anglo-American. In the following section a comparative-international explanation for the “why” of the Portuguese local government accounting is offered. The final section draws attention to some concluding and open issues.

The thesis finishes with a conclusions chapter (**Chapter VI**) where a general overview of the research is presented, summarising the key contributions. Some limitations of the study are highlighted, leading to opportunities and some suggestions for future research.

CHAPTER II

LITERATURE REVIEW

The fundamental importance of governmental accounting is undeniable to all civilised States since many years ago. However, what seems to be contradictory is the fact that the discipline has attracted little interest in the academic accounting literature, at least until the last twenty years. One of the reasons for this, suggested by Professor W. J. M. Mackenzie, relates to the meticulous and even “pedantic” character traditionally attributed to governmental accounting and auditing (Chan and Jones, 1988b, p.4). Indeed, it seems that the excessively technical governmental accounting work, somehow inconsistent with the traditional academic research freedom¹, has been partially responsible for the lack of academic interest and consequently for the lack of literature and theory on governmental accounting.

Furthermore, even politicians and public administrators’ interest on accounting also seem to have been minimum, inasmuch as budgeting was the central issue.

In order to stimulate particularly academic interest for the subject it was necessary to promote the idea of how important is to understand governmental accounting, so as to understand accounting itself. In fact, both accounting academic researchers and practitioners should start to consider governments as organisations using accounting in an historical and international perspective: entities accountable for past transactions, frequently and regularly accountable beyond their national borders, using techniques with a long tradition, possibly imported from other countries.

In the last twenty years there have been significant international pressures (e.g. from European supra-national bodies) for individual countries to change governmental accounting and budgeting from cash to accruals basis (the framework of which derives from Anglo-American accounting). However, most of these pressures seem to have been created by practitioners, not by academics. Hence, most of the debates and literature have tended to address the “how” of governmental accounting technique, more than the “why” – normally the main concern of theoretical researchers (academics). Consequently, worldwide there is a great lack of theory explaining why governmental accounting systems are as they are and have evolved as they have, not only towards more informative systems (possible explanations for the why of this are offered by the

¹ According to Chan *et al.* (1996, p.2) “academic freedom” means that traditionally academics tend to conduct their research freed of ideological inhibition and national constraints.

Contingency Model addressed in Section 4) – but more specifically in terms of their contents (concepts, standards, policies and procedures).

Accordingly, the main purpose of this chapter is to show what is known in the literature on the “why” of governmental accounting systems – particularising local government accounting when possible.

Since this thesis is based on the Portuguese situation, Section 1 starts by referring to the literature in English on Portuguese (local) governmental accounting. This is very scarce, essentially descriptive on the “how”, and prepared mainly by Spanish authors within comparative studies. Although most of it is somehow outdated, some authors have already addressed the recent changes. Additionally, some recent material in Spanish, which roughly only explains the “how”, still not the “why”, of Portuguese governmental accounting, is also described. Some comprehensive up-dated literature already exists in Portuguese, which we will address in Chapter III, but yet again basically explaining the “how”, inasmuch as it is reduced to a few accounting and budgeting manuals, as well as legislation.

Section 2 presents some relevant material regarding governmental accounting conceptual framework studies, addressing both the “how” and the “why” of accounting technique. This is essentially Anglo-American literature.

The section starts with a brief introduction on the history of governmental accounting conceptual frameworks, continuing discussing the notion, importance, need and functions of such a theoretical arrangement, as well as its main features. It also addresses the controversy of having a single accounting conceptual framework, or separate conceptual frameworks for governmental and business accounting. It continues with objectives and functions of governmental financial accounting and budgeting, since they are recognised as important components of a governmental accounting conceptual framework. Since most of the literature on accounting purposes relates these with accounting information users/beneficiaries and their needs, some literature and discussion on this subject is also presented. Conceptual framework studies commissioned by standard-setting bodies are distinguished from others developed by academics, as we describe some governmental accounting conceptual frameworks that have been developed on a national basis.

Section 3 concerns the IPSASs. It starts with a brief history, then addressing the contents and explaining how IPSASs have been adapted from IASs for business accounting. The Anglo-American literature previously presented on the governmental

accounting conceptual frameworks may help to understand this IPSASs derivation. Additional references are made to advantages and criticisms that have been pointed towards IPSASs. Finally, a discussion concerning governmental accounting international harmonisation is introduced.

As to the context of other Continental European countries, Section 4 presents and discusses the only existent comparative-international government accounting theory – the Contingency Model – that addresses not the accounting systems themselves, but the likelihood that the traditional, budgetary accounting systems that are typical in Continental Europe will change to the Anglo-American-based accrual budgeting and accounting (i.e. the “why” for the innovations process to happen). The section firstly discusses why Professor Lüder came out with the initial Contingency Model, when in fact his study was seeking a further purpose. Furthermore, it offers a critical presentation of the Contingency Model, from its first version up to the most recent one – the FMR Model – also considering modifications and extensions resulting from the model wide application. It finishes summarising some problems that still exist in the contingency approach of governmental accounting innovations, particularly in the FMR Model, despite all its revisions. We extend these problems to CIGAR itself as well.

Finalising the chapter, Section 5 offers some final remarks highlighting several problems/criticisms concerning the literature reviewed.

1. INTERNATIONAL LITERATURE ON PORTUGUESE GOVERNMENTAL ACCOUNTING

Like in other countries, there is no tradition in researching on governmental accounting in Portugal. This might be due to the fact that the importance of Portuguese governmental accounting itself was not recognised until recently. Accordingly, it is understandable that the literature on the subject is scarce.

Considering the great changes that have been happening in the Portuguese governmental accounting since the 1990s, significant changes are expected in this research field as well: governmental accounting has been introduced in many courses, both in polytechnic institutes and universities, not only at undergraduate level but above all at post graduate level; also professionals have been more aware to the subject, promoting meetings and conferences; finally, academics seem to have an interest on the topic as well.

However, up to the moment, there is little up-dated published material, mainly descriptive on the “how” and summarised in manuals in Portuguese, which we will be using in Chapter III.

Internationally, particularly in English, although we believe the tendency is changing as well, the published studies or papers on Portuguese governmental accounting have also been very rare.

Nevertheless, mainly since the late 1970s, we may find very frequently studies related to Portuguese governmental system itself. In fact, Portuguese Public Administration has not been aside from international English literature, inasmuch as a large range of studies has been published on Portuguese public policy and management. Some important references might be Norton (1991) for a comparative perspective of the Western European Local Government including Portugal, Pereira (1991) for a thorough approach to the Portuguese Local Government system, and other approaches concerning political science (all referred to in Pereira, 1991): Gallagher (1979), Opello (1978a and 1978b), Schmitter (1975), Story (1976), and Wiarda (1977). More recently, Araújo (1999) used the neo-Institutionalist paradigm to explain the processes of administrative reform in two Portuguese government general departments.

Specifically on Portuguese (central and local) governmental accounting, as far as it is our knowledge, seven interesting papers were recently published in English, though five of them prepared by Spanish authors, including Portugal within comparative descriptive on the “how” studies. Some of these are not so accurate and up-dated, since they address the situation before the issuance of the 1997 CAPA; others already refer to the recent Portuguese governmental accounting innovations.

The literature in Spanish, also mainly by Spanish authors, tend to include more studies embracing the Portuguese situation. We found this understandable, given the geographical, cultural and linguistic proximity between the two countries. Additionally, considering the popularity of Spanish PhD programmes in governmental accounting amongst Portuguese researchers, it is expected some joint studies to be published. Hence, given the scarcity of international literature on this topic, we believe it is important also to mention some relevant references in Spanish, even if once again they essentially address the “how” of Portuguese governmental accounting.

1.1. Literature in English

Montesinos Julve *et al.* (1995) developed an empirical comparative analysis of governmental accounting systems in the OECD countries, where Portugal was included. The main purpose was

(...) to obtain a good knowledge of the current procedures and practices in the central, regional governments and local authorities of the more developed countries in the western world. (Montesinos Julve *et al.*, 1995, p.163)

The data were gathered sending a questionnaire to academics and practitioners, namely accounting and auditing professionals, in the different countries (thus not gathered from governmental accounting standards eventually already existent in some countries), covering issues concerning: objectives of governmental financial reporting, basis of accounting and governmental accounting standards of disclosure.

From the analysis of the different practices, the paper attempted for classification criteria of the accounting systems, considering both its differences and similarities. This classification in particular was aiming at

(...) building a map of current accounting practices and identifying the degree of development of Public Sector Accounting in the OECD countries environment. (Montesinos Julve *et al.*, 1995, p.163)

This study was also a first attempt to question the possibility and feasibility of a governmental accounting harmonisation (regional or global) process amongst the OECD countries. It also identified possible difficulties in comparing governmental accounting information.

The methodology used involved some statistical techniques of analysis, such as frequency tables, hypothesis tests and cluster analysis (Montesinos Julve *et al.*, 1995, pp. 164-166).

In particular **regarding Portugal** the results were as follows:

- As all the countries in the study, Portugal had set up formal objectives at central, regional and local levels that were inspiring the development of the Portuguese governmental accounting system (Montesinos Julve *et al.*, 1995, p.166).
- The objectives of governmental financial reporting in Portugal (that the authors finally considered as objectives of governmental accounting) were the same for Central and Local Government (Montesinos Julve *et al.*, 1995, p.172 and p.174):
 - Legal control;
 - The monitoring of the budget execution process;
 - Accountability;
 - Capital maintenance;
 - Financial viability;

- Providing information for the management decision-making process;
 - Providing information for the external users decision-making process;
 - Providing information on the cost of the services provided;
 - Disclosure information on the financial position;
 - Inventory disclosure;
 - Economic surplus or deficit;
 - Recording budgetary execution;
 - Control of efficiency and effectiveness.
- Concerning the basis of accounting, in the majority of countries and levels of government studied, the cash basis was predominant for the budget execution. However, cash basis for the budget execution and accruals basis for financial accounting were considered to coexist in almost every country. Portugal was included in these (Montesinos Julve *et al.*, 1995, p.173 and p.175).
- As to the measurement focus, an expenses focus (economic perspective) seemed to cover more countries than an expenditures focus (cash perspective), both at central and local level. At regional level no uniform results were obtained. Portugal was considered within the majority (Montesinos Julve *et al.*, 1995, pp.175-176).
- In relation to the elements of the Portuguese government annual accounts, they were (Montesinos Julve *et al.*, 1995, pp.176-182):
- Balance sheet, profit and loss account, annual budget, statement of budget execution (with information on current revenues and expenditures), and capital expenditures statement – at central, regional and local level;
 - Statement of changes in financial position, namely cash flow statement (or statement of cash position), and statement of budgetary modifications – at central level;
 - Statement of budgetary surplus/deficit, debt statement, statement of financial assets, statement of revenues and expenditures earmarked for specific purposes, and statement of budgetary encumbrances – at central and local level.
- On the cluster analysis of the governmental accounting systems, Portugal was grouped with Greece at central level; at regional level it was enlisted in a rather heterogeneous group, together with Australia, New Zealand and Canada, but also with Japan, which was still using a single-entry accounting system. At local level it was difficult to form groups, though some affinities had been identified among certain countries. Portugal was considered isolated.

In 1996, the same group of authors continue the empirical comparative analysis, this time emphasising governmental accounting principles and practices adopted in the OECD countries, at central, regional and local levels (Montesinos Julve *et al.*, 1996). A

questionnaire was used then gathering information concerning accounting practices and general accounting principles adopted. This was basically obtained from academics, accounting and auditing professionals, auditing bodies (regional and central) and standard setting bodies (Montesinos Julve *et al.*, 1996, p.73). Some problems were recognised in gathering information for every country for all levels of government.

From here the authors once again tried a possible classification for the governmental accounting systems, according to the answers on those subjects. This was aimed at appreciating the degree of development as well as the informative dimension of the several systems. Additionally, they intended to highlight the main problems concerning the development of a possible harmonisation to enforce the comparability of the information provided.

The same statistical techniques were used for analysis, namely frequency tables and cluster analysis.

In the paper the authors first presented a descriptive analysis of the accounting principles and main standards that, in their opinion, could be used to define the governmental accounting system in each studied country. As they explained (Montesinos Julve *et al.*, 1996, p.75):

The results obtained evidenced an important degree of diversity of principles and practices among the different countries, even among different regional governments of a single country. This last circumstance showed that a regional comparative analysis ought to be developed by region independently of the country. This is why the regional analysis *was not developed* (...) [italics provided].

In what respected to accounting principles, the results showed that 78% of the countries studied had issued official pronouncements of accounting principles used for financial reporting purposes, for central and local governmental accounting. These principles were (Montesinos Julve *et al.*, 1996, pp.78-79): accounting entity, going concern, uniformity, materiality, recording, conservatism, accruals, historical cost, matching concept, no compensation, and true and fair view concept.

Concerning Portugal, the authors clearly stated (Montesinos Julve *et al.*, 1996, p.75):

In Portugal, accounting principles considered in this study are not applied. This is why we will omit from now on the mention to this country when referring the exceptions or cases related with the non-application of such principles.

As to accounting practices, they analysed some regarding fixed assets, leasing, depreciation, stocks, accounts receivable, accounts payable and equity.

For Portugal they found (Montesinos Julve *et al.*, 1996, pp.80-83):

- It was included within 81% of the entities studied that considered presenting information on fixed assets classified by wide categories (land, buildings, etc.);
- The valuation criteria for fixed assets used at central and local level was acquisition cost; accumulated depreciation was also reported;
- Both at central and local level, interest of loans used to finance assets were included in its cost, during their construction period;
- Intangible assets were depreciated in the period they generate profits (central and local level);
- Leased assets were generally considered as purchases at central and local level; information on the expenditure associated to long term leasing contracts was reported, as well as on future commitments associated to these contracts;
- The calculation and reporting of depreciation was compulsory both at central and local level, being calculated according to systematic and rational criteria; not all assets were depreciated; the method to calculate depreciation was set by law or official pronouncements;
- Both at central and local level, stocks were valued at acquisition cost or market value, if lower;
- Accounts receivable (central and local level) were accounted in different items, differentiating those that matured in the current fiscal year (short term), from those whose maturity was beyond that date (long term);
- Accounts payable (central and local level) were reported separating the amounts of each long term debt issuance; interest on debt were accrued;
- Equity was defined, both at central and local level, as the difference between the values of net assets and liabilities; no reserves were reported in governmental balance sheets.

Montesinos Julve *et al.* (1996, pp.83-86) continued discussing the level of acceptance of three accounting principles they found having a more significant incidence in financial reporting: accruals, matching concept, and conservatism. Because of what they stated for Portugal regarding governmental accounting principles, this country was not considered in the discussion.

Finally, the cluster analysis allowed establishing affinity groups between countries and regions according to the different accounting practices covered by the study. **For Portugal** the findings were (Montesinos Julve *et al.*, 1996, pp.86-92):

- At central level Portugal was identified as having clear affinity of practices concerning fixed assets with Austria, Japan and New Zealand. Because fixed assets were reported and compulsorily depreciated, and related financial expenses were also capitalised, these countries were using practices rather similar to those used in business accounting;
- At local level, regarding leasing practices Portugal was included in the same group as USA, Japan, Sweden and Australia;

- In what concerned reporting information on contingencies, at central level Portugal was grouped with Austria, Japan and New Zealand, as offering the most informative accounting system according to the disclosure of contingencies reported. At local level it was grouped with Japan, USA and Sweden;
- As to reporting information on extraordinary gains and losses, at local level Portugal was grouped with Norway, Sweden, France, Finland, USA, Japan, Germany and New Zealand.

Some critical comments are required to be made to these studies regarding Portugal. First of all they had the merit of being empirical analyses, maybe the first including governmental accounting in Portugal. But, as any survey based on questionnaires, the findings depend on the answers, which in turn depend both on who is answering and on how understandable and unambiguous the questions are. It is our understanding here that the results concerning Portugal are not accurate and sometimes contradictory, though we do not believe this is due to the statistical methodology applied. Some examples are:

- The authors did not precise the concept of regional governments – in Portugal they are autonomous insular regions, with central and local government as the Continental Portugal, so thus maybe different from those in other countries (e.g. Sweden).
- They explained that all countries in the survey, Portugal included, had set formal objectives for governmental accounting at all levels of government, which were inspiring the development of its governmental accounting systems (Montesinos Julve *et al.*, 1995, p.166). In our point of view, this is admitting the existence of a conceptual framework for governmental accounting, which we believe (as others recognise) that does not exist yet in Portugal.
- Montesinos Julve *et al.* (1995, p.171) stated that Portugal had an official board responsible for the establishment of efficiency indicators at central and local level. This was not quite true. What actually happens is the Local Government General Department occasionally publishing some indicators concerning Portuguese Local Government, but in a public finances perspective, not exactly assessing or reporting the efficiency of each entity in particular. In fact, in spite of all the recent innovations in the Portuguese governmental accounting, such entity seems still not

extant. As Bravo and Vasconcellos e Sá (2000, p.140) clearly explain, in particular for Local Government,

(...) we think it should exist a body (...) that would set more operational objectives and indicators of reference that would allow, later, evaluating the results of competing projects.

- As to governmental accounting principles, Montesinos Julve *et al.* (1996, p.75) stated that they were not applied in Portugal. This is not correct, since by the time the survey was conducted, Portugal was already applying the State Financial Management New Regime, which had started with the Public Accounting Basis Law in 1990. This allowed that governmental entities administratively and financially autonomous from the State Budget, to apply an accounting system close to that used in business accounting. In this context, even before the 1997 CAPA, charts of accounts close to the business one were issued and used for governmental autonomous services such as public higher education and health. Accordingly, those principles, most of them common to business accounting, were already being applied in Portuguese governmental accounting.

Some more recent studies were developed including the Portuguese governmental accounting present situation. Although they might not be empirical, they are accurate, up-dated and thus relevant to be mentioned here.

Fernandes and Carvalho (2001), two Portuguese authors, developed a comparative theoretical analysis between the Portuguese and Spanish governmental accounting reform process. Their main purpose was to briefly present the current situation of the Portuguese Public Administration accounting, highlighting its main characteristics and innovations compared to the Spanish model, in which the Portuguese was strongly based.

Accordingly, they briefly describe the governmental accounting recent reform in both countries. The whole recent innovations process is explained both for Portugal and Spain, also referring to laws and other regulations considered seminal for the changes.

The main objectives of changing, as well as the tendency for using charts of accounts, were identified as common features to both countries governmental accounting reforms.

Similarities and differences between the two systems were then analysed. The most important similarities concern (Fernandes and Carvalho, 2001, pp.10-12): measurement/recognition basis, object to be recorded, and bookkeeping method.

It is recognised that, notwithstanding the Spanish inspiration, the Portuguese governmental accounting system is different and ahead in some aspects (Fernandes and Carvalho, 2001, p.12):

(...) Portugal has its own specificity and, in several aspects is more advanced than Spain (for example, in what concerns to Cost Accounting in Public Administration, in the approval of an accounting system for Local Municipalities already adapted to POCP, in the assets valuation criteria recently approved – CIBE).

As most significant differences they identified (Fernandes and Carvalho, 2001, pp.12-17): the phases of the governmental accounting reform, the norms for sub-sectional adaptation, the recognition/disclosure of public domain assets (such as infrastructures and heritage), the recognition of multi-annual expenditures, the simplified regime of governmental accounting, grants for investments (capital grants), and accounts consolidation in governmental groups.

The authors overall concluded (Fernandes and Carvalho, 2001, p.17) that the reform processes in both countries have a positive balance, in particular concerning the increase of accounting information to internal and external users as well as the increased efficiency, effectiveness and economy in the management of public money.

For Portugal they emphasised that, despite the resemblances with Spain, the Portuguese governmental accounting system, in some aspects as consolidation, is closer to those countries where governmental accounting is more advanced (e.g. Australia and New Zealand).

Hepworth (2001) presented a discussion on the European experience and attitudes to the development of IPSASs. First he looked at the role of the *Fédération des Experts Comptables Européens* (namely its Public Sector Committee), and the accountancy profession in Europe concerning the introduction of IPSASs. Additionally he provided a brief summary of where the development of accrual accounting was at in the European countries, and identified not only some particular questions raised regarding using IPSASs within the European context, but also conditions that have to be precedent to the introduction of accruals in Continental European governments.

Regarding Portugal some features were pointed out:

- As in the most Continental European countries, the accounting profession in Portugal has only a very limited role within the public sector. Hepworth (2001, p.2) explained,

Where regulations exist governing the role and responsibilities of the profession, the profession has difficulty in becoming involved in the public sector and therefore in obtaining an understanding of how the public sector works, except as a consultant. It also consequently means that the profession has considerable difficulty in influencing those responsible for the setting of accounting standards in the different countries.

According to the author, this also seems to be related to the fact that Continental European countries are heavily influenced by the legal approach to the public sector audit, meaning that instead of having an “Auditor General” as in Anglo-Saxon countries, they have “Courts of Audits” (Courts of Accounts) with auditors technically being magistrates. This once again creates problems when the accounting profession tries to influence the development of national public sector accounting standards.

- Concerning the current status of accrual accounting for financial reporting purposes of the Portuguese central government, Hepworth (2001, p.3) includes Portugal within the group of European Union countries using full cash basis. Although the information had been gathered from OECD reports, it is not up-dated, inasmuch as the Portuguese governmental accounting system is using full accrual basis in financial accounting even since before the 1997 CAPA. A modified cash basis is indeed still used but only for budgetary accounting.
- In what respects to who is responsible for determining central government accounting standards, Hepworth (2001, p.4) sets Portugal as the only country within the European Union where the Ministry of Finance appoints an independent board to determine those standards. We believe he is referring to the PAASC, which in our point of view is more a board than a committee, once the majority of its members are not accounting professionals, but representatives of local, regional and central government. Its president is the Head of the Budget General Department, which is comprised within the Ministry of Finance, thus this body’s independence might be questionable. Additionally, such a body also exist, for example, in Spain, under the responsibility of IGAE – the unit within the Spanish Ministry of Finance responsible for regulating all issues concerning governmental accounting.

Buch Gómez and Cabaleiro Casal (2001) developed a comparative analysis between the local government accounting systems of Portugal and Spain, in order to

show the extent to which the innovations that have been happening in both countries mean an advance in the process of convergence of the economic-financial information of the European Union.

They analysed what they considered the GAAP prevailing at local level in both countries. In particular they looked at which of those were explicitly reflected in the national laws and other regulations and which were actually applied, analysing its consequences on the rules of the theoretical functioning of the two accounting systems. In the Spanish case, they considered not only local government accounting regulations, but also the CAPA in force at central level.

In their analysis the authors pointed out the top-down approach followed by the governmental accounting reforms in both countries, having business accounting as its last reference and, in consequence, the Fourth Community Directive (Buch Gómez and Cabaleiro Casal, 2001, p.4).

They also explained that the recent reforms

(...) seem to subscribe to a context clearly favourable to convergence, by means of the analysis of the GAAP present in their norms, and the prevailing implantation of the same, considering their presence through the information contained in the annual accounts. (Buch Gómez and Cabaleiro Casal, 2001, p.4)

The study starts with a brief description of the historical evolution of the accounting information systems both in the Portuguese and Spanish local governments. However, the most important part concerns the characterisation of those systems information structures, namely the GAAP on the national regulations and practice:

- The GAAP on Portuguese local government accounting regulations are set on the 1999 CALG as: accounting entity, going concern, consistency, accruals, historical cost, conservatism (prudence), materiality, and non-compensation. In the Spanish equivalent to the Portuguese CALG – the ICAL – the majority of these principles are not expressly defined, although they are not absent from the accounting system, since they are stated in other complementary regulations such as the Local Finances Regulator Law. Moreover, the Spanish system also includes other GAAP not expressed in the Portuguese legislation: recording/recognition, allocation of the transaction, and matching concept.

The authors presented two possible reasons for these not to have been included in the Portuguese framework: they can conflict with the accruals principle, as well as with the budgetary principles, and they are controversial within the context of governmental entities (Buch Gómez and Cabaleiro Casal, 2001, pp.11-12).

- As to the presence of the GAAP in the theoretical operation of the system (they did not carry out any empirical analysis), they focused on three principles in their opinion more representative of the prevailing reform process in governmental accounting, and consequently of the criteria to bring this closer to the current accounting practices in the business sector (Buch Gómez and Cabaleiro Casal, 2001, p.12). Those principles were historical cost, conservatism and accruals. For these they offered a detailed analysis on theoretical differences between the Portuguese and the Spanish local government accounting frameworks (Buch Gómez and Cabaleiro Casal, 2001, pp.13-16).

Aiming at providing some useful insights towards the European local government accounting harmonisation, Balaguer Coll *et al.* (2001) carried out an empirical study also trying to identify patterns of convergence of the economic environments that characterise the European Union member-States local governments.

Although the authors had recognised that the governmental harmonisation process is irreversible, they also acknowledged that one of its main problems is determining the speed at which it must progress. They argued for the need to take into account the different interests hiding behind the harmonisation processes. Accordingly, they explain:

(...) as opposed to what happens in the private sector, the external users of governmental accounting do not exert any pressure to accelerate harmonisation process. After all, the operations of the local governments lack international scope and, therefore, neither supranational organisms (*which usually prefer to use National Accounting*), nor the potential lenders, nor even public opinion need to compare accounts of local governments that operate in different countries [italics provided]. In these conditions, the speed of the harmonisation process will depend, not only of the political will of the nations involved, but also on the resistance to change of the local governments themselves. (Balaguer Coll *et al.*, 2001, pp.1-2)

The authors also argue that if the political, economic and cultural differences among the European countries become weaker, it would be easier to design a common system to be accepted and adopted by all countries involved in the harmonisation process. Consequently, they defend a close relationship between accounting harmonisation and the convergence of the environments. Furthermore they explain that this is actually a corollary of the results presented in some studies (deductive and inductive approaches) developed for business accounting international harmonisation, which have discussed the role played by the environment as a cause of the differences between the accounting systems.

If the environment explains the differences that exist among the accounting systems, the convergence of the environment will facilitate harmonisation and the speed of the convergence will determine the pace of the process. (Balaguer Coll *et al.*, 2001, p.4)

Thus, their study tried to determine whether an absolute convergence was evolving towards a common European environment, or convergence was only proceeding in specific geographical areas, each made up of a small group of politically, economically and culturally similar nations.

Balaguer Coll *et al.* (2001, pp.2-3) recognised the operational problem of gathering information concerning the whole list of variables that characterise the environment: many are not quantifiable; others, even quantifiable, are not measured by international bodies. Thus, they focused on the economic aspects directly related to the model of local administration existing in each country, in particular to the internal users of accounting information, selecting three key variables (Balaguer Coll *et al.*, 2001, pp.4-5): per capita expenditure; degree of (financial) autonomy – Central Government Grants/Total Revenues; and deficit – Total Expenditures/Total Revenues.

The convergence of these would mean convergence of accounting information internal (decision-making) needs and purposes, and of design of the governmental accounting system.

The authors gathered data from the International Monetary Fund concerning those indicators, from 1978 to 1995. Individualised budgeted data were used for all European Union countries with the exception of Greece (which was excluded). **For Portugal** the data were available only from 1988.

A statistical analysis was then developed to determine the convergence between the countries variables over time. The indicators were tested as following non-normal distributions, with two kinds of dynamics occurring simultaneously in the probability density functions: changes in its exterior shape, and intra distribution mobility. The probability density functions (annual average value) per year for the three indicators showed marked asymmetry and scarce kurtosis evidencing multimodality.

Common statistical techniques for normal distributions could not be used to solve the problem and were instead replaced by non-parametric techniques for estimating the probability density functions. The “Kernel smoothing” was used to analyse the external shape of the probability density functions, dividing the whole period in three (1978-83, 1984-89, and 1990-95). An “ergotic” (long-term) distribution to analyse the intradistribution mobility of the values along time was used, being complemented with a stochastic “Kernel function”.

The main results for global convergence amongst all European Union countries were (Balaguer Coll *et al.*, 2001, pp.11-23):

- Per capita expenditure – Throughout the period considered, local governments expenditures had not exactly tended to converge. On the contrary, the results seemed to indicate a divergence process;
- Degree of (financial) autonomy – The results revealed that the models of funding between European local governments also had not tended to converge in recent years;
- Public deficit – Statistics show as a fact that European local governments had tended to reduce its deficit in the last twenty years. The authors’ analysis also demonstrated clear convergence during the period comprised within their analysis, as they expected.

Although they had recognised that the convergence on the objective of reducing public deficits might have contributed for the European local government accounting systems to have followed a common direction, they did not find strange that, even after the 1990s reforms, important differences still exist among those. They considered this to be reasonable, since very different models of local administration still exist, bound to require very different accounting information systems – divergence in per capita expenditures as well as in the degree of local financial autonomy (Balaguer Coll *et al.*, 2001, p.23).

The results were different though, when they analysed regional convergence (possible regional harmonisation). For this, they classified the countries in four large regions, considered to be geographical, cultural and economical close. **Portugal** was grouped with Belgium, France, Italy and Spain.

The indicators for what they called “conditioned convergence” were “conditioned indicators”, obtained dividing the country indicators by the annual average of the region it is comprised with in. The main findings for regional convergence were (Balaguer Coll *et al.*, 2001, pp.24-33):

- Per capita expenditure – The results showed that convergence existed at regional level, indicating that the (internal) information needs of local governments tended to be homogenous within the regions defined, though heterogeneous in the broader scope of the European Union;
- Degree of (financial) autonomy – This also tended to converge among countries of the same region, which did not imply that the regions were tending to converge among each other.
- Deficit – It seemed clear that the deficit had not only tended to converge among the different regions, but also amongst the different countries within each region.

This study concluded that (Balaguer Coll *et al.*, 2001, pp.34-35):

(...) since the national environments do not tend to converge towards a common European environment, it does not seem reasonable to try to harmonise the accounting of the local

government in the short term. (...) less rejection will be generated by advancing (...) along the path of regional harmonisation (...).

In our opinion, this might suggested that the **Portuguese local government accounting system** tend to be close to those from Belgium, France, Italy and Spain, which in fact seems to be true, as least regarding Spain, as the aforementioned studies confirm. Regarding the other countries, as far as it is our knowledge, no comparative studies exist.

Still regarding international harmonisation in governmental accounting, Brusca Alijarde and Condor (2002) develop a theoretical analysis, comparing the local government accounting systems in force in ten countries: five from the so-called Anglo-Saxon area, plus five from the Continental European area, where Portugal (with the 1999 CALG) was included.

Recognising the recent reforms as a common feature of governmental accounting systems at an international level, the authors raise the question if the processes have been heading towards the same direction, i.e., if there is any convergence (Brusca Alijarde and Condor, 2002, p.129). They start from a few previous empirical studies (e.g. Lüder, 1989; and Vela Bargues and Fuertes, 1999) that showed heterogeneity indeed exists among the governmental accounting practices of most countries they intended to analyse. While acknowledging that accounting diversity really exists in a multitude of items, both in the balance sheet and in the results statement, the authors address only those considered more important in characterising a (governmental) accounting system. Following in particular Chan *et al.* (1996), these are: objectives of the accounting information, accounting recognition and measurement, financial reporting, contents of financial reports, and information dissemination.

Nevertheless, Brusca Alijarde and Condor (2002, p.130 and p.160) do not refer to the objectives of the financial information, since they found evidence showing those to be generally similar among the countries in the study, with some eventual differences appearing in the importance given to each objective.

Their comparisons focus in particular on local government accounting systems, distinguishing between differences in current accounting criteria for elaboration of financial statements and those referring to the presentation and disclosure of accounting information.

In what respects to differences in accounting recognition and measurement, some points were highlighted **concerning Portugal** (Brusca Alijarde and Condor, 2002, pp.130-134):

- It was included in the group of countries (together with France, Spain and Canada), especially from Continental Europe, where a modified accrual system is still used in local government accounting, inasmuch as there are some exceptions that do not allow it to be considered a complete accrual system.
- The approach towards accrual accounting in local government accounting system was acknowledged as a reality in Portugal, as in other Continental European countries still in the process of converting its accounting system to a complete accrual criterion.
- The accounting treatment of non-financial fixed assets was regarded as one of the most controversial aspects in the development of accounting standards for governmental entities, for which there is great diversity of practices at international level. The recognition of these assets within the accounting system will depend on the measurement focus adopted, being recognised only if a modified or a complete accrual basis is used. The Portuguese CALG although distinguishing public domain assets (e.g. infrastructures and heritage) from other assets, requires for all assets to be registered on the balance sheet. The Portuguese local government accounting system was identified as following the international trend for countries using full accrual basis, to report information on all kinds of assets, because this allows a more global vision of the entity financial structure and capacity.
- Even more controversy was recognised in the valuation criteria for fixed non-financial assets at international level. Between the several valuation alternatives (historical cost, replacement cost, realisable value and present value), the historical cost criterion is seen as the one that internationally has received more support, both for business and governmental accounting, though its acceptance is not without criticisms (e.g. some suggest using a mixed system, following different criteria according to the type of assets). In the Portuguese CALG, historical cost is compulsory, with the possibility of carrying out asset revaluations to reflect its fair value, although this has to be authorised and defined by law. Also it was decided in Portugal to reflect the assets use in the accounts, thus the depreciation of assets is

compulsory in the CALG even for those considered as of public domain (general use).

Regarding differences in financial reporting, contents of financial reports and information dissemination, the authors analyse in particular the degree of diversity existing in financial reporting to be prepared, the treatment that is given to budgetary reporting in different countries and the presentation of consolidated financial statements. The features **on Portugal** were (Brusca Alijarde and Condor, 2002, pp.134-141):

- According to the CALG, the contents of the Portuguese governmental accounting financial reporting are: balance sheet, statement of economic result (operating statement), budgetary execution statements (including statement of cash flows, often called statement of changes in financial situation), appendix to the financial statements (complementary information), and management report.
- Although the financial reporting contents might be similar among the countries studied, some differences are recognised as existent in the information disclosed by each financial statement itself. For example, because some countries, such as Portugal, include all assets within the balance sheet, this discloses different information than for other countries not recognising all assets. Also differences appear within the operating statement, with some countries, like Portugal, calculating different types of results as in the business accounting, whereas others just present the final net result. Some countries follow a results classification by nature, while others prefer by functions. The CALG sustains the former, although the latter might also be pursued. As to the cash flows statements there are also heterogeneity, with the Portuguese framework not following the business model but developing a specific one for Public Administration: payments and receipts are divided between budgetary and non-budgetary.
- Portugal is within the group of countries where budgetary information is still in the centre of attention, so being very important within the accounting report. As the authors emphasise, the major differences between governmental accounting of Anglo-Saxon and Continental European countries relate to different accounting traditions, with the latter traditionally giving more importance to the budget and legal control, and the information being mainly directed towards the legislative and executive power. In a different way, in Anglo-Saxon countries legal accountability

is not so important, being replaced by operational accountability to the electorate and general public (Brusca Alijarde and Condor, 2002, p.158).

- As to the relationship between budgetary and economical-financial information within the accounting system, which the authors also consider a characteristic of the governmental accounting models itself, Portugal is included (together with United States, Italy, France and Spain) within the group of countries where the budgetary and accounting systems are connected, although the budgetary system continues to have priority. The linkage between budgetary and financial accounting is such that the later allows monitoring the budget execution, but the two systems remain separated and ruled by different standards (accounting criteria are not affected by budgetary criteria and vice-versa).
- Some discrepancies were also acknowledged among the criteria followed to the preparation of budgetary information, normally set in legal dispositions. Though there is wide acceptance to apply accruals in preparing financial statements, there is no consensus as to whether these should be extended to budgetary statements. As the authors highlight,

In fact, it seems that a cash criterion or similar (current financial resources flows) predominates in the budgetary information, whether or not this information is included in the annual financial report. However, several countries are beginning to make efforts towards the elaboration of budgets according to the accrual criterion, elaborating a forecast statement of revenues and expenses, of cash flows and of financial situation. (Brusca Alijarde and Condor, 2002, p.139)

Portugal is considered together with the Continental European countries where a cash criterion predominates on budgetary accounting, and the governmental accounting objective of compliance with the budgetary regimen still strongly determines the development of the accounting and reporting system. Indeed, budgetary control is still a major objective of governmental accounting information and budgetary statements are thus included in the reporting model. Brusca Alijarde and Condor (2002, p.140) explain that

This is due to the interest that Continental European countries have in demonstrating compliance with restriction concerning the raising and spending of public money. So, given that resources are allocated through the budgetary process, the budget is converted in the primary instrument for accountability.

- As to the presentation of consolidated financial statements, the authors are very clear in considering that with the Portuguese CALG there is no obligation to elaborate consolidated financial statements nor has any initiative been taken in this area. Accordingly, Portugal is classified within the group of countries where

consolidation in governmental accounts is still pending development, opposing others such as New Zealand where it is fully developed. Even so, the authors recognise Portugal within the countries where the Public Administration reform has been towards decentralisation, with local entities considerably increasing their competencies, and leading in many cases to the appearance of dependent bodies within its own legal entity.

- Finally they identify some common tendencies of the local government accounting systems recent reforms, which Portugal might be included in (Brusca Alijarde and Condor, 2002, p.144): for example, the reforms are included in a wider process of global reforms in public sector management, with special emphasis on the control of public spending; an ever-closer approximation to the business accounting model; and reforms with the intention to go beyond mere legal control through budgetary information, increasing the importance of financial accounting and especially of financial statements.

After showing the diversity, Brusca Alijarde and Condor (2002, pp.146-151) present possible causes and nature for the (local) governmental accounting differences. They recognise that this diversity is due to a large number of intervening factors in the configuration of the accounting systems of a country, both in public administrations and in business. Subsequently, they discuss some reasons that they believe can make local government accounting systems take different orientations (Brusca Alijarde and Condor, 2002, pp.146-151): legal system, organisation of the public sector, specific objectives of governmental financial reporting, main users of the governmental financial reporting, financial resources suppliers, impulse of governmental accounting regulatory bodies, interest and formation of professionals, and political and administrative environment in which each system operates.

In general, this study is updated and accurate and might offer some useful explanations for the “why” of the Portuguese local government accounting system. This is the reason why it is going to be picked up in Chapter V.

1.2. Literature in Spanish

Pina Martínez (1997) presented a brief description on the diversity of governmental accounting at an international level, among OECD countries. However, its main focus was intended to be the European Union countries. The purpose was to

make known the basic characteristics that were describing the governmental accounting of those countries, namely regarding the accounts presentation, as well as its most representative elements.

In his opinion, such a study was of seminal interest, not only for a better knowledge of the several countries governmental accounting systems, as well as to establish the degree of evolution and comparability of public accounts, very important specially within the European Union in the auspice of the Euro introduction, which would increase the need for implementing homogenous and comparable governmental accounting systems (Pina Martínez, 1997, p.297).

Data were gathered from annual accounts published by central governments of seventeen countries in 1994.

Portugal was included in the study, for which the main findings were (Pina Martínez, 1997, pp.298-302):

- As other countries, given the direct linkage to the traditional concept of rendering accounts, Portugal was publishing only budgetary information. Nevertheless, there were differences among the features of budgetary information provided by the several countries in the study. From the eleven items considered, Portugal was presenting eight: annual budget, functional classification of expenditures, economical classification of expenditures, economical classification of revenues, budgetary execution, earmarked expenditures, statement of cash flows from budgetary activities, and debt statement.
- There was great uniformity regarding the recognition and measurement criteria of budgetary expenditures and revenues. The Portuguese governmental accounting system, as the majority, was providing information on revenues and expenditures financial flows, recognised according to a cash or modified cash basis.
- As other countries within Continental Europe, in Portugal the budgetary information was still dominating governmental accounting, thus prevailing in public accounts yearly disclosed. Moreover, no financial information was prepared.
- Portugal was within the group of European member-States (together with Belgium, Germany, Denmark, Finland, Greece and United Kingdom) not presenting annual governmental accounts with similar features to those presented by companies.
- Portugal was included in the European Union context where there was still heterogeneity among the governmental accounting systems, though a tendency to incorporate financial accounting within governmental accounting could be identified for those countries not yet using it.
- Concerning additional information inside the annual accounts (indicating some concerns with the quality of the information disclosed), there was also great heterogeneity, with most countries, including Portugal, presenting additional information mainly regarding budgetary issues. In particular, Portugal was identified as disclosing historical information (from previous budgets and budgetary executions) for purposes of better following the budget evolution. Yet, it was not presenting other additional information more related to financial accounting, such as

GAAP, changes on the GAAP applications from one year to another, reasons for these changes, as well as consequences on the financial statements.

This information if it could be accurate, since it was gathered before the application of the 1997 Portuguese CAPA, it is no longer up-dated. On the other hand, as we argued before, even before that framework, some sub-sectors of the central government (e.g. public education and health) were already using accounting systems close to those used in business accounting.

More recently, Aibar Guzmán and Fernandes (1999) carried out a narrower theoretical analysis, briefly comparing the legal frameworks regulating local government accounting in the Iberian countries, evidencing the most important differences and similarities.

They started recognising that, although the recent reforms of the governmental accounting systems, in particular in the Western developed countries, have had as major common objective improving accounting procedures towards better quality of the information provided, the fact is that reform processes have been having different focus amongst countries. Referring to other studies (e.g. Lüder, 1992), the authors defended that governmental accounting international differences derive mainly from the specific political-administrative features characterising each country environment.

Accordingly, their comparative analysis is developed considering both Iberian countries as having similar environmental features, given their geographical and cultural closeness. Furthermore, they considered the fact that the 1997 CAPA, general framework for the whole Administrative Public Sector in Portugal, was inspired in the Spanish one, in force since 1994.

The first part of the paper addressed the structure and composition of local administration in both countries, in order to situate it within the public sector (Aibar Guzmán and Fernandes, 1999, pp.140-148).

They continued both for Portugal and Spain, briefly referring to local government accounting evolution, as well as different regulations that over time have been ruling the functioning of local government accounting systems (Aibar Guzmán and Fernandes, 1999, pp.148-155).

Finally they compared the (legal and compulsory) frameworks (charts of accounts) that presently underlie the local government accounting systems – CALG for Portugal and ICAL for Spain – namely in what respected to: scope of application,

objectives, general features, accounting principles, implementation methodology, and financial statements (Aibar Guzmán and Fernandes, 1999, pp.155-166). The main purpose was identifying which issues of both systems were converging and which were differing.

Their main conclusions might be summarised as follows (Aibar Guzmán and Fernandes, 1999, pp.166-167):

- The course followed by the governmental accounting reform processes had been similar in both countries, with innovations first being implemented at central level and then extended to other levels of Public Administration, namely Local Government.
- Regarding the differences between CALG and ICAL:
 - Scope of application – This is coincident for both frameworks, i.e., they are applicable to all entities comprised within the Local Administration;
 - Special (simplified) accounting regime – There are differences concerning the criterion used by both laws to apply the special regime: in the CALG local government entities are included in the special regime if its annual revenues are lower than a certain amount, while in the ICAL they have to have less than 5,000 inhabitants. The simplified regime in Portugal is traditional cash-based single-entry budgetary accounting; in Spain is the general regime (comprising financial accounting with accruals), except the preparation of certain financial statements;
 - Accounting system – In both countries the local government accounting system uses a double-entry bookkeeping method, with accrual basis for financial accounting and modified cash basis for budgetary accounting;
 - Cost accounting – In both systems, calculating costs for goods and services is compulsory;
 - Accounting principles – The CALG distinguishes between budgetary principles and rules applicable to budgetary accounting, and accounting principles applied to financial accounting. The accounting principles in the ICAL are of general character, not evidenced within the main regulation but as an appendix, and applied for all entities, regardless being included in the general or special regime. In Portugal the (financial) accounting principles are not used in entities within the simplified regime, since they do not have financial accounting;
 - Implementation methodology – In both countries a transition period was allowed to start implementing the new local government accounting system, during which entities could use the previous system though learning already about the new one.

Carrasco Díaz *et al.* (2000) presented a succinct comparative analysis between the 1997 Portuguese CAPA and the corresponding framework in force in Spain since 1994, evidencing differences and similarities.

They basically presented the general features of the Portuguese framework, referring to the main differences in face of the Spanish one.

The differences highlighted concerned: entities applying both frameworks; the structure of both charts of accounts; accounting principles; items for which valuation criteria are defined; financial statements type, form and contents; and accounts groups (lists and codes).

Brusca Alijarde and Benito López (2002) provided a panorama of governmental accounting at international level, embracing several countries, Portugal included. They aimed essentially at analysing the current governmental accounting systems state of the art (as at the end of 2001), offering some insights concerning harmonisation. Their study focused on local governments accounting.

The data were gathered using a questionnaire sent to governmental accounting professionals and academics within the countries to be analysed, once these were considered as better familiar with the system. People were selected from those attending CIGAR conferences. The questionnaire comprised 33 questions on local governments accounting systems, organised according to several subjects: 1) governmental accounting legal framework, 2) accounting information users, 3) objectives of the governmental accounting system, 4) accounting principles and measurement criteria, 5) treatment given to the budgetary information, 6) financial statements and accounting information to be disclosed, 7) criteria and practices to disclose and value the elements within the balance sheet, 8) results statement, and 9) cash flow statement.

The sample included 23 countries from several geographical areas around the world: 11 belonging to the European Union, including Portugal; 3 European countries not belonging to the European Union; 2 North-American; 3 Central and South-American; 2 Asian; and 2 Australasian.

The main purposes of their analysis were both showing the local government accounting diversity still existent around the world, and systematising both differences and similarities in order to suggest a possible international classification for the local government accounting systems. For the former they used statistical analysis of frequency and contingency tables; for the latter they chose cluster analysis already used in international classifications for business accounting systems.

On the description of the state of the art of the local government accounting international context, they observe a great degree of diversity.

Regarding Portugal they presented the following (Brusca Alijarde and Benito López, 2002, pp.159-165):

- The governmental accounting system is regulated by law, with specific accounting standards for local governments, though influenced to a great extent by those used in business accounting.
- Although there are not conceptual statements, there seems to exist an implicit conceptual framework.
- There are four basic objectives for local governments accounting information: demonstrating if the resources have been obtained according to law and the budget; informing on the origins and destinations of the financial resources; showing the entity's capacity to finance its own activities; and showing the entity's financial situation. Showing economy, efficiency and effectiveness in the entity's management is not a priority for the accounting information.
- A full-accruals basis is used to recognise the elements within the financial statements. Yet, cash basis is still used in preparing budgetary statements.
- Budgetary and financial accounting systems are linked, but using different principles, rules, and accounting basis.
- Both form and contents of the financial statements are ruled by legal pronouncements. The financial statements to be prepared are: balance sheet, results statement, cash-flows statements, budgetary execution statements, and notes. No consolidated statements are prepared.
- All assets are disclosed in the balance sheet, including infrastructures and heritage, using the historical cost convention. Financial costs, namely interest, concerning borrowing associated to capital assets, might be included in the acquisition/production (historical) cost. Revaluations have to be legally authorised. All depreciable assets are to be systematically depreciated.
- R&D expenses might be included as assets in the balance sheet in certain circumstances, being depreciated within at least five years.
- Assets on financial leasing are capitalised in the balance sheet using the acquisition price, and depreciated accordingly.
- Financial investments are recognised in the balance sheet at the acquisition (historical) cost.
- Transactions in foreign currency are recognised using the exchange rate at the date of the transaction; however, at the end of each year, they must be converted using the exchange rate at the moment. Eventual favourable or unfavourable differences are generally considered revenue or cost affecting the net result of the year; according to the prudence principle, there is an exception: favourable exchange rate differences associated to long-term debts must be deferred, if possible to be reverted.
- Following the full-accruals basis, transfers and subsidies granted are recognised as costs at the moment when the obligation arises, regardless the payment. Additionally, capital grants received are accrued along the depreciating period of the investments they are financing.
- The results statement is prepared according to the nature of costs and revenues, distinguishing current from extraordinary results.
- Expenditures are classified according to both an economical and a functional classification.

- A cash-flow statement is prepared, summarising payments and receipts from budgetary and non-budgetary operations.

Within the global international classification proposed, the **Portuguese local government accounting system** is considered in the middle level, amongst the accounting systems with a **medium-high degree of development**, together with others from Austria, Argentina, Finland, Italy, Spain and Canada, for example (within the highest level are essentially Anglo-Saxon countries). In fact, this is the level where most of the countries belonging to the European Union are comprised (Brusca Alijarde and Benito López, 2002, pp.166-176).

They also presented causes and nature of the local government accounting international differences, discussing the same factors as Brusca Alijarde and Condor (2002).

The paper additionally addresses the international harmonisation in governmental accounting, referring to purposes, advantages and obstacles (Brusca Alijarde and Benito López, 2002, pp.183-190).

Some frameworks of governmental accounting international standards are briefly described, namely those from INTOSAI and IFAC-PSC – IPSASs (Brusca Alijarde and Benito López, 2002, pp.191-202).

From the information gathered, the authors were able to develop an additional empirical analysis of the current status of conformity of each country local government accounting system with the IPSASs (Brusca Alijarde and Benito López, 2002, pp.206-209). Subsequently, for each country they computed a conformity index as follows:

$$\text{Index of conformity with IPSASs} = \frac{\sum \text{Practices in which conformity exists}}{\text{Total of practices analysed}} * 100$$

This index allowed a quantitative and objective assessment of the degree of homogeneity between the practices of each country and the IFAC-PSC recommendations (i.e. the local governments accounting worldwide harmonisation), hence evidencing the degree of adaptation of the national standards to the international ones. In general, there were large differences in the index values amongst the countries analysed. **Portugal** was presenting a global conformity index of 72.86%, being the eighth country in the total ranking. Two separate conformity indexes were also computed for measurement and disclosure criteria. **Portugal** reached 85.71% in the former and 60% in the latter (Brusca Alijarde and Benito López, 2002, p.208).

1.3. Some comments

Finishing this section, some comments are worthy to be made to the studies previously presented:

- First of all they are comparative analyses mostly addressing the problematic of governmental accounting international harmonisation;
- Only two of them were developed directly by Portuguese researchers, which might contribute for some lack of accuracy of the information regarding Portugal, since the majority of the authors do not have a factual knowledge of the Portuguese reality;
- Those that concentrate on the more recent and current issues of the Portuguese governmental accounting, they mainly briefly describe the evolution and accounting system currently in force (“how”), some of them even addressing only particular issues, as the general accepted accounting principles; none of them tried to explain “why” Portuguese (local) governmental is as it is, or “why” it has followed a particular orientation;
- Two studies though – Brusca Alijarde and Condor (2002), and Brusca Alijarde and Benito López (2002) – might have presented some explanations for the “why” of (local) governmental accounting when they discussed causes and nature of the international governmental accounting diversity; however, they did not aim at the Portuguese situation in particular, but include Portugal in an international analysis.

Therefore, we may conclude for a very limited and poor international literature, both on the “how” and the “why” of Portuguese (local) governmental accounting justifying, first of all, some systematic revision in English on its recent evolution and current state. This is going to be done in Chapter III, where we offer a comprehensive description and explanation of the “how”, focusing particularly on local governments accounting.

Additionally, due to the lack of a theory explaining the “why” of governmental accounting, we expect to make some contributions on the basis of the Portuguese case, applying the FMR Model (contingency approach) to Portugal in Chapter IV, and above all, towards an inductive (positive) theory in Chapter V, proving some insights on the “why” of Portuguese local government accounting in comparison with the United Kingdom.

2. GOVERNMENTAL ACCOUNTING CONCEPTUAL FRAMEWORKS

The main purpose of this section is presenting some theoretical developments in governmental accounting, mainly those carried out in the last twenty years within the Anglo-American context.

The majority of the literature addressed concerns fundamentally governmental accounting conceptual framework studies that have been commissioned by national standard-setting organisations.

However, the section starts referring to the history, definition, importance, functions and main components of a conceptual framework for governmental accounting. Some distinctive characteristics that might be responsible for the specificities of governmental accounting conceptual framework within the general accounting theory are going to be reviewed as well. It additionally discusses the functions of governmental accounting and budgeting, within the users/users' needs approach.

2.1. Brief history

The subject of a conceptual framework for accounting has been discussed particularly over the past thirty years. The debate started in the USA but has expanded all over the world. In fact, the USA have had a relative importance in initiating and deriving the development of accounting conceptual frameworks, once much work of the American accounting standard-setting bodies has directly influenced projects in other countries (Jones, 1992, p.256).

According to Jones (1992, p.249), the most important related study is the American Accounting Association (AAA) 1966 "A Statement of Basic Accounting Theory" (ASOBAT). This seemed to have had great influence on subsequent conceptual framework projects, both for business and non-business accounting.

Nevertheless, attempts to reach an accounting theory seem to have started a few years earlier, namely in the 1930s in the USA². Yet, as Vela Bargues (1992, p.103) explains, more recent theory recognises the influence of former ones. Quoting Gonzalo Angulo (1989, in Vela Bargues, 1992, pp.103-104), he presents three main stages for the accounting conceptual frameworks development process:

² See for example, American Accounting Association (1936); «A Tentative Statement of Accounting Principles Affecting Corporate Reports»; *The Accounting Review*; June, pp.187-191; in Dopuch and Sunder (1980).

- The professional, inductive and heuristic stage, from the 1930s to 1950s, where the American Institute of Certified Public Accountants (AICPA) had an important role;
- The doctrinal stage, from the beginning of the 1960s up to 1973, in which development the Accounting Principles Board (APB – USA) was particularly important³;
- The conceptual framework stage, from 1973 onwards, since the creation of the FASB, disbanding the APB. According to Jones (1992, p.250), in 1973 the AICPA published the first major response from the profession to ASOBAT – “The Trueblood Report” – considered by many as the main pronouncement that has had more influence on the accounting conceptual framework theory since then, culminating the previous attempts.

However, the major and most elaborated accounting conceptual framework was the one started by the FASB in 1973, which involved six statements on several financial accounting and reporting matters, the last one of which issued in 1985⁴. This work has inspired others, such as those from the Accounting Standards Committee (ASC – UK) and the IASC, as well as others in Australia and Canada, although most of them had begun more than ten years later (Vela Bargues, 1992, pp.105-110).

As to governmental accounting, the origins of its conceptual frameworks come from the USA as well, and somehow seem to be derived from those of business accounting, at least in the last twenty years.

Jones and Pendlebury (2000, p.125) state that

The 1970s saw the beginning of serious and substantial attempts to understand and improve financial reporting practices of public sector organisations.

Yet, the fact is that, as Remis (1981, in Drebin *et al.*, 1981, Vol. II, p.1.1) states,

The beginning of the concepts that led to the first authoritative pronouncements on governmental accounting and financial reporting can be traced roughly to the beginning of the 20th century. The motivation at this time came basically from the municipal reform movement *in North America* [italics provided].

³ As the main of its intents of formulating an accounting conceptual framework, Vela Bargues (1992, p.104) highlights the 1970 Statement N. 4 – Basic Concepts and Accounting Principles underlying Financial Statements of Business Enterprises.

⁴ Statement N.1 (1978) – Objectives of Financial Reporting by Business Enterprises; Statement N.2 (1980) – Qualitative Characteristics of Accounting Information; Statement N.3 (1980) – Elements of Financial Statements of Business Enterprises; Statement N.4 (1980) – Objectives of Financial Reporting by Nonbusiness Organisations; Statement N.5 (1984) – Recognition and Measurement in Financial Statements of Business Enterprises; and Statement N.6 (1985) – Elements of Financial Statements (this replaced Statement N.3, adding pronouncements concerning non-business enterprises and stating that Statement N.2 without change would apply to non-profit organisations). For further details on these statements outline, see for example, Anthony (1987, p.79) and Vela Bargues (1982, pp.106-107).

After three decades of individual contributions and textbooks⁵, mainly related to municipal accounting, there was very little development in practical aspects of governmental accounting, although municipal accounting theory appeared to be proceeding (Remis, 1981, in Drebin *et al.*, 1981, Vol. II, p.1.3).

In this context the Municipal Finance Officers Association (MFOA) created the National Committee on Municipal Accounting (NCMA) in 1934.

(...) *this* body of knowledge of municipal accounting represented the uncoordinated ideas of a variety of groups and individuals. (...) *It* was created (...) in order to formulate principles of municipal accounting, to develop standard classifications and terminology for municipal reports, to consider principles which should be followed in making municipal audits and to promote the recognition and use of these standards [italics provided]. (Remis, 1981, in Drebin *et al.*, 1981, Vol. II, pp. 1.3-1.4)

Its main work was a list of bulletins, mainly on principles and standards. The Committee was not very concerned with the formulation of accounting procedures⁶.

Because it was not envisioned to be a permanent organisation, the NCMA was discharged in 1941, being reactivated in 1948 in order to update its previous work.

According to Remis (1981, in Drebin *et al.*, 1981, Vol. II, p.1.8),

The new committee was called The National Committee on Governmental Accounting (NCGA). This name change was to indicate that the accounting principles which the committee prescribed were applicable, not only to municipalities, but all types of state and local government.

Up to 1953, when this committee was again disbanded, four additional bulletins were issued revising and upgrading those from the NCMA. In 1967, the NCGA was re-established, and its most important publication “The Governmental Accounting, Auditing and Financial Report” issued in 1968.

As to AICPA and its predecessor organisations, its role for governmental accounting conceptual frameworks was very limited prior to 1974, mainly providing a member for the NCMA and later for the NCGA.

In 1971 the MFOA appointed a special task force to study its relationship with the NCGA. From this study a report was issued in 1973, resulting in the creation of the National Council on Governmental Accounting. This Council was a quasi-independent body under the sponsorship of the MFOA, representing an outgrowth of the former Committee, with the same authority and responsibility. Its main objective was to

⁵ Remis (1981, in Drebin *et al.*, 1981, Vol. II, p.1.2) highlights Herman A. Metz as a major contributor to the development of improved governmental accounting and reporting practices, mainly as a leader in the development of accounting procedures for local governments. His most important work was the “Handbook of Municipal Accounting” published in 1913 that became the basis for other textbooks and articles published in the following decade.

⁶ For further details on the bulletins, see Remis (1981, in Drebin *et al.*, 1981, Vol. II, appendix A, p.1.17).

develop and issue standards for financial accounting for state and local government units (Remis, 1981, in Drebin *et al.*, 1981, Vol. II, pp.1.8-1.16).

Meanwhile, also in 1973, the FASB was created issuing the first concepts statement in 1978 – Statement N.1: Objectives of Financial Reporting by Business Enterprises. As a board of the Financial Accounting Foundation (FAF), the FASB was institutionally distanced from the accounting profession (Jones, 1992, p.252), and concerned explicitly with business organisations. However, at some point, it started to concern with non-business organisations as well, particularly after the study developed by Professor Robert Anthony in 1978⁷. Consequently, in 1980, Statement N.4: Objectives of Financial Reporting by Nonbusiness Organisations – was published.

The FASB interest in non-business organisations, in Jones' (1992, p.254) opinion, (...) was bound to challenge a wide range of vested interests.

In fact,

(...) 'governmental accounting', even if federal accounting could be set aside, was an extremely complicated amalgam of laws and practice across fifty states with widely different histories and traditions. (Jones, 1992, p.254)

Federal government had the power to set its own standards. As to state and local governments, the responsibility for accounting standards was to the NCGA. Nevertheless,

State law continued to prescribe accounting rules and there was significant noncompliance with the NCGA's recommendations. (Jones, 1992, p.254)

Within this confused context, the Governmental Accounting Standards Board (GASB) replaced the NCGA in 1984, and was established also as a board of the FAF. Once its responsibilities cover state and local governments⁸, soon enough there was some conflict with the FASB's responsibilities related to non-business organisations.

This was eventually resolved by assigning private, non-for-profits to the FASB and non-for profits of governmental units to GASB. But this relates only to the broadest level of principle: the detailed implications for accounting will take years, probably decades to resolve themselves. (Jones, 1992, p.254)

⁷ According to Jones (1992, p.252), this study – Financial Accounting in Nonbusiness Organisations – commissioned to Professor Anthony by the FASB, aimed to provide the basis for non-business organisations to be included in its conceptual framework project. Moreover, this kind of "sudden" FASB interest in non-business organisations derived from a FAF statement that the FASB should deal with municipal accounting. In turn, this seems to have derived from a big financial crisis that was happening in New York City in the middle 1970s, which appear to have been great to due to accounting. For further details on this matter, see Anthony (1985).

⁸ The GASB was established as an arm of the Financial Accounting Foundation in April 1984 to promulgate standards of financial accounting and reporting with respect to activities and transactions of state and local governmental entities. The GASB is the successor organization to the National Council on Governmental Accounting (NCGA). (GASB, 1997, p.xiii)

Although the GASB's pronouncements seem to have resulted from former conceptual frameworks (e.g. Drebin *et al.*, 1981), this body immediately started a project of its own. In 1985 a study on the users of governmental financial reports and their needs was published, and in 1987 the GASB issued its first concepts statement: "Objectives of Financial Reporting", including a list of users and users' needs (Jones, 1992, p.255).

One of the most recent GASB's publications is a "Codification of Governmental Accounting and Financial Reporting Standards" (GASB, 1997), which includes some statements that are not yet in effect (e.g. Statement N.11: Measurement Focus and Basis of Accounting – Governmental Fund Operating Statements).

As to central/federal government, the Auditor General of Canada and the Comptroller General of the USA developed the "Federal Government Report Study", published in 1986, exploring the applicability of the commercial accounting model to national government. Jones (1992, p.257) explains as distinguishing feature of this study:

(...) clearly, this is a conceptual framework commissioned and written by governments, at least by branches of governments.

In conclusion, the 1970s and the 1980s seem to have been turbulent decades for accounting conceptual frameworks. Even if governmental accounting particularities tended to be neglected at first in the majority of the works⁹, the truth was that, starting in the USA, but extending to other countries (English-speaking first) – accounting conceptual frameworks for national and state/local governments started to "blossom", which we will refer to in section 2.7.

2.2. Defining conceptual framework

In the accounting literature one may find several definitions for "conceptual framework". Vela Bargues (1992, pp.110-111) argues that, although this might lead to conclude for a certain lack of doctrinal consensus in what respects to its definition,

(...) such diversity is more an answer to the multiple features bounded in the conceptual framework notion than to the existence of a lack of consensus in its conception. (Vela Bargues, 1992, p.111)

The author supports his arguments with two fundamental reasons:

In first place, practically the totality of opinions is coincident considering the conceptual framework as the basis on which the establishment and interpretation of accounting standards should be laid.

⁹ One exception was the Australian project published in 1987, which according to Vela Bargues (1992, pp.108-109) included public sector organisations.

In second place, the deduction of conceptual framework notions in view of the existence of different definitions seems as an adventure lacking of scientific accuracy, considering above all that the accounting profession always have operated within a conceptual framework. (...) the accounting conceptual framework has existed since long time ago and it is not new. What is doubtless new is the intent to characterise, to bound and to develop it in order to give a universal character to something already implicit. (Vela Bargues, 1992, p.111)

Supporting the idea of a single conceptual framework for the whole accounting, Vela Bargues (1992, p.111) states that having several notions of accounting conceptual frameworks would be as destroying the unity proper to the discipline. Consequently, he argues that several definitions exist not because there are different notions, but because each definition expresses emphasis given by each author to different elements of the conceptual framework.

In order to support this argument, he presents several definitions, some emphasising the conceptual framework contents, others highlighting its purposes.

In the first category he refers to Anthony (1978, in Vela Bargues, 1992, p.111):

(...) every conceptual framework integrates a set of wide and internally consistent fundamentals as well as definitions of key terms.

He additionally quotes Points and Michelson (1979-80, in Vela Bargues, 1992, p.111):

(...) it embraces the underlying concepts that provide a basis for the accounting practices.

Within this current, Miller (1985, in Bloom and Elgers, 1995, p.325) considers a conceptual framework as

(...) a comprehensive set of concepts for theory and practice.

Also Jones (1998, p.11) defines it as

(...) the result of a comprehensive project to determine the fundamental principles that underlie financial statements.

This last definition is of particular interest since it stresses that a conceptual framework generally results from comprehensive studies, developed either by (or at request of) official (authoritative) bodies or individual authors (academics)¹⁰. One example of this process is the NCGA's conceptual framework research project. The report covering the first phase of the project stated:

¹⁰ Anthony (1983, p.8) states that the conceptual frameworks that have been developed can be grouped as unofficial and official, being the first those not developed by, or at request of, an authoritative body. He also presents some references for unofficial sources of concepts (Anthony, 1983, footnote 19, p.211): Eldon S. Hendriksen (1982), *Accounting Theory*; Philip Meyer (1981), *Applied Accounting Theory*; and Kenneth Most (1982), *Accounting Theory*. Additionally, Dopuch and Sunder (1980, in Bloom and Elgers, 1995) also mention M. Monitz (1961), *The Basic Postulates of Accounting*; and R. Sprouse and M. Monitz (1962), *A Tentative set of Broad Accounting Principles for Business Enterprises*.

This report covers the first phase of the conceptual framework research project: the development of objectives for accounting and financial reporting by state and local governments. The next phase of the project will involve the development of principles, consistent with the proposed objectives, that will guide the establishment of standards for governmental accounting and financial reporting. (Drebin *et al.*, 1981, Vols. I, p.2)

Such statement also highlights the idea of having first accounting objectives that will guide the establishment of concepts and principles, which in turn will be followed by standards more procedures-oriented.

As to the second category – defining of accounting conceptual framework considering its purposes – Vela Bargues (1992, p.111) mentions Bromwich (1981, in Vela Bargues, 1992, p.111):

(...) its purposes are identified with the setting of evaluations and measures of the income.

He also refers to the FASB (1977, Exposure Draft for Statement N.1, in Vela Bargues, 1992, p.111):

(...) its purposes are the setting of objectives and concepts to be used in the developments of the accounting standards.

In this trend, the NCGA's report (Drebin *et al.*, 1981, Vol. I, p.2) states that

(...) the purpose of the conceptual framework is to provide guidance in setting standards for governmental accounting and financial reporting (...).

Some authors also present a definition for conceptual framework as a system.

Anthony (1983, p.1) states:

A framework of concepts comprises ideas that coordinate to form the fabric of a system – the fabric that determines the bounds of the system and makes it hang together.

In a very firm critic to the FASB's model, he additionally presents a more prescriptive definition for conceptual framework:

(...) a broad outline of what financial accounting practices should be. (Anthony 1987, p.75)

Also Gonzalo Angulo (1989, in Vela Bargues, 1992, p.112) defines conceptual framework as a

(...) coherent system of inter-related objectives and fundamentals.

All the above-mentioned definitions refer to important aspects of the conceptual framework. However, since each one emphasises a particular issue, none of them seems to be embraceable enough. Consequently, Vela Bargues (1992, p.112) endorses the FASB's definition as the most complete notion of conceptual framework (FASB, 1976, in Vela Bargues, 1992, p.112):

(...) a conceptual framework is a constitution, a coherent system of inter-related objectives and fundamentals that can lead to coherent standards and that prescribe the accounting nature, function and limits, and the financial statements. The objectives identify the accounting aims and purposes. The fundamentals represent the accounting underlying concepts, which guide the selection of the facts to be registered, its measure, and the means of summarise and communicate those facts to the interested parties. This type of concepts become fundamental in the sense that other concepts flow from them and references to

them are necessary in establishing, interpreting and applying the accounting and information standards.

Indeed, this definition apart from endorsing the conceptual framework purposes, provides further enlightenment on what its contents must be, thus addressing its structure. Furthermore, its importance as basic theory is also acknowledged.

More recently, Rodrigues and Branco (2001) discuss the development of accounting conceptual frameworks on a national basis, in a context of international accounting harmonisation. They argue that, once the main purpose of the conceptual framework is supporting the process of accounting standards setting, it is understandable to find several national conceptual frameworks, given the need for these to be adequate to the characteristics of social, juridical and economic contexts (Rodrigues and Branco, 2001, p.164). Following this reasoning, they state:

Conceptual frameworks have sought to answer questions related to financial accounting objectives – who financial information should be prepared for and which are the purposes that it should be serving – and to its contents and way of presentation. A conceptual framework is the materialisation of an interpretation of the financial accounting theory towards an explicit choice of a certain accounting model. Underlying that choice is a certain understanding of the usefulness of that model in relation to the socio-economic context in which it is going to be used, as well as to the accounting regulation process which it is going to serve as conceptual basis. (Rodrigues and Branco, 2001, p.185)

Most of the definitions presented result from studies related to business accounting, which is understandable since it has been discussed for much longer than governmental accounting. Nevertheless, some authors, as Vela Bargues (1992, p.117) for example, believe in the unity of the accounting conceptual framework, i.e., one single accounting theoretical support. Accordingly, there is no different definition, importance, purpose or even general structure of the conceptual framework for the particular context of public sector, governments in particular. Like Wyatt (1979, in Vela Bargues, 1992, p.117) argues

(...) a single conceptual framework is essential to accomplish the objective of a unique vision and general definition for the financial statements of all organisations... Although certain definitions might be more applicable to one type of entity than another, definitions do not change due to the type of organisation on what information is being reported.

Yet, we will refer to and discuss the governmental accounting conceptual framework. The reason for this is not therefore the existence of a conceptual framework different from the one for business accounting. Instead it is because, as Vela Bargues (1992, p.118) clearly explains:

Given the characteristics of Governmental Accounting and the differences presented by organisations under its regime in relation to those from private sector, the integration of the former within the conceptual framework structure raises (...) the need to interpret in a particular way some of the basic accounting concepts underlying the referred framework.

Another issue it is important to mention concerns to management accounting and how it has been treated in the conceptual frameworks.

In what respects to business accounting, as far as it is our knowledge, it has been neglected to a great extension. This is understandable recognising as Jones and Pendlebury (2000, p.125), that

Accounting theory is conventionally concerned with financial accounting, i.e. with accounting to external providers of finance.

This justifies why the great majority of conceptual frameworks has defined the objectives of accounting information and reports considering their external users and users needs¹¹.

At this respect Anthony (1983, p.vii) offers a different opinion, basically stating that there are no justified differences between financial and management accounting. Although admitting that in previous studies he emphasised the differences, the author later recognised that those were not so important. Therefore, he argues that there are no reasons for companies to develop internal accounting systems whose principles differ from those of financial accounting, i.e., these should have a common conceptual framework.

Even so, companies do not normally publish management accounting information, namely budgetary information; also companies' budgets are not audited. Thus, rules in order to harmonise management accounting concepts and procedures do not seem to be so important¹².

However, in a governmental context, the scenery is significantly different. Management accounting, namely budgeting, has the central role in governmental

¹¹ Jones (1992, p.260) refers to 1966 ASOBAT as an exception not followed by the subsequent frameworks:

ASOBAT's objectives of accounting implicate the *preparers* of financial statements as 'users': the preparers use accounting information to direct and control the organisation's human and material resources, for example. This is not difficult to understand, given that ASOBAT is equally concerned with 'financial accounting' and 'management accounting', but it is clear that in ASOBAT's view this control function of accounting is inextricable from any other potential roles.

Also Rodrigues and Branco (2001, p.166) refer to the 1996 *Ordre des Experts Comptables* (France) accounting conceptual framework as one that, opposing the majority, defines the financial statements objectives referring to a particular entity definition. This theory considers that, once it is impossible to consider the great diversity of users needs, none of them should be privileged. Thus, it does not consider the addressees of the information, whose common needs might be the basis for the type of information to be provided. Instead, the financial information objectives must be set referring to its relevance in relation to what they intend to represent, namely the company.

¹² It seems relevant to clarify here that we are not restricting management accounting to budgeting. However, in a governmental context, this embraces great part of the management accounting scope.

accounting and management. Furthermore, budgets are published and publicly compared with executions in order to control and evaluate public management. Therefore, budgets are laws. Accordingly, though recognising that conceptual frameworks cannot be above the laws, it seems that they can be, and effectively are, theoretical references underlying accounting laws. As it is stated in the NCGA's report:

Although the setting of standards by any authoritative body is essentially a legislative process, theoretical support for alternative positions can be helpful in achieving decisions that are consistent with the values of the standard setting body. (Drebin *et al.*, 1981, Vol. I, p.2)

Fortunately it seems that authoritative governmental accounting standard-setting bodies are becoming aware of the importance of extending conceptual frameworks to budgeting. For example, GASB's (1997) codification has two sections entirely dedicated to budgeting, budgetary control and budgetary reporting. GASBCod.Sec.1700 starts with a statement of principle:

- a. An annual budget(s) should be adopted by every governmental unit.
- b. The accounting system should provide the basis for appropriate budgetary control.
- c. A common terminology and classification should be used consistently throughout the budget, the accounts, and the financial reports of each fund.

In turn, GASBCod.Sec.2400 starts:

Budgetary comparisons should be included in the appropriate financial statements and schedules for governmental funds for which an annual budget has been adopted.

In a more peremptory way, this section continues emphasising that a special codification (implicitly this one, but separated from that for financial reporting) must rule state and local government budgetary practices (GASBCod.Sec.2400.101):

State constitutions, statutes, political subdivisions, charters, and local ordinances assign the responsibility of the budgeting process and establish budgetary authority. The scope and method of state and local government budgetary practices are outside the scope of financial reporting standards. However, financial reporting guidance for budgetary comparisons is within that scope.

From our point of view, the main reason why governmental accounting conceptual frameworks tend to neglect budgeting, is that budget theory has much to do with political science (Wildavsky, 1975) and also with economics, particularly public finance, which do not seem so attractive for accounting theorists (academics/researchers) and even less for professionals.

Indeed, as Jones (2000b, p.3) states, within the budgetary philosophy,

The discussion of most technical issues *on management accounting in government* focuses on budgeting and most of that literature was not written by accountants (the literatures of economics, politics and public administration having been dominant); (...) [italics provided]

Throughout this paper, Jones (2000b) presents and discusses examples of literature in English that eventually addressed budgetary theory. Most of the examples are non-official conceptual frameworks, developed by individual academics mainly since the beginning of the 20th century. What is highlighted is that most of this literature (e.g. Willoughby *et al.*, 1917, Bastable, 1903, Shirras, 1936, and Sundelson, 1935, all referred to in Jones, 2000b) essentially on public finance or political economy, only incidentally raised matters of budgetary theory or dealt with it in small appendages; most of the authors resume to describing procedures instead of discussing concepts (Jones, 2000b, p.19 onwards).

2.3. Discussion of the need, importance and functions

It is by far well known that the practices of accounting are very ancient, opposing the accounting discipline, which seems to be no more than two hundred years old. Furthermore, as Jones and Pendlebury (2000, p.8) observe, the accounting theory, since ever appears to have been developed from the accounting profession practices:

The discipline did not begin, and it did not develop, in universities. It undoubtedly grew from practice (...), although the causal factors are not well understood.

This accounting profession and the associated accounting discipline, which we now think of as Anglo-American, have grown in influence around the world.

Because of its pragmatic origins, accounting is often understood as a body of practices developed in response to practical needs rather than by deliberate and systematic thinking (Chambers, 1963, in Bloom and Elgers, 1995, p.273). Indeed, it did not seem to have existed some theory that researchers had tried to prove to be true.

Instead, the rather utilitarian perspective of the development of accounting rules and procedures has had little to do with an orderly and systematic formulation. This has led to the adoption of multiple solutions for many specific accounting problems.

This quite confused and confusing environment in the accounting development constitutes one of the main justifications for the need for an accounting conceptual framework. As Chambers (1963, in Bloom and Elgers, 1995, pp.273-274) argues:

For, if accounting is utilitarian there must have been some concept or some theory of the tests which must be applied in distinguishing utilitarian from nonutilitarian procedures. And, if rules are not formulated with reference to general laws or ideas of some kind then it is quite pointless to speak of rules and to write textbooks about them. It is largely because of the tests of “utilitarian-ness” and the general ideas of laws that underlie accounting rules have not been made explicit that the body of accounting practices now employed contains so many divergent and inconsistent rules. Even rules which have been adopted, and recommendations which have been made, after considerable discussion over the past thirty years exhibit indeterminacies, divergences and inconsistencies. The application of good intentions and long deliberations in an *ad hoc* setting cannot free practice of those features.

Accordingly, the need for a conceptual framework seems to rely upon the one of having a common explicit theoretical reference (set of concepts and principles based on postulates¹³ or premises¹⁴), capable of giving coherence to accounting practices, and on which rules (standards) and recommendations must lay.

In the same line, Anthony (1983, pp.1-2) states:

Those who comment on proposed standards usually do so in terms of their personal conceptual frameworks. Thus, concepts provide guidance in the development of standards (also referred to as generally accepted accounting principles, or GAAP), although concepts are at a higher level of generality than standards.

On the actual importance of a conceptual framework for accounting, Solomons (1986, in Vela Bargues, 1992, p.105) explains:

(...) a standard-setting body without a conceptual framework would be as a legislation promulgating laws without a constitution that protects citizens from the government arbitrary actions.

The idea of a guidance basis for the development of accounting rules and procedures is important in order to prevent these of being issued randomly, leading to inconsistencies and contradictions in preparing accounting information¹⁵, which in turn would lead to difficulties in comparisons and above all, to possible harmful consequences for the entities performances. Therefore, one may say that the main function of a conceptual framework is making explicit a common basis for analysis of accounting principles and standards.

Indeed, as Anthony (1987, p.75) states:

Financial accounting reports are governed by generally accepted principles, or standards, which are derived from a conceptual framework. Accounting needs this framework for the same reason a country or state needs a constitution to guide the development of its laws (although the accounting framework does not have the legal force of a constitution).

¹³ Chambers (1963, in Bloom and Elgers, 1995, pp.282-283) defines “postulates” as (...) descriptions of some thing, some event or some form of behaviour found in the environment of accounting. Accounting has no justification whatever in itself. It has no rationale beyond the domain of man acting purposefully in monetary economies. All of its postulates must therefore be outside of it, must be descriptive of the world in which it plays a part.

He continues arguing that the importance of postulates for setting concepts and principles relies upon the fact that they are a man’s substance of his understanding of the world in which he acts. Moreover, to examine one’s postulates is the simplest and most effective way to discover improvements opportunities in practice (Chambers, 1963, in Bloom and Elgers, 1995, p.283).

¹⁴ Anthony (1983, p.23) states that:

The premises (...) are intended to describe what the world really is like, and the conceptual framework is based on these perceptions of reality. If the perceptions are correct, and if the theoretical framework is, in fact, based upon them, then there should be no difference between accounting theory and good accounting practices.
(...) accounting practice should be based on sound concepts and (...) these concepts should be derived from realistic views of the world.

¹⁵ As Anthony (1987, p.75) acknowledges, standards are developed within the framework provided by concepts; unsatisfactory concepts lead to unsatisfactory standards.

Without it, debate over the issues bogs down because arguments are based on individual frames of reference that are rarely made explicit, with no common basis for analysis.

Yet, in view of these arguments pro conceptual framework, there are as expected, arguments against. Anthony (1983, p.11) states, in particular for financial (business) accounting:

Although most people grant the usefulness of a conceptual framework for financial accounting, a few think that efforts to construct such a framework are not worthwhile. Some argue that the development of a framework is not feasible; others that it is not necessary or desirable. Arguments of these critics are cited frequently enough that discussion of them is warranted.

Accordingly, following Anthony's (1983, pp.12-15) discussion, on the group of arguments doubting the feasibility of developing a generally acceptable conceptual framework, there are those who point out that

(...) none of the attempts by various persons or organisations has succeeded. No official framework exists, and unofficial frameworks have had little impact on the development of accounting. (Anthony, 1983, p.12)

Nevertheless, in spite of some previous efforts not being successful, the truth is that, with more or less difficulties, accounting conceptual frameworks have not been impossible to develop. The proof is the development of the FASB's conceptual framework, and others that mainly during the 1980s follow that one, both for business and governmental accounting, which will be presented in 2.6 and 2.7.

On the difficulties related to the development of an accounting conceptual framework, Anthony (1987, p.80), referring particularly to the FASB, recognises those related to the lack of accounting theorists:

Developing a conceptual framework for financial accounting is not easy. (...) Part of the trouble is the theoretical nature of the job. Many disciplines recognize the distinction between theory and practice; (...) In accounting the distinction is not clear. Most accountants are practitioners, as preparers of accounting information, auditors, or teachers. Only a handful are interested in making a career as theorists, and for those few the opportunities are limited to the largest public accounting and investment firms and a few university positions. (...) Moreover, accounting requires a special kind of theorist: a person who has a thorough knowledge of both the real world and accounting concepts. (...) The FASB has an almost insurmountable problem in identifying and attracting qualified conceptualizers to its staff.

Apart from this, Anthony (1983, p.12) also acknowledges that, in order to be accepted, any conceptual framework has to be recognised by an authoritative body. This has in reality been done. Jones (1992, p.259) states that, both for business and governmental accounting, they have been developed by, or on behalf of, bodies of preparers and auditors of financial statements, many of which being professional accounting associations (mainly for those more recently developed, since at first

professionals were not so involved¹⁶). However, although being representative of preparers and attestors, none of these bodies has the power to enforce their accounting standards:

(...) the ultimate power rests with the government. Obviously, when we turn to accounting standard-setting for public sector organisations, there is an additional element to government power: now the power is not only in relation to other organisations in society but in relation to itself. (Jones, 1992, p.259)

This lack of enforcement power is understandable if we consider that through its setting power, accounting standard-setting bodies are in effect challenging the sovereignty of governments (Jones, 1992, p.262). Furthermore, it appears to lead to two inter-related consequences. On the one hand, accounting standard-setting bodies, realising its power being restricted to setting but not enforcing accounting standards, might be seen as mere advisors having some difficulties in justifying the normally huge amounts of money involved in its projects. Subsequently they need to legitimise its activities and, at an extreme case, its existence. A conceptual framework seems to provide the rationality for this. But, on the other hand, the use of conceptual frameworks to justify the public position of private non-enforcing accounting standard-setting bodies, raises questions concerning any conceptual framework effectiveness, particularly its purposes or functions, in providing a basis for establishing accounting standards.

As Jones (1992, p.262) argues, although this might not be the case for all standard-setting bodies, the truth is that many of them use the development of conceptual frameworks to establish its legitimacy. Some examples are known for governmental accounting:

The way that conceptual frameworks were used in the formative years of the GASB seems clear-cut. The New Zealand case, where radical government practice has preceded the conceptual framework of the profession, fits neatly too. (Jones, 1992, p.262)

Consequently this leads to the conclusion that the primary purpose of any accounting conceptual framework, either for public or private sector,

(...) is to establish the legitimacy of the standard-setting bodies, rather than to provide principles that will guide specific accounting standards. (Jones, 1998, p.11)

¹⁶ According to Peasnell (1982, in Bloom and Elgers, 1995, p.285), most of the efforts to develop an accounting conceptual framework (in particular trying to define the nature and purposes of companies financial reporting) resulted, at first, from studies developed by individual scholars or academic committees concerned to give sound theoretical ground to the teaching of financial reporting subject.

Only relatively recently (*mainly since the late 1960s*) have the professional accounting bodies shown any inclination to take part in this process [*italics provided*]. (Peasnell, 1982, in Bloom and Elgers, 1995, p.285)

The author even suggests that this need for legitimacy might be an explanation for why there has been comparatively much less theorising in public sector accounting than in commercial accounting:

In the UK, the government has not needed to establish its legitimacy for many years, probably centuries: it has the power to set and enforce its financial and accounting policies and, one way or another, it has done this. It has not needed a conceptual framework. It has not even needed to explain its accounting policies, or changes in them (...). (...) politicians have no incentive to become generally involved in accounting policies. Public sector accounting is therefore likely to be a matter for government officials. (Jones, 1992, p.262)

The fact that the establishment of fundamental principles had followed, rather than led, the setting of specific standards both for private and public sector accounting (one recent example in the UK is the “Resource Accounting Manual”, HM Treasury 1997, referred to in Jones, 1998), have not helped much to refute that conclusion; on the contrary, it has pointed to its corroboration.

Dopuch and Sunder (1980, in Bloom and Elgers, 1995) sustain arguments on this very same line. Although they address in particular the FASB’s conceptual framework (specifically the statements on objectives and elements of financial accounting for business enterprises), some of their comments might be extended to other accounting conceptual frameworks.

They start questioning what FASB’s statements were bringing as new or different from previous not succeeded frameworks.

Regarding financial reporting primary objectives, definitions of the elements of financial statements, and characteristics and limitations of financial information, the review of Dopuch and Sunder (1980, in Bloom and Elgers, 1995, pp.304-307) revealed that little was new in the FASB’s accounting conceptual framework comparatively to previous ones, namely “The Trueblood Report”. Nevertheless, they still admitted that such effort could have potential to produce some benefits. Accordingly, they question two specific benefits claimed by the FASB itself to be achieved with its framework: guidance for establishing standards, and providing a frame of reference for resolving accounting questions in the absence of a specific promulgated standard.

Using specific unsolved accounting issues, they examine the degree to which those two benefits were likely to be obtained, considering the given objectives and definitions in the FASB’s statements (Dopuch and Sunder, 1980, in Bloom and Elgers, 1995, pp.308-311). On these matters they conclude:

(...) the results of the FASB’s effort to write objectives and definitions are hardly different from previous attempts of this nature and, as such, are unlikely to help resolve major

accounting issues or set standards of financial reporting as the FASB had expected. (Dopuch and Sunder, 1980, in Bloom and Elgers, 1995, p.311)

Thus, the authors express strong reservations about the fruits of the FASB's works, though they are not seen as surprising, given the previous experiences with other standard-setting processes. In particular, they found difficult deriving accounting standards from objectives and definitions. Consequently, they do not believe that an accounting conceptual framework might be the basis for establishing standards and therefore for coherent practices.

Moreover, they argue:

There is little evidence that official statements of objectives of financial accounting have had any direct effect on the determination of financial accounting standards. Whenever the APB of the FASB has had to consider a financial accounting standard, various interest groups presented arguments to support the methods that each perceived to be in its own best interests. The standards issued had to be compromises among the contending interests. (Dopuch and Sunder, 1980, in Bloom and Elgers, 1995, p.321)

Dopuch and Sunder (1980, in Bloom and Elgers, 1995, pp.311-318) continue discussing the nature of objectives of financial accounting, which they consider as creating the fundamental difficulties in developing a set of objectives.

Financial accounting is seen as a social activity engaged by several parties, from corporate managers to teachers and students, passing through accountants, auditors, investors and many others.

Each group of individuals engaged in financial accounting possesses its own private motives or objectives leading to this involvement. (Dopuch and Sunder, 1980, in Bloom and Elgers, 1995, p.312)

The financial accounting objectives are therefore defined considering the private individual objectives of those engaged in it, which are certainly heterogeneous (Dopuch and Sunder, 1980, in Bloom and Elgers, 1995, p.311).

Subsequently, Dopuch and Sunder (1980, in Bloom and Elgers, 1995, p.318) conclude:

(...) the union of individual objectives, being too diverse and contradictory, cannot serve to guide policy; intersection of individual objectives may be null; the dominant-group objectives, assuming user primacy, do not reflect the economic reality of the power of suppliers in the accounting marketplace and are, therefore, unworkable.

In view of their review, the authors then raise the question "why search for a conceptual framework?". Their purpose is trying to understand why, despite the difficulties in interpreting the objectives of financial accounting, one can still find repeated efforts from authoritative bodies to prepare statements of objectives and definitions. Two main reasons are presented and discussed (Dopuch and Sunder (1980, in Bloom and Elgers, 1995, pp.319-320).

The first one relates to the form in which accounting problems are brought to the authoritative bodies. As the authors explain, reasons for authoritative bodies to continue defining accounting conceptual frameworks

(...) may arise from the genuine belief that a determination of precise definitions of certain terms will somehow help resolve accounting controversies. Such belief is reinforced each time an accounting controversy surfaces and the proponents of alternative methods present their arguments in the established terminology of accounting so as to convince the policy makers that the weight of tradition, so highly prized in accounting, is on their side. (Dopuch and Sunder, 1980, in Bloom and Elgers, 1995, p.319)

The other lies in attempts of the accounting profession to keep the rule-making power in its own hands. Dopuch and Sunder (1980, in Bloom and Elgers, 1995, p.319) state:

The conceptual framework-seeking behaviour of the FASB and its predecessors can also be explained in terms of self-interest perceived by the public accounting profession.

This is related to the aforementioned “legitimacy” argument for the existence of accounting conceptual frameworks.

Indeed, the authors recognise that any accounting authoritative definition, no matter how carefully worded, faces the problem of not being satisfactory for various interest groups. In a different way than legal definitions (which are authoritative interpretations by the courts backed by the power of the State) accounting definitions are not supported by a body with the power to enforce them.

Accordingly, Dopuch and Sunder (1980, in Bloom and Elgers, 1995, p.320) explain that, because many accounting authoritative bodies are derived from the accounting profession, they cannot defend themselves against the criticism of not having legitimate authority to make decisions which affect wealth transfer among members of society.

Subsequently, they need a conceptual framework to “boost its public standing”.

A conceptual framework provides the basis for arguing that: (1) the objective of its activities is to serve the users of financial statements (it is easier to use the public-interest argument for the user group than for any other group), and (2) it selects among accounting alternatives on the basis of broadly accepted objectives and not because of pressures applied by various interest groups seeking a favourable ruling from the Board. The ability, intelligence, ethical character, and past services, *etc.*, of the members of the FASB are not sufficient to convince the parties adversely affected by its ruling that it makes social choices through an impartial consideration of conflicting interests in society. Rather, a conceptual framework is needed to provide the rationalization for its choices. (Dopuch and Sunder, 1980, in Bloom and Elgers, 1995, p.320)

The authors finally argue that if more enforcement power was given to accounting standard-setting bodies, maybe there would be less of a need for a conceptual framework. Extending this argument a bit further, they seem to suggest that standard-setting bodies

(...) could assume that various functions of financial statements are well established and known generally by those who produce, audit, and use accounting information. Its task would be essentially one of trying to appease conflicting interests in the presence of disagreements over accounting rules, measurements, disclosures, *etc.* (Dopuch and Sunder, 1980, in Bloom and Elgers, 1995, p.322)

Actually, they appear to acknowledge that though authoritative recommendations on accounting theory might seem important in the short run, in the end they are not so beneficial, as they might contribute to hinder individual thought and judgement within a profession supposedly liberal and learned.

Anthony (1983, p.12) mentions another reason for the infeasibility of developing a conceptual framework for financial (business) accounting: the assertion that the purpose of financial accounting is to measure the “true income”. Since no one knows what true income is, that aim cannot be achieved. Yet, as the author continues, though one cannot say that one way of measuring income is more valid than the others, there are acceptable premises for the concepts that might lead to accept some ways of measuring income as more useful than others¹⁷.

Perfection is indeed impossible because accounting concepts are based on premises that cannot be verified and also because some premises conflict with others, and a balance must be struck. (Anthony, 1983, p.12)

The arguments of the so-called “positivists”¹⁸ also seem to be for the infeasibility of accounting concepts. According to Anthony (1983, pp.12-13) those authors sustain that while one cannot understand why accounting is as it is and accountants do what they do, an accounting conceptual framework cannot be developed. Once those questions most likely can never be answered by research, one will never develop an accounting theory. Still, as Anthony (1983, p.13) continues, the main problem with this positivist argument is that

(...) its proponents are unwilling to settle for anything less than perfection, whereas accounting needs a conceptual framework, even if it is imperfect, as a guide in resolving important outstanding issues.

Other argument related to the previous one, states that the conceptual framework should embrace only accounting objectives and criteria; standards, though consistent with those, should emerge from a process of common law. Anthony (1983, p.13) sustains that, unless the conceptual framework deals with something more than objectives and

¹⁷ Anthony (1983, p.12) explains that a sophisticated version of this argument derives from the “impossibility theorem” of Kenneth Arrow and attempts to show that conditions similar to those that allegedly prohibit the development of a rational theory of choice in economics apply to accounting as well.

¹⁸ For further on these see Watts and Zimmerman (1978) and Watts and Zimmerman (1979, in Bloom and Elgers, 1995).

criteria – namely suggesting how to solve criteria conflicts when they happen – it cannot be the basis for develop a coherent body of standards.

Another line of arguments supports that accounting concepts are not necessary or even desirable. Within this current, Anthony (1983, pp.13-15) presents several opinions. The first one is that accounting progresses by dealing with specific issues, whose resolution is essentially a political process, in which the winners are those who have the strongest power to influence the resolution in their favour. Therefore, a conceptual framework is not necessary. In Anthony's (1983, p.13) opinion, a process of political debate and negotiation is present in any discipline whose premises are not verifiable, either accounting or even natural sciences.

The second argument on this set is what Anthony (1983, p.13) calls rely on accountants, meaning that public accounting firms should prepare the financial reports of the firms they audit in whatever way they think is best. Some people seem to continue to argue that accounting standards should have never been developed.

An even more extreme proposal, in Anthony's (1983, p.14) point of view, is that entities should report essentially disaggregated data, i.e. raw data that users could then arrange in whatever way they found most useful. Financial reporting should be then considered as a database in the context of management information systems. Against this Anthony (1983, p.14) explains that

It seems unlikely that the users have the time, the inclination, or the ability to construct their own financial statements from disaggregated data. They expect accountants to do this.

Another idea arguing that accounting conceptual frameworks are not necessary is supported by several research studies said to show that users “see through” the effects of certain accounting alternatives; this means that users are said to be able to mentally compare the use of different methods, either in relation to other companies or to the company itself in other periods using different methods. In Anthony's (1983, p.14) belief, let users adjust is also a weak argument. Those studies were inconclusive, once they were conducted in periods of dramatic changes in accounting practices. Accordingly, they did not consider the numerous small-scale alternatives, which would be likely in the absence of standards. Users could not adjust to those changes, for example, preparing different sets of financial statements in order to be comparable with others from the entities they want. This is accountants' job.

The final argument relates not to the need but to the desirability of an accounting conceptual framework. Its development is undesirable because it would lead to too

much rigidity in accounting (Anthony, 1983, pp.14-15). This possible rigidity on one hand would inhibit certain transactions of being faithfully reported, if they did not fit nicely into the accepted framework, and on the other hand would freeze accounting into a mould, hindering further progress. Anthony (1983, p.15) makes clear that,

Although a conceptual framework can lead to rigidity, this danger is less grave than the alternative of attempting to develop standards without a framework. Although a written framework can indeed be an obstacle to progress (because there is a strong burden of proof on anyone who wants to change it), on balance the resulting stability is probably desirable.

To conclude the arguments against the development of a conceptual framework, Anthony (1983, p.15) states that

Critics (...) are too pessimistic. There is already a considerable degree of agreement on concepts. If these noncontroversial aspects are properly articulated, and if the controversial aspects are thoroughly discussed, a consensus should emerge.

The truth is that, for good or for bad, conceptual frameworks are a reality today, both for business and governmental accounting, which shows that many of Anthony's (1983, pp.12-15) beliefs against the arguments that concepts are not feasible, and not necessary or desirable, were somehow supported and those criticisms surpassed.

Another author that discusses the development of conceptual frameworks, particularly in the context of financial commercial accounting, is Miller (1985, in Bloom and Elgers, 1995, pp.325-337). Although he addresses in particular the FASB's project, he explores what he calls myths that have sprung up about accounting conceptual frameworks in general, explaining first what a conceptual framework might accomplish.

Hence, for Miller (1985, in Bloom and Elgers, 1995, pp.325-326) there are three main reasons (that may be interpreted as an accounting conceptual framework functions) for bringing together accounting concepts:

- To describe existing practice – In a convincing and simple way, i.e., through a few broad principles rather than a multitude of specific details, the conceptual framework should make understandable what accounting is all about;
- To prescribe future practice –
 (...) developing descriptive concepts, theorists generally become aware of inconsistencies and other deficiencies in practice. One result of these discoveries is the desire to develop another type of conceptual framework, one that goes beyond mere description and prescribes what ought to be done. These frameworks are often called normative because they reflect the values, or norms, of their compilers. (Miller, 1985, in Bloom and Elgers, 1995, p.326)
- To define key elements and fundamental issues – A set of concepts must establish

(...) broad definitions of basic terms to be used in debates about what ought to be done in practice. (...) These terms, moreover, help the profession and other interested parties identify the issues to be debated. (Miller, 1985, in Bloom and Elgers, 1995, p.326)

In this sentence the author highlights the idea that definitions within a conceptual framework are not pacific or static. A continuous debate is needed leading to different outcomes.

These functions of an accounting conceptual framework might conflict contributing to the mythmaking. In fact, Miller (1985, in Bloom and Elgers, 1995, p.326) recognises that not only any single framework cannot satisfy more than one of those, but also there are barriers preventing setting up a framework that will meet even one of them (e.g. there is no agreement on what accounting practice is or should be; broad definitions might be difficult to become operational).

In view of these problems, as acknowledged, developing an accounting conceptual framework is a hard and complex task, not exempt from criticisms and resistances. These criticisms became, in Miller's (1985, in Bloom and Elgers, 1995, p.327) opinion, myths about conceptual frameworks. He then presents some discussion around eight myths directly related with the FASB's project, although possible to generalise to others considering the influence of the former.

In each case, as is true of most myths, there is an element of truth, but there has been distortion over time, through telling and retelling. (Miller, 1985, in Bloom and Elgers, 1995, p.327)

It might be worthy to present here two general categories in which those myths fall within, mainly because they relate to the purposes or functions of an accounting conceptual framework (Miller, 1985, in Bloom and Elgers, 1995, pp.327-332):

- The political role of a conceptual framework – as justification for the success or failure of standard-setting bodies; failure is caused by not having a conceptual framework and success is not reached unless it exists. This seems somehow related to the “legitimacy” purpose already discussed.

Against this Miller (1985, in Bloom and Elgers, 1995, p.328) seems to argue that, considering other factors involved, the relation between having a conceptual framework and the bodies' success or failure is not so linear. This means that, from a political perspective, conceptual frameworks do not seem to be crucial for those entities viability, though might contribute for them to operate more efficiently.

- The technical role of a conceptual framework – as leading to consistent standards and eliminating the problem of standards overload. Like in the previous case, accepting this as always true might not be easy.

On the standards consistency, for example, Miller (1985, in Bloom and Elgers, 1995, p.328) explains that it depends on the process by which they are created. The consistency would be true if the process was descendent: standards handed down by a higher authority strictly on the basis of their conceptual soundness.

But standards don't descend. Rather they emerge from a nested set of political processes that create inconsistencies as the search for a consensus continues. (Miller, 1985, in Bloom and Elgers, 1995, p.328)

Within the standard-setting body there are political negotiations. Compromises must be made in order to reach the final pronouncements, often implying the lost of some conceptual consistency. Some external broader political pressures might also generate inconsistencies among standards.

On the overload of standards, the author emphasises that, first of all, there is no agreement on its existence. Moreover, he explains that, though a framework of broad concepts could allow some flexibility in its interpretation (e.g. decentralising the responsibility for decisions about accounting standards on auditors), the fact is that standard-setting bodies would be pressured to translate those into authoritative and detailed standards, considering the problems of placing power in auditors *versus* statements users and preparers.

One point Miller (1985, in Bloom and Elgers, 1995, p.332) highlights for the FASB's project, is the fact that it helped the board itself:

Now that the members and their constituents are using the definitions, clear communication is a likely result. And this improved communication will benefit the profession and the financial world in general as the effects of the framework make themselves felt.

Notwithstanding the observations of Dopuch and Sunder (1980, in Bloom and Elgers, 1995) particularly regarding the legitimacy role of the FASB's conceptual framework, this author seems to believe that it would have another important function: to improve communication among those involved in accounting (from researchers to practitioners), not only increasing the debate before accordance on the final statements, but also in the sense that it would create a common accounting language for the financial world in general.

Finalising this section, we think it is worthy refer to Watts and Zimmerman (1979, in Bloom and Elgers, 1995, p. 158) more radical (positivist) opinion on the role of accounting theories:

In our view, accounting theories have had an important role in determining the contents of financial statements – although it might not be the role envisioned by the theorists. Instead of providing “an underlying framework” for the promulgation of “sound” financial reporting practices by standard-setting boards, accounting theory has proven a useful “tactic to buttress one’s preconceived notions” (...). While accounting theories have always served a justification role in addition to information and pedagogic roles, government intervention has expanded the justification role. The predominant function of accounting theories is now to supply excuses which satisfy the demand created by the political process; consequently accounting theories have become increasingly normative.

In one word, they conclude that there is not and never will be, a general accepted accounting theory to justify standards.

This conclusion is based on what they observed concerning the involvement of politicians, managers and investors, among others, in the process of accounting standards setting. All of these are different vested interest groups, which will use its “individual theory” (that the authors consider an excuse) to justify standards that will beneficiate themselves directly.

It is important however to clarify that these conclusions were reached within a study where they tried to develop a positive theory of the determinants of accounting theory.

(...) a theory capable of explaining the facts determining the extant accounting literature, predicting how research will change as the underlying features change, and explaining the role of theories in the determination of accounting standards. (Watts and Zimmerman, 1979, in Bloom and Elgers, 1995, p. 130)

In some authors’ understanding their aim was and still is utopian. As mentioned in Anthony’s (1983, p.13) arguments, they seek for perfection in a conceptual framework, which he judges will never exist, since that has to result from negotiations and somehow political compromises and to be based on premises or postulates.

Yet, as stated, there are many still believing that accounting needs a theory addressing both the “why” (objectives and concepts) and the “how” (standards and procedures). Academically, this might be the reason why accounting researchers continue addressing the subject of accounting theory. This theory, as we have just described, either positive or normative, has been recognised as required to be broad and stable enough, and at the same time allowing accounting to progress. Moreover, accounting theory must allow different interpretation of the same concepts, considering different organisational features. According to Vela Bargues (1992, pp.117-118), this is

the case for public sector (namely government) accounting, where though concepts are not different than in commercial accounting (there is no reason for a different conceptual framework) certain specificities of government units demand for particular details interpreting basic concepts.

2.4. Main features of a governmental accounting conceptual framework

The following discussion on the structure of a governmental accounting conceptual framework is carried out not considering a different theoretical framework for governmental accounting, but in the line of those that argue for one single accounting conceptual framework.

Still, as explained, they also admit some particularities in governmental accounting, to be explained next, which demand for special interpretation of certain accounting basic concepts.

Like Freeman *et al.* (1988, in Vela Bargues, 1992, p.118) make clear,

(...) accounting should be characterised as the business language, but it is also the language of governmental and non-profit organisations. Although many terms and its meaning are the same for both, each one of them has its own terms and occasionally use them with a different connotation.

These differences might explain why some defend a separated conceptual framework for governmental accounting. Nevertheless, others as Vela Bargues (1992, p.118) for example, argue that those particularities (differences from commercial accounting) are not significant at a conceptual level, although they are important to be considered at a more detailed level of the conceptual framework application. Accordingly, in order to understand how governmental accounting fits within the accounting conceptual framework, those details have to be taken into account. This explains why we address here a governmental accounting conceptual framework – somehow interpreted as a set of detailed accounting definitions within the general framework.

Hence, what we are about to present is some discussion on the general structure of the accounting conceptual framework, emphasising some details that might make it slightly different for governmental accounting.

As Jones and Pendlebury (2000, p.125) explain, financial accounting was conventionally defined as a purposive activity, which means it is something directed towards a specific end. Additionally, it must above all be useful. In other words, though further on this will be presented in 2.6, financial accounting aims at providing useful

information using published financial reports to do it. Subsequently these have to be useful. But this utility concept raises the questions “useful for what?”, and “for who?”.

Accounting conceptual frameworks have sought to answer these questions related to accounting objectives, financial accounting in particular. Moreover, financial information contents and forms of presentation have also been within its subjects.

Related to the accounting conceptual framework structure is the model followed to its development. On this matter, Anthony (1983, p.6) explains:

Although not always described in these terms, standards in most disciplines are developed in the following way. First *premises* about the “state of nature” are developed by the process of *induction*. Second, *concepts* are *deducted* from these premises. Third, *standards* are developed that guide the application of these concepts to practice. (...) Premises, the inductive statements, are supposed to describe the way things are. Concepts, the deductive statements, are ideas about what accounting standards should be. Premises are descriptive; concepts are prescriptive, normative.

This three-step process is for Anthony (1983, footnote 16, p.210) considerably simpler than that used by the FASB, which he presents as follows.

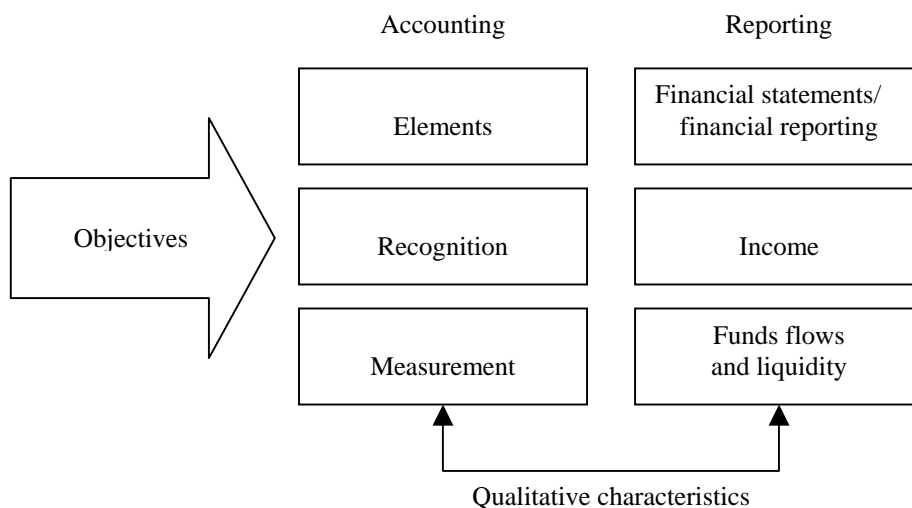


Figure II.1 – FASB’s Conceptual Framework
(Source: Anthony, 1983, footnote 16, p.210)

Rodrigues and Branco (2000, pp.165-166) present another description of the process that seems to comprise elements from Anthony’s (1983) model together with others from the FASB’s:

The model that more frequently has been used in the development of financial information conceptual frameworks is the one called “logical-deductive itinerary”, which is characterised by the importance given to the definition of the financial information objectives. The objectives definition constitutes one first stage of the itinerary that must be well-substantiated on an analysis of the economic, juridical and social characteristics of the context (*allowing premises to be established*) [italics provided]. Following the objectives definition is the establishment of financial information fundamental hypothesis and requirements, that is, the qualitative characteristics that such information must have in order to accomplish the objectives established. The next step concerns the definition of the

financial statements elements and its recognition, to which follows the treatment of questions related to the measurement of those elements. (Rodrigues and Branco, 2000, pp.165-166)

From these descriptions we may conclude that the structural components of an accounting conceptual framework must embrace subjects such as:

- The objectives of financial information;
- The qualitative characteristics determining the usefulness of financial information;
- The definition of the financial statements elements (assets, liabilities, equity, expenses, revenues...);
- The criteria for recognition and measurement of the financial statements elements.

Indeed, these components are mirrored not only in FASB's statements, but in those from the 1989 IASC's project as well, as Vela Bargues (1992, p.113) makes clear. He also mentions another element that has been included in those frameworks: concepts of capital and capital maintenance.

Also Jones and Pendlebury (2000, p.125) explain that financial accounting theory

(...) includes all aspects of published financial reports:

1. their purpose;
2. their form;
3. their content;
4. the laws, regulations, and guidelines governing them;
5. the accounting policy-makers who determine them.

One interesting point of this statement is the inclusion of the accounting policy-makers, which seems to mean that accounting conceptual frameworks should somehow embrace issues concerning the bodies responsible for its development.

Peasnell (1982, in Bloom and Elgers, 1995, p.301) suggests what he believes to be the appropriate structure for a conceptual framework (CF) designed to provide a base for the standards programme:

If a CF is to serve as a guide to the standard setters then it should, in effect, provide them with a set of objectives and constraints. (...) At a minimum, it seems essential to provide the elements of a 'constitution'. The framework should therefore set out: the basic principles of and sources of authority for 'accountability' and 'rights to know'; the consequences which financial reports are intended to have (and to avoid); the trade-offs which have to be made.

While following a different perspective, he also emphasises that the accounting conceptual framework must comprise statements of principles and rules according to the purposes of accounting information, as well as to their users and respective needs. Furthermore, he clearly states the need for trade-offs, implicitly admitting that some components might conflict.

Vela Bargues (1992, p.114) presents a different structure that he finds particularly interesting for the accounting conceptual framework. Although embracing issues from the previous ones, this model (Figure II.2) suggested by Professor Gabás Trigo (1989, in Vela Bargues, 1992, p.114) introduces a new subject – factors related to the accounting environment.

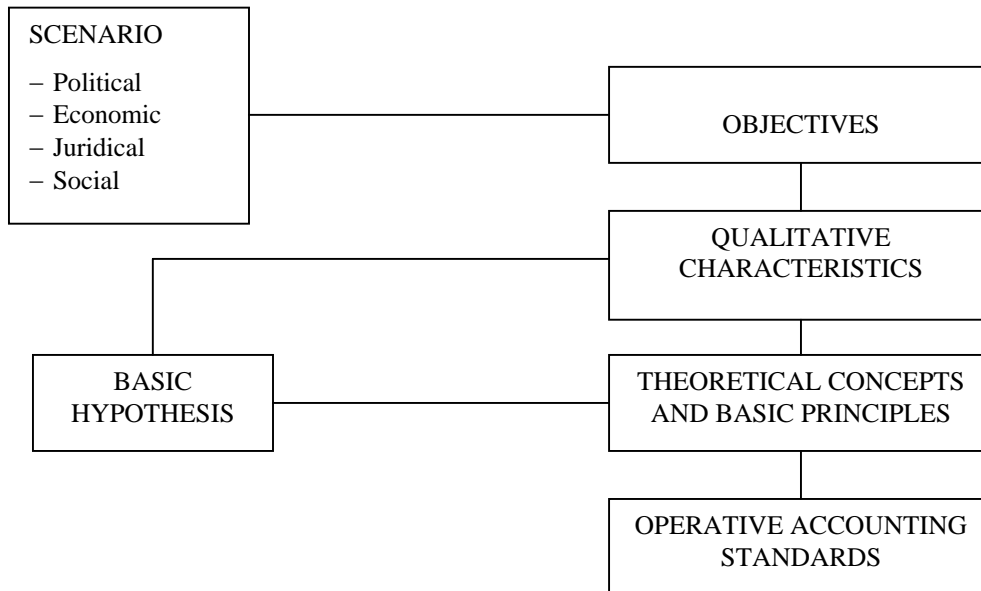


Figure II.2 – A Model for the Accounting Conceptual Framework Structure
(Adapted from Vela Bargues, 1992, p.114)

It is understandable, as it seems generally accepted, that the specificities of public sector accounting, namely governmental accounting, derive from the public sector environment, both internal and external. In particular, environment is deemed to determine the objectives of accounting information and consequently other dimensions of the accounting conceptual framework (once, as presented, objectives seem to be the first level of its structure, from which all the other elements are derived).

As Vela Bargues (1992, p.115) states,

There is no doubt that the adaptation of the accounting information objectives to the public sector environment will affect the relations and connections between the accounting information characteristics, which might lead to theoretical concepts, principles and standards that in some cases move away from those of the private field.

Although we will address some issues of the governmental accounting environment later in 2.5, its importance must be highlighted here, considering the more or less directed consequences it is believed to have on the other elements of the conceptual framework.

Vela Bargues (1992, pp.115-116) presents several characteristics of the public sector environment, which he divides into two groups:

- Elements external to the organisation or indirectly influencing accounting information objectives – heterogeneity, power fragmentation, responsibility, and market absence;
- Elements internal to the organisation or of direct influence on accounting information objectives – priority objective of providing a service, not aiming profit, difficulties in measuring output, different meaning of benefit, emphasis on the financial position, importance of the budget, and importance of legality.

Considering these elements, the author proposes his own structure for the governmental accounting conceptual framework. While following an approach that is rather close to the above-mentioned models, he groups the structural elements into two main levels: Conceptual Framework Fundamentals and Conceptual Framework Conceptual Elements. Accordingly:

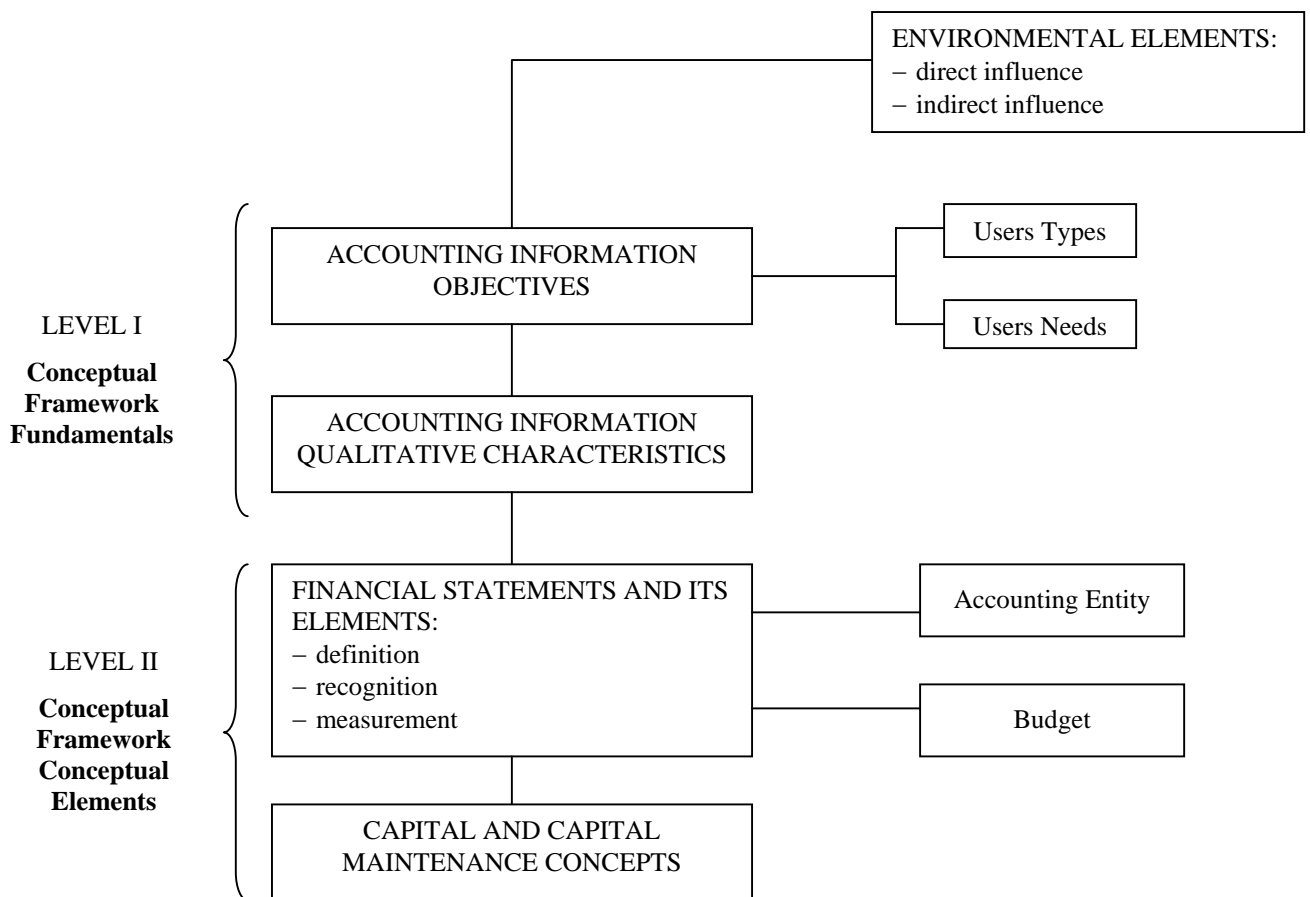


Figure II.3 – Proposal of a Conceptual Framework Structure for Governmental Accounting
(Adapted from Vela Bargues, 1992, p.120)

For Vela Bargues (1992, p.119) this different presentation has the advantage of clarifying the elements involved in the conceptual framework, as well as the relations between them.

In Level I, although accounting information objectives are at first stage, they are determined by the environment. On the other hand, they are established considering the accounting information users as well as their needs.

In Level II the financial statements definition, as well as its elements, considering the public sector context, raises the need not only for defining the accounting entity concept, but also extending all the issues in this stage to the budget (given its central role in governmental units).

Although allowing a very good understanding of the elements embraced by the conceptual framework, particularly considering the governmental context, this model seems to show a rather hierarchical relationship among those elements, which might not exist in practice. In fact, while objectives have a basic/fundamental role, it seems that the conceptual framework structure has to follow a rather holistic approach, where all the elements must be considered more or less at the same level and at the same time, more like in the FASB's model (Figure II.1). Nevertheless, we think that including a cluster with the environmental elements of accounting, Vela Bargues (1992, p.120) has the merit of making explicit in that structure the premises underlying the conceptual framework. This has not been done in other models. As Anthony (1983, p.8) explains, this is important mainly to understand the criticisms and debate around accounting concepts.

Although conceptual frameworks are necessarily based on premises about the nature of accounting entities and about the needs of users of accounting information, in most of them the underlying premises are not made explicit. When the premises are implicit, it is difficult to know whether a critic's dissatisfaction with the concepts is based on disagreement with the premises themselves or on the belief that the concepts are not consistent with the premises. (Anthony, 1983, p.8)

In conclusion, for those sustaining “one single world of accounting”, the environmental elements particularly important in the public sector context are seen as determining the governmental accounting particularities, requiring its conceptual framework structure to have some detailed differences from the one for the whole accounting. Hence, while studying a conceptual framework for governmental accounting, public sector (governmental units) environment must be additionally considered within its components.

2.5. Some distinctive characteristics for a governmental accounting conceptual framework

One of the authors that more have advocated the unity between business and non-business “worlds of accounting” is Professor Robert Anthony. As Jones (1992, pp.252-253) explains, since his 1978 study *Financial Accounting in Nonbusiness Organizations* he has emphasised that there is nothing inherently different in accounting for business and non-business organisations:

My thesis is that the existence of these two worlds of accounting is unnecessary. With one major exception, the financial statements of a nonbusiness organization can be constructed according to the same principles that apply to business financial statements, and these financial statements can be as just understandable to the reader. (Anthony, 1980, p.84)

Although those who become involved in the non-business world (as managers, taxpayers, members of governing boards or legislatures, or as prospective bondholders or other lenders) might feel the need to learn a new accounting language, Anthony (1980, pp.83-84) argues that this is not necessary, once financial statements can use the same principles with a few modifications for the “unique features” of non-business organisations.

In here we present and discuss some of these unique features addressed in the literature that may (or may not) imply some adaptations/modifications of the accounting conceptual framework for governmental units.

Anthony (1980, p.87) explains that two arguments have been presented for the separation between business and non-business accounting:

First, nonbusiness organizations, by definition do not exist to earn profit and it is therefore argued that they should not use business accounting principles, which are focused on the measurement of profitability. Second, managers of nonbusiness organizations must adhere to restriction on spending – either legal, such as those set forth in the approved budget of a governmental unit, or other limitations specified by donors or grantors – and it is argued that the purpose of accounting should therefore be to ensure compliance with these restrictions.

While recognising that the absence of a profit objective and the need for fiscal compliance are typical characteristics for non-business organisations, Anthony (1980, p.87) clearly argues that neither is a sufficient reason for the differences in accounting that currently exist.

On the matter of **profit objective**, he recognises that the main reason for the non-business organisations to exist is to provide services. Subsequently their success should be measured by how much service they provide with the resources available. Yet, there are many difficulties in measuring the quantity of services provided in most of non-profit organisations, particularly governmental units. In fact, although recognising the

importance of measuring effectiveness, efficiency and economy in non-profit public sector organisations, many authors (e.g. Vela Bargues, 1992, pp.40-44) also acknowledge that the specificities of their objectives raise problems when analysing the “value for money” framework: in many of those entities outputs cannot be quantified and/or measured in monetary terms. Hence, the net income not only is difficult to calculate, but even when it is possible, the meaning tend to be hollow in what respects to “value for money”¹⁹. As Jones and Pendlebury (2000, p.129) state for typical public sector organisations,

(...) the extent to which income from non-revenue sources such as taxation covers cost is only a very narrow measure of performance: it only measures the extent to which the organisation spent what it said it would spend (...).

Indeed, also Anthony (1980, p.87) explains that,

In a business, revenues are a good (...) measure of the amounts of goods and services that the organization provided. In a nonbusiness organization, there is no corresponding measure, except to the limited extent that the organization earns revenues from the sales of its services. It follows that the operating statement of a nonbusiness organization cannot have the same meaning as the operating statement of a business. In a business, the bottom line – the difference between revenues and expenses – measures success in achieving objectives; in a nonbusiness organization, the bottom line cannot have this meaning.

Nevertheless, the author argues that the bottom line in a non-business organisation can have a highly significant meaning of its own. While expenses have the same meaning in the two worlds (resources used in an accounting period), revenues do not. However, in a non-business entity they can measure the amount of resources provided (from sales, taxation, grants, etc.) for operations in an accounting period. Thus, although not focusing on profitability, the difference between revenues and expenses in a non-business organisation measures if the organisation is “living within its means”.

Anthony (1980, pp.87-88) continues explaining that, despite the difference between business and non-business organisations on the meaning of the bottom line in the operating statements, the idea of “operating capital maintenance” unites those meanings:

A business maintains its capital through operations if its revenues for the period exceed its expenses for the period by an amount that provides a satisfactory return to the equity shareholders. A nonbusiness organization has no equity owners and therefore no equivalent need to earn a return on equity, at least as general rule. (...) A nonbusiness organisation maintains its capital through operations if it breaks even – that is, if its revenues at least equal its expenses.

Thus a business and a nonbusiness operating statement can convey the same message: the extent to which the organization has maintained its capital through operations. Maintenance

¹⁹ Regarding this matter, Jones and Pendlebury (2000, p.14) additionally explain:

(...) outputs can often only be measured at lower levels, and where the gap between the highest level and the lower – but measurable – level is large, then the lower levels are of limited use in assessing whether value for money has been achieved.

of capital is the most important single piece of information about nonbusiness operations. It is also important for a business, but in a business the bottom line conveys an additional message – how well the organisation attained its objective of earning profits.

A nonbusiness operating statement can also convey important additional information on how much was spent for various services (...). The amounts spent for each program do not represent the quantity of services provided, but they do indicate relative magnitudes of effort.

Therefore, Anthony (1985, p.169) concludes that in most respects the same principles applied to business accounting should be applied to government accounting.

A nonbusiness entity measures its financial performance by the extent to which its net income is approximately zero. If it reports, on average, a large amount of net income, it has not used its resources for their intended purpose. If, on average, it operates at a deficit, it will eventually cease to exist – just like a business. My point is that the accounting concepts are the same. (Anthony, 1987, p.77)

Subsequently, fund accounting²⁰, developed in the USA municipalities particularly from the 1920s, that he explains to be the concept responsible for the persistent division between the two worlds of accounting,

(...) is not needed except to the extent that it is a convenient way of making the essential separation between operating transactions and capital transactions (...). Aspects of fund accounting are useful as internal control devices, but they need not govern the format or content of financial statements. (Anthony, 1980, p.89)

In what respects to the argument that non-business accounting must report the degree of **fiscal compliance** (once non-business organisations must adhere to restrictions on spending), Anthony (1980, p.88) highlights what he considers two wrong things with that argument: the first one relates to the fact that not only non-business organisations are subject to spending limits; the second concerns the fact that fiscal compliance can be reported in other ways than using fund accounting (separate funds intended to reflect the spending restrictions).

On the latter the author states that companies keep track of restrictions using appropriate internal accounting controls; those limits do not need to be shown on financial statements, except to the extent that there are liabilities for work not yet performed. Therefore, fiscal compliance should not shape the format or content of the financial statements. It must be auditors' responsibility to attest that the restrictions have been complied with, and disclose the nature of non-compliance if necessary

²⁰ Jones and Pendlebury (2000, p.157) explain fund accounting as an accounting technique referring to the practice of accounting, not in terms of an organisation as a whole, but in terms of its separate, independent, constituent parts – funds. This practice, which can be adopted together with other accounting techniques such as cash accounting or accruals accounting, for example, contrasts with the typical business accounts that present the business as a whole. For further see Jones and Pendlebury (2000, pp.177-184)

Anthony (1980, pp.84-86) emphasises its complexity, particularly in the USA municipalities, as well as the easiness that it allows in manipulating the numbers and subsequently not reporting the economic reality of transactions. For further on this see also Anthony (1985).

(Anthony, 1980, p.88). Once again fund accounting is argued as not necessary for this (Anthony, 1980, p.89).

Despite these arguments against two different accountings, Anthony (1980, p.89) still admits that a few modifications are needed to prepare the financial statements of non-business organisations according to the same principles applied to business ones. This is because he recognises in fact some special problems in non-business entities:

There are two, and only two, significant differences between the accounting problems in a municipality and those in a business. First, defining the municipal entity is a problem. (...) Second, accounting for capital assets is a problem. (Anthony 1985, p.169)

On the **reporting entity** the author explains that in business is current practice the financial report of a consolidated corporation embracing subsidiaries for which the parent company owns the majority of common stock. In governmental units (e.g. municipalities) there is no common stock; so another criterion for defining the reporting entity has to be found, which Anthony (1985, p.169) considers not so difficult to achieve.

Concerning this matter, Drebin (1981c, in Drebin *et al.*, 1981, Vol. II, pp.3.4-3.8) explains:

Many critics of governmental accounting have suggested that governments should prepare consolidated statements reflecting all the activities and resources of the operating unit in a fashion similar to that used by commercial enterprises. (Drebin, 1981c, in Drebin *et al.*, 1981, Vol. II, p.3.4)

According to this author, the arguments pro consolidation in government units, within a context of fund accounting, related to the accounting information users need of having a view of the entire organisation as a whole. The consolidated statements would allow marshalling the vast amount of available financial data about the government unit into a single composite picture, facilitating an understanding of the size and scope of its activities. Still, as he adds, the use of consolidated statements in governmental accounting was generally not considered as a desirable practice, once the integrity of each individual fund had to be preserved. Moreover, even though those arguments could be accepted in the sense that a governmental unit might be identified as an economic, political and social operating entity, defining the appropriate entity for consolidation was recognised as not easy as in business. The problem emphasised was the criterion for consolidation – “ownership” – as Anthony (1985, p.169) seems to acknowledge. What is argued is that governments do not “own” the other governmental entities operating within their geographical jurisdiction.

Another aspect that Drebin (1981c, in Drebin *et al.*, 1981, Vol. II, p.3.7) explains is that the arguments against consolidation were based on the objective for governmental accounting to be enabling administrators to ensure and report compliance with finance-related legal provisions, i.e., spending limits. Concerning this, we have just presented Anthony's (1980) arguments supporting the auditors' attestation role. As to the ownership criterion and to the non-existence of common stock, as Anthony (1985, p.169) anticipated, some consensus was already found, working out satisfactory solutions.

Indeed, *IPSAS 6 – Consolidated Financial Statements and Accounting for Controlled Entities* issued in 2000, addresses the subject defining rules for consolidated financial statements within governmental non-business entities in terms of "control". This is determined not by ownership but by power and benefit conditions and indicators.

Whether an entity controls another entity for financial reporting purposes is a matter of judgement based on the definition of control (...) and the particular circumstances of each case. That is, consideration needs to be given to the nature of the relationship between the two entities. In particular, the two elements of the definition of control (...) need to be considered. These are the power element (the power to govern the financial and operating policies of another entity) and the benefit element (which represents the ability of the controlling entity to benefit from the activities of the other entity). (IPSAS 6, para.26; in IFAC, 2001f, p.180)

Though still only for financial accounting, this shows that something has been done in defining governmental reporting entities, allowing further use of consolidation standards and rules applied in business organisations.

Concerning the problem of accounting for **capital assets**, Anthony (1985, p.169) relates this with two aspects: one is the way capital assets acquisition is funded; another is how, if at all, to incorporate their depreciation into the measurement of operating performance. He explains that many governmental units often receive grants for acquiring new buildings, equipments, roads, etc. These grants raise two issues: one relates to the possibility of being considered revenues of the period, and the other concerns how to depreciate capital assets financed by these grants. Normally the assets acquired with this contributed capital are intended to benefit future periods; on the other hand, grants sometimes are received in one period, although to be used through different periods. Hence, as Anthony (1985, p.169) explains, these grants are not revenues by definition, once they have no relation to operations of the current period. He then argues that they must be accounted separately, maybe using fund accounting. On the depreciation of contributed capital assets, Anthony (1980, p.89) explains that once there

is no need to recover the cost from revenues because the organisation did not use its own resources in acquiring the assets, some believe that a depreciation charge is unnecessary. Others defend that those assets should nevertheless be depreciated in order to report a full cost of services rendered during the period.

Further on the depreciation problem, Anthony (1985, pp.169-170) relates this with the useful life of the assets: those with an indefinitely long life, as a national monument for example, should not be depreciated. Others to support current operations, as office equipment, should be depreciated and the depreciation charged to operations, in a similar way as in business sector. The problem seems to be with infrastructure assets – roads, bridges, etc. – with no counterpart in business. In the author's opinion, they seem to have a life so long that a depreciation charge could be unrealistic.

From these comments one thing seems to be clear: there are some special capital assets within governmental entities for which an agreement seems not yet to have been reached, both on its inclusion within the entity financial statements and on its depreciation as well. Moreover, the international trend of moving towards accrual basis in governmental accounting and budgeting, requiring forecasting and reporting on resources consumed and the full cost of services provided, has been adding to the controversy.

In summary, what Professor Anthony basically seems to argue is that one single accounting conceptual framework should be developed, applied to business and non-business organisations. Within this, some distinctions must be drawn only between those features that are really different. In his opinion, these relate to no more than the notion of reporting entity and capital assets funding, namely capital contributions (grants).

However, other authors point out different particularities requiring some special considerations in order to understand governmental accounting within the accounting general conceptual framework.

For example, Vela Bargues (1992, pp.40-44) considers that one of those, already mentioned when discussing the profit objective, relates to **difficulties in measuring outputs** in non-business organisations, particularly governmental units. These difficulties come from the specificities associated to the non-profit objective of governmental organisations. The consequences for governmental accounting relates, on one hand, with the different meaning and careful interpretation of the “bottom line” in the operating statement, as discussed above, and on another hand, with the problem of

linking costs with revenues, i.e., applying the matching concept (consequence of the difficulty of relating outputs with inputs).

In a business environment, the relation between costs and revenues seems to be a good support for decision-making. Nevertheless, in this environment, it is clear that both costs (inputs) and revenues (outputs) are quantifiable. Because this does not happen in governmental organisations, any analyses based on that relation have to be completed, if and when it is possible, with special care.

Evidencing this, Jones and Pendlebury (2000, pp.9-10) state:

Our proposition is that there is enough commonality in the accounting problems of public bodies for these to be worth discussing separately from business accounting, the techniques of which are of most use in the context of physically identifiable units of output for sale to customers. These techniques include cost-volume-profit analysis, standard costing, profit and loss, and return on capital employed. And while these can be, and are, used in the public sector, it is when 'units of output' are not identifiable that public sector accounting comes into its own.

Another issue is raised when one wants to evaluate the success or failure of one governmental organisation: the fact of not having an objective measure as the profit, raises the need to find other methods of performance evaluation. At this respect, Vela Bagues (1992, p.43) refers to some works that in the last twenty years have developed performance indicators for non-profit bodies (e.g. social indicators). As he explains,

It is though necessary to use a return measurement of no monetary character that will allow analysing efficiency in the use of resources and effectiveness in achieving the organisation objectives. (Vela Bagues, 1992, p.43)

An additional particularity of governmental organisations with consequences on accounting is the need to put **emphasis on the financial position**. As Vela Bagues (1992, p.73) explains, this need to reflect the entity financial position was not traditionally important in governmental organisations. In fact, a few years ago, the important issue was that accounting, more specifically budgetary statements, should allow accountability on the budget execution and legality control. However, presently it seems to be one of the main purposes of governmental accounting to highlight the organisation financial viability²¹. Still,

(...) it is important to take into account that, when considering the financial position of a governmental entity, this presents a meaning that in certain way comes changed by the specific nature of the organisation, and in particular by the fact that its financial sources in great part come from the State fiscal power. (Vela Bagues, 1992, p.73)

²¹ Vela Bagues (1992, p.74) explains that this purpose has been reflected in some standard-setting bodies statements, such as in those from the NCGA and the GASB.

In fact, it is important to make clear some points when one speaks of governmental units financial viability. As presented through Anthony's (1987) arguments, governmental entities operating in deficit will eventual cease to exist.

In fact, notwithstanding governments' fiscal power assuring their financial viability, one governmental non-business unit cannot continue to accomplish its objectives if it does not have enough resources available for that, i.e., available resources have at least to equal the necessary ones to provide services at a satisfactory level. It is in this situation that one must understand Anthony's (1980) statement that non-business entities have to break even; below break-even (in deficit) they will not be able to accomplish its objectives. Thus they might cease to exist, once the main reason for its existence is not achievable. This cessation does not mean that the governmental unit have necessarily to be "closed" (while this might happen in some cases), but that it must adopt a different way of operating (different organisation, management...) in order to continue its purpose: provide services.

Vela Bargues (1992, pp.74-75) presents three reasons why governmental units, particularly more recently, need to emphasise its financial position:

1. The nature of the organisation – not profit oriented, particular configuration of its financial resources, and its own objectives system – determines somehow its accounting system;
2. More active role of taxpayers as external users of governmental units accounting information – Recent studies show that, due maybe to the increasing on fiscal pressure, information on the entities financial position have been one of the requirements for accounting information from its users;
3. Financial crises that happened in many USA municipalities, starting from New York City Council in 1975 – From then, North-American public opinion became interested in a "better" governmental accounting, namely reflecting in the entities financial statements their (more or less critical) financial situation.

In some authors' beliefs (e.g. Jones, 1992), the second reason might not be so straightforward to accept, particularly in the context of European counties. The subject of the governmental accounting users and their needs is addressed in 2.6.

One other aspect issue that is also important to consider in governmental units, and that has some influence in the accounting for those organisations is the **legality issue**.

Traditionally, Governmental Accounting has been very influenced by the weight of legality that since ever has supposed, to a greater or less extension, a considerable limitation of the scope of action of governmental entities. Such entities since ever have been under administrative, statutory and legal requirements, which have been imposed at the moment of preparing the financial statements and that have influenced its frequency, contents and nature. (Vela Bargues, 1992, pp.77-78)

Indeed, governmental entities have always had to obey internal and external legal restrictions that cannot be forgotten in analysing its accounting system. Sometimes legal requirements might lead to the adoption of accounting practices that eventually have little to do with accounting rationality. As Johnson (1975, quoted in Vela Bargues, 1992, p.78) explains, those laws, which include constraints related to financial management and budgeting, might imply accounting practices opposed to the general accepted accounting principles. One example is the difficulty in accepting the principle of substance over legal form in governmental organisations. That is one case that justifies an exception in the application of the accounting general conceptual framework to governmental units.

In Vela Bargues's (1992, p.79) opinion, this legality problem latent in governmental accounting financial statements, is nowadays treated following what he considers a more rational and consistent approach. Referring particularly to North-American governmental accounting practices, the author explains that, while before, in conflict situations between laws and general accepted accounting principles, the laws should prevail, currently, accomplishment to the latter is recognised as very important in preparing financial statements. If such is necessary, supplementary statements might be prepared showing the adherence to legal regulations that might conflict with those principles. He continues explaining that this does not mean the entity has to keep two financial statements sets, but that it has to recognise those as having a double function: showing legal compliance but also including the necessary data to inform within the (conceptual) general accepted accounting principles framework (Vela Bargues, 1992, p.80).

One final subject to be considered here relates to the **importance of the budget**, generally regarded as a significant environmental feature of governmental organisations. In fact, the budget not only has a central role for public management, but also is the central piece of government accounting.

Wildavsky (1984, p.128) highlights the budget central role in the managerial process of public sector:

The budget is the lifeblood of the government, the financial reflection of what the government does or intends to do.

Therefore, regardless the technique to be used, the budget should express what the government activities ought to be during a particular period of time, in the light of limited resources.

In turn, Doost (1984, in Vela Bargues, 1992, p.80) emphasises the budget importance as an instrument for planning; a way of controlling expenses, achievements and programs; a means for coordinating governmental activities that imply financial consequences. If this control activity is acknowledged as important in a business profit-oriented entity, it is recognised as fundamental in governmental units, due to the fact that here the budget embraces authorised expenditures and estimated revenues, the latter mainly resulting from the ability to collect taxes (Vela Bargues, 1992, pp.80-81).

Also emphasising the budget primary role within the managerial planning and control processes, Jones and Pendlebury (2000, p.57) explain:

Planning is important. Controls to ensure the achievement of plans are important. The budget provides the essential link between the two processes. (...) Long-term and medium-term plans are obviously important in any well-run organisation, but no matter how sophisticated and comprehensive these are they only express intentions. It is only when these intentions are incorporated into the annual budget that they become firm commitments, with funds being allocated to enable their achievement. (...)

Chan (2001, p.2) also highlights the role of the budget but as primary instrument for creating and enforcing accountability in government at three levels: from civil servants at lower level to ministers, from executive to parliament, and from government (encompassing legislative, executive and judicial components) to electorate. In his opinion, this function results from the fact budgetary process is, or should be, the way resources are allocated in the public sector.

In fact, it is a self-evident truth that the budget has a central position as a management tool for governmental entities. Furthermore, regardless of its functions within governmental accounting, many acknowledge the budget as the most significant of the governmental accounting financial documents.

Related to this major role that the budget has played in governmental accounting since ever, today it seems to be acknowledged that budgets need to forecast the resources expected to be consumed (not just paid), as well as sources of financing, in order to convey information other than cash-flows, i.e. they need to be accrual-based.

Although it has been discussed here that these particularities, as others, do not justify a different conceptual framework for governmental accounting, it is expected that not everybody would agree with these arguments. In fact, some authors argue precisely the opposite. For example, Nobes (1988) after discussing some arguments on the usefulness of financial statements of government, concluded that

(...) governments need to institute internal mechanisms for control, (...) governments need to be accountable, but (...) a decision-making need is not so obvious.

Control of a government by itself is unlikely to be achieved through published financial statements. Accountability of government is due primarily to the public through the parliaments they elect. Government and governing are complex. The idea that individual members of the public could be given governmental financial statements that were simultaneously summarized, intelligible and useful seems far-fetched.

What is needed is a tailor-made system of financial accountability controlled by experts. These would be both non-elected (e.g. auditors general) and elected (finance committees of parliaments). Such a tailor-made system would be unlikely to approximate Anglo-Saxon commercial accounting, because the purposes and the contexts are quite different.

(...) commercial accounting is likely to be inappropriate for non-commercial entities (...)
(Nobes, 1988, p.202)

2.6. Functions of governmental budgeting and accounting

In this section we are going to address in particular the purposes and objectives of budgeting and accounting within governmental units.

As stated, accounting is a purposive and useful activity, in the sense that it provides information useful for someone to do something. As a consequence of this assertion its functions have been defined considering users of accounting information and their needs. Indeed, as is clear from 2.4, these seem to have a fundamental role in determining the main components of an accounting conceptual framework with particularities for governmental accounting. Additionally, as Jones and Pendlebury (2000, p.128) emphasise, most of the conceptual frameworks for national governments developed during the 1980s, used a users/users' needs approach, making it important to include here a discussion on this matter.

2.6.1. Information users and their needs

The establishment of objectives for accounting information (both in business and in governmental accounting) seems to call for a logical process where its users and their needs have to be firstly defined.

Vela BARGUES (1992, pp.126-127) explains that the importance of analysing the users of accounting information and their needs reveals itself at three different levels. The first one is obviously at the objectives level: the study of users and their needs will lead to seek for financial information satisfying those needs, which in turn will drive the accounting and financial information objectives. The second one is at the financial statements level: the users and their needs must be reflected in the financial statements, in the sense that the former must determine the contents for the latter. The third one is at the level of the accounting process itself: in order to serve the users' needs, this should embrace an inter-related and compatible system of objectives, principles and standards, and practices and procedures. Objectives should identify the accounting purposes and

standards should follow the objectives and provide instructions for practices according to those sought objectives. All the components of the system must be rationally linked to the users' needs, otherwise accounting information objectives will be fruitless.

Jones and Pendlebury (2000, p.126) also refer to the importance of the users/users' needs approach for the development of accounting theory, in particular for financial accounting theory. At this respect they state:

If accounting reports are to be useful, therefore, we must define the users of those reports and the uses to which they put them. If we assume that accountants play a passive role in this, namely that they provide only what is expressly requested, then we build our accounting theory on that. However, if we assume that accountants also have an educational role, we might add to our definitions, to include potential users and potential users' needs. (Jones and Pendlebury, 2000, p.126)

The authors also explain that, from the beginning, some difficulties were identified as central when trying to find out who the users are and what are their needs. These problems are particularly related to the great number and diversity of accounting information users, and to the fact of their needs might conflict and change over time. Studies on these have been developed as attempts to surpass those complications.

One way of addressing this intended useful character of accounting going around all the problems concerning, was considering potential users and potential needs²². Another more refined methodology, according to those authors, has been to rank these hypothesised users in order of importance and to concentrate on the most important. However, if this approach is simple to implement in business entities, where investors and creditors are considerably the most important users of accounting information, it is not so easy within governmental organisations, where there is a great diversity of users (which Borgonovi and Anessi-Pessina, 1999, p.7, called "stakeholders") and needs, most likely due to the public sector environment heterogeneity. Accordingly, it is difficult here to select the most important ones.

Nevertheless, as Caperchione (1999, p.73) emphasises, every reform that has been happening in governmental accounting recently, meets a certain version of the information needs of some specific categories of users of financial statements. Hence, the paradigm of users' needs has been largely implemented. Indeed, several national governmental accounting conceptual frameworks, as we will present, define lists of users and draw up lists of information needs. As he continues explaining, such an

²² According to Rutherford (1992, p.267) this means searching for users/users' needs following a normative approach – building a specification of information needs by *a priori* theorising, which must be derived from empirically plausible, actual or potential, users with empirically plausible classes of decisions to be taken.

approach entails a substantial modification to the way governmental accounting is now conceived, inasmuch as it no longer simply holds the function of showing compliance with budgetary and other legal limitations. There are now various individual and group stakeholders that require the information they need in order to make evaluations and take circumstantial decisions. Still,

(...) the reference to the information needs of the users of financial statements is in many cases too generic, and risks begging the question, inasmuch as it is not possible to define a clear hierarchy of the various categories of users so that – not knowing exactly what to privilege – the purposes ascribed to governmental accounting grow out of all proportion (...). (Caperchione, 1999, p.73)

Even so, as Caperchione (1999, pp.74-77) also demonstrates, studies on the recent worldwide governmental accounting reforms illustrate that, notwithstanding the diversity of purposes ascribed to the governmental accounting system, all of them seem to find an answer in accrual accounting, i.e., this seems to be acknowledged as the necessary and sufficient means to build an accounting system capable of meeting users' needs.

However, the author additionally recognises that, though there might be some commonalities among governmental accounting users/users' needs internationally, the fact is that there are different priorities and different nuances in every different country. Therefore,

Managing to satisfy manifold and diversified needs by means of one singly system only, is not very simple at all, and does not comply with the rule “one goal – one tool” (...). Thus, there remains a basic problem, shared by many innovation attempts, and consisting in the fact that an accounting system cannot possibly meet widely divergent information needs at the same time. (Caperchione, 1999, p.74)

Finally, Caperchione (1999, p.74) highlights that, in spite of many national governmental accounting conceptual frameworks have been developed based on it, the paradigm of users' needs is not widely acknowledged. In fact, considering some arguments presented next, it has been object of some criticism due to its poor empirical foundation, which has led many organisations to define “ideal” sets of accounting information.

Vela Bargues (1992, p.76) considers the users of public sector accounting information as another distinctive particularity of governmental accounting in relation to business accounting. While in business entities financial reporting users are mainly external, in public sector they have been primarily internal (management) users. The author argues that this is understandable taking into consideration the traditional role of governmental accounting. However, studies developed in the last twenty years have

shown that the universe of governmental accounting information users have been enlarging particularly to include external users, such as taxpayers. Moreover, Vela BARGUES (1992, p.77) acknowledges that, whilst internal users are still very important, governmental accounting is increasingly oriented towards external users, whose needs tend to be different than those from the internal ones. This will have immediate consequences on the information required to the accounting system, which has to respond to these changes. On another hand, most probably there are specific users and needs for governmental accounting, different than those for business accounting. Accordingly, the accounting conceptual framework has to consider this, adapting accounting information general purposes to particularities of governmental accounting.

Addressing the objectives of public sector accounting theory, Jones and Pendlebury (2000, p.132) explain that, in the last instance, everyone in the population could be assumed as a user or potential user of the accounts of public sector organisations. This assumption has been considered in much work done in user analysis, as it accords with basic notions of democracy. Nevertheless, as the authors also emphasise,

The problem is (...) that it is of little help in producing a list of users needs: the temptation would be to say either that everyone requires the same information or that everyone requires different information; the former would make the exercise redundant and the latter would make it impossible to handle. (Jones and Pendlebury (2000, p.132)

Subsequently they discuss two practical approaches for users/users' needs that have been adopted in the non-business area (Jones and Pendlebury, 2000, pp.132-139):

- The differential approach – Users and their accounting information needs are analysed considering differential aspects. It emphasises the complexity of financial accounting and thus produces many users groups. The similarities and dissimilarities between business and non-business financial reporting tend to have equal importance.
- The integral approach – It emphasises the commonalities amongst users and their accounting information needs. It tends to lead to an emphasis on the similarities of business and non-business financial reports, thus producing few user groups.

In both approaches, users and potential users are grouped so that the members of each group require the same information (needs), and the number of groups is manageable.

In what respects to the **differential approach**, they state as best example the NCGA's report (Drebin *et al.*, 1981) – *Objectives of Financial Reporting for Government Units: a Research Study*. This consists in two volumes:

Volume I provides the basic rationale and conclusions concerning the objectives of accounting and financial reporting. Volume II contains a series of papers which explore the

issues and information needs of users in greater depth. These papers provide supporting documentation for the material in Volume I. (Drebin *et al.*, 1981, Vol. I, p.v)

They address potential users of financial reports of state and local government units identified in Volume I, exploring decisions and information needs of:

- Voters, taxpayers and service recipients
(Chan, 1981c, in Drebin *et al.*, 1981, Vol. II, Ch.4)
- Legislative, governing and oversight bodies
(Chan, 1981b, in Drebin *et al.*, 1981, Vol. II, Ch.5)
- Management
(Ferguson and Drebin, 1981, in Drebin *et al.*, 1981, Vol. II, Ch.6)
- Intergovernmental grantors
(Chan, 1981a, in Drebin *et al.*, 1981, Vol. II, Ch.7)
- Investors and lenders
(Drebin, 1981b, in Drebin *et al.*, 1981, Vol. II, Ch.8)
- Vendors and employees
(Drebin, 1981a, in Drebin *et al.*, 1981, Vol. II, Ch.9)

In Volume I special attention is also given to users and their needs, since the report is trying to develop a governmental accounting (state and local) conceptual framework based on those. Chapter 3 starts referring to previous studies that have enumerated potential users for who governmental accounting and financial reporting information might be relevant. However, it is acknowledged that before this report, no systematic effort had been made

(...) to identify the users who have a legitimate need for financial information concerning state and local government, and the extent to which they are entitled to this information. (Drebin *et al.*, 1981, Vol. I, p.51)

Jones and Pendlebury (2000, p.133) summarise ten users groups offered in the NCGA's report (Drebin *et al.*, 1981, Vols. I and II):

1. Taxpayers
2. Grantors
3. Investors
4. Fee-paying service recipients
5. Employees
6. Vendors
7. Legislative bodies
8. Management
9. Voters
10. Oversight bodies (including higher-level governments)

Groups 1 to 4 are considered financial resources providers; 5 and 6 are providers for labour and material resources; 7 and 8 take the decisions concerning the resources allocation; and 9 and 10 impose the constraints over all the others and legitimate governments. In other words, potential users of financial information are identified based on their relationships to state and local governments entities. Their decisions and

information needs are subsequently discussed in the report (Drebin *et al.*, 1981, Vol. I, pp.77-105), which continues explaining the objectives of accounting and financial reporting for governmental units (Drebin *et al.*, 1981, Vol. I, pp.106-125).

The basic objectives set on the report are supported by the users' needs that stem from them (Jones and Pendlebury, 2000, p.133); on the other hand, they support the overall goals (highest level objectives) of accounting and financial reporting for governmental units. These are stated as follows²³:

To provide (1) financial information useful for making economic, political and social decisions, and demonstrating accountability and stewardship, and (2) information useful for evaluating managerial and organizational performance. (Drebin *et al.*, 1981, Vol. I, p.126)

Those basic objectives consist in providing useful financial information regarding five subjects within the governmental units (Drebin *et al.*, 1981, Vol. I, p.110). Accordingly, the users' information needs concern (Drebin *et al.*, 1981, Vol. I, pp.126-128):

1) Short-term financial resources

- Determining and predicting the balances and availability of short-term financial resources, including cash, for specific uses;
- Predicting the need to obtain additional short-term financial resources;
- Predicting the impact on short-term financial resources of specific revenue and other financing resources;
- Predicting the impact on short-term financial resources of planned programs and activities;
- Predicting the ability of the governmental unit to meet its short-term obligations as they come due.

2) Economic condition

- Determining the value and predicting the service potential of resources held by the government unit;
- Determining whether the value and service potential of physical resources have been maintained during a period;
- Predicting the amounts and timing of future outflows resulting from existing commitments and the ability of the governmental unit to meet these when they come due;
- Determining and predicting the cost of programs or services provided by the governmental unit.

3) Legal, contractual and fiduciary requirements

- Determining whether resources were utilised in accordance with legal and contractual requirements;

²³ As Jones and Pendlebury (2000, p.133) notice, this definition clearly separates accountability from performance, which implies for the former a definition narrower than that they present.

- Determining whether resource contributions of taxpayers, grantors and service recipients intended to support activities of a given time period were sufficient to recover the cost of those activities;
- Determining whether fees or reimbursements are in accordance with legal, grant or contractual requirements;
- Accounting for the use and disposition of resources entrusted to public officials.

4) Planning and budgeting

- Predicting the impact of programs alternatives on short-term financial resources of the governmental unit;
- Predicting the impact of programs alternatives on the economic condition of the governmental unit;
- Predicting the amount of resource contributions of taxpayers, grantors, and service recipients needed to support activities of a given time period;
- Predicting the effectiveness, including the distribution of benefits among groups, of proposed programs and activities in achieving goals and objectives;
- Predicting the incidence of the burden of providing resources for governmental operations.

5) Organisational and managerial performance

- Determining the cost of programs, functions and activities in a manner which facilitates analysis and valid comparisons with established criteria, among time periods, and with other governmental units;
- Evaluating the efficiency and economy of operations of organisational units, programs activities and functions;
- Evaluating the results of programs, activities and functions and their effectiveness in achieving their goals and objectives;
- Evaluating the equity with which the burden of providing resources for governmental operations is imposed.

According to Jones (1992, p.255) the main idea offered in this study is that governmental accounting is necessarily quite different from business accounting. Furthermore, a clear distinction is drawn between revenue and capital items, as well as between historical financial accounting and financial information for planning and budgeting. Also the need “for determining whether resource contributions of taxpayers, grantors and service recipients intended to support activities of a given time period were sufficient to recover the cost of those activities” (within legal, contractual and fiduciary requirements), implies that a distinction must be made and accounted for, between resources provided by taxpayers, grantors and service recipients. Jones and Pendlebury (2000, p.135) conclude:

(...) it is fair to say that these distinctions characterise the existing reporting models of governmental organisations, particularly in the USA. And, although it must be said that if the needs suggested by the report were met there would be many changes to existing reporting practices, it is also true that many of the needs rationalise the existing complexities of governmental accounting reports.

Contrasting with the differential one is the **integral approach**, which emphasises the commonalities among business and non-business financial reporting, considering the relationship between its users and the organisation as rather abstract. Jones and Pendlebury (2000, p.135) point out as main example for this approach the Professor Anthony's 1978 study. As stated, this study argues for one single accounting theoretical basis (conceptual framework) for business and non-business organisations. According to those authors, Anthony aimed to produce an easily understood foundation upon which the specific nuances of particular organisations could be built. As Jones (1992, p.253) explains, the study offers

(...) a list of users and their needs in general terms that could be applied to any organisation, business or nonbusiness. Similarly, Anthony avoids dealing with areas where schisms between business and nonbusiness might open up: the measurement of efficiency and effectiveness and the question of budgetary information, for example.

With respect to the latter, Jones and Pendlebury (2000, p.135) emphasise that because Anthony cannot conceive of a situation where budgetary information would determine the financial accounts, he suggests that users' needs can be set in terms of financial accounting; if budgetary information is required, it should then be made consistent with the financial accounts²⁴.

The study suggests five users groups and four types of users' needs, not for governmental units only, as the NCGA's report does, but for all non-business organisations. Jones and Pendlebury (2000, pp.135-136) summarise these as follows:

²⁴ Indeed, Anthony (1983, p.3) suggests a conceptual framework for financial accounting, which applies only to general-purpose financial statements prepared to meet the needs of external parties who cannot prescribe the statements contents. Nevertheless, he explains:

Limiting this framework to information furnished to external parties does not imply that information prepared for management is inherently different from that in an entity's published financial statements. Management, of course, uses accounting information (...).(Anthony, 1983, p.3)

Additionally, he explains that in most respects, management accounting practices are consistent with financial reporting standards. Presumably, the standards that are most useful in reporting to external parties are also useful in conveying information to management. Management accounting information though is more detailed than that in general purpose financial statements, but the detail is normally an elaboration of what is contained in the financial statements (Anthony, 1983, footnote 6, p.208). He concludes clarifying:

(...) I have argued that management accounting was inherently different from financial accounting because top management had stronger enforcement capability than external bodies and could therefore tolerate more subjective practices than was appropriate for financial accounting. This argument now seems weak to me, and I am coming to believe that there is almost much risk of biased internal reporting within a large organization as there is in biased reporting to external parties. (Anthony, 1983, footnote 6, p.208)

Users groups²⁵

1. Governing bodies
2. Investors and creditors
3. Resource providers
4. Oversight bodies
5. Constituents

Users' needs²⁶

1. Financial viability – Refers to the ability of the organisation to continue in its present form or in its planning form. Anthony suggests that this need of information is satisfied by certain procedures useful not only for non-business, but also for business organisations: tests of solvency and liquidity; the relationship between inflows and outflows; and the degree of resources transferability, concerning the extent to which resources might be restricted.
2. Fiscal compliance – Refers to the extent to which the organisation has complied with the conditions (imposed internally by a budget, or externally by the law) laid down in its authority to spend.
3. Management performance – This would be expected to refer to measuring effectiveness. Nevertheless, Anthony believes that not enough is known about measuring effectiveness to include it as a users' need. Thus, management performance is instead defined here as a need to know whether money was spent wisely, and not as the achievement of the organisation objectives.
4. Cost of services provided – This is needed for comparison purposes both between organisations and between the needs of present and future generations.

As the authors also explain, Anthony is more concerned in discussing the problems than providing the solutions. Thus he then suggests the type of specific accounting information to satisfy the afore-mentioned needs, presenting arguments for and against. Jones and Pendlebury (2000, p.137) highlight the discussion around performance measurement, since Anthony's view on this is totally contrasting with the NCGA's report. According to Anthony's users' needs, performance management does

²⁵ These are much broader than those suggested in the NCGA's report. Comparatively, Anthony groups taxpayers, voters and employees as *constituents*, and grantors and fee-paying service recipients as *resource providers*. Additionally, for the reasons explained, he deliberately disregards management. He closely follows the FASB focus on external users who lack authority to prescribe the financial information they want from an entity, and therefore must use the information that management communicated to them.

²⁶ As the author himself explains (Anthony, 1983, p.43), he develops a conceptual framework based on premises to describe users' needs rather than users' wants because users of any type of information tend to want the information they are currently getting. Thus, if the premises were based primarily on wants, they would tend to describe existing practice. In our understanding, this shows the clear normative character intended for most of accounting conceptual frameworks that have been developed: in this case, they intend to explain what the users' needs should be, i.e., accounting information needs are developed based on the belief that users may need that information. This normative approach, though is the one that has been followed to develop financial accounting theory in general, it is also acknowledged as not so easy to achieve. For the users' needs, Anthony (1983, p.43) recognises:

An analysis of needs is more difficult than an analysis of wants because evidence on the latter can be obtained by observing the information that users currently use, whereas the former requires speculation about the nature of information that would be useful if it were available.

not relate to efficiency and effectiveness (areas which Anthony avoids to deal with), but to economy. Those authors explain:

His rationale is understandable: there is no generally accepted way of defining and reporting the measurement of high-level outputs in non-profit organisations. Efficiency and effectiveness demand the measurement of outputs. Anthony, therefore, chooses to ignore them. Since the business model is a generally accepted way of reporting *measurable* outputs, the tendency is to conclude that the business model can serve as the basis for satisfying Anthony's users' needs. (Jones and Pendlebury, 2000, p.137)

Other studies also considered the integral approach of users/users' needs, thus contrasting with some conclusions of the NCGA's report. Another one also commissioned by the NCGA, though previous to the one afore-mentioned, was developed by Holder (1980, in Jones and Pendlebury, 2000, p.137). It

(...) surveyed all relevant studies to that date and concluded that the commercial model is the most appropriate one for governmental units because the user group with the most intense interest in accounting information and the least command over what is produced, is investors. Obviously, this conclusion did not meet with the approval of the NCGA. (Jones, 1002, p.254)

Accordingly, his study limited the users' groups to those who: had limited authority over the reporting entity, and possessed a relatively intense need for financial information. For Jones and Pendlebury (2000, p.137), this is a well-recognised solution to the problem of the manageability of many user groups.

As Jones and Pendlebury (2000, pp.137-139) continue, following these studies, the GASB adopted an approach that is much more integral than differential. In fact, GASB's 1987 Statement N.1 – *Objectives of Financial Reporting* – suggests a list of primary users that though keeping governmental units separated from business entities, leaves the door open to the adoption of business accounting ideas in some areas of governmental accounting. Those users are (GASB, 1997, pp.B15-B16, paragraphs 30-31):

- CITIZENRY – those to whom government is primarily accountable – This group includes citizens (whether they are classified as taxpayers, voters, or service recipients), the media, advocate groups, and public finance researchers.
- LEGISLATIVE AND OVERSIGHT BODIES – those who directly represent the citizens – These include members of state legislatures, county commissions, city councils, boards of trustees, school boards, and those executive branch officials with oversight responsibility over other levels of government.
- INVESTORS AND CREDITORS – those who lend or who participate in the lending process – Include individual and institutional investors and creditors, municipal securities underwriters, bond rating agencies, bond insurers, and financial institutions.

In what respects to the users' needs, the statement declares (GASB, 1997, p.B16, paragraph 32):

Financial reporting by state and local governments is used in making economic, social, and political decisions and in assessing accountability primarily by:

- a. Comparing actual financial results with the legally adopted budget
- b. Assessing financial condition and results of operations
- c. Assisting in determining compliance with finance-related laws, rules, and regulations
- d. Assisting in evaluating efficiency and effectiveness.

Additionally it is explained that the needs of intergovernmental grantors and other users are considered to be comprised within the needs of those three user groups. Internal managers in the executive branch of government, who have ready access to financial data through internal reporting, are not considered in the statement as primary users, once this aims strictly general purpose external financial reporting.

As happened in the NCGA's report, these needs were triggered from a general objective set for financial reporting by state and local governments:

Financial reporting is not an end in itself but is intended to provide information useful for many purposes. Financial reporting helps fulfil government's duty to be publicly accountable. Financial reporting also helps to satisfy the needs of users who have limited authority, ability, or resources to obtain information and who therefore rely on the reports as an important source of information. For that purpose, financial reporting objectives should consider the needs of users and the decisions they make. (GASB, 1997, p.B7, paragraph 3)

Jones and Pendlebury (2000, pp.137-138) highlight in particular the financial reporting function of helping "government's duty of be publicly accountable". This means that financial reports might be defined in part without explicitly referring to the users' needs. For them,

This is important in practice because there are elements of traditional financial reports of governments that are not easily rationalised in terms of explicit users and their needs. (Jones and Pendlebury, 2000, p.138)

On the other hand, Caperchione (1999, pp.73-74) criticises that fact of both GASB's lists of users and uses of financial reports (GASB, 1997, pp.B15-B18, paragraphs 30-42) are too generic, leading an acceptance that governmental accounting functions might bear no relation to accounting itself (e.g. put the elected representative of citizens in a condition to take conscious decisions, communicate information to the citizens, favour the comparisons among entities within the same country, and make assessments on the existence of chain effects among generations).

Jones (1992, pp.256-259) additionally refers to conceptual frameworks for national governments that also were based in a users/users' needs approach:

- 1980 *Financial Reporting by Governments* by the Canadian Institute of Chartered Accountants (CICA)
 - Users – legislators, policy makers, administrators, analysts, investors, and the public;
 - Users’ needs – to demonstrate stewardship and compliance with legislative authority, to facilitate evaluation of economic impact, to facilitate evaluation of program delivery choices and their management, and to display the state of the government’s finances.
- 1983 *Public Sector Accounting Statement N.2* by CICA
 - Users – the same as the 1980 document, except administrators;
 - Users’ needs – the allocation and use of financial resources, the sources and types of government revenues, the extent to which revenues were sufficient to meet expenditures, how the government financed its activities and how it met its cash requirements, the government’s financial condition, actual results of financial activities in comparison with those originally forecast and those of past periods, and how public financial resources were managed in accordance with legislative authorities.
- 1992 *A proposed framework for financial reporting in New Zealand* by the New Zealand Society of Accountants
 - Users – details on the users of accounting reports are avoided, most likely because it is a common framework for public and private sector;
 - Users’ needs – defined considering the objectives of general purpose external financial reporting as providing information to external parties for assisting in: 1a) assessment of financial and service performance, financial position and cash flows of the reporting entity, 1b) assessment of the reporting entity’s compliance with relevant legislation, regulations, common law and contractual arrangements relevant to the assessment mentioned in 1a); 2) the making of decisions about providing the resources to or doing business with or being employed by the reporting entity.

Jones and Pendlebury (2000, pp.138-139) also refer to the 1994 *Objectives of Federal Financial Reporting* by the Federal Accounting Standards Advisory Board (FASAB) in the USA. Its importance, according to those authors, relies upon the fact that in dealing with the US federal government it is clearly setting the background for the most significant development in accounting standard-setting for national governments in the world. Additionally, it offers an integral approach but comes to conclusions about users’ needs totally in contrast with Anthony study: to the FASAB the role of the budget is supreme. Accordingly, four users’ groups are defined, as well as four types of needs, which seem to be more like financial reporting functions within the federal government context (Jones and Pendlebury, 2000, p.139):

- Users groups – citizens (including news media, pressure groups, state and local legislatures and executives, and analysts), the legislative branch (including their staff), and two groups in the executive branch, namely the senior members and the program managers.

- Users’ needs
 - Budgetary integrity – Assisting in fulfilling the government’s duty to be publicly accountable for monies raised through taxes and other means and for their expenditure in accordance with the government’s legally adopted budget and related laws and regulations.
 - Operating performance – Assisting in evaluating the service efforts, costs, and accomplishments of the reporting entity, as well as the way those efforts have been financed; assisting the management of the entity’s assets and liabilities.
 - Stewardship – Assisting in assessing the impact on the country of the government operations and investments for the period and how, as a result, the government and the nation’s financial position has changed and may change in the future.
 - Systems and control – Providing information on internal controls and the adequacy of financial management systems.

Borgonovi and Anessi-Pessina (1999) address the governmental accounting information users and their needs within a study of accounting and accountability in Local Government (LG).

The authors explain that the recent changes in the role and structure of local governments around the world have had implications on local government accounting. Indeed, due to several sources pressuring those changes²⁷, local governments have become professional organisations that must be kept accountable to a large number of heterogeneous stakeholders. Local politicians have been realising the greater importance of efficiency and effectiveness in reaching consensus. Furthermore, local civil servants are no longer expected to simply follow the rules and implement decisions, but are increasingly assessed on the results of their actions (Borgonovi and Anessi-Pessina, 1999, p.7).

Under these circumstances, LG accounting should no longer be aimed at imposing a given allocation of resources or preventing the abuse or misuse of formal powers, not should it simply be expected to report inflows, outflows, assets, liabilities, surpluses and deficits. (Borgonovi and Anessi-Pessina, 1999, p.7)

²⁷ Borgonovi and Anessi-Pessina (1999, pp.6-7) state as main sources of pressure to change:

- The worsening of public finances, forcing local governments either to pursue greater efficiency, or to reduce the volume and scope of the services provided;
- Technological innovations creating alternative ways of producing and delivering public services;
- As a consequence, an increasing public awareness of the efficiency and effectiveness implications of each alternative;
- A weakening of ideological positions in the public *versus* private debate;
- The development of both new ways of managing economic systems to prevent market failures, and new ways of managing social behaviour and social relationships to ensure an increasing level of substantial democracy;
- Increasing decentralisation, defined as the breakdown of large government bureaucracies into smaller corporatised units, the devolution of power from the central to local levels of government, and the delegation of power and responsibilities within individual organisations.

Instead, the local government accounting system is increasingly expected to provide information on the “true and fair view” of the entity performance, to a wide group of internal and external stakeholders. Additionally, it is supposed to become a useful tool for supporting their decision-making, also helping them to understand how the entity inflows, outflows, assets, liabilities, deficits and surpluses affect their interests and expectations.

Based on previous studies, namely the above-mentioned Anthony (1978) and Drebin *et al.* (1981), Borgonovi and Anessi-Pessina (1999, pp.7-8) present the following users groups and needs for local government accounting information:

External stakeholders

- Citizens (and their organisations) as consumers of public services – They require information on the costs, prices and quality of services.
- Citizens (and their organisations) as taxpayers – They need to know where, how and to what extent tax money is spent.
- Firms and other socio-economic organisations using public services as inputs for their own activities – Apart from information on the costs, prices and quality of services, they also demand for information on the entity contribution to productivity and competitiveness. This is important since the efficiency and effectiveness of the public sector is considered as significantly affecting the productivity and competitiveness of individual firms.

The authors consider that for these three groups, the value-for-money principle has become increasingly more important.

- Upper levels of government and other oversight agencies – These are particularly interested in local governments fiscal discipline; they need to prevent creative accounting.
- Banks, individuals and international institutions as lenders – They require information on the entity solvency and liquidity.
- Foreign investors and country analysts – Basically, these need information to evaluate the risk of their investments.
- Future generations, with respect to the inter-temporal distribution of consumption, the creation and reimbursement of government debt, as well as the creation, purchase and sale of government assets – The interest of future generations must be protected, so the local government accounting system must provide information on inter-period and inter-generational equity, i.e., on the creation of surpluses or deficits that will burden or benefit future periods and on the future benefits and costs of current investments.

Internal stakeholders

- Institutional bodies (e.g. government and legislature) and political groups (e.g. political parties) – These are mainly concerned with preventing a biased representation of the entity financial conditions, which could be exercised as an undue political influence.

- Public managers, i.e., the new top and middle-level bureaucrats – For these, financial accounting is a component of a wider management information system, which should help them guiding their organisations towards their objectives.
- Government employees, especially when salaries and careers are performance-related – The accounting system must therefore correctly reflect individual contributions in terms of commitment, productivity and professional competence.
- Public sector trade unions – They need information to formulate their claims and assess their margins of negotiation.

Several criticisms have been presented to both differential and integral users/users' needs approaches. Jones (1992, p.260) refers in particular to the fact that none of them is empirical. Though Jones and Pendlebury (2000, p.138) had recognised that GASB's approach was partially based on an attempt to empirically identify users and their needs, they also acknowledge some disappointment on the exercise, given the very low response rate. Additionally, they explain this as

(...) symptomatic of a continuing problem with the user/user needs approach of financial reporting theory: we are still not clear that substantial number of users exist. (Jones and Pendlebury, 2000, p.138)

This argument is related to the main uses that have been recently considered for governmental accounting. As presented, either in the NCGA's report or in GASB's Statement N.1, or even in other conceptual frameworks for national governments, the overall purpose of governmental financial reporting seems to be providing information useful for accountability and decision-making. Moreover, in the context of the public sector, the latter appears to be emphasised over the former. On the other hand, the most important users have been identified as external parties to the organisations. Jones (1992, p.260) explains that this is not surprising considering that governmental accounting conceptual frameworks have been developed by bodies whose imperatives relate to financial reporting.

Nevertheless, those users' needs for accountability and decision-making seem to be rather controversial within the public sector context, justifying Jones and Pendlebury's (2000, p.138) arguments about the existence of substantial number of users.

For example, Jones (1992, p.260) explains that the "accountability" notion should somehow have implicit "decision-making":

(...) accountability must imply some purpose for some external user and that, however casual the decision might be, the purpose must lead to a decision: if the accountee is entirely passive, accountability surely must be an empty notion.

Still, he acknowledges with some disappointment that current appeals to accountability do not link the accountant, accountee and how published financial statements are useful to consequent decisions.

Rutherford (1992) also highlights some problems regarding those two purposes of financial statements within the public sector. He clearly explains that, as in the context of profit-seeking entities, financial reporting in the public sector is supposed to provide useful information for decisions to be taken by external parties. He refers in particular to the IFAC's framework as focusing on external users needing relevant information to help them making economic, social and political decisions, and to evaluate the use of resources in a government or governmental unit. Information for accountability is additionally recognised as an important users' need, coming to precede decision-making.

This relegation of decision-making for "second position" might be related to the recognition of some important problems concerning. Indeed, as Rutherford (1992, p.271) clarifies,

The elusiveness of a *decision* may explain why there is a greater tendency in conceptual frameworks directed at the public sector (...) to introduce notions of *accountability*. But, noble as they are, notions of accountability are also vague and ill-formed by comparison with the clear-cut decision-making setting which applies in relation to profit-seeking entities. They are thus ill-suited to the provision of rigorous specification of information requirements. If a conceptual framework for the public sector is to be constructed which bears comparison with those applying in the profit-seeking sector, the notion of accountability need to be fleshed out.

Furthermore, Rutherford (1992, p.267) acknowledges that accounting conceptual frameworks in the public sector tend to be normative in approach and to base arguments about information needs on *a priori* assertions rather than rigorous empirical research²⁸.

Accordingly, he explains:

There is no difficulty in identifying parties who are unequivocally external to a public sector organisation who might in principle be users of financial reports (*e.g. taxpayers, voters, service recipients, investors*). (...) There is however, a difficulty in identifying the decisions which a rational actor falling within one of these classes might seek to take by employing the general purpose statements of any government unit. [italics provided]. (Rutherford, 1992, p.267)

On these difficulties he exemplifies the decision that a voter needs to make from time to time – choosing the political party for the next government (Rutherford, 1992,

²⁸ For him this is not surprising considering the failures of studies that tried a positive approach for the governmental accounting information users and uses. Rutherford (1992, pp.269-270) refers to some of these studies explaining that they had little success even in locating individuals unequivocally external to the public sector organisations, who could be held to use its financial statements for any purpose. Additionally, referring to particular studies developed in UK, he explains that their results suggested, at best, a limited use of financial reports of local authorities and central government.

p.268). Even assuming that he/she wishes to make the decision on the basis of a rational economic calculation of self-interest (to which information about past performance of the current and previous administrations, as well as information about his/her past personal burden of taxation and benefits, could be helpful),

It is not clear that there could be anything in general purpose financial reports, no matter how they were prepared (within the constraints of currently available accounting methods), that would provide sufficient incremental information to justify the time involved in reading them. (Rutherford, 1992, p.268)

Rutherford (1992, p.268) still recognises that voters have a general interest in government units to be efficient and effective. However, he argues that this is not enough for them to be sent off to read governmental financial statements. Additionally he emphasises that even with full-accruals reports, information about efficiency and effectiveness can be difficult to get, since those are not purported to measure outputs. Therefore, it seems that the interests of parties that are unequivocally external to government²⁹ are sufficiently heterogeneous to make it highly unlikely that general purpose financial statements can provide information for them to make any decision. This is understandable considering that those reports are highly aggregated with respect to the recipients of the services covered and the taxpayers providing the resources consumed.

Consequently, Rutherford (1992, p.270) concludes that there are no rational reasons why external parties should wish to use public sector financial statements, which is confirmed by the difficulties in empirically identifying the external users.

Even considering various “experts”, such as the media and policy analysts sometimes suggested as external parties using public sector financial reports on their behalf, Rutherford (1992, p.270) still argues that it is not possible to identify the decision which a skilled user would take for her/himself using general purpose financial statements. As to the lenders, the author finds it reasonable (though limited) these to be identified as external users for public sector financial statements. In fact, though investors might concern about the risk and return of their investments, this is not important above all at the level of central government, once governments always can raise taxes to cover necessary payments, i.e., they never go bankrupt.

²⁹ At this respect, Rutherford (1992, p.271) explains that the character of the user-community differs between the public and private sectors: in the former the dichotomy between internal (managerial) and external users is much less marked than in the latter. Indeed, in the public sector there are a variety of intermediate users, internal from some perspectives and external from others (e.g. legislature in the case of central government accounting).

Discussing the purpose of the publication of financial statements particularly in the public sector, Jones (1992, p.261) refers to an economic theory about the role of information developed by Downs (1957, in Jones, 1992, p.261), that has been applied to accounting, namely by Watts and Zimmerman (1978). He explains that, though this is not a general accepted theory on why financial statements are published, it has been very influential within governmental democratic contexts, particularly in the field of public choice.

That theory applies economic analysis to voters and pressure groups in a democracy. Basically it develops a cost/benefit analysis for these to become informed about the government, predicting that the incentives are very small for voters to become informed for the purpose of voting, and only exist about very specific matters for pressure groups.

Jones (1992, p.261) then refers to its own application of the Downsian theory in helping to understand the influences on local government accounting in UK. In all his historical research, he concluded that not only users do not appear to play an important role for accounting objectives and standards, but also that the statute for the financial control of elected councillors is what essentially has been determinant. Consequently he argues that public sector accounting is likely to be a matter for government officials – namely accountants and auditors (Jones, 1992, p.262). In such a chaotic world as politics, where bargains are subsequently used within governmental units to arbitrate between the competing claims on public money,

(...) information is at premium. If a piece of financial information can be cheaply extracted by a pressure group and included in a report that tries to shift the distribution of wealth, the published accounts might well be 'used'. But use in this way is a by-product. The publication of financial statements is not in the public interest, because the public has no interest (...). (Jones, 1992, p.262)

In spite of these problems and criticisms, Rutherford (1992, pp.270-271) still believes in some hope for the users/users' needs approach. Indeed, though he had recognised the empirically and theoretical failure of the search for external users of public sector financial reports, and for decisions for which they might need information included in those, he also states that this does not mean that the users' needs model must be abandoned.

Accordingly, he suggests as possible approach to view the activities of intermediate users as the exercise of indirect control, weaker than direct control exercised by governing bodies themselves, but stronger than the passive, reactive

decision-making of fully external parties (Rutherford, 1992, p.271). Additionally, this approach would have to recognise the nature and objectives of financial statements in the public sector, considering its heterogeneity and variety of activities, which would point to a narrower focus for a conceptual framework than that used in conceptual frameworks developed for business sector. In conclusion, Rutherford (1992, p.279)

(...) argues for an approach which works outwards from individual units and programmes, enabling users and needs to be identified in the specific context of the activity, rather than one which seeks to identify users and needs, and hence specifications of information, at a high level of generalisation. Such approach will, of course, require extensive and detailed empirical work rather than *a priori* theorising.

Mayston (1992) makes some comments on Jones' (1992) and Rutherford's (1992) conclusions related to the lack of demand by individual potential users, such as taxpayers and consumers, for public sector financial reports. In particular he argues for the importance of distinguishing between the words "demand", "need" and "interest", in order to avoid counter-productive conclusions.

Using the economic theory for the demand of information, Mayston (1992, pp.317-319) compares the individual marginal benefit and marginal cost of information used. He explains that with public sector financial reporting information, the marginal cost of acquiring, understanding and acting on that information is individually very high when compared to the marginal benefit, so that the information quantity that the individual will demand if acting alone will be zero. Yet, while the individual will not be interested in acquiring (demand) information, he still might have an interest in and need for its provision and use.

Given that the activities of the public sector include major public services, such as education and health care, and regulation involves major utilities, such as electricity, the individual taxpayer and consumer has a significant positive interest in seeing that information which might improve the quality and efficiency of these services is made use of. (Mayston, 1992, p.318)

It is then important to analyse the social (of large number of taxpayers and consumers) marginal benefit comparatively to the social marginal cost, instead of the individual perspective. The main goal is maximising the social net benefit of the production and use of information provided centrally. Information is then viewed as a collective good that might be valuable for a group as a whole, but does not offer individually any incentive to bear any costs. Mayston (1992, p.319) considers subsequently the interest of central government as provider for that amount of information socially optimum. He explains that in the case of public sector financial reporting, the government might have some interest in limiting the information revealed

about its own performance, which means that the government own demand for financial information and its use might be lower than the social optimum. Consequently he argues:

Precisely because one cannot rely on the individual demand for information to generate a social optimum, one cannot rely on a *positivist empirical approach* (...) to determine the information that should be made available. This becomes even more strongly true when one recognises that before individuals themselves can determine their own optimal informational needs, they must first themselves incur information costs to determine what these needs are. The disincentives for individuals acting alone to acquire relevant information are then even greater.

In contrast, a *deductive approach* can make use of economic analysis to establish the information that is relevant to protecting individual interests, and thereby investigate what is socially optimal. (Mayston, 1992, p.320)

Additionally he makes clear that protecting the interests of some individuals may involve the use of information by other information intermediaries. Accordingly, what has been defined in many conceptual frameworks as “user’s need”, must be interpreted more widely than the direct use of information by the individuals who may benefit from its use. Therefore, Mayston (1992, p.320) states that, in the especial case of public sector financial reporting information, “beneficiaries” may be a more appropriate term than “users”, and “individual informational benefits” better than “users’ needs”.

2.6.2. Accounting and budgeting purposes

Many of the governmental accounting purposes were addressed in the previous section. Subsequently, here essentially add some clarifications as well as explanations particularly related to budgeting.

Vela Bagues (1992, p.145) distinguishes between governmental accounting traditional and current objectives, the latter triggered by what he considers the new conception of governmental accounting (including budgetary, financial and cost accounting). He explains that traditionally, it was oriented towards accomplishment and control of the budget execution, so it was essentially an instrument for stewardship and legality control. Following the users/users’ needs approach, he recognises that currently that main goal is no longer sufficient, once governmental accounting information functions go far beyond those. Accordingly, apart from the traditional functions, he suggests that governmental accounting information today aims at (Vela Bagues, 1992, pp.145-146):

- Offering a “true and fair view” of the patrimony (assets and liabilities), financial condition and results of the entity which the information refers to, within the legal framework that regulates its activities and economic-financial information;

- Providing useful and reasonable information concerning costs and revenues of responsibility centres and services provided by the several entities and bodies;
- Allowing the integration of the public sector economic-financial information within the macro-economic accounts, at regional, national and supranational level.

Furthermore, Vela Bargues (1992, p.146) highlights that all these functions are structured around one current main goal for accounting in general, and governmental accounting in particular – offering its users economic-financial information appropriate to fulfil their needs and to allow them supporting decision-making. As explained, he recognises the importance of considering specific objectives of governmental accounting, eventually supported by particular needs, since they might affect the accounting conceptual framework. In summary, he argues for the main functions of governmental accounting to be the afore-discussed accountability and decision-making, which are viewed as the overriding objectives that all the other objectives flow from.

Within this trend, we can find the above-stated overall goals set for governmental accounting (state and local governments) in the NCGA's study, particularly focusing on decision-making, but also referring to accountability and performance evaluation.

On the other hand, the 1979 NCGA's Statement N.1 – *Governmental Accounting and Financial Reporting Principles*, quoted in Drebin (1981c, in Drebin *et al.*, 1981, Vol. II, p.3.7), pronounces as an important function of governmental accounting systems “enabling administrators to assure and report upon compliance with finance-related legal provisions” – legal restrictions on the resources utilisation (i.e., spending limits). In what respects to the role of the budget, the same statement declares that “budgetary comparisons should be included in the appropriate financial statements and schedules for governmental funds for which an annual budget has been adopted” (Drebin, 1981c, in Drebin *et al.*, 1981, Vol. II, p.3.12).

Thus, it is assumed that users also have a need for budgetary information (not only on the planned allocation of financial resources, but also on how these resources are actually utilised in comparison with the plan), which must then be included in financial reports of governmental units.

Yet, as Drebin (1981c, in Drebin *et al.*, 1981, Vol. II, p.3.12) adds, some have questioned this need. He refers to Professor Anthony, for example, as arguing that budgeting in non-business organisations is a matter of internal not external (reporting) accounting. We already referred to this argument, explaining that Anthony avoided to deal with subjects that could somehow raise conflicts between business and non-

business accounting: budgeting is one of these, once enterprises usually do not publish budgets while its publication is compulsory by law in governments. Additionally, arguments against the inclusion of budgetary information in governmental units financial reports assume a clear-cut distinction between internal and external users; as explained, in governmental units this does not seem to be so.

Another function that seems to derive from the publication of budgetary information relates to public sector financial control. As Drebin (1981c, in Drebin *et al.*, 1981, Vol. II, p.3.13) explains, the budgetary process provides a necessary control mechanism in the public sector, replacing the role that in business is played by the marketplace. In fact,

In the governmental sector, the market cannot be relied upon to control resource allocation decisions. These decisions may be made by governmental officials but they must be responsive to the needs and preferences of their constituents. The political process acts to control these decisions but the process cannot work effectively unless appropriate information is provided to the electorate. (Drebin, 1981c, in Drebin *et al.*, 1981, Vol. II, p.3.13-3.14)

In turn, GASB's Concepts Statement N.1 – *Objectives of Financial Reporting* also presents financial reporting objectives, considering that governments comprise governmental-type activities and business-type activities, thus having a variety of financial information users and users' needs. One pronouncement that we believe interesting, namely because it somehow shows the above-mentioned integral character pursued by the GASB in the users/users' needs approach is the following:

The Board has concluded that there are no major differences in the financial reporting objectives of governmental-type and business-type activities. This is because business-type activities, whether performed through a separate legally constituted entity or through a department of government, are nevertheless a part of government and are publicly accountable. To the extent that there are differences in financial reporting objectives, they tend to be differences in emphasis caused by differences in the operating environment of each. In addition, the Board believes that many governmental activities cannot be easily categorized into either governmental-type or business-type. Users of financial reports may require different kinds of information depending on where on the overall spectrum of governmental- to business-type activities a particular activity falls. As a result, the Board believes the objectives presented (...) may apply in differing degrees to the two types of activities. For example, because of the differences in environmental factors, budgetary comparisons or information about funds flows may be less important to business-type activities, but cost of services information may be more important. However, both types of information are useful in different degrees for all activities. The Board will recognize these different needs in developing specific standards to implement these objectives. (GASB, 1997, p.B26, paragraph 75)

As to the objectives themselves, an overall goal for governmental financial reporting is also firstly stated (GASB, 1997, p.B26, paragraph 76) as providing information to assist users in: assessing accountability, and making economic, social

and political decisions. As the Board recognises, more emphasis is given to accountability, because governments have the duty to be publicly accountable. Moreover, assessing accountability is considered a pervasive use for governments' financial reports, thus being implicit in all objectives then derived. Each of these is detailed by what could be considered users' needs, as in the NCGA's report. Accordingly (GASB, 1997, pp.B27-B28, paragraphs 77-79):

- Financial reporting should assist in fulfilling government's duty to be publicly accountable and should enable users to assess that accountability. Thus, it should:
 - Provide information to determine whether current-year revenues were sufficient to pay for current-year services (Do current-year citizens shift part of the payment burden for the services they received to future-year citizens? Were previously accumulated resources used up in providing services for the current-year citizens? Were current-year revenues not only sufficient to pay for current-year services, but also to increase accumulated resources?);
 - Demonstrate whether resources were obtained and used in accordance with the entity's legally adopted budget, as well as demonstrate compliance with other finance-related legal and contractual requirements;
 - Provide information to assist users in assessing the service efforts, costs, and accomplishments of the governmental entity – this, when combined with information from other sources, helps users assess economy, efficiency and effectiveness of government and may help form a basis for voting or funding decisions; this information must be based on objective criteria to aid inter-period analysis within an entity and comparisons among similar entities; information about physical resources should assist in determining the costs of services.
- Financial reporting should assist users in evaluating the operating results of the governmental entity for the year. Therefore, it should:
 - Provide information about sources and uses of financial resources – financial reporting should account for all outflows by function and purpose, all inflows by source and type, and the extent to which inflows met outflows;
 - Provide information about how the governmental entity financed its activities and met its cash requirements;
 - Provide information necessary to determine whether the entity's financial position improved or deteriorated as a result of the year's operations.
- Financial reporting should assist users in assessing the level of services that can be provided by the governmental entity and its ability to meet its obligations as they become due. Hence, it should:
 - Provide information about the financial position and condition of a governmental entity (resources and obligations, both actual and contingent, current and non-current, as well as tax sources, tax limitations, tax burdens, and debt limitations, considering that the major financial resources of most governmental entities are derived from the ability to tax and issue debt);
 - Provide information about a governmental entity's physical and other non-financial resources having useful lives that extend beyond the current year, including information that can be used to assess the service potential of those resources – this is to help users assess long and short-term capital needs;

- Disclose legal or contractual restrictions on resources and risks of potential loss of resources.

These functions clearly point to an accounting system that has to be accruals-based.

In what concerns to budgeting, GASB's statement (GASB, 1997, p.B13, paragraphs 19-20) presents some discussion on its role as an expression of public policy and financial intent and as a method of providing control. It is stated that the budget – defined as a plan for the coordination of revenues and expenditures or as the amount of money that is available for, required for, or assigned to a particular purpose – is believed by many to be the most significant document produced by a governmental entity. Though recognising different types of budgets, the Board considers the legally adopted annual budget as the most important, which, by its nature, has significant implications in the financial reporting. Accordingly, some functions are discussed for a governmental entity annual budget (GASB, 1997, p.B13, paragraph 19):

- It is an expression of **public policy** – budgets result from the legislative process and require resolution of conflicting views about the way in which and extent to which financial resources will be raised and used; they are formal expressions of public policy on the entity's objectives and priorities and on how resources will be provided to meet those objectives; additionally, the citizenry participate on the budgetary process, either directly or indirectly, through elected representatives or advocate groups;
- It is a financial plan, or an expression of **financial intent** – it sets forth the proposed expenditures for the year as well as the means to finance them; because there is a common perception that state and local governments must “live within their means”, this implies a concept of balanced-budget, though the term may not be precisely defined;
- It is a form of **control** usually having the force of law – because it is legally adopted, the budget provides *authorisations of* and *limitations on* amounts to be spent for particular purposes; budgetary authorisations result from competition for scarce resources and budgetary limitations generally cannot be exceeded – this implies the governmental entity needs to demonstrate that it is accountable from both authorisation and limitation perspectives;
- It may provide a basis for **evaluating performance** – information comparing actual with the legally adopted budget might help users to assess if resources were obtained and expended as anticipated; nevertheless, detailed evaluation performance still requires the government to establish service efforts and accomplishment goals and to accumulate actual data for comparison purposes.

Finalising, it is stated:

Budgetary expression of public policy, financial intent, control and performance measures need to be considered when developing financial reporting objectives, even though financial accounting concepts of inflows and outflows may differ from budgetary concepts. (GASB, 1997, p.B13, paragraph 20)

Borgonovi and Anessi-Pessina (1999) develop and analysis of the relationship between the goals assigned to governmental accounting systems over time and their technical features. Although they focus on local government accounting, they also address other levels of government.

They start explaining that:

Governmental accounting was initially viewed as a key element in the transition from the “absolute-power” model of government to a “relative (controlled, shared) power” model of government. (Borgonovi and Anessi-Pessina, 1999, p.3)

Under the model of “relative power”, governmental accounting was an instrument used by the parliament to limit the monarch’s powers, meaning that it forced the executive to:

- State the amount, nature and purpose of its planned expenditure and the taxes it consequently needed to raise (present the budget);
- Ask for and obtain approval from the legislature (budget discussion and approval);
- Comply with the expenditure authority granted by the legislature and demonstrate such compliance (budget execution).

As governments changed to modern democratic regimes, the use of governmental accounting changed as well. Apart from its original role of allowing the legislature to steer and control the executive behaviour, it undertook two additional functions (Borgonovi and Anessi-Pessina, 1999, p.3):

- Providing the population with information on the behaviour of its political representatives;
- Allowing the cabinet (politicians) to guide and control the behaviour of the bureaucrats (professional neutral executives).

Governmental accounting main technical features had then to be in accordance with these new roles. The authors present some examples they believe still exist in actual governmental accounting systems in many countries: balanced line-item budgets; budgets given much more importance than the year-end financial statements; the main function of the financial statements is to show budgetary compliance; inflows and outflows recognised according to cash and/or obligations accounting bases; single-entry bookkeeping method, recording the monetary side and disregarding the non-monetary side of transactions (Borgonovi and Anessi-Pessina (1999, pp.3-4).

Later, more changes happen in the role of (local) governments within the society, leading to more modifications in (local) government accounting functions. As the authors continue explaining,

When the model of government evolved towards the “welfare state”, the role of government accounting was significantly modified. More specifically, government

accounting became a tool (i) to evaluate the macroeconomic viability, compatibility and implications of different social policies, and (ii) to acquire and maintain voter consensus. (Borgonovi and Anessi-Pessina (1999, p.4)

Notwithstanding, the technical features of the governmental accounting systems were left unchanged, which created inconsistencies. While those characteristics were coherent with the purpose of limiting expenditures, this purpose was now not so important. The governmental accounting system main function was now providing information to support decision-making on delivering services useful for citizens, in order to increase their well-being.

The authors add that these inconsistencies had as main consequence in many countries the preparation of unrealistic budgets and frequent budgets overruns. They exemplify that in Italy many accounting rules and constraints were increasingly circumvented.

More recently, between the end of the 1980s and the beginning of the 1990s, as the condition of public finances worsened, local government accounting was used to impose constraints (especially cash restrictions) on policy decisions. Borgonovi and Anessi-Pessina (1999, p.5) explain:

The basic assumptions were as follows: (i) the central government could use government accounting rules to impose expenditure ceilings and pursue the financial equilibrium of the public sector as a whole; (ii) the financial equilibrium of each LG would then follow automatically. This approach, however, was not always effective.

In fact, in many countries (e.g. Italy) central government cost control policies led to processes of intergovernmental bargaining, with deficits starting to emerge during the year in local governments and these predicting disastrous consequences on their capacity to provide adequate services. Subsequently, central governments had to concede supplementary funding or cover local governments deficits. Additionally, because grants were often attributed on the basis of past expenditure, there were no incentives for local governments to rationalise their operations, which created further inefficiencies.

One last issue that Borgonovi and Anessi-Pessina (1999, pp.5-6) emphasise is that the basic conceptual framework remained unchanged during the entire evolution described, despite different goals assigned to (local) government accounting over time. In particular, government accounting remained a key element in a top-down power model: accounting rules and constraints were initially mediating the relationship between the legislature and the executive, and later between voter consensus and laws and regulations derived within the welfare policies; on the other hand, accounting

responsibilities first were helping the executive in guiding and control the bureaucracy, and later were supporting the welfare policies guidance of the actual economic behaviour.

Finally they acknowledge that, considering local governments are developing into professional organisations, which must be kept accountable to a large number of highly heterogeneous stakeholders, local government accounting should evolve accordingly. Though accruals accounting is certainly a key factor in this evolution, they state that government accounting need to become “accounting for governance”. Subsequently,

(...) LG accounting should become a component of a wider information system covering cash flows, cost and revenues, assets and liabilities, but also activities, outputs, needs, customers satisfaction. In this information system, the absolute precision of figures should not be the only objective. On the contrary, greater attention should be paid to the quality of the information provided, its validity and its relevance for the entity’s internal and external stakeholders. In other words, interpretation models should be given greater importance than pure accounting technicalities. (Borgonovi and Anessi-Pessina, 1999, p.9)

Within the very recent tendency for what is called “resource accounting and budgeting”, accounting functions and particularly budgeting functions, might have to be redefined. In fact, considering that resource accounting demands for financial reporting disclosing information on resources consumed and not just cash spent, this calls for resource budgeting (forecasting resources to be consumed and not just paid), implying the extension of accrual basis to budgeting. Accordingly, Lüder and Jones (forthcoming in 2003) refer to the following functions of governmental budgeting and accounting:

Budgeting

- Fiscal control (planning of cash inflows and outflows in sufficient detail)
- Performance control (output budgeting)
- Providing incentives for efficient/effective behaviour (accrual budgeting, flexibility, consistency with accounting)

Accounting

- Meeting accountability requirements by complete and fair presentation of financial condition and use of resources (accrual accounting and financial reporting, consolidated accounts for the government)
- Protection of present and future taxpayers (ensuring inter-period equity and providing complete and reliable information on financial condition and use of resources)
- Budget control (consistency of budget and accounting system).

One interesting point in this framework (which the authors consider as normative, though admitting that additional functions may be empirically observed) is that functions/objectives do not appear to be set using a users/users’ needs approach, maybe because all the controversy surrounding that, as presented. It seems that instead they are

set on an organisational perspective, i.e., budgeting and accounting information tends to be seen as useful much more from the entity standpoint (eventually internal users) than from an outsider angle.

Another study on the functions of accounting in general was carried out by Mellemvik *et al.* (1988). It is a very comprehensive study that tries to answer to a set of questions namely related to: why almost all organisations prepare accounting reports, with what purpose, to whom are the accounts of interest, why is there a demand for accounting reports, and whether they satisfy this demand. The authors argue that answering these questions is of enormous importance to understand why accounting exists as it is.

Recognising the terminological confusion that surround the concept of “function”, Mellemvik *et al.* (1988, pp.101-102) explain that they address in particular how and why local actors and organisations are influenced by accounting, and/or how they in turn influence it.

They seem to approach accounting functions in an organisational behavioural and rather sociological perspective, considering the organisational environment. Indeed, they discuss the certainty of accounting in view of the uncertainty of its context (Mellemvik *et al.*, 1988, pp.105-109), coming to one first conclusion that the intended function of accounting is in sharp contrast to the functions that are assigned to accounting in action (Mellemvik *et al.*, 1988, p. 114).

The authors believe that, from the many accounting objectives that have been suggested, it seems that the intended function of accounting is to reduce uncertainty in control and decision-making processes (Mellemvik *et al.*, 1988, p.101). Nevertheless, when they turn to functions assigned to accounting in action (Mellemvik *et al.*, pp.109-113) they realise it has a much richer and greater variety of functions in organisations and society than the intended function (Mellemvik *et al.*, 1988, p.114): delegation of responsibilities and evaluation, legitimating, myths, power, and conflicts.

Their main conclusions were (Mellemvik *et al.*, 1988, pp.114-115):

- The functions which accounting fulfils are dependent on its context, while at the same time the context is dependent on the accounting – a kind of reciprocal or dialectical interdependence was found between accounting and the functions assigned to it;
- There is a complex relationship between accounting and its context – this was a more speculative conclusion, which led to the following;

- The main function of accounting in a strong organisational context, where each organisation is interdependent with its environment, is to support the organisation legitimating processes (they provide examples: in business organisations the return on investment is used to support actions and ideologies rather than decisions; local governments are much more interested in program budgeting than *ex-post* accounting because it promotes the generation of a lot of alternatives in the decision processes – program budgeting helps the various political groups to express their ideologies to the environment);
- The main function of accounting in a strong organisation with a dependent environment is to support the organisation in the exercise of power – strong organisations, such as strong State enterprises and departments, are strong because they are able to control their environments; one way of strengthening this situation is to make the actors in the environment accountable to the organisation (e.g. strong State organisations may force their environments to present their accounting figures in a certain way);
- These functions do not match with the intended function of reducing uncertainty in decision-making and control processes.

2.7. Conceptual frameworks on national basis: central and local/state governments

As stated in 2.1, the development of conceptual frameworks for accounting is of relatively recent origin; it started in the USA with the FASB's work in the middle 1970s, particularly for business organisations. This was later extended to non-business entities, but a conceptual framework for accounting in local and state governments was not formally developed until the middle 1980s with the GASB's project. Additionally, a conceptual framework study covering federal government started in 1986, involving the Office of the Auditor General of Canada and the United States Comptroller General Office. Consequently, in what respects to accounting conceptual frameworks in the USA, not only commercial and governmental accounting are separated, but within the latter national and local/state governments are divorced as well. This is most likely related to the fact that standard-setting responsibility lies on different bodies.

It is undeniable that the projects of USA bodies have been very important in initiating and driving the development of accounting conceptual frameworks in other countries. Concerning business accounting, Vela Bagues (1992, pp.107-109) highlights the great influence of the FASB's work on other projects such as those from the Canadian Institute of Chartered Accountants (CICA), the British Accounting Standards Committee (ASC) and the IASC. In what respects to governmental accounting, Jones (1992, p.256) also acknowledges the USA influence, namely on the Canadian local government accounting.

Subsequently, during the 1980s several accounting conceptual frameworks were developed for national governments, first in Anglo-Saxon countries, such as those developed by the Public Sector Accounting and Auditing Committee of the Canadian Institute of Chartered Accountants (CICA-PSAAC), the Public Sector Accounting Standards Board of the Australian Accounting Research Foundation (AARF-PSASB), and the New Zealand Society of Accountants (NZSA).

As Montesinos Julve and Vela BARGUES (1994, p.398) explain,

Those bodies not only issued pronouncements that define the objectives of financial reporting in the context of a conceptual framework for Public Sector Accounting, but also a great number of standards for specific accounting transactions that introduce a more rational framework for the measurement of performance.

Furthermore, other Continental European countries (e.g. France, Spain and Holland) also started developing government accounting conceptual frameworks. Vela BARGUES (1992, p.317) also refers to the project developed in 1983 by the Chinese Auditing Governmental Agency: the general budgets accounting system.

Nevertheless, as Rutherford (1992, p.265) points out, not every country has adopted the USA picture. For example, while Canada, as USA, have been developing separated accounting conceptual frameworks for public sector, in Australia and New Zealand a single framework has been prepared to cover all organisations in the public and private sector.

In USA, as Jones and Pendlebury (2000, p.151) emphasise, traditionally there were many standard-setting bodies for the public sector. Some of them were already referred in 2.1.

On the other hand, as it was also explained, Professor Robert Anthony's 1978 study – *Financial Accounting in Nonbusiness Organisations* – was very important for the development of a governmental accounting conceptual framework in USA. This study generally concluded that no significant differences exist between accounting for business and nonbusiness organisations (governmental entities included). Thus there was no point of having different standard-setting bodies, meaning that the FASB should deal with governmental (local and state level) accounting as well as business accounting. Subsequently, this body issued in 1980 Statement N.4 – *Objectives of Financial Reporting by Nonbusiness Organisations* – but some reservations were made on its application to local and state governmental units, considering that the FASB did not have power to set accounting standards for governmental units. According to Jones (1992, p.253), it was this FASB attempt to seize power that led to the GASB creation in

1984, representing a radical change in governmental accounting standard-setting in USA.

Indeed the GASB establishment, while uniquely covering state and local governments (federal government continued to be covered by the General Accounting Office), aimed among other things to produce a conceptual framework for aspects of governmental accounting, which would then be generally accepted and would provide the base for future standard-setting.

Nevertheless, because some power struggle still exists between the GASB and the FASB, the former

(...) has to be sensitive to the traditional concerns of the governments themselves but it also has to provide strong arguments for deviations from generally accepted accounting principles for business. Whether the end result will lead to better governmental accounting is impossible to say, but it seems clear that major steps are being taken and will continue to be taken at least to understand the commonalities and differences between accounting for business and accounting for governmental units. (Jones and Pendlebury, 2000, p.152)

Since its creation, the GASB's activity has been essentially towards the regulation of several issues, among which one can stress the codification of accounting standards applicable to governmental entities, and a clear intent of developing aspects comprised within the accounting conceptual framework (Vela Bargues, 1992, p.327). Hence, up to now, as far as we know, more than thirty statements were already issued regarding standards. In turn, only two concepts statements were issued: *Concepts Statement N.1 (1987) – Objectives of Financial Reporting* – resulted from a 1985 study on the users of governmental financial reports and their needs; and *Concepts Statement N.2 (1994) – Service Efforts and Accomplishments Reporting*. Because concepts statements are not authoritative, they are not included in the GASB's codification; still, no doubt they constitute part of a conceptual framework that has been developed by that body for local and state governmental units. Additionally, as Vela Bargues (1992, p.324) argues, conditions seem to indicate that this project will continue, considering the increasing role of the Committee to Review Structure for Governmental Accounting Standards. This body created in 1988 has the major function of revising the GASB's work, namely supporting the standard-setting process, but also assisting the conceptual framework project. Yet, some find hard to see the conceptual framework project as taking priority in the GASB. For example, Jones (1992, p.256) argues that the GASB seems to have more pressing concerns than with an articulated conceptual framework, mainly because the effective application of statements on more controversial issues have been often postponed almost *sine die*.

Jones and Pendlebury (2000, p.152) refer to the FASAB, created in 1990, as an advisory not standard-setting body at national level. They explain that this body, advising several USA authorities related to public finances and accounting (e.g. the Secretary of Treasury and the Comptroller General, among others), has produced different views of public sector accounting, helping to understand the differences and similarities to business accounting. Therefore, it seems to have an important contribution for the USA governmental accounting conceptual framework, perhaps diminishing the divorce between federal and local/state government.

Regarding **Canada**, as the general tendency mentioned in 2.3, governmental accounting standards seem to have preceded the conceptual framework. In fact, according to Vela Bargues (1992, pp. 331-332), in 1975 the CICA Director Committee created a working-group to assess the needs for accounting standards in federal and provincial governments. An empirical study was subsequently published in 1980 – *Financial Reporting by Governments* – to help future committees organising conclusions on accounting, financial information and auditing in the Canadian public administration. Despite the initial purpose of the study had addressed standards, it came out to be much more than that.

Indeed, though it recommended CICA to create a unit responsible for elaborating accounting standards generally admitted for the Canadian public administration accounting information (Vela Bargues, 1992, p.332), in Jones' (1992, p.256) opinion, that study was also a landmark in the Canadian governmental accounting conceptual framework, since it offered and discussed among other things, a list of users and users' needs for governmental financial reports.

Subsequently, in 1981 the CICA-PSAAC was created, having as main functions: to study theoretical and practical issues concerning Canadian public sector accounting and auditing, and publishing related pronouncements; and to encourage the development and publishing of specialised works on Canadian public sector accounting and auditing (Vela Bargues, 1992, p.332).

According to Jones (1992, p.256), in September 1983 the CICA-PSAAC began issuing Public Sector Accounting Statements. *Statement N.1 – Disclosure of Accounting Policies* (quoted in Vela Bargues, 1992, p.332) was of central importance since it set the accounting principles for Canadian public sector accounting. *Statement N. 2 – Objectives of Governmental Financial Statements*, issued in 1984, is considered by Jones (1992, p.256) as seminal as well. Defining governmental financial statements

objectives, this revises the 1980 study, namely in what respects to users and users' needs. Moreover, the CICA-PSAAC has published some significant resolutions, as one emphasised by Vela Bargues (1992, p.332) concerning the delimitation of the public sector concept for purposes of governmental accounting. Additionally, the aforementioned *Federal Government Reporting Study* developed together by the Canadian Auditor General and the US Comptroller General was published in 1986, analysing the possibility of the commercial accounting model to be applied to national government.

In summary, all those pronouncements clearly constitute at least a good start of a conceptual framework for the Canadian governmental accounting.

In what respects to **Australia**, as stated, a single accounting conceptual framework has been developed embracing since the beginning governmental organisations. This was an innovative and distinctive feature comparatively to other countries. Though in line with the FASB's project, in Vela Bargues' (1992, p.108) opinion, the Australian accounting conceptual framework was also very influenced by the British accounting doctrine. It was issued in December 1987 comprising (Vela Bargues, 1992, p.108):

1. Guidance for the proposal of statements on accounting concepts
2. Objectives of financial information
3. Characteristics of financial information
4. Assets definition and recognition
5. Liabilities definition and recognition.

In spite of a single conceptual framework, it was acknowledged that particularities of the Australian public sector should be considered at a more detailed level of accounting procedures and practices, meaning that standards in particular for governmental accounting should be issued. Thus, the establishment during the 1980s of the Public Sector Accounting Standards Board within the AARF – similarly to what was happening in Canada and UK – was of fundamental importance, in particular for the accounting standard-setting process for Australian governmental units (Vela Bargues, 1992, p.334).

New Zealand is another country that has developed an accounting conceptual framework, making significant contributions to the literature on that matter during the last fifteen years. Its first developments are summarised in Jones (1992, p.257):

In 1987, the New Zealand Society of Accountants (NZSA) issued a Statement of Public Sector Accounting Concepts, which applied to all parts of public sector including central government. Limiting itself to external financial reporting, the statement identifies a set of users and establishes (...) objectives of external reports (...).

Nevertheless, public administration reforms with consequent changes in the law relating to public sector accounting, overrode that statement. On the other hand, New Zealand governmental accounting system was also strongly affected by the one from the neighbour country – Australia. Subsequently, in 1992, the NZSA issued a different statement: *A proposed framework for financial reporting in New Zealand*. Jones (1992, p.258) highlights the importance of this document:

The particular significance of this proposed framework is that it is based on a common set of concepts for all entities in the country, whether private or public sector.

It defines the overall purpose of financial reporting as meeting

(...) the information needs common to a range of users who are unable to require or contract for, the preparation of reports designed to satisfy their specific information needs (...) (NZSA, 1992, ED60, para. 2.1, quoted in Jones, 1992, p.258)

It also set the objectives of general purpose external financial reporting, which relate on one hand to an accountability role, and on another to an informative role.

The New Zealand accounting conceptual framework is considered a radical structure in what concerns to governmental accounting, not only because the same framework is applied both for private and public sector, but also due to the implications of this fact: namely the use of the full accrual accounting technique in financial statements of governmental units. According to Jones (1992, p.258), in December 1991 New Zealand was the first country to publish financial statements for the government indistinguishable from commercial accounts except in that they provide much more information and are based on current value accounting. As he adds:

The framework has clearly been influenced by the FASB's conceptual framework project, has adopted a slightly modified version of the FASB's qualitative characteristics and also offers definitions of the elements of financial statements: assets, liabilities, equity, revenues and expenses, and income. (Jones, 1992, p.258)

In **UK** one may say that the intents to develop an accounting conceptual framework not only were later than in the other Anglo-Saxon countries, but also this is the one amongst them that has experimented less advances. In Vela Bargues' (1992, p. 107) point of view, this happened because of the lack of consensus in what respects to the conceptual framework formulation, above all considering the British tendency to submit the discussion of accounting problems to expert committees. Nevertheless this has not prevented the preparation of an accounting conceptual framework in UK.

The Accounting Standards Steering Committee of the Institute of Chartered Accountants in England and Wales (ICAEW-ASSC), in association with other professional groups among which the Chartered Institute of Public Finance and Accountancy (CIPFA) commissioned a study that was published in 1975 as *The*

Corporate Report. According to Jones (1992, p.251) it was prepared mostly in the same moulds as the 1973 *Trueblood Report – Objectives of Financial Statements* from the AICPA. As this one, *The Corporate Report* was limited to business entities.

In 1981 the Accounting Standards Committee (ASC)³⁰ published *A Conceptual Framework for Financial Accounting and Reporting*. This aimed to prepare preliminary conclusions on the possibilities of developing a consensual conceptual framework for the issuance of accounting standards (Vela Bagues, 1992, p.108). Yet, the definite project was not issued until 1988, where the document *The Making of Accounting Standards* was published closely following the American FASB's model.

According to Jones and Pendlebury (2000, p.149) significant changes occurred in companies accounting policy-making in 1990 in UK by the establishment of the Financial Reporting Council. Within this, two subsidiary limited companies were created: the Accounting Standards Board (ASB) and the Review Panel. The ASB replaced the ASC as the legitimate non-professional accounting standard-setting body, not only issuing its own Financial Reporting Standards (FRSs), but also taking over all the existing ASC Statements of Standard Accounting Practice (SSAPs). As the authors make clear, though it can be assumed that professionals continue to have an important say in accounting policy-making,

The primary purpose of these new developments is to distance accounting standard-setting from the accounting profession, in much the same way that the establishment of the Financial Accounting Standards Board did in the USA. (Jones and Pendlebury, 2000, p.150)

In 1999 the ASB issued a *Statement of Principles for Financial Reporting* – an authoritative statement for the business sector. Considering its conceptual nature, as well as the fact that it adopted the users' needs approach to accounting theory (Jones and Pendlebury, 2000, p.126), it seems to be a very good basis for the British business accounting conceptual framework.

³⁰ The creation of the ASC in 1970, within the ICAEW, changed the environment of professional accounting standard-setting in UK. In 1976 it became a joint committee of the Consultative Committee of Accountancy Bodies. The main function of the ASC was to propose standards of financial accounting and reporting to be approved by governing bodies. According to Jones and Pendlebury (2000, p.149), those standards embraced: fundamentals of financial accounting, definition of terms used, application of fundamentals to specific classes of business, and the form and content of financial statements, including presentation and disclosure. In other words, it seemed that the ASC main functions comprised the definition of a conceptual framework for business accounting in UK.

In what governmental accounting is concerned, in 1975 the CIPFA³¹ published the exposure drafts *Local Authority Accounting 1: Accounting Principles* and *Local Authority Accounting 2: Finance in Management*. However, as Jones (1992, p.252) emphasises, these were not conceptual frameworks: only one paragraph was related to users and neither of those reports were concerned with setting out any kind of framework of ideas to be used for standard-setting.

In 1982, a sub-committee was created within the ASC, to deal with public sector accounting issues: Sub-Committee on Public Sector Accounting. In the same year this body prepared *The Fowler Report*, which was presented to the ASC, essentially analysing the problems surrounding accounting standards for public sector. Among the main requirements settled on that report, Vela Bagues (1992, p.333) emphasises:

- Consulting to the main entities and users of accounting information within the public sector, aiming at the establishment of a conceptual framework within which accounting standards would be developed;
- Defining the ASC role relatively to public sector; and
- Setting a working-program for the sub-committee, which from 1983 was renamed Public Sector Liaison Group of the ASC.

In spite of these intentions, a governmental accounting conceptual framework did not seem to have known any developments.

As Jones (1992, p.252) states, at least until 1992,

There were no other conceptual framework projects for other parts of the public sector published in UK.

Rutherford (1992, p.266) also says that, up to that date, no attempt had been made in UK to develop a governmental accounting conceptual framework of the same scale and character as those in USA, Canada or New Zealand. Moreover, the ASB established in 1990, was not seeking prescribing accounting requirements for the public sector. The same author continues explaining:

Although some attempts have been made over the years to contribute to the establishment of conceptual frameworks for branches of the public sector (see, for example, CIPFA, 1975), little has come of them. As far as central government is concerned, the Treasury's *Central Government: Financial Accounting and Reporting Framework* (HM Treasury,

³¹ As Jones and Pendlebury (2000, p.149) explain, until the mid-1970s, what one might call public sector professional accounting practice in UK had been promulgated by the Institute of Municipal Treasurers and Accountants (from 1901 to 1973), which after 1974 became the CIPFA. The authors continue stating:

The majority of its work in standard-setting was primarily concerned with the form, particularly standardisation of the form, of accounts, although practices that concern content have also been recommended. (Jones and Pendlebury, p.149)

Additionally, it concerned specifically standards in local government accounting. Accounting standard-setting for central government has been always entirely the responsibility of the Treasury.

1988) takes, by comparison with the documents produced in other countries, a very narrow and technical approach. (Rutherford, 1992, p.266)

In an opposite way, standards seem to have advanced notably, namely in what respects to local government accounting. During the last twenty years, pronouncements have been issued in order to establish the applicability of the SSAPs (for commercial accounting) – to the public sector. According to Vela Bargues (1992, p.333), from 1987 the ASC started to publish Statements of Recommended Practice (SORPs), discussing the applicability of SSAPs to local governments. Even before, in 1982, CIPFA had prepared together with the ASC some guiding notes on that matter.

However, Jones and Pendlebury (2000, p.150) make clear that

The relevance of SSAPs to the public sector has never been entirely clear.

Indeed, while the ASC seem to have admitted those to be applied to public sector bodies, except where they were clearly inappropriate, the ASB came out with a different vision: the prescription of accounting requirements for the public sector in UK should be a matter for the government, with some exceptions admitted for the public sector bodies that prepare annual reports and accounts on commercial lines; in these cases, accounting requirements will normally accord with the principles underlying the ASB pronouncements. On the other hand, the ASC introduced the SORPs, while the ASB has adopted a different approach: it did not develop SORPs but it admitted to recognise those prepared by other entities to specific industries including the public sector, if they would obey to the ASB code of practice.

Jones and Pendlebury (2000, p.151) highlight some problems regarding public sector accounting policy-making in the UK:

- Accounting standards both from ASC and ASB were not established with public sector organisations primarily in mind;
- Because public sector accounting standards have been essentially professional standards, they suffer the problem of not having the force of law; consequently it is difficult to ensure its compliance. If this problem was surpassed for commercial accounting under the new regime for companies, it prevails in public sector accounting – compliance here depends on the preparers and the auditor; thus public organisations might chose not to follow professional accounting prescriptions. No legal power appears to exist to enforce compliance.

The authors conclude:

What remains true is that the responsibility for accounting standard-setting for companies is clear, as it is for the government. In between, there is a host of organisations, including public sector organisations, for which there is no comprehensive set of accounting policies established exclusively for their cases. The result has been that within the legal framework, policies have been chosen in an *ad hoc* basis. This situation might have led to a drive for better theory for public sector accounting, to sustain these *ad hoc* policies – but it has not. Policy-makers have, in effect, left unaddressed the difficult theoretical questions about

how, or to what extent, public sector accounting should be different. (Jones and Pendlebury, 2000, p.151)

In what respects to central government accounting, even in what respects to standards, things seem to have stayed very much the same, with the Treasury having the responsibility for standard-setting. Specifically, as Jones and Pendlebury (2000, p.148) explain, central government accounting had until very recently the 1866 Exchequer and Audit Department Act as statutory basis. Moreover, traditionally, the Treasury prescriptions were laid down in the manual *Government Accounting: A Guide on Accounting and Financial Procedures for the Use of Government Departments*. This provided a guide to bookkeeping using cash accounting, though as a whole was more concerned with financial procedures for controlling departments' finances.

Lately, the 2000 Government Resources and Accounts Act became the statutory basis, as a consequence of government's proposals to change to the accruals basis of accounting and budgeting. The standard-setting function currently is still Treasury responsibility, but a Financial Reporting Advisory Board was created to revise and comment its accounting policies. Consequently, the current Treasury accounting policies are given in the 1999 *Resource Accounting Manual*, which one may say replaced the previous one.

However, this is still not a conceptual framework for governmental accounting. In fact, despite the statement that resource accounting will be based on the UK generally accepted accounting practice, adapted where appropriate to consider the public sector context (HM Treasury, 1995, *Better Accounting for Taxpayers' Money*, Cm 2929, in Jones, 1998, p.11),

Resource accounting does not have a conceptual framework in the sense in which the phrase is used in the academic literature, i.e. as the result of a comprehensive project to determine the fundamental principles that underlie financial statements. (Jones, 1998, p.11)

Concerning governmental accounting conceptual frameworks that have been developed in Continental Europe, the one developed in **Spain** is worthy to be mentioned, particularly because the revolution it represented within the Spanish public sector accounting. In spite of, as the others, very influenced by the Anglo-American doctrine (the need to prepare statements of accounting principles), we believe that the more recent developed Spanish governmental accounting conceptual framework might have great importance in helping the preparation of similar structures in other European

civil law countries (e.g. Portugal), once legal restrictions typical here were already taken into consideration.

Since the late 1970s that Spanish public sector accounting have been suffering radical reforms, namely towards a more informative system, using an accrual basis. A new public sector accounting system has been developed since the 1977 General Budgetary Law, leading to the implementation in 1984 of the first Spanish CAPA, closely following the one for business accounting. Because that law did not contain precise details on accounting theory and techniques, which were needed to implement the reform, the CAPA was fundamental for these, attempting to cover the most important aspects of accounting (financial, management and budgetary accounting) and the need for information in the Public Administration.

According to Pina Martínez (1994, p.419), the CAPA was of the seminal importance for the modernisation of the Spanish governmental accounting system, once it was the first attempt at systematizing, structuring and regulating public sector accounting by introducing the double-entry bookkeeping method in the public sector entities, and by also introducing clear and homogenous accounting and evaluation criteria. Moreover,

This was to help to obtain financial statements, such as balance sheets and profit and loss accounts for the State Administration and all public entities. This meant it was necessary to have reliable knowledge of the financial position and the economic result of the latter's activity. (Pina Martínez, 1994, p.419)

Yet, the CAPA was basically a system embracing accounting standards towards accounting procedures uniformity, following the French accounting model of charts of accounts. Consequently, as Pina Martínez (1994, p.420) also recognised, the improvement on public sector economic and financial information, although very important, had essentially been technical. A theory of accounting was still needed to be developed and closely applied so that general principles and rules of public sector accounting could be drawn up, including specific characteristics of the public sector, just as in the business sector.

This meant the acknowledgement of two facts: first, the influence of Anglo-Saxon doctrine, namely related to the need of developing a governmental accounting conceptual framework; and second, this would follow the one developed for commercial accounting. Concerning the latter, like the governmental accounting conceptual frameworks eventually existent in USA and UK were inspired in *The Trueblood Report* and *The Corporate Report* respectively, also in Spain a similar structure was about to be

developed clearly inspired in the pronouncement prepared in 1980 for commercial accounting by the Spanish Professional Accounting Association *AECA – Asociación Española de Contabilidad y Administración de Empresas*. Additionally, it would also consider the IASC conceptual framework issued in 1989: *Framework for the preparation and presentation of Financial Statements* (Montesinos Julve and Vela Bargues, 1994, pp.403-404).

Consequently, in 1989 the Spanish Finance Office of State created a commission to prepare a document on principles and standards for governmental accounting. The *Intervención General de la Administración del Estado – IGAE*, a public body similar to the Anglo-Saxon Government Audit Office, under the Ministry of Economy and Finance, published the final version of this document in 1992, as *Document N.1: Public Accounting General Principles*. Additionally, six more documents were issued until March 1993 covering accounting rules applicable to the most important events and transactions in the State Administration, and incorporating considerable differences in relation to the business sector (Montesinos Julve and Vela Bargues, 1994, p.399):

- *Document N.2: Expenses;*
- *Document N.3: Revenues;*
- *Document N.4: Grants and Transfers;*
- *Document N.5: Debt;*
- *Document N.6: Non-Financial Fixed Assets;*
- *Document N.7: Financial Public Information.*

Documents N.2 to N.6 embrace rules for accounting procedures related to the recognition, quantification and qualification of: liabilities and expenses, receivables and revenues, grants and transfers, and public borrowing (this including foreign currency). Instructions for the classification of non-financial fixed assets are also provided, including those related to investments for the benefit of the general public³². Document N.7 introduced some general indicators that are useful for evaluating public sector economic, budgetary and financial performance: instead of a unique result figure, it is argued for a wider set of figures, whose meanings are discussed, in order to help reaching an accurate performance assessment. These figures obtained from public sector financial information are classified into three categories of economic, budgetary and financial results (Montesinos Julve and Vela Bargues, 1994, pp.407-411, and Pina Martínez, 1994, pp.428-430).

³² For further on these statements, see discussion presented in Pina Martínez (1994, pp.422-427).

Carvalho *et al.* (1999, p.201) further refer to *Document N.8: Expenses with Pre-allocated Financing*, which establishes criteria to manage and control these particular expenses, as well as its consequences in calculating the budgetary result and the cash flow balance.

Though these can be considered statements on accounting principles, Document N.1 is the one that might be the foundation of the Spanish public sector accounting conceptual framework. In Montesinos Julve and Vela Bargues's (1994, p.403) opinion, this was one of the most significant pronouncements issued in public sector accounting in Spain since 1977. Indeed, as Vela Bargues (1992, p.346) fairly emphasises:

- a) The accounting principles that such document acknowledges are going to be of general application for any Public Accounting developments in the future. This implies that the master lines of the standardisation process in (...) *Spain* are already clearly defined, above all considering (...) *future reforms* of the Public Accounting Chart of Accounts (...).
- b) The document content on public accounting principles clearly reflects a first important intent of providing Public Accounting with a conceptual framework coherent with the *accounting* information objectives [italics provided].

This pronouncement is much more than a mere list of accounting principles. It contains key assumptions on matters that constitute, as discussed in 2.4, the main components of any accounting conceptual framework. According to Montesinos Julve and Vela Bargues (1994, p.404), in Document N.1 these are:

- I. Economical and juridical environment
- II. Accounting information users
- III. Objectives of financial reporting
- IV. Qualitative characteristics of accounting information
- V. General accounting principles

It is important to underline that neither of these pronouncements are compulsory; they are not set by law. Indeed, as in many Continental European countries, in Spain, civil law has a powerful centralising tradition, thus any accounting standards has to become law to be applied (opposing the professional recommendations in UK, for example, although as mentioned, these may raise compliance problems). Nevertheless, the IGAE's statements of governmental accounting principles, if not for other reasons, at least for its recognised fundamental importance in given theoretical coherence to governmental accounting in Spain, most likely have led to governmental accounting different regulations.

The proof for this was, as expected, the revision of the CAPA in the light of that governmental accounting conceptual framework. In reality, it provided the Spanish public sector accounting system with a set of basic criteria that serve as a reference in

guiding its process of revision and change. Subsequently, in 1994 a new CAPA was published in Spain, already considering the underlying “theory” mainly set in the IGAE Document N.1. As far as it is our knowledge, a new revision is being now considered, namely to attend the IPSASs.

One feature that seems to be common among the accounting conceptual frameworks that we have just presented relates to the approach that has been followed. As Jones (1992, p.256) explains, most of the accounting conceptual frameworks that have been developed for national governments have considered decision-usefulness as having a central part. Consequently, all of them are based on some form of users/users’ needs analysis, as well as on hypothesised users and hypothesised needs³³.

Also Rutherford (1992, p.266) highlights two common features of the frameworks in that same line. The first one is the proposition that financial reports should provide information to their users which is itself useful.

In the main, the frameworks concentrate on what is called general purpose external financial reporting. This means that the users for whom the reports are to be designed are taken to be parties *external* to the organisation who do not access to the underlying data and who cannot call for specific reports tailored to their particular needs. (Rutherford, 1992, p.266)

The second one is that usefulness is generally determined in the context of decisions to be taken by the parties to whom the information is supplied. Yet, from 2.6 it comes clear that the accounting information usefulness for decision-making in the governmental context is controversial. Consequently, Jones (1992, p.260) explains that

What is particularly striking about these ‘public sector’ conceptual frameworks is that the user/user needs approach has with ease produced radically different conclusions about accounting information.

The author argues that the main reason for this lies upon the fact that none of them is empirical: they do not provide evidence of the use or potential use of the accounting model. They are based on premises, leading accounting theorists to reach different rational models (theories) if they select different postulates. Jones (1992, p.260) believes that, at least in USA, this frustration has radically changed the academic accounting research, moving away from the inductive and deductive approaches of the past to positive and empirically tested approaches.

Still, he concludes stating:

³³ The exception is the 1986 Federal Government Reporting Study developed together by Canadian and US authorities, which was based on the empirical identification of users and a direct questioning of their needs. For further on this see, for example, Jones (1992, p.257) and Rutherford (1992, pp.267-270).

(...) what remains clear, for the private and public sector, is that we have no generally-accepted theory or evidence about the purpose of the publication of financial statements: from the trial balance onwards, the reasons for what is done become extremely problematic. Jones (1992, p.260)

Finally, two additional common characteristics of governmental accounting conceptual frameworks are: they have been clearly following parallel pronouncements for business accounting; and they have been developed by bodies that have no powers to enforce them. These have been the basis for criticisms towards the development of conceptual frameworks for governmental accounting, some already addressed.

3. INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS

The main purpose here is addressing the IPSASs as the most important set of international standards for governmental accounting. Although they are essentially recommendations for practice, focusing on the “how” of governmental financial reporting technique, there is some underlying theory, which might be a basis for a governmental accounting international conceptual framework.

The section introduces a general overview on IPSASs brief history and contents, criticising how they have been based on codifications that were originally written for businesses in reporting to their creditors and investors. Some advantages are also emphasised.

A short discussion on the controversy around governmental accounting international harmonisation is additionally presented.

3.1. Brief history and contents

The IPSASs project started to be developed by the IFAC in 1996, ten years after the PSC establishment. The first stage of the project, up to the end of 2001, aimed at developing (Adhemar, 2001, p.7):

- A background paper which would provide guidance on issues to be confronted in financial reporting by public sector entities and approaches to their resolution. Work on this paper started in 1996, and it was published in May 2000 as *Study 11 – Governmental Financial Reporting: Accounting Issues and Practices*;
- A set of IPSASs firstly based on International Accounting Standards (IASs) promulgated by the IASC and on issue in August 1997, to the extent that the requirements of the IASs were appropriate for public sector entities.

Up to December 2002, the IFAC-PSC issued twenty IPSASs that apply to all public sector entities, including national, regional and local governments, and their component entities. They do not apply to government business enterprises, which

according to the PSC resolution should apply the IASs (IFAC, 2001f, p.43, paragraph 20).

In Table II.1 we list these IPSASs in comparison with the IASs that were its bases (clearly stated in each IPSAS statement). There is great similarity between the two frameworks, since in the IASs adaptation process to a public sector context, the PSC have been trying, whenever possible, to maintain the accounting treatment and original text of the IASs unless there is a significant public sector issue which warrants a departure (IFAC, 2001f, p.40, paragraph 5).

IPSASs (IFAC-PSC)	IASs (IASC)
IPSAS 1 – Presentation of Financial Statements (May 2000)	IAS 1 – Presentation of Financial Statements
IPSAS 2 – Cash Flow Statements (May 2000)	IAS 7 – Cash Flow Statements
IPSAS 3 – Net Surplus or Deficit for the Period, Fundamental Errors and Changes in Accounting Policies (May 2000)	IAS 8 – Net Surplus of Deficit for the Period, Fundamental Errors and Changes in Accounting Policies
IPSAS 4 – The Effects of Changes in Foreign Exchange Rates (May 2000)	IAS 21 – The Effects of Changes in Foreign Exchange Rates
IPSAS 5 – Borrowing Costs (May 2000)	IAS 23 – Borrowing Costs
IPSAS 6 – Consolidated Financial Statements and Accounting for Controlled Entities (May 2000)	IAS 27 – Consolidated Financial Statements and Accounting for Controlled Entities (reformatted in 1994)
IPSAS 7 – Accounting for Investments in Associates (May 2000)	IAS 28 – Accounting for Investments in Associates
IPSAS 8 – Financial Reporting of Interests in Joint Ventures (May 2000)	IAS 31 – Financial Reporting of Interests in Joint Ventures
IPSAS 9 – Revenue from Exchange Transactions (June 2001)	IAS 18 – Revenue (revised in 1993)
IPSAS 10 – Financial Reporting in Hyperinflationary Economies (June 2001)	IAS 29 – Financial Reporting in Hyperinflationary Economies (reformatted in 1994)
IPSAS 11 – Construction Contracts (June 2001)	IAS 11 – Construction Contracts (revised in 1993)
IPSAS 12 – Inventories (June 2001)	IAS 2 – Inventories (revised in 1993)
IPSAS 13 – Leases (December 2001)	IAS 17 – Leases (revised in 1997)
IPSAS 14 – Events After the Reporting Date (December 2001)	IAS 10 – Events After the Balance Sheet Date (revised in 1999)
IPSAS 15 – Financial Instruments: Disclosure and	IAS 32 – Financial Instruments: Disclosure and

IPSASs (IFAC-PSC)	IASs (IASC)
Presentation (December 2001)	Presentation (revised in 1998)
IPSAS 16 – Investment Property (December 2001)	IAS 40 – Investment Property (2000)
IPSAS 17 – Property, Plant and Equipment (December 2001)	IAS 16 – Property, Plant and Equipment (revised in 1998)
IPSAS 18 – Segment Reporting (June 2002)	IAS 14 – Segment Reporting (revised in 1997)
IPSAS 19 – Provisions, Contingent Liabilities and Contingent Assets (October 2002)	IAS 37 – Provisions, Contingent Liabilities and Contingent Assets (1998)
IPSAS 20 – Related Party Disclosures (October 2002)	IAS 24 – Related Party Disclosures (reformatted in 1994)

TABLE II.1 – INTERNATIONAL ACCOUNTING STANDARDS

Although we do not intend to describe IPSASs contents in detail, a brief summary for each standard is presented in Table II.2, mainly considering the objectives set individually in each statement (IFAC, 2001a to 2001f, and 2002a to 2002c).

IPSASs	Objectives and Content
IPSAS 1 – Presentation of Financial Statements	<p>To prescribe the manner in which general purpose financial statements should be presented in order to ensure comparability both with the entity own financial statements of previous periods and with the financial statements of other entities.</p> <p>It sets out overall considerations for the presentation of financial statements, guidance for their structure, and minimum requirements for the content of financial statements prepared under the accruals basis of accounting.</p> <p>It does not deal with recognition, measurement and disclosure of specific transactions and other events.</p>
IPSAS 2 – Cash Flow Statements	<p>To require the provision of information about the historical changes in cash and cash equivalents of an entity by means of a cash flow statement. This classifies cash flows during the period from operating, investing and financing activities, identifying the sources of cash inflows, the items of which cash was expended during the reporting period, and the cash balance as at the reporting date.</p> <p>It is acknowledged that information about the cash flows of an entity is useful in providing users of financial statements with information for both accountability and decision-making purposes. It allows users to ascertain how a public sector entity raised the cash it requires to fund its activities and the manner in which that cash was used. In making and evaluating decisions about the allocation of resources, such as the sustainability of the entity activities, users require an</p>

IPSASs	Objectives and Content
	understanding of the timing and certainty of cash flows.
IPSAS 3 – Net Surplus or Deficit for the Period, Fundamental Errors and Changes in Accounting Policies	<p>To prescribe the classification, disclosure and accounting treatment of certain items in the financial statements so that all entities prepare and present these items in a consistent basis. This enhances comparability both with the entity financial statements of previous periods and with the financial statements of other entities.</p> <p>It requires the classification and disclosure of extraordinary items and the separate disclosure of certain items in the financial statements. It also specifies the accounting treatment for changes in accounting estimates, changes in accounting policies and the correction of fundamental errors.</p> <p>The disclosure of extraordinary items in the cash flow statement is dealt in IPSAS 2.</p>
IPSAS 4 – The Effects of Changes in Foreign Exchange Rates	<p>To prescribe the accounting treatment for the effects in the entity financial statements of changes in foreign exchange rates.</p> <p>It is admitted that an entity might have both transactions in foreign currencies and foreign operations, which have to be included in its financial statements. Accordingly, they have to be respectively expressed and translated into the entity reporting currency.</p> <p>The statement deals in particular with issues concerning to decide which exchange rate to use and how to recognise in the financial statements the financial effect of changes in exchange rates.</p>
IPSAS 5 – Borrowing Costs	<p>To prescribe the accounting treatment for borrowing costs. It generally requires the immediate expensing of borrowing costs, although permitting, as an allowed alternative treatment, the capitalisation of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset.</p>
IPSAS 6 – Consolidated Financial Statements and Accounting for Controlled Entities	<p>To prescribe instructions to be followed in the preparation of consolidated financial statements for an economic entity, as well as in accounting for controlled entities in the separate financial statements of the controlling entity</p> <p>It provides directives in order to establish control of another entity for financial reporting purposes.</p>
IPSAS 7 – Accounting for Investments in Associates	<p>To provide the basis for accounting by an investor for investments in associates where the investment in the associate leads to the holding of an ownership interest in the form of a shareholding or other formal equity structure.</p> <p>The ownership interest confers risks and rewards to the investor, which have also to be reflected in its financial statements.</p> <p>The standard applies only to investments in the formal equity structure (or its equivalents) of an investee.</p>

IPSASs	Objectives and Content
IPSAS 8 – Financial Reporting of Interests in Joint Ventures	To provide the basis for accounting interests in joint ventures as well as the reporting of joint venture assets, liabilities, revenue and expenses in the financial statements of venturers and investors, regardless of the structures or forms under which the joint venture activities take place.
IPSAS 9 – Revenue from Exchange Transactions	To prescribe the accounting treatment of revenue arising from exchange transactions and events. “Revenue” encompasses both revenues and gains. Certain specific items recognised as revenues are excluded from the scope of this standard, being addressed in others (e.g. gains arising on the sale of property, plant and equipment – IPSAS 17). Revenue is recognised when it is probable that future economic benefits or service potential will flow to the entity and these benefits can be measured reliably. Accordingly, the standard identifies the circumstances in which those criteria for the recognition of revenues will be met. It also provides practical guidance on the application of these criteria.
IPSAS 10 – Financial Reporting in Hyperinflationary Economies	To prescribe instructions to be followed in the preparation of the primary financial statements, including the consolidated financial statements, of any entity that reports in the currency of a hyperinflationary economy. It is recognised that in a hyperinflationary economy, reporting of operating results and financial position in the local currency without restatement is not useful. Money loses purchasing power at such a rate that comparison of amounts from transactions and other events that have occurred at different times, even within the same reporting period, is misleading. However, this standard does not establish an absolute rate at which hyperinflation is deemed to rise. It is a matter of judgement when restatement of financial statements in accordance with this standard becomes necessary. Hyperinflation is indicated by characteristics of the economic environment of a country, some of which are referred in the statement.
IPSAS 11 – Construction Contracts	To prescribe the accounting treatment of costs and revenue associated with construction contracts. It: (a) identifies the arrangements that are to be classified as construction contracts; (b) provides guidance on the types of construction contracts that can arise in the public sector; and (c) specifies the basis for recognition of contract expenses and, if relevant, contract revenues. Because many construction contracts due to its nature are not finished within the same period they started, they fall into different reporting periods. Thus, one accounting issue dealt in this standard concerns the allocation of construction costs to the reporting period in which the construction work is performed and the recognition of related expenses. It is additionally recognised that construction contracts

IPSASs	Objectives and Content
	<p>entered into by public sector entities might be established either on a commercial basis or a non-commercial full or partial cost recovery basis. Hence, another accounting issue considered here is the allocation of both contract revenue and contract costs to the reporting periods in which construction work is performed.</p>
<p>IPSAS 12 – Inventories</p>	<p>To prescribe the accounting treatment for inventories under the historical cost system, namely regarding the amount of cost to be recognised as an asset and carried forward until the related revenues are recognised. It also provides practical guidance on the determination of cost and its subsequent recognition as an expense, including any write-down to net realisable value. Guidance on the cost formulas that are used to assign costs to inventories is additionally offered.</p>
<p>IPSAS 13 – Leases</p>	<p>To prescribe, for lessees and lessors, the appropriate accounting policies and disclosures to apply in relation to finance and operating leases.</p>
<p>IPSAS 14 – Events After the Reporting Date</p>	<p>To prescribe: (a) when an entity should adjust its financial statements for events after the reporting date; and (b) the disclosures that an entity should give about the date when the financial statements were authorised for issue and about events after the reporting date. It also requires that an entity should not prepare its financial statements on a going concern basis if events after the reporting date indicate that the going concern assumption is not appropriate.</p>
<p>IPSAS 15 – Financial Instruments: Disclosure and Presentation</p>	<p>To enhance financial statements users’ understanding of the significance of on-balance-sheet and off-balance-sheet financial instruments to a government or other public sector entity financial position, performance and cash flows. Here “balance sheet” has the same meaning as “statement of financial position”. It prescribes certain requirements for presentation of on-balance-sheet financial instruments and identifies the information that should be disclosed about on-balance-sheet (recognised) and off-balance-sheet (unrecognised) financial instruments. Regarding presentation, it deals with the classification of financial instruments between liabilities and net assets/equity, the classification of related interest, dividends, revenues and expenses, and the circumstances in which financial assets and financial liabilities should be offset. In what concerns disclosure, it deals with information about factors that affect the amount, timing and certainty of an entity’s future cash flows relating to financial instruments and the accounting policies applied to the instruments. Additionally, it encourages disclosure of information about the nature and extent of an entity’s use of financial instruments, the financial purposes that they serve, the risks associated with them and management</p>

IPSASs	Objectives and Content
	<p>policies for controlling those risks.</p> <p>It is recognised that, due to the dynamic nature of international financial markets, a great variety of financial instruments have appearing (ranging from traditional bonds to derivatives instruments such as interest rate swaps), which might also be used by public sector entities. However, some of them cannot issue or hold some of those, so this standard might be of limited application for these cases. An appendix is provided guiding the preparers of financial statements in identifying the aspects of this standard to be applied in a particular entity.</p>
IPSAS 16 – Investment Property	To prescribe the accounting treatment for investment property and related disclosure requirements.
IPSAS 17 – Property, Plant and Equipment	To prescribe the accounting treatment for property, plant and equipment, namely regarding the timing of recognition of the assets, the determination of their carrying amounts and the depreciation charges to be recognised in relation to them. It does not address infrastructure and heritage assets.
IPSAS 18 – Segment Reporting	To establish principles for reporting information by segments. The disclosure of this information will: (a) help users of the financial statements to better understand the entity’s past performance and to identify the resources allocated to support the major activities of the entity; and (b) enhance the transparency of financial reporting and enable the entity to better discharge its accountability obligations.
IPSAS 19 – Provisions, Contingent Liabilities and Contingent Assets	To define provisions, contingent liabilities and contingent assets, identify the circumstances in which provisions should be recognised, how they should be measured and the disclosures that should be made about them. It also requires that certain information be disclosed about contingent liabilities and contingent assets in the notes to the financial statements to enable users to understand their nature, timing and amount.
IPSAS 20 – Related Party Disclosures	<p>To require the disclosure of the existence of related party relationships where control exists and the disclosure of information about transactions between the entity and its related parties in certain circumstances. This information is required for accountability purposes and to facilitate a better understanding of the financial position and performance of the reporting entity.</p> <p>The principal issues in disclosing information about related parties are identifying which parties control or significantly influence the reporting entity and determining what information should be disclosed about transactions with those parties.</p>

TABLE II.2 – IPSASs OBJECTIVES AND CONTENT

Moreover, from an exposure draft (ED) firstly issued in 2000, an exceptional cash basis IPSAS was finally issued in January 2002 – *Financial Reporting under the Cash Basis of Accounting* – after a two-year extended period of consultation. This includes requirements for a government or a government entity to report all cash receipts, payments and balances that it controls and to disclose information about amounts settled on its behalf by third parties.

An additional “Invitation To Comment” (ITC) on *Impairment of Assets* was also issued, which became ED 23 in September 2003. The IPSAS to be approved is intended to complete IPSAS 17.

According to Adhemar (2001, p.13), this initial stage of the IPSASs project was established with specific limited objectives to be achieved within a limited timeframe. Still, during the standards development process, the PSC was able to identify specific public sector issues not addressed, or not adequately addressed, by the IASs. These are included in its future standard-setting work program (Adhemar, 2001, pp.14-17):

- *Taxes and other non-reciprocal revenue*
- *Provisions Arising from Social Policy Initiatives*
- *Non-financial performance reporting*
- *Government Budgets*
- *Public/Private Sector Arrangements*
- *Harmonisation of IPSASs with GFS and SNA*
- *Measurement of Infrastructure and Heritage Assets*

As to the authority of IPSASs, the IFAC-PSC (IFAC, 2001f, p.42, paragraph 12) acknowledges not only its lack of compulsory character, but also that they cannot override regulations³⁴ governing the issue of general purpose financial statements by public sector entities within each jurisdiction. As it is stated,

Some sovereign governments and national standard-setters have already developed accounting standards that apply to governments and public sector entities within their jurisdiction. IPSASs may assist such standard-setters in the development of new standards or in the revision of existing standards in order to contribute to greater comparability. IPSASs are likely to be of considerable use to jurisdictions that have not yet developed accounting standards for government and public sector entities. The Committee strongly encourages the adoption of IPSASs and the harmonisation of national requirements with IPSASs. (IFAC, 2001f, p.42, paragraph 12)

Standing alone, neither the Committee nor the accounting profession has the power to require compliance with IPSASs. The success of the Committee’s efforts is dependent upon the recognition and support for its work from many different interested groups acting within the limits of their own jurisdiction. (IFAC, 2001f, p.42, paragraph 13)

³⁴ These regulations may be in the form of statutory reporting requirements, financial reporting directives and instructions, and/or accounting standards promulgated by governments, regulatory bodies and/or professional accounting bodies in the jurisdiction concerned (IFAC, 2001f, p.42, paragraph 11).

The last statement also relates to the lack of enforcement power recognised by the IFAC-PSC itself.

3.2. Advantages and criticisms

Adhemar (2001, p.5) emphasises some main IPSASs advantages. They:

- Allow to improve the quality of government financial information reported to external users and managers, and subsequently to increase the standard of financial discipline, avoiding corruption and mismanagement;
- Support good governance in the public sector – good governance calls for accountability and fiscal transparency of governments and their agencies; generally accepted accounting standards play a fundamental part for these;
- Benefit users of financial statements of governments and their agencies, particularly those concerned with financial transparency – they lead to: the establishment of appropriate financial reporting practices, consistency in their application (both between countries and, within the same country, from period to period), and the potential harmonisation of financial reporting between economic and accounting bases;
- Provide for greater efficiency and effectiveness in the audit and analysis of governmental financial reports, as common rules are adopted around the world for the financial reporting of similar transactions and events;
- Allow financial reporting expertise, considered very often a scarce resource in the public sector, to become more mobile across national boundaries.

Also Jones (2000a, pp.10-12) provides some arguments for IPSASs. He starts stating:

IPSASs are a set of measurement and disclosure policies (that is not exhaustive and that explicitly allows choices) for financial reporting under accrual accounting. (Jones, 2000a, p.10)

Therefore, as shown, they are close to the rules for business accounting. Yet, for public sector, IPSASs introduce different measures. As Jones (2000a, p.10) explains,

Technically, what IPSASs add to financial reporting under cash accounting are measures of revenues, expenses, assets and liabilities. Since most cash accounting systems in the public sector have a fund accounting basis (formally or informally), IPSASs also add these measures for each public entity taken as a whole (and would usually add, via the cash flow statement, an overall statement of cash movements).

As the author continues, it is easy to argue for IPSASs as it is for accrual-based financial statements for business: they are directly relevant to any public sector entity in reporting what that entity costs (Jones, 2000a, p.2). Indeed, if the purpose is measuring the entity overall performance, a set of financial statements as those for businesses must be prepared under IPSASs, even if the resulting financial statements are less complete as measures of performance of a public entity than they would be for a business. While the revenues, expenses, assets and liabilities of a public sector entity provide very

incomplete measures of income, they measure what the entity costs, which is a necessary, though not sufficient, condition for measuring performance in countries in which public sector entities buy from the same markets as businesses do (Jones, 2000a, p.11).

Consequently, the author summarises two arguments for IPSASs (Jones, 2000a, p.11):

- From a technical point of view, they are a set of rules that would significantly improve reliability of national accounts statistics;
- From a policy-making perspective, they add a set of policies for accrual-based financial reporting that has been developed by a representative body of professional accounting bodies, though reflecting Anglo-American contexts.

Jones (2000a, pp.11-12) concludes that, as happened for IASs, there is some competition between comparable sets of policies that have been developed for public sector accounting in countries like UK and US, both by professionals and governments themselves (the latter specially for central governments). This competition is expected to be beneficial in the sense that it might help producing an optimal set of IPSASs. Finally, as it is happening with IASs being attractive for supra-nationals bodies (e.g. EU), it might be expected that IPSASs also become appealing.

Notwithstanding, some are still very critic about IPSASs. For example, Chan (2001, pp.5-7), points out:

- Areas of Neglect – IPSAS essentially assume what Chan (2001, p.2) considers to be the Model Y of relationship between accounting and budgeting. This means that accounting exerts influences on budgeting, an accrual basis of accounting is used, and governments are accountable to the electorate and general public. Despite all rationality and strengths that this model might have, it is not universally adopted. An alternative model – Model X (cash-based accounting, subordinated to budgeting, with hierarchical accountability from the executive to parliament) still used in many countries – has not been considered by the PSC. In other words,

(...) the IPSAS has emphasized financial accounting and external reporting to the neglect of budgeting and cost analysis (“managerial accounting”). This neglect is unjustifiable in view of the importance of budgeting and cost analysis in the public sector. (Chan, 2001, p.5)

- Uncritical Acceptance of Business Accounting Standards – The fact that existing IASs were considered and modified to get IPSASs would not produce a body of coherent government accounting standards. Chan (2001, p.6) highlights that, at a minimum, one would expect the IFAC-PSC to differentiate general standards from specific ones.

Additionally, the author states that it is not enough to state that governmental accounting is deservedly different from business accounting. It is also very important to recognise that not everything is right in this, which might question it as a “model” for governmental accounting. Besides, in some aspects, such as

disclosing budgets and reporting actual performance in relation to the budget, governmental accounting is ahead of business accounting.

- Failure to Address Governmental Issues Early – The IPSASs project should have had the value-added of provide insights on the accounting consequences of the uniqueness of governments. Special cases such as the particular nature of public services, the governments’ power of tax and its consequences on non-reciprocal transactions, among others, are problematic issues not considered in commercial accounting concepts and standards. While businesses are particularly concerned with efficiency, governments’ main goal is essentially equity. Even though accounting and financial reporting for equity are not easy to reach,

(...) the “standards first, conceptual framework later” approach is not only intellectually unsatisfying, it is also an inefficient and ineffective way to produce a set of coherent standards applicable to the public sector. (Chan, 2001, pp.6-7)

- Insufficient Justification – The IFAC-PSC has not provided adequate justification for some of the major accounting or reporting policy position it has taken. For example, it has not explained why: a government should be reported as a whole, the accrual basis is preferable to the cash basis, or the historical cost basis is generally preferred to the other basis.

Concluding his IPSASs analysis, Chan (2001, p.7) acknowledges that the approach followed for its development was most probably not only the less costly but also the one allowing them to be more readily accepted: modifying extant IASs which most of the IFAC members were already familiar with. Despite this, he still argues that these benefits are offset by some costs, namely the opportunity that the IFAC-PSC missed to advance in the development of government accounting if issues unique to government have not been overlooked.

Jones (2000a, pp.12-15) too offers some opinions against IPSASs.

The author starts stating:

IPSASs are demonstrably part of the Anglo-American tradition – for the most part established in the context of businesses – in which non-profit accounting bodies promulgate practices to be used by preparers and auditors of financial statements who make accounting judgements that are ostensibly non-governmental and non-political; these accounting practices, by their nature, are – in terms of measurement and disclosure policies – different between sectors of an economy and between economies. (Jones, 2000a, p.5)

Once inspired in IASs, IPSASs address specifically financial reporting. Additionally, as in business accounting, they dissociate financial reporting from finance. In business accounting it has been recognised as important for accounting numbers to reflect the economic reality more closely. Subsequently, several business accounting codifications that have emerged since the 1960s within the North-American context have focused only in one part of the accounting systems – financial reporting – depending implicitly on more extensive control systems (Jones, 2000a, p.12).

However, in public sector entities, the traditional and enduring role of accounting is in the control of financial assets and liabilities, thus being very close to finance. Furthermore, particularly governmental entities commonly use comprehensive and complex control systems (e.g. budgets) with more and different dimensions than those from the business sector. If accrual-based financial statements, prescribed in the IPSASs, may be convenient, it is not clear whether the effect on the much greater part of accounting will be beneficial. Consequently, Jones (2000a, p.13) concludes that

(...) IPSASs divorce financial reporting even from financial accounting but also from management accounting, auditing and finance. The immediately related issue that IPSASs avoid is whether accrual-based budgets should accompany the financial statements.

As the author additionally explains, the reason why it was possible to produce a plausible set of IPSASs to be used in public sector entities is that they apply to highly stylised representations of organisations (Jones, 2000a, p.12), i.e., IPSASs are rules focused on financial reporting to investors and creditors. Yet, opposing businesses, in most public sector entities, the risk is not borne by investors and creditors, hence questioning the appropriateness of the type of financial reporting sustained in the IPSASs framework, once it is frequently observed that almost nobody has interest in reading governmental entities annual financial reports. Accordingly, Jones (2000a, p.13) argues that

Any material costs incurred in the production of such reports, including those of developing codifications of measurement and disclosure policies, are difficult to justify.

Another issue addressed by the author concerns the fact that, once IPSASs are inspired in the Anglo-American accounting tradition, they include great specification of the processes to be followed by accountants and auditors – “cookbook approach”. This approach might be useful for accountants and auditors in a risky and litigious environment, but it is not clear if it would be appropriate in a non-risky and non-litigious financial reporting environment such in public sector entities.

Finally, Jones (2000a, pp.14-15) refers to the IPSASs features in relation to its defining processes. Because public sector accounting policy-makers are bodies that though making the rules have no power to enforce them, the IPSASs reflect technically inferior accounting as a result from successful lobbies on accounting policies. Nevertheless, the author explains that it is difficult to understand why this happens in public sector accounting, once public sector entities are controlled by the government with power to eradicate inferior accounting alternatives.

In our point of view, all these criticisms are very important as they might explain why governments have been reluctant to accept and implement IPSASs.

For example, within the European Union context, Hepworth (2001, pp.4-6) discusses some issues that have been arisen concerning attitudes towards IPSASs. These regard mainly four subjects of general concern to European countries (as expressed through the accountancy profession), leading the Public Sector Committee of the *Fédération des Experts Comptables Européens* (FEE-PSC)³⁵ to take a particular position:

- The bases of accounting – The FEE-PSC strongly argued for the use of only two bases of accounting within IPSASs: cash and accrual basis. Practical problems were recognised in defining the two intermediate bases (modified cash and accruals). Additionally, in the European context, governments having problems in reaching the accrual basis would be discouraged from moving towards it, once they would be allowed to use a modified version. As Hepworth (2001, p.5) emphasised, this was politically unacceptable.
- The language of the standards – The FEE-PSC worries with the fact that the IPSASs language is not familiar to public sector managers or indeed to those responsible for the setting of accounting standards. One related aspect that the author highlights is the divorce between the accounting profession and the European governmental accounting standard-setting process. He continues exemplifying with the term “going concern” that might be well understood in the business sector, but appears to have little or no relevance to a public sector management that has little contact with the accounting profession. Also given the nature of public sector organisations, circumstances where they might be financially unable to continue in operation (thus not going concern) are difficult to imagine.
The FEE-PSC sustained that the language of IPSASs should be such that the implications of not keeping to a standard should be expressed in terminology that is relevant to the operating environment of the public sector. Because public entities have statutory responsibilities, consequences of a failure to act or act improperly should be defined in similar terms. For example, the “going concern” term should be given an explanation within the public sector context – “a continuing ability to fulfil its statutory obligations”. Hepworth (2001, p.5) adds that, as public sector bodies derive their powers from statute and as “compliance” is an important element of audit, such an explanation would be helpful to understanding.
- Transitional periods – The FEE-PSC generally sustains for short transitional periods to apply standards affecting both assets and liabilities. Yet, it also recognises that within Europe this might cause particular problems, considering European governments own an extensive class of assets from infrastructures to heritage.

³⁵ As Hepworth (2001, p.1) explains, the FEE is the representative organisation for the accountancy profession in Europe and started operating in January 1987. Its main concern is with the European Commission, representing the profession’s interest to that body. Lately it has encouraging the Commission to adopt international accounting standards rather than develop a separate European set of standards or even adopt US GAAP. Since its establishment, the FEE has a Public Sector Committee, which has been concerned to ensure that it complements and supports the IFAC-PSC work, rather than replicates it. Once the IFAC-PSC has focused on the development of IPSASs, the FEE-PSC has had an important role as commentator on those standards from an European standpoint.

Identification and valuation of all these assets under a full accrual accounting basis is not easy. The same applies to liabilities (e.g. non-funded pension liabilities). The problem might be solved either using “escape” clauses within the standards (as the IFAC-PSC seems to propose for heritage assets, for example) or extending transitional periods up to say ten years. The FEE-PSC recommendation is for the latter alternative, since it would provide a reasonable and practical time limit and therefore encourage the wider adoption of the accounting standard. A further advantage is that it should encourage political commitment because the risks associated with the decision are delayed often beyond the immediate political horizon.

- Cash standards – It was decided for IPSASs to focus on the accrual basis, but cash basis should be dealt as well (as there is no equivalent in the business sector) through the development of one unified standard. Cash is still the dominant accounting basis for European governments at least for budgetary reporting, with some countries still using it in financial reporting as well. Subsequently, it is the way in which the greatest impact could be made in Europe. Nevertheless, the FEE-PSC believes that the concerning IPSASs draft is complex because it deals with the definition of the cash basis at the same time as the consolidation of the cash accounts. These issues should urgently be dealt with separately.

Notwithstanding, considering the IFAC-PSC future work program, most of these fundamental problems might be surpassed in the short run. One though, also evidenced by Chan (2001, p.5), still prevails: the intended IFAC-PSC independence and authoritativeness as international governmental accounting standard-setting body. The author argues that this dependence is relative: in first place because the IFAC-PSC reflects the interests of its parent organisation, the IFAC; secondly because not being financially independent, it has also to reflect the interests of the sponsor international organisations, whose support would presumably be contingent upon whether their objectives are well served; and finally, due to IPSASs inspiration in IASs, the IFAC-PSC is conceptually dependent from the IASC. As to authoritativeness, the author discusses some conflict between this and independence: the fact that the IFAC-PSC is independent from governments has its merits; nevertheless, this might lead IPSASs to be ignored or even opposed. As Chan (2001, p.5) makes clear,

The IFAC’s professional authoritativeness is not operative unless private-sector auditors are engaged to perform government financial audits based on the IPSAS. Only in a small number of countries are governments audited by private-sector auditors. (...) For the standards to be accepted – and become authoritative legally and administratively – the involvement of senior budget or accounting officers is almost indispensable. In this regard, this group is conspicuous by their virtual absence from this global initiative, thus casting doubts about the prospect of the acceptance of IPSAS.

3.3. Governmental accounting international harmonisation

We believe it important to start this discussion presenting some reasons why governmental accounting conceptual frameworks have been developing on a national basis.

Both in commercial and governmental accounting, many believe in the importance of having a conceptual framework within which standards might be integrated and better defined. Nevertheless, questions seem to have been raised regarding the usefulness of conceptual frameworks on a national basis, particularly considering the current context of globalisation where, as we will show, apart from the IFAC and the IASC, other international organisations have developed great efforts towards international accounting harmonisation (Rodrigues and Branco, 2001, p.163).

Many believing in the importance of an accounting conceptual framework, also argue for this to be a single one, for business and governmental accounting, though considering particularities for the latter (e.g. Anthony, 1978; Vela Bargues, 1992).

Yet, as far as we know, up to the moment, business accounting and governmental accounting continue to be divorced at an international level, since standard-setting entities continue to be separated. Nevertheless, they are closely related. Nobes and Parker (2000, p.70) exemplify that the IASC, though independent from all bodies, from 1983 onwards established a close connection with the IFAC. Furthermore IPSASs, as explained, have been inspired by IASs for business accounting. Thus it seems that there are no longer reasons strong enough for the extant separation.

On another hand, although some might believe in the importance of any international accounting conceptual framework as a fundamental reference for an international harmonisation process (essential in the current context where countries are increasingly integrated in supra-national communities), they also seem to support that it is important to take into account the social, economic and juridical context where the framework is going to be used. If it is to be the base for accounting standards, it is essential to adapt the conceptual framework to the reality where particular standards are going to be issued and used. This seems to justify the development of (governmental) accounting conceptual frameworks on a national basis (Rodrigues and Branco, 2001, p.185).

Additionally, it seems that an international conceptual framework for business accounting appears to already exist, and to be accepted as such. For governmental accounting what is formally recognised as existent are only IPSASs, issued during the

last six years, still suffering from many problems as discussed. Yet, the IFAC-PSC acknowledges the need to address an accounting conceptual framework to be internationally recognised for public sector entities. Efforts are already being made in this direction.

Indeed, as Adhemar (2001, p.13) explains,

(...) the *IFAC-PSC* and many of its constituents have recognised the need to develop a framework for financial reporting by public sector entities to explicitly identify the underlying concepts adopted in the standards setting process. Such a process will also provide broad guidance to preparers and auditors on the resolution of specific issued not yet subject of specific Standards [italics provided].

Nevertheless, this indicates that the divorce between business and governmental accounting tends to be extended to conceptual structures.

Furthermore, it also reflects that, as in other cases, international standards for governmental accounting have been published before the fundamental concepts and principles, instead of following these. In our point of view, this may raises two questions. The first relates to the need of an accounting international conceptual framework. The second concerns the role of IPSASs within or as a governmental accounting international conceptual framework.

As to the **first**, the same arguments previously discussed on the need for an accounting conceptual framework in general, might be extended to the international context, i.e., an accounting conceptual framework might be needed as a theoretical fundamental basis to allow standards to be coherent and to substantiate accounting practices, or instead, as others believe, to legitimise the existence and activities of international accounting standard-setting bodies.

On the other hand, as it was just presented, in a globalisation context where entities all over the world develop transactions between them, accounting harmonisation is increasingly important, meaning having a common set of accounting concepts and standards as a reference for practice. Additionally, this harmonisation need seems to be much more understandable in business than in governmental context.

For example, Nobes (1988, p.204) argues that in commercial accounting there are obvious advantages and beneficiaries of harmonisation:

- An increasing number of shareholders, lenders, analysts and brokers, among others, operating internationally, who need to compare companies;
- The existence of multinational corporations which have to present consolidate accounts and assess foreign subsidiaries performance, as well as move staff around;

- The existence of multinational accounting firms, which audit and advise multinational corporations and also move staff around;
- Government and tax authorities struggling with information from multinational corporations;
- Unions and employees facing multinational corporations.

Notwithstanding, the author sustains that there is no evidence that commercial Anglo-Saxon accounting practices, namely related to accruals-based accounting, lead to a good use of resources in an economy. Therefore, it is far from clear that these practices would be advantageous for other developed countries (e.g. Germany and Japan), not to speak about developing countries.

Besides, Nobes (1988, p.205) argues that, even within developed countries, there is a strong question mark over the appropriateness of commercial accounting for governments. Additionally, he also states that most of those reasons for accounting harmonisation do not apply to governments. In fact,

People do lend to governments, but very few lend internationally to governments. It is not clear that a strong case for harmonisation in this area exists. (Nobes, 1988, p.204)

Nevertheless, others present strong arguments pro governmental accounting harmonisation, which we judge to have been strong enough to justify the increasing participation of international bodies in governmental accounting policy-making. Chan (2001, p.1) for example, states:

Globalization has increased the financial interdependency and vulnerability of governments and international financial institutions. Regional integration, such as the creation of the European Monetary Union, has also given rise to the need for policy coordination in the monetary and fiscal areas. International and regional organizations have therefore increasingly called for greater transparency and commonality in government finance statistics.

Still, as explained, he is very critic on the way IPSASs have been developed. Thus, he argues for (Chan, 2001, pp.7-8):

- Global government accounting principles to be preferable to the approach followed by IPSASs (detailed technical rules that have a strong overtone of regulation). These principles should be broad enough to appeal to governments of under diverse political, economic and social systems. Accordingly, five principles are suggested: Principle 1 – specifying the objective of governmental accounting; Principle 2 – placing accounting in the context of the entire financial management cycle; Principle 3 – providing the basis for the possible introduction of the accrual basis of accounting; Principle 4 – identifying the key financial variables to be accounted for; and Principle 5 – introducing users’ right and need to know as the primary determinants of financial reports (Chan, 2001, p.8).

This framework is not intended to reduce government accounting practices to the lowest common denominator, but to set a base level that could be endorsed by financially accountable governments. Additionally, it provides a foundation for the development of government accounting standards.

- Accounting issues unique to government, namely: the relationship between accounting and budget; non-reciprocal transactions, such as taxation, grants in aid and subsidies; government subsidies; valuation and presentation of infrastructure and heritage assets; and responsibilities under social insurance and entitlement programs. The IFAC-PSC should work closely to other national government accounting standard-setting boards and finance officers that have struggled with these problems.
- The IPSASs to have an advisory nature – The setting of government accounting standards is, or should be, responsibility of national bodies.

Also Brusca Alijarde and Condor (2002, pp.152-153) put forward some arguments in favour of governmental accounting international harmonisation, emphasising some particular for the European Union context.

At international level they highlight the following reasons for harmonisation (Brusca Alijarde and Condor, 2002, p.152):

- Externalisation of the financial activity of public administrations – Governmental entities might issue bonds traded in international financial markets as well as ask for loans from foreign financial institutions.
- Helping the preparation and comparability of Macroeconomic Accounting – Homogeneous governmental accounting systems would be of great help towards elaborating National Accounting; additionally, homogeneous governmental accounting could be used for some of the National Accounting purposes, such as controlling public deficit or the level of national debt.
- Facilitating the job of international organisations that use economic-financial information from different countries, once they could compare public entities information. For example, entities such as the World Bank, the International Monetary Fund or the European Investment Bank could evaluate the risk of loans with sufficient reliability and in a similar manner.
- Leading to generally accepted accounting principles in the international context, which could be very helpful for supranational public organisations, such as OECD and EU, which would have reference standards. These would also be a reference for countries wishing to modernise its accounting systems.
- Supporting the general modernisation of accounting system in less developed countries – The harmonisation process can be a stimulus towards improving governmental accounting information, especially in countries which maintain traditional governmental accounting systems, in which it can push forward reforms and modernisation.

The authors additionally acknowledge that within the European Union context, the need for governmental accounting harmonisation seems to be more easily justified. Indeed, a common market demands for preparing complete financial statements providing the financial situation of the European Union as a whole, with the purpose of facilitating decision-making processes at the European level. Accordingly, apart from those mentioned for international level, they present the following main reasons

particularly for governmental accounting harmonisation within the European Union (Brusca Alijarde and Condor, 2002, p.155):

- The need to establish comparisons between different countries, requiring for comparable accounting systems.
- The need for consolidating financial statements of the member countries to get an overall picture of the financial situation of the Community.
- The need for an equal treatment of European Union grants and dues in the national accounting systems, in order to increase national governments transparency on the use of funds awarded from the Community and accountability for proper and efficient spending.
- The need for citizens, as well as possible investors, to compare the situation of different member countries. This would require comparable information on the financial position and its changes, as well as on the performance, among the member countries.
- European Union Institutions could adopt the generally accepted accounting principles in the European Union, and all European citizens could understand its financial statements. This would allow comparable accounting systems between different countries and between them and the European Union Institutions.
- It could contribute to guarantee the proper functioning of the common market.
- It would bring about the comparability of the values that are used in analysing whether different countries comply with the Maastricht Treaty criteria, undoubtedly a very important issue in the current European context.

Notwithstanding recognising the afore-mentioned important benefits of governmental accounting and financial reporting international harmonisation, Brusca Alijarde and Condor (2002, p.154) still admit some obstacles indicating that a long and hard road will have to be walked within the harmonisation process:

- The over-importance that the legal framework exerts on governmental accounting, derived from the importance of the budget and the regulations around it;
- Cultural and language differences;
- Differences in the economic development of the countries in the international framework, in which it seems impossible to give priority to accounting harmonisation when they have not even developed adequate accounting systems yet;
- The attitudes of public administrations themselves, inasmuch as they do not see important benefits in the comparability of information at trans-national level;
- The little pressure exerted by potential interested groups, which cannot be compared to the pressure exerted by international investors in the business sector;
- The deep-rooted nationalism, whereby each country considers its accounting system as the most adequate;
- The general conservatism of public administrations regarding change;
- The countries do not seem favourably predisposed to harmonise governmental accounting systems;
- There is no agreement among the scientific community on the convenience of governmental accounting harmonisation: on the contrary, at the moment there is an open debate between those who think international accounting harmonisation is convenient and those who think it is not necessary. Moreover, others in an

intermediary position argue for regional harmonisation between regions or groups of countries with similar characteristics.

The debate around international harmonisation or standardisation is not new in accounting, though it might be more recent for governmental accounting. If it has been controversial for the first, it has been even more problematic for the latter, as some of the above stated arguments demonstrate.

Nobes and Parker (2000, p.66) distinguish “harmonisation” from “standardisation”. Accordingly,

‘Harmonization’ is a process of increasing the comparability of accounting practices by setting bounds to their degree of variation. ‘Standardization’ appears to imply the imposition of a more rigid and narrow set of rules. (Nobes and Parker, 2000, p.66)

Still they recognise that, within accounting, the normal difference between the meanings of these terms is not so reliable. The term “harmonisation” has been associated to trans-national legislation emanating from the European Union, while “standardisation” is a word often associated with the IASC. Yet, it seems that theoretically these are two ways of reaching accounting globalisation.

According to Monteiro and Pontes (2002, p.21), the European Union strategy concerning business accounting among the member-States has been a process of “harmonisation”. In fact, what has been done is assuring that accounting information is comparable by reducing accounting diversity, i.e., directives have been issued (particularly the Fourth and the Seventh) providing instructions for the companies within the European Union countries to conform its accounting practices in order to allow comparability between its financial statements. This harmonisation process has implied reconciliation between different accounting perspectives (e.g. eliminating non-recommended methods and simultaneously unifying others accepted). However, the work developed by the European Union has led to great diversity, since a wide range of accounting practices is still allowed. This explains why some argue that the accounting harmonisation efforts within the European Union have not been enough.

As the authors continue, at least in theory, a harmonisation process will reach some uniformity and in the long run it will lead to “standardisation”. The latter seeks for an absolute uniformity between accounting systems, through the existence of one single set of accounting principles and rules. Yet, as Monteiro and Pontes (2002, p.22) also acknowledge, a process of accounting standardisation is absent of legislative power, since it is developed by the profession.

Subsequently, they additionally explain that the European Union strategy concerning business accounting is changing from a “harmonisation” towards a “standardisation” process. In fact, a large step was given when the European Commission approved in July 2002 a proposal from the European Council for the IASs to be compulsory applied in the preparation of consolidated statements of European listed companies³⁶.

The new European strategy of having a common framework of standards is acknowledged as highly beneficial for the future of European companies and investors, despite (Monteiro and Pontes, 2002, p.20):

- The transition period up to 2005;
- The selection of IASs made by the European Commission – only IASs not contradicting the “true and fair view” of the entity financial position and results, as well as contributing for the European public well-being, might be chosen;
- Some standards added by the European Commission, which might even contradict some IASs;
- It is for the member-States to decide if the IASs should apply to consolidated statements of other companies with securities not being traded, or to individual annual accounts.

Nevertheless, we believe that a large degree of diversity will continue to exist, because the system being imposed, i.e. IASs, is based on the Anglo-American one, which admits a great diversity.

As for governmental accounting, as far as it is our knowledge, the European Union has been silent regarding IPSASs (notwithstanding the FEE-PSC). Considering that on one hand, IPSASs seem to be still in a stage of discussion and disclosure, and on the other hand, there is great controversy regarding its general acceptance, the debate seems to keep on going. Moreover, as happened in business accounting, if an harmonisation process seems to be possible soon³⁷, a standardisation process implying having a single set of rules to be used for governmental accounting systems in every worldwide country, seems to be impossible, not only because many countries believing

³⁶ Regulation CE n.1606/2002, 19/97/02, published in the Journal of the European Communities in 11/09/02.

³⁷ See for example the uniform features of recent governmental accounting reforms in several countries around the world, as Caperchione (1999, pp.74-79), among several authors, emphasises:

- The introduction of accrual-based accounting systems;
- The modification of policies and tools to disclose economic and financial performance;
- The introduction of tools to assess actual performance, i.e. the impact on consumer needs, and to adequately disclose it to the various stakeholders (performance evaluation and measures of service and effort accomplishments);
- The setting up of a corpus of national accounting standards.

in their best practices do not want to abandon them, but additionally considering that the IFAC-PSC, as any other international standard-setting bodies for governmental accounting, do not have the power to enforce its policies.

As to the role of IPSASs within or as an governmental accounting international conceptual framework (**second** question), some comments also have to be added.

As it is clear in Adhemar's (2001, p.13) statement, IPSASs are not intended to be a conceptual framework. Nevertheless, this does not mean that concepts and principles have been ignored for its issuance. As Vela Bagues (1992, p.314) makes clear, it is undoubted that a standardisation process must be drawn upon GAAP. Although up to now, at an international level, these were not yet rigorously and explicitly stated, they were implicitly considered has clearly underlying every standard that have been issued for governmental accounting. Furthermore, the author sustains that, only through a standardisation process following these terms, it is possible to understand the objectives that governmental accounting currently pursues.

In fact, Adhemar (2001, pp.7-8) also states that, despite the IPSASs issuance "due process" had started in 1997, some background work somehow embracing components of a conceptual framework, started to be developed before. The author refers to IFAC-PSC publications such as *Study 1: Financial Reporting by National Governments* (1991), *Study 2: Elements of Financial Statements* (1993), and *Study 8: The Government Financial Reporting Entity* (1996). These were the basis for another work considered the most important IPSASs background paper – *Study 11: Governmental Financial Reporting: Accounting Issues and Practices*. Its exposure draft was issued in 1998, although its final version came out only in May 2000. According to Adhemar (2001, pp.7-8) this study:

- Considers users of general purpose financial reports of public sector entities and their likely information needs;
- Identifies the likely objectives of financial reporting by public sector entities;
- Outlines common bases of accounting currently used by governments – cash accounting (including modified cash accounting) and accrual accounting (including modified accrual accounting);
- Identifies issues to be resolved in preparing financial reports under the different accounting bases;
- Considers the extent to which financial reports prepared under cash basis satisfy the objectives of financial reporting;
- Focus on the cash and accrual bases, though it is intended to assist governments in the preparation of their financial reports whichever basis is adopted;

- Considers the objectives of the United Nations *System of National Accounts* and the International Monetary Fund *Government Finance Statistics*.

In our point of view, this is clearly a start for a governmental accounting international conceptual framework to the formally established. On the other hand, even if IPSASs as they are could be thought as the governmental accounting international conceptual framework, they are incomplete. Indeed, as previously explained, they are focused on financial reporting by governments and other public sector non-business entities, neglecting budgeting that is self-evident as a very important component on governmental entities financial management. Though this might be explained by the IASs source of inspiration, it seems that the IFAC-PSC expects to address the subject in IPSASs to be issued in the short run. Indeed, presenting the future standard-setting working program for IFAC-PSC, Adhemar (2001, p.15) emphasises its intention of issuing standards on government budgets, among others dealing with public sector specific issues not dealt with in the IASs.

We think that, in spite of all the problems they might have, IPSASs seem to have some importance in moulding the common tendency of the recent developments in governmental accounting at a national level. As Vela Bargues (1992, p.72) highlights:

(...) the high degree achieved in the last years by the process of accounting standardisation in the public sector have notably influenced the informative dimension that Public Accounting has reached actually. The clearer manifestations of such process are not only visible in the field of accounting principles, but also have been extended to the users and accounting information that they require.

Additionally, Brusca Alijarde and Condor (2002, p.160) state that it is true IPSASs are serving as a stimulus for accounting reform in some international organisations, such as OECD or European Union Institutions.

In spite of the afore-mentioned developments towards a governmental accounting international conceptual framework, one may say that standards more than concepts have been in the centre of international governmental accounting concerns. Indeed, even before the IFAC-PSC had started in 1996, other entities had been intervening in governmental accounting international policy-making.

Vela Bargues (1992, p.353) refers to the International Monetary Fund. While its role was reduced to basically providing technical assistance regarding the development of governmental accounting systems, this might be considered a clear antecedent for governmental accounting harmonisation, though not carried out by a body directly related to accounting.

Jones and Pendlebury (2000, p.152) also mention the FEE-PSC. They find this body similar to IFAC-PSC, whilst with naturally narrower membership. Though this had been previously addressed, some notes concerning the FEE-PSC functions are worthy to be added.

Hepworth (2001, pp.1-2) explains that the FEE-PSC focus on activities that help the public sector to work better from a management point of view. This contrasts with the value of IPSASs, which aim at ensuring that the public sector reports in a clear and understandable manner. Subsequently, it has been concerned, for example, with performance measurement, benchmarking, and business planning in the public sector, as well as with the role and responsibilities of auditors towards fraud. Moreover, it has searched for identifying good practice from different European countries and make that more widely available.

In turn, the IFAC is an international, not only European, body of accountancy professionals established in 1977; since then, both through its internal committees (e.g. Public Sector Committee and the International Auditing Practices Committee), and working closely with the IASC³⁸, it has been one of the most important bodies for international accounting and auditing policy-making.

Jones and Pendlebury (2000, p.153) also mention the International Organisation of Supreme Audit Institutions (INTOSAI), started in 1953. Although it endorses essentially government auditing,

It has also a Committee on Accounting Standards whose terms of reference include identifying and reporting on issues to be addressed for the development of international accounting standards for governments. (INTOSAI, 1992a, quoted in Jones and Pendlebury, 2000, p.153)

Brusca Alijarde and Condor (2002, p.155) address INTOSAI standards too, explaining that these are general and provide orientation for INTOSAI members to develop more specific standards.

The authors highlight several pronouncements issued by the Committee on Accounting Standards since 1992:

- *Users of Governmental Financial Reports*
- *Objectives of Government Financial Reports*
- *Qualitative Characteristics of Government Financial Reports*
- *Meeting the Objectives of Government Financial Reports*

³⁸ According to Adhemar (2001, p.6) and IFAC (2001f), in 2001 the International Accounting Standards Board (IASB) and the International Accounting Standards Committee Foundation replaced the IASC as international accounting standard-setting body for business accounting. The IASB took over the former IASs and issues now International Financial Reporting Standards (IFRSs).

- *Accounting Standards Framework Implementation Guide for Supreme Audit Institutions: Departmental and Government-wide Financial Reporting*

Therefore, they conclude that, despite the last statement, this body has focused on the elaboration of a conceptual framework for governmental accounting information, without entering into more detailed recommendations on accounting practices (Brusca Alijarde and Condor, 2002, p159).

At the supra-national level, Jones and Pendlebury (2000, p.153) also refer to what they judge a surprising absence of the European Union (particularly in the context of a single currency) regarding international governmental accounting policy-making. At this respect they argue that, considering what seems to be a great controversy surrounding European Union directives for commercial accounting and auditing, it is perhaps not surprising that, up to the moment, there has been no overt concern with harmonisation on accounting for governmental units.

The authors conclude:

For all these bodies, the lack of power is even greater than is typical in national accounting standard-setting bodies, because they are in essence challenging the sovereign power of governments. They can only work to persuade governments that their standards should be followed. Nevertheless, it is useful for individuals in specific countries, in lobbying for different practices, to be able to turn to ‘international best practice’ (...). (Jones and Pendlebury, 2000, p.153)

Considering that several international bodies have developing accounting-policy efforts aiming at reducing the differences amongst countries, the governmental accounting international harmonisation process seems somehow ongoing.

4. COMPARATIVE GOVERNMENTAL ACCOUNTING RESEARCH AND THE CONTINGENCY MODEL

Professor Klaus Lüder and his associates from the Speyer School of Administrative Sciences, were one of the first known European academics to recognise the importance of understanding the “why” of government accounting, developing in the late 1980s an innovative comparative-international study of governmental accounting that came out to produce the only theoretical foundation up to the moment for CIGAR: the Contingency Model of Governmental Accounting Innovations.

Although this model has been effectively serving the role of a paradigm for CIGAR (Chan *et al.*, 1996, p.3), once widely used and cited, Professor Lüder himself still admits some failures and limitations. As we will refer to, discussions of the initial

model as well as additional empirical evidence from country studies and cross-country comparisons, allowed some of those problems to be surpassed.

On the other hand, this has led to several revised versions of the Contingency Model until the 2001 FMR Model, developed once again by Professor Lüder, combining previous modifications but also new ideas caused by additional experiences.

Despite all the revisions, the model still does not address the “why” of governments accounting systems themselves but its reform processes, in particular the more or less favourable combination of contextual conditions within one country to conduct the so-called traditional governmental accounting system to change towards performance and resource accounting and budgeting.

4.1. The “fascination” for comparative international accounting

The importance of studying comparative international accounting had been recognised since a long time ago. Ever since world trade started to develop, corporations across nations started to import and export accounting practices as well, realising that they could gain more insight into its own accounting system by studying those used by others in different countries (Nobes and Parker, 2000, p.13).

Accordingly, what seems to be one reason for comparative international accounting is “learning”. Indeed, like Nobes and Parker (2000, pp.6-7) state:

It is possible for a country to improve its own accounting by observing how other countries have reacted and are reacting to problems that, especially in industrial nations, may not differ markedly from those of the observer’s home country. It is also possible to satisfy oneself that, where accounting methods differ, the differences are justified by differences in the economic, legal and social environment and are not merely the accidents of history.

Those authors discussed this reason in a context of business accounting. Nevertheless, like Chan and Jones (1988b, p.5) argue,

Governments, of course, long preceded corporations, the predominate context of much contemporary accounting debate. Indeed, in the context of sovereign governments, ‘private sector accounting’ can be seen as one part of the structure of accountability defined by that government; (...). In governmental accounting, then, there is the promise of finding answers to some fundamental accounting questions.

Accordingly, we may say that the same reason can be presented for comparative international studies in governmental accounting.

Furthermore, in the actual international context of globalisation, it is clear that the central reason for comparative-international business accounting is harmonisation/standardisation. In governmental accounting this is also the main motive for comparative international studies, considering that nowadays every country is, to a

greater or lesser degree, integrated in one or more supra-national communities, which it must be accountable to.

In fact, as far as we can understand, this was the major stimulus for the first CIGAR study developed by the Speyer School, as well as for the other cross-country studies. Moreover, we may say that this reason underlies the need to develop theoretical frameworks, which might be commonly used both to explain governmental accounting innovations/reform processes (like the Contingency/FMR Model) and to explain and describe the governmental accounting systems contents.

4.2. From the Contingency Model to the FMR Model

This section describes and critically discusses the several versions and applications of the Contingency Model, mainly considering some issues presented by several authors. The FMR Model is also presented and discussed with some particular details. Before this though, we think it is important to question why Professor Lüder came out with the Contingency Model in first place.

4.2.1. Why the Contingency Model?

The role that the Contingency Model has played in the still short CIGAR history is invaluable. We believe that, regardless future contributions that might be important for research in comparative governmental accounting, Professor Lüder's contributions will always be considered as a major part of the basic CIGAR theoretic framework.

Nevertheless, as Lüder (2001, p.2) himself recognises,

The initial model (...) was a by-product of the Speyer Comparative Governmental Accounting Study focused on the features of (central) government budgeting and accounting systems of half a dozen industrialised countries, their communalities, their peculiarities and pending reform endeavours.

Yet, the purpose of the Speyer study seems to have been wider. It intended to perform a comparative analysis in order to find distinct patterns of the several governmental accounting systems studied, and explain the reasons for the differences between those patterns.

For this, Professor Lüder and his team followed a methodology that embraced personal in-depth interviews with government officials in the respective countries, supplementary discussion with independent government accounting experts, and

analysis of accounting documents (Lüder, 1989). An interview guide was used for conducting the field studies³⁹.

The essence of the comparative analysis was to classify the several countries governmental accounting systems according to internal and external criteria⁴⁰, emphasising the differences and similarities, in order to learn about the different governmental accounting systems, but mainly to provide some insights for harmonisation strategies.

The observed differences in practices and procedures as well as in the direction, the state and the pace of reform discussions and the implementation of reforms required an explanation. (Lüder, 2001, p.2)

The experience from the empirical research suggested that the observed differences were, at least partly, due to differences in the national politico-administrative settings. This seemed to confirm the hypothesis initially stated (Lüder, 1989) that the primary user orientation of governmental accounting and reporting determines the design of the governmental accounting and reporting system and, in turn, is determined by specific contextual variables.

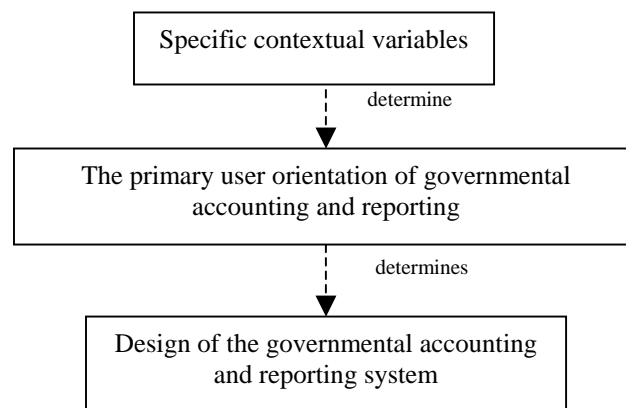


FIGURE II.4 – HYPOTHESIS INITIALLY STATED UNDERLYING THE GOVERNMENTAL ACCOUNTING COMPARATIVE STUDY
(Lüder, 1989)

³⁹ This interview guide, later reformulated into a questionnaire by Professor James Chan, is presented in the Appendix of Chan *et al.* (1996, pp.17-18). Its focus was on governmental accounting and financial reporting, covering both institutional framework (professionalism and independence, private sector influence, functional integration, and centralisation) and policy questions (objectives of the system, accounting recognition criteria and measurement rules, financial reporting practices and contents, and the dissemination of financial information). Some aspects related to budgeting and auditing were also considered.

⁴⁰ The internal criteria were: accounting entities for governmental-type activities, the measurement concept of accounting, the reporting entity, the consolidation approaches, and the summary financial statements provided. The external criteria were the contextual variables like: the distribution of political power, the legal system, and the professional influence on governmental accounting (Lüder, 1989).

It is not a causal relation though, but a conducive one instead, as we will explain later.

In the last phase of the study, due to happen in the beginning of the 1990s, a conceptual framework for the development of governmental accounting and financial reporting was to be elaborated.

However, in our understanding, although in the interim summary report (Lüder, 1989) some accounting and financial reporting theoretical issues were discussed and clarified, and country accounting systems had been classified according to those aspects, this approach was not continued, once no further explanations were developed for the “why” of different governmental accounting systems contents/designs. What was emphasised instead was the contextual approach of the reform process, i.e. the “why” of changes in governmental accounting systems towards more informative ones, which had led to several interesting discussions over the last ten years.

Because the internal approach for characterising and explaining governmental accounting systems has not been picked up by others, there

(...) is still not available (...) a common framework for describing a governmental accounting system in sufficient detail that would allow cross-country comparisons on the basis of country studies carried out by different researchers. (Lüder, 2001, p.17)

What exists is a Contingency Model that

(...) attempts to specify the features of the political-administrative environment prevailing in a country and to identify their likely influences particularly on the outcome of governmental accounting reform processes. (Lüder, 2001, p.2)

We believe that in the Speyer research project development, Professor Lüder came out to redirect his research towards a better understanding of the context of governmental accounting rather than to the accounting system itself. This is why the main conclusions related to a relationship between national context characteristics and the orientation of the governmental accounting systems users (only part of the initial hypothesis).

What was expected was an explanation for a relationship between the contextual variables and the contents of the governmental accounting systems. In the end, this was more or less conscientiously neglected, to give place for a framework that, although of an extreme importance, only allows analysing, explaining and somehow predicting, the consequences of a certain context and behaviour (later emphasised in the model) in the governmental accounting changing process. Moreover, it is also assumed that this process is towards a more informative accounting system, so it must be innovative in

the sense that the outcome must show improvements comparatively to the previous situation.

4.2.2. The Contingency Model of Governmental Accounting Innovations

As it was explained, the **initial Contingency Model** was one of the outputs of the afore-mentioned comparative study developed in the late 1980s. This project involved USA (Federal and State governments), Canada (Provincial and Federal governments) and central governments of a group of European countries (Germany, Sweden, France, Denmark and United Kingdom). The European Community government was also considered.

These were selected considering three criteria: the legal system, the Constitution-based organisation of government, and the state of governmental accounting and reporting. The sample should include both civil/roman law and common law countries, unitary countries as well as federations, and countries following more traditional governmental accounting approaches together with others adopting more innovative frameworks.

4.2.2.1. General description

Chan *et al.* (1996, pp.3-4) summarise the Contingency Model functioning as follows:

The Contingency Model is fundamentally an economic model. It posits an information market with users and producers of governmental financial information. The attitudes and behaviours of users and producers alike are shaped by their respective environments. If the conditions are ripe – as occasioned by some stimuli (such as financial scandals or government financial crises) – the interactions between demand and supply could spark governmental accounting innovations.

Accordingly, as it is illustrated in Figure II.5, there are four main modules of the model:

- 1) Stimuli of a reform process – events that occur at the initial stage of the innovation process, which individually or combined reveal a need for better accounting information from the users' side and increase the producers' readiness to supply such information. Accordingly, the stimuli change both the users' expectations and the producers' behaviour (intervening variables).
- 2) Characteristics of a country social structure – structural variables external to the government, which influence the basic attitudes of information users and thus change their expectations towards the governmental accounting system.

3) Characteristics of a country politico-administrative system – internal structural variables, which influence the basic attitudes of information producers and thus their behaviour, in particular their willingness to make changes in the accounting system. Information producers’ behaviour is also affected by the information users’ expectation of change.

4) Existing implementation barriers –

(...) environmental conditions that inhibit the process of implementation, thus hindering, and in extreme cases preventing, the creation of a more informative system which is in principle desirable. (Lüder, 1992, pp. 108-109)

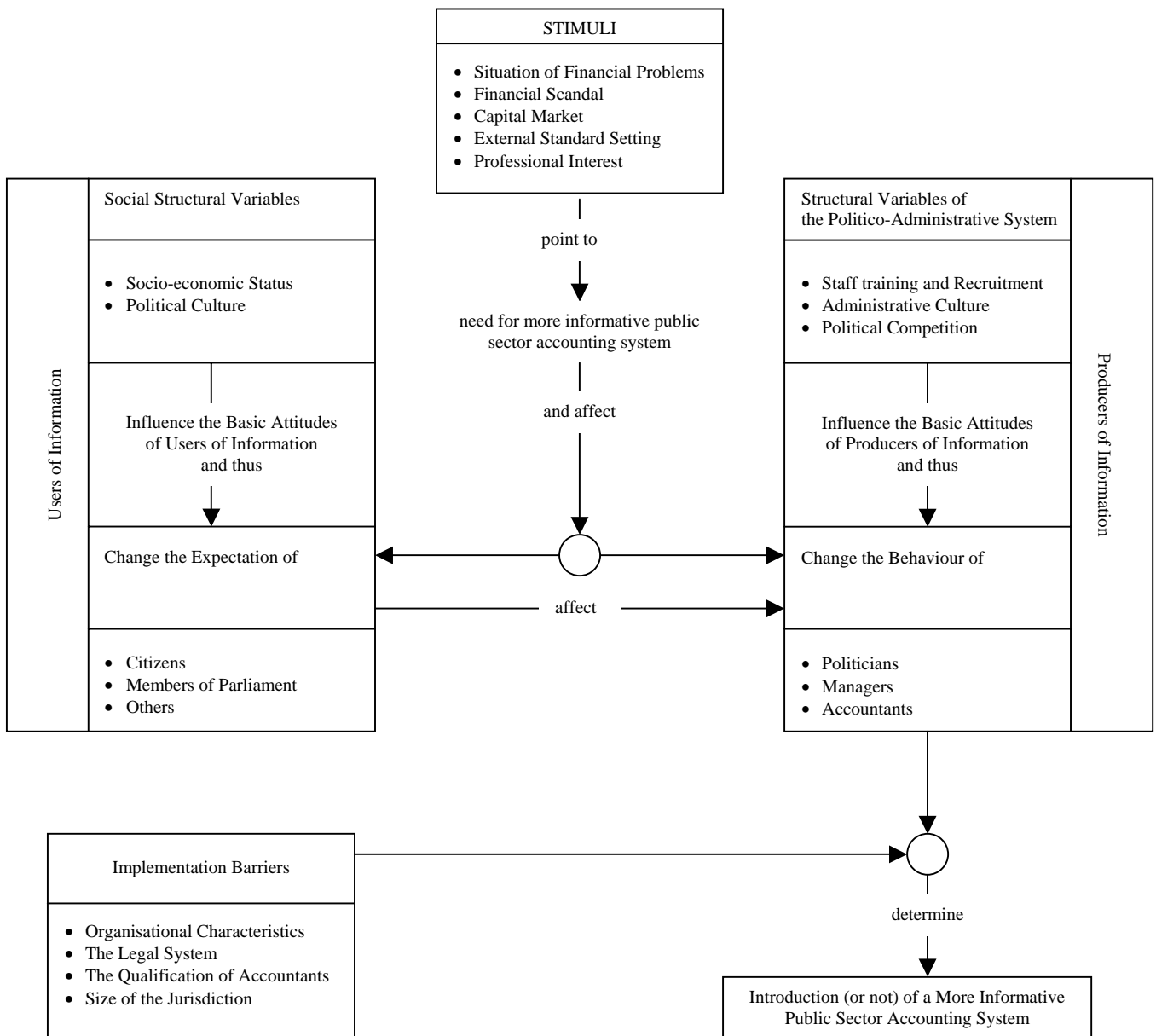


FIGURE II.5 – CONTINGENCY MODEL OF PUBLIC SECTOR ACCOUNTING INNOVATIONS – Detailed Model
(Lüder, 1992, p.111)

Lüder (1994b, p.3) summarises that

The first three types of contextual variables are supposed to influence the two categories of intervening variables: the change expectations of information users and the change behaviour of information producers. The intervening variables together with the fourth category of contextual variables, the implementation barriers, directly affect the outcome of the innovation process which is a conceptually different accounting system (dependent variable).

As Lüder (1992, p.119) also explains, the environmental factors affecting one country governmental accounting reforms may be described by a combination of the various manifestations of the model institutional modules. For simplicity reasons, the author assumes that each module exhibits just two different manifestations: favourable and unfavourable to governmental accounting reforms. This assumption allowed deriving sixteen ($2^{\text{manifestations} \times 4^{\text{modules}}}$) different patterns of environmental conditions, which are differently favourable to the implementation of a more informative governmental accounting and financial reporting system⁴¹.

Like Chan *et al.* (1996, p.3) shortly state,

A combination of conducive contextual conditions and favourable attitudes/behaviour would facilitate the innovation process.

However, even if the information producers are willing to change, the innovation process might not happen due to the implementation barriers.

It seems to be clear then that this model, which Chan *et al.* (1996, p.3) consider as the beginning of the “first generation of contingency models”, explains the transition from traditional governmental accounting to a more informative one. Like in the versions that followed, this transition is assumed to be an innovation process.

According to Lüder (2001, p.2) this initial model had a double purpose. On one hand, it intended to serve as a framework for empirical investigations into governmental accounting reforms, creating a comparison basis for research carried out by different researchers; on the other hand,

(...) it was meant as complex hypothesis aimed at contributing to the explanation of context influence on a special reform or innovation process and thus triggering research in confirming, falsifying and amending it. (Lüder, 2001, p.2)

In order to accomplish this second purpose, the model specifies the social-political-administrative environment prevailing in a country and its impact on governmental accounting innovations. Furthermore, it expects to contribute to explain why those innovations took place in some countries and not in others.

⁴¹ A more informative system performs two functions: it supplies comprehensive and reliable information on public finance, and it provides a basis for improved financial control of government activities. (Lüder, 1992, p.108)

Nevertheless, like Lüder (2001, p.2) himself recognises,

(...) the evidence that can be derived from applying the initial model is rather weak and confined to statements of conduciveness of national contextual conditions to governmental accounting reform.

4.2.2.2. Strengths and shortcomings

On the basis of what we have just presented, some critical issues may be raised. The following discussion separates those that we consider to be strengths from others that we will refer to as weaknesses of the initial Contingency Model.

STRENGTHS:

- 1) As major strength of the approach we consider to be **the merit of being the first attempt to describe such a reality, in such a way, creating an invaluable basic theoretical framework for CIGAR.**
- 2) The model was **put together from a literature review** and not only from empirical studies.

Indeed Lüder (1992, p.100) refers to other previous attempts to analyse and explain the similarities and differences between various public sector accounting systems considering the influence of politico-administrative factors. Accordingly, in terms of theoretical orientations, he roughly identified two groups: one more related to political science (political economy and public choice), and another more orientated towards behavioural theory (Lüder, 1992, pp.100-101).

Furthermore, in order to support his own framework, Lüder (1992, pp.101-107) concerned about explaining and discussing the research methods applied (some previous studies tested hypotheses by means of statistical and econometric techniques, while others examined the plausibility of hypotheses through a series of case studies of particular situations), as well as analysing some themes and variables suggested in recent literature, that he was about to use (e.g. political competition, size of the government, professionalism, users' socio-economic status, among others).

- 3) Comparatively to other intents to explain the effect of environmental conditions on the business accounting systems, the **Contingency Model methodology and structure reached a more systematic characterisation of the environment, rigorously differentiating the contextual factors according to its influence – stimuli, independent variables and implementation barriers** (Vela Bargues, 1996, p.48).

- 4) Although it is a model based on the contingency theory, it is in reality an **extension of the classical contingency theoretical approach**⁴² to variables of collective behaviour, in order to adapt the original contingency model to CIGAR.

Unlike the classical contingency theoretical approach, the Model consists of a set of contextual (independent) variables, a set of behavioural (intervening) variables and a dependent variable. (Lüder, 1994b, p.2)

It is assumed that the specific configuration of institutional components influence attitudes and behaviour of the participants in public life, politics and administration (Lüder, 1992, p.110).

- 5) **There was some empirical validation.** After the model has been described, the information on the several countries (case studies) that allowed it to be designed was compared along its several dimensions (Lüder, 1992, p.108).

- 6) **The predictive character.** In spite of its mainly explanatory character, the Contingency Model seems to be, up to a certain extent, a predictive framework.

Actually, considering the purpose of being a framework for empirical comparative research, it should be able to predict the possibility and/or the speed of changing in the existing governmental accounting system of a country.

When Lüder (1992, pp.121-126) compares the state of the art in the governmental accounting systems of the countries studies, with the respective situational patterns derived from the model, he classifies the countries into three categories: progressive units, traditional units, and special cases.

From our point of view, this is a clear indication of the predictive character: it is possible, for example, to predict that countries classified as progressive units will most likely incur in a reform process; furthermore, once started, this will be a rather fast one. The progressive environment will most probably quickly point to the need of a more informative accounting information system⁴³. The same reasoning is opposable applied to traditional units.

As to WEAKNESSES or SHORTCOMINGS we may point out:

- 1) It assumes a specific constellation of background conditions collectively affecting the governmental accounting system. Consequently, **there is a complex of multi-**

⁴² Chan *et al.* (1996, footnote 2) explain that the original contingency model in organisation theory includes only contextual variables.

⁴³ According to Jaruga *et al.* (1995), this was clearly the case of Poland, where the changing to a democracy, with all associated economic and social changes, quickly required a more informative governmental accounting system.

causal relationships between the specific form assumed by the public sector accounting system and the factors that affect it (Lüder, 1992, p.110).

Accordingly, like it is acknowledged by Lüder (1992, p.108) himself,

Due to its **high degree of complexity**, the model currently **may not be statistically testable**.

Discussing about possible research methods, Lüder (1992, p.101) explains that a methodology based on case studies, due to its flexibility, make it possible to describe a given situation closer to the reality. However, unlike studies that allow hypotheses to be tested by means of statistical or econometric techniques, the causal hypotheses underlying case studies are not susceptible to statistical test, although they could still meet plausibility tests.

Additionally, multi-causal relationships admit that independent variables may have an additional mutual effect on each other, generating synergetic effects only statistically embraced if multiple regressions are carried out. Multiple regression analysis though is only rarely carried out, because multicausality and multicollinearity problems arise, turning the statistical results very doubtful (Lüder, 1992, pp.106-107). Moreover, statistical tests demand for direct measurable (quantifiable) variables, which is not the case of those from the Contingency Model. Nevertheless, even if statistical and econometric methods are very popularly used due to its precision and accuracy, they do not exclude the possibility for the data to remain empirically insignificant.

- 2) In spite of have been drawn on the results of a number of empirical studies, personal experience, subjective interpretation and deduction were used as well up to some extent. Therefore, **the Contingency Model has some speculative features** – e.g. the empirical relevance of the environmental conditions and their relationships with the accounting system are not definitely settled (Lüder, 1992b, p.110). Hence, Lüder (1994, p.3) refers to the methodological approach applied as “informed speculation”.

Consequently, as it is explained by Vela Bargues (1996, p.48),

(...) the model has a **probabilistic nature** that does not permit to establish definite and immutable causal relationships between its variables.

Indeed, a specific configuration of the model contextual variables may be conducive to an innovation process in governmental accounting system, but the existence of such configuration in neither a necessary nor a sufficient condition for an innovation (Lüder, 1994, p.3).

- 3) Partially due to the speculative nature mentioned in 2), **the model might be incomplete**, once it may not contain all conceivable and relevant independent variables (Lüder, 1992, p.110).
- 4) Once the empirical basis was confined to industrialised democratic countries, **it may not be applicable to countries that are economically less developed and/or with other than democratic political systems** (Lüder, 1994b, p.3).
- 5) Once the model only specifies the environmental variables and their impact on the innovation process, it **emphasises the contextual variables**. In fact, no explanations are presented on how the social structure variables shape the information users' expectations, and on how the structural variables of the politico-administrative system influence the information producers' behaviour (Lüder, 1994b, p.3).
- 6) The model is **oriented to the transition (changing) process** linking two conceptually different public sector accounting systems⁴⁴ to each other; it explains how the contextual environment affects this process.

Although this might be seen as a strength, because it is different from what is done in comparative international private sector accounting (Lüder, 1994b, p.1), in our understanding, this is more a consequence of the “informed speculation” methodology. On the other hand, this emphasis on the transition process is also responsible to a great extent, for the complexity addressed in 1) and consequently for the probabilistic nature explained in 2).

In fact, Lüder (1994b, p.1) **assumes the proposition that the information needed, not the environmental context, determines the appropriate contents for the governmental accounting system** (not only for the particular countries covered by the Speyer study but also for industrialised democratic countries in general). This explains why the **Contingency Model does not make any attempt to establish a link between the political, social, legal and cultural features of a country and the peculiarities of its governmental accounting system**. In the last instance, all the industrialised democratic countries will have the same information needs and consequently will demand for conceptually similar governmental accounting

⁴⁴ The two systems are supposed to be conceptually different because the transition process involves governmental accounting “innovations”, defined by Lüder (1994b, p.1) as

(...) conceptual not merely procedural changes of the accounting system to ensure the supply of comprehensive, reliable and meaningful financial information needed for appropriate financial accountability and sound financial management.

Thus, it is assumed that the new system will be more informative, considering that innovations and reforms have the connotation that the change is for better (Chan *et al.*, 1996, p.13).

systems (“one conceptual framework for governmental accounting fits them all”). If in any moment this does not happen, according to the Contingency Model, it is due to differences in the change-conduciveness of environmental factors (Lüder, 1994b, p.2), which while not affecting the suitability of a governmental accounting system, affects the possibility and speed of its changing. This means that **any observable differences between the features of governmental accounting in different countries are not considered as due to contextual differences**, although these might apparently be the main causes.

In our opinion, this is a very debatable assumption. For example, discussing the influence of the size of a jurisdiction as an implementation barrier for innovations in the governmental accounting system, Lüder (1992, p.118) explains that

(...) as the size of jurisdiction increases, technical and administrative problems of implementing a new accounting and financial reporting system multiply and cost of implementation rises.

Indeed, it may be true that governmental accounting innovations might be easier and cheaper (thus more likely) to implement in smaller countries, with a small number of government agencies. But on another hand, it is also true that the agencies’ characteristics, particularly their size, may affect not only the innovations probability and speed but also the innovations features, which is the same as saying the accounting system contents. For example, for some smaller agencies – e.g. parishes – it may be more costly than beneficial to implement a comprehensive, complex and detailed accounting system, like accruals-based financial and cost accounting. Consequently, whilst the information provided by such a system might be important, it may not be a priority.

Therefore, we believe that governmental accounting systems tend to be conceptually similar amongst democratic developed countries – the same concepts and functions/objectives for governmental accounting. Nevertheless, we also support that each country as a sovereign independent State, can address that conceptual framework in its own way, different than any other country, as governments sovereignty allows them to chose, for example, issuing certain laws different than others in other countries although addressing the same purpose. Consequently, governmental accounting systems might be, at least, formally different among countries, or even within the same country, among different levels of government. These rather political choices (priorities in approaching the same internal information needs) of addressing a single “suitable for all” governmental accounting

conceptual framework are, in our opinion, highly affected by national and trans-national contextual factors (e.g. efforts for international standardisation and standards of national accounts) meaning that governmental accounting systems formal contents might be affected by some contextual variables considered in the Contingency Model.

In other words, we believe that in different contexts the accounting systems might be conceptually similar, as Lüder (1994b) supports, but at least its formal contents might be different, due to differences in the environment⁴⁵.

- 7) Although different signs are admitted for the **several factors** affecting the governmental accounting system to change, **within the Contingency Model** they are **implicitly admitted as having equal (even) weights**. Indeed, the model does not try to differentiate the factors weights. On the contrary, it looks as that a national context favourable or unfavourable to governmental accounting innovations is overall assessed simply considering the number of factors affecting the process in one or another direction. However, as Chan (1994, p.20) states,

In any event, the weights could very well change over time.

We must add that, even in the same moment of time, factors can have different relative importance, thus having stronger or weaker impacts on the governmental accounting changing process. For example, social and political-administrative variables might be totally favourable to innovations, but one single very strong factor as implementation barrier can overcome those and prevent the reform from happening. The opposite might be though if there is a single very strong stimulus, despite the rest of the context is unfavourable.

In summary, we may say that that the Contingency Model assumes several hypotheses to explain a rather complex reality, some of them very difficult to prove. Although some plausibility tests might be admitted, the use of an “informed speculation” methodology jeopardises the model reliability.

⁴⁵ This is clearly the Portuguese situation for Local Government accounting system, as we will explain in Chapters III and IV. Portugal has more than 300 municipalities and 4000 parishes, which size varies within a very large range. Accordingly, there are very large and also very small entities. For the latter, a simplified accounting regime has been considered, meaning that the accounting system formal contents are different (e.g. less contents on financial reports, and preparing only cash-based budgetary accounting), although the reporting objectives and general orientations will remain the same. For these entities, providing information for controlling cash-based budgets was considered a priority for the (local) governmental accounting system.

From other countries, Mellemvik and Monsen (1995) and Godfrey *et al.* (1995), as we will explain in following sections, provide empirical evidence on this.

However, as we will present,

(...) the contingency model has shown remarkable robustness and adaptability. Not only has it guided CIGAR research, the model itself has been the subject of research. (Chan *et al.*, 1996, p.9)

4.2.3. The Revised Contingency Model

Once Lüder (2001, p.2) himself admits weaknesses on the initial model, he also recognises that

There may be abundant opportunities of methodological and material improvements. (Lüder, 1994b, p.3)

Additionally, because the model is drawn on case studies, more insight from new case studies may lead to changes in the model design and/or components. Therefore, with new experiences from Italy, Spain and Japan, Lüder (1994b) introduces new features into the Contingency Model, though its basic structure is maintained. The **revised model** starts the “second generation of contingency models” (Chan *et al.*, 1996, p.4).

4.2.3.1. Differences from the initial model

The revision of the initial Contingency Model was an “almost natural” consequence of the first version, after further discussions and additional empirical evidence. Indeed, methodological and material improvements were expected to be explored from the first approach, considering the shortcomings presented before.

Figure II.6 sets out the components of the modules, the relationships between them and their effects on the results of the governmental accounting innovation process, considering a critical review with suggestions for restructuring done by Lüder (1994b, pp.6-10) himself. This new version posits basically the same as the previous one, in spite of the modifications that were done.

Comparatively to the initial model (Figure II.5), some main differences can be pointed out:

- Broad behavioural variables were introduced, as intervening variables between the contextual and the dependent ones

Although these behavioural variables were considered in the initial model, its intervening role was not so clear, once they were included in the contextual variables modules. Because the behavioural variables are those that affect directly the innovation process, being like “instruments” used by the contextual ones, the

introduction of separated clusters allowed further emphasis on its important function.

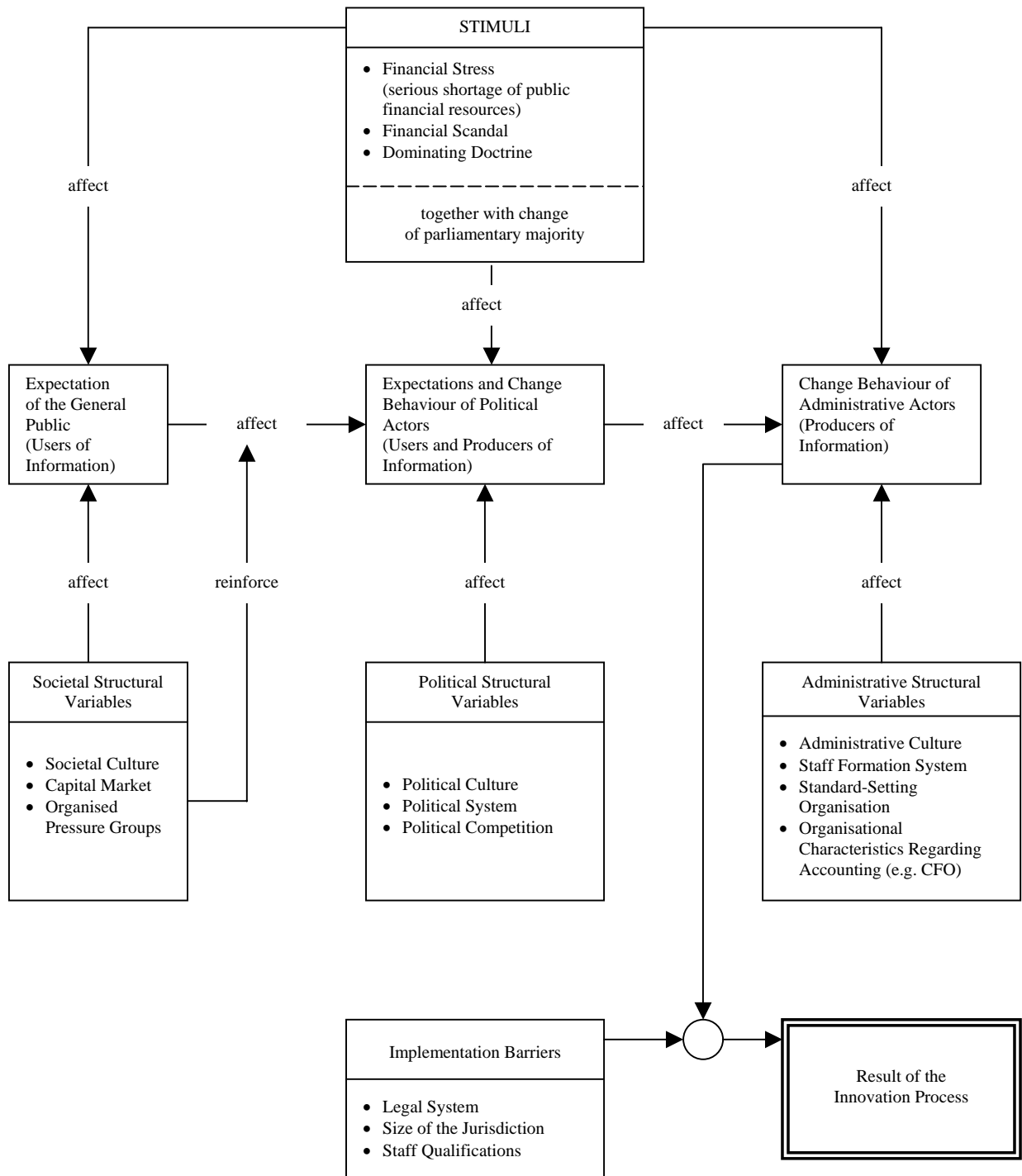


FIGURE II.6 – REVISED CONTINGENCY MODEL OF PUBLIC SECTOR ACCOUNTING INNOVATIONS (Lüder, 1994b, p.9)

This was particularly acknowledged by Jaruga and Nowak (1996, p.22). In fact, they even suggested a rearrangement of the model major components presented in Figure II.6, in order to highlight the importance of the direct effect of the behavioural variables on the results of the innovation process: all the clusters were positioned vertically, so as to the effects point down directly to the result of the innovation process (see Figure II.9).

In our opinion, this modification of the initial model structure was also, to a certain extent, an attempt to surpass the problem of too much focus on the contextual variables.

- The contextual variables were also clarified, considering both the mode of influencing the innovation process and the temporal stability

Lüder (1994b, p.6) presented a different classification for the contextual variables: temporarily present (relatively unstable environmental characteristics – stimuli), indirect relatively stable (relatively stable environmental characteristics that affect the innovation process via behavioural variables – structural variables), and direct relatively stable (relatively stable environmental characteristics that directly affect the innovation process – implementation barriers).

- The roles of political and administrative actors were differentiated

The structural variables of the politico-administrative were separated into two components: the political structural variables and the administrative structural variables.

This seemed to be more adequate, considering the importance of the political actors (members of parliament and members of government) in initiating and sustaining an innovation process (Lüder, 1994b, p.6). Moreover, a separate cluster for political variables allowed to consider the particular situation of political actors: both producers (with respect to general public) and users (with respect to bureaucracy) of information, while social actors are only users and administrative actors only producers (with respect to politicians and general public) of accounting information.

- Some of the modules components were reclassified, others were omitted, and new ones were added

a. The “capital market”, before considered as stimulus, was reclassified as part of the social structure. This was done taking into consideration bond rating agencies in particular, which are users (general public) of governmental accounting information (Lüder, 1994b, p.10).

- b. The “external standard setting”, instead of being a stimulus was better considered as an intrinsic part of the administrative structure. Accordingly, the establishment of “standard setting organisations” was explicitly identified as having an impact on the behaviour of administrative actors (Chan *et al.*, 1996, p.6).
- c. The “professional interest” was transformed in “organised pressure groups”, moving accordingly from being an external stimulus to become part of the social structure. This was done because Lüder (1994b, p.10) considered that (accounting) professionals could be interpreted as a possible pressure group with interest in public sector accounting and reporting information. Their interest affects and eventually reinforces the general public demand for more comprehensive and more reliable financial information. Indeed,

The expectations of the general public in regard to the government’s financial structure disclosure and financial management need reinforcement by powerful pressure groups (*e.g. professional accountants’ organisations, business corporations’ associations, labour unions, tax payers’ associations, etc.*) to affect the change behaviour of political and administrative actors [italics provided]. (Lüder, 1994b, p.7)

Moreover Lüder (1994b, p.7) considered that the function of these pressure groups in the governmental accounting innovations is making certain issues (such as administrative efficiency and effectiveness, and governmental accounting and financial reporting) to become a political matter.

- d. “Organisational characteristics”, considered before as implementation barriers, became instead part of the administrative structure. Lüder (1994b, p.10) recognised that government characteristics regarding accounting, such as the distribution of responsibilities for the development of the accounting system (strengthening of financial functions), is a factor that directly influences the change behaviour of administrative actors.
- e. The “socio-economic status” was omitted from the model because no evidence was found for its influence on the expectations of the public regarding governmental financial disclosure and financial management. As Lüder (1994b, pp.7-8) explained, it did not seem to be plausible to assume such a direct influence, once the empirical validity of such hypothesis was substantially questioned.
- f. The existence of a “dominating doctrine” was added to the conceivable and observable stimuli. Lüder (1994b, p.7) explains that

A dominant doctrine can either further the effect of other stimuli on the innovation process or even function as a stimulus on its own.

Additionally, it was recognised that a dominating doctrine “together with change of the parliamentary majority” could affect the attitudes and behaviour of political actors. Such a political change may be a factor also furthering governmental accounting innovations.

In short, politics affect governmental accounting. (Chan *et al.*, 1996, p.6)

Considering the dominating doctrine as a possible stimulus allowed, among other things, distinguishing two main variants of the Contingency Model (Lüder, 2001, p.3): the accountabilism-driven and the managerialism-driven. Subsequently, two approaches of the observable innovation processes were derived.

The main purpose of the **accountabilism-driven process** is an improvement of governmental external reporting towards more transparency. In fact, Lüder (1994b, p.10) considered that this kind of process

(...) is often triggered by some type of financial scandal that results in a demand for more transparent, comprehensive and reliable financial information to be released by the government.

Accordingly, in the accountabilism-driven contingency model users are primary important actors in the governmental accounting reform process.

The **managerialism-driven approach** aims in first place at contributing to more efficient, effective and economic public sector management. Therefore, it is

(...) primarily concerned with reforming governmental internal (managerial) accounting, but improvements in financial accounting and reporting sometimes is a by-product of the innovation process. (Lüder, 1994b, p.10)

Such an approach, where producers of governmental accounting information play the primary role, is mainly stimulated by fiscal stress and can be either an isolated reform – like Lüder (1994b, p.13) presented for Spain – or part of a comprehensive administrative reform – as Lüder (1994b, p.12) presented for UK and other Anglo-Saxon Non-American countries (e.g. Australia and New Zealand)⁴⁶.

⁴⁶ Lüder (1994b, pp.12-13) distinguished this two situations, considering that in the Spanish case there was a minor involvement of the political actors in the reform; the main impulse was given by administrative key actors, after perceiving a dominating doctrine; there was no fiscal stress. On the other hand, in the Anglo-Saxon Non-American countries, the main driving force for the reform was the “will” of political actors; this led to a more embraceable process, extended beyond accounting issues.

As has been stated, one of the purposes of the Contingency Model was to stimulate subsequent CIGAR, providing a basic methodological framework for such research. Thus, while recognising difficulties in statistically testing the model, Lüder (1994b, p.14) suggests other ways of verify its plausibility:

(...) what can and should be done to substantiate or falsify it, are case studies of special governmental accounting reform processes either in the form of “action research” (...) or in the form of “ex-post analyses” (...). The Contingency Model is thought to contribute to a more uniform shaping of those studies carried out by different researchers in different countries and thus contribute to a better comparability of CIGAR results. If CIGAR is able to identify typical government accounting innovation processes and their linkages to the characteristics of the national social-political-administrative environment it has much more achieved than private sector ICFAR which has – in addition to single-country studies – not much more to offer than groupings of countries according to more or less debatable spheres of accounting influence.

In our opinion, the several country studies and cross-country comparisons that have been followed this version of the Contingency Model, some of which we are about to present, are most likely not only a consequence of Professor Lüder’s suggestions, but also the result of a certain enthusiasm for having available, for the first time, a comparative framework with such potentialities.

4.2.3.2. Studies and applications

Many authors have been using the Contingency Model, particularly the revised version, to describe the contextual situation and/or explain public sector accounting innovations within an individual country. Nevertheless, only a few studies have been developing cross-country comparisons. Regardless if individual or comparative, the fact is that studies on national and/or local government accounting and financial reporting, summarised in Table II.3, have covered countries all over the world.

Country Studies ⁴⁷		
Country	AUTHORS	Level of Government
United States	Chan, 1994	Federal
Switzerland	Mäder and Schedler, 1994 Schedler, 1996	Federal Local
Denmark, Norway and Sweden	Mellemvik and Monsen, 1995	Local
Germany	Lüder, 1998	Federal
Italy	Mussari, 1995	Local
Poland	Jaruga <i>et al.</i> , 1995	Central
New Zealand	Pallot, 1995	Central
Spain	Montesinos Julve and Vela BARGUES, 1996, 2000	Central

⁴⁷ Studies developed for Germany, Sudan, Australia (New South Wales) and Japan (local level) are referred to in Lüder (2001, p.6). Analyses for China and Japan (central level) are mentioned in Chan *et al.* (1996, p.10).

Kenya, Tanzania and Uganda	Godfrey <i>et al.</i> , 1995	Central and Local
Sudan	El-Baltoni and Jones, 1996	Central
China	Chan, 1995	Central
Japan	Yoshida, 1996 Yamamoto, 1999	Central Local
Australia (New South Wales)	Christensen, 2001	Central
Country Studies using variants of the Model⁴⁸		
Albania	Godfrey <i>at al.</i> , 2001	Central
European Union	Lovell, 1995	Supreme Audit Institutions
Spain	Montesinos Julve, 2000	Auditing in local authorities
Cross-Country Comparisons		
UK, Netherlands, Finland, Germany, USA and New Zealand	Budäus and Buchholtz, 1996a, 1996b	Local
Denmark, Norway and Sweden	Mellemvik and Monsen, 1995	Local
Kenya, Tanzania and Uganda	Godfrey <i>et al.</i> , 1995	Central and Local
Germany, UK, France and Spain	Vela Bagues, 1996	Local
Germany, Canada, Switzerland, Denmark, USA, France, Italy, Japan, Kenya, New Zealand, Poland, UK, Sweden, Tanzania, Uganda and Spain	Vela Bagues and Fuertes, 1999	Central and Local

TABLE II.3 – COUNTRY STUDIES AND CROSS-COUNTRY COMPARISONS

Notwithstanding the great enlightenment that these studies have brought to CIGAR, there are some limitations that have to be emphasised:

- Unfortunately, as the table shows, there have been relative few genuine CIGAR studies, with large samples (Chan *et al.*, 1996, p.10) – although an universal working language (English) had been adopted for CIGAR, it seems that some language barriers, together with resource constraints, have hindered the ability of communicate internationally and consequently held up comparative studies;
- Most of the country studies are focused on western democracies, mainly in Western Europe, North America and Oceania – although this tendency has been changed, there is still a great deficit of studies on countries from Eastern Europe, Asia, Africa and, above all, Latin America. Accordingly, because one does not know if the framework embodied in the Contingency Model would be applicable to those countries, the generalisation of the ideas supporting that approach is jeopardised;
- As Lüder (2001, p.16) explains, there have been an emphasis of desk studies over empirical studies – the problem here seems to be the lack of funding, always a critical factor for developing empirical research; subsequently, researchers have to support their studies using secondary data, meaning that their personal knowledge is completed with available written material;

⁴⁸ Researches for European Union and Spain are referred in Lüder (2001, p.6).

- In spite of some changing in some recent CIGAR publications (e.g. Bac, 2001), the majority of the studies still focus on the context of governmental accounting – not only the accounting system contents continue to be neglected, but also the behavioural variables are still seen as “black boxes” (what attitudes?; which type of influence?; ...). Regarding the later, we think that more developments have not been happening maybe because the need to deal with aspects of organisational psychosociology does not seem so attractive to accounting researchers;
- With a few rare exceptions, most of these studies did not use the Contingency Model as a predictive framework – in other words, the large majority of the studies used the model to explain which and how contextual factors were affecting the governmental accounting reform happened and/or happening in the countries they were describing. Yet, three of the above-listed studies might have used the model in a predictive way:
 - Mäder and Schedler (1994) – applying the Contingency Model (revised version) to the Swiss federal government, these authors described how the current features of Switzerland environment were likely to conduct to a very slow governmental accounting innovation process. Despite a general recognition that the information provided by the existent governmental accounting system was not enough for control and efficient, effective and adequate decision-making, the ponderous reform process typical of Switzerland would indeed prevent rapid and revolutionary solutions as some implemented in other countries.
In our opinion, they are clearly using the framework to predict the future of the Swiss governmental accounting.
 - Jaruga *et al.* (1995) – these authors used a generalised innovation model, adapted as we will explain from the Contingency Model, to present the transformations of Polish governmental accounting; they conclude stating that some environmental changes happening in Polish social-political-economic environment would require certain characteristics for the Polish public sector accounting system – e.g. universal application of accounting based on full accrual basis; universal application of a reporting model that includes balance sheet, income statement, and statement of cash flows; among others (Jaruga *et al.*, 1995, p.16).

This seems to have been an attempt to predict what were going to be the consequences on the governmental accounting system reform of a particular environmental change towards a more democratic country.

- Budäus and Buchholtz (1996a and 1996b) – using the managerialism-driven variant of the Contingency Model to local government, they clarify the importance of controlling and management accounting for public management, arguing that the sophistication of those systems depends on the reform approach undertaken. Accordingly, a reform driven by so-called “hard factors” (procedures and instruments) is expected to lead to a highly developed controlling and management accounting system; the opposite is expected to occur when the reform is carried out emphasising “soft factors” (oriented to staff culture, behaviour and attitudes).

In our understanding, this is a clear predictive conclusion.

4.2.3.3. Modifications and extensions

In this “thrilled” context of using the Contingency Model, particularly in the years that followed the publication of the revised version, some modifications and extensions were made to its structure and variables contents, mainly as a consequence of critical applications of the framework to individual country studies. Some authors also used different theoretical approaches to complement the contingency one. In effect,

As other CIGAR scholars used the contingency model to guide their field observations, they sometimes discovered the need to modify it. (Chan *et al.*, 1996, p.6)

4.2.3.3.1. Eastern Africa

Some of the modifications of the model resulted from the first attempt to **apply it to developing countries**, in particular Kenya, Uganda and Tanzania. The consequent version of the model developed by Godfrey *et al.* (1995) is presented in Figure II.7.

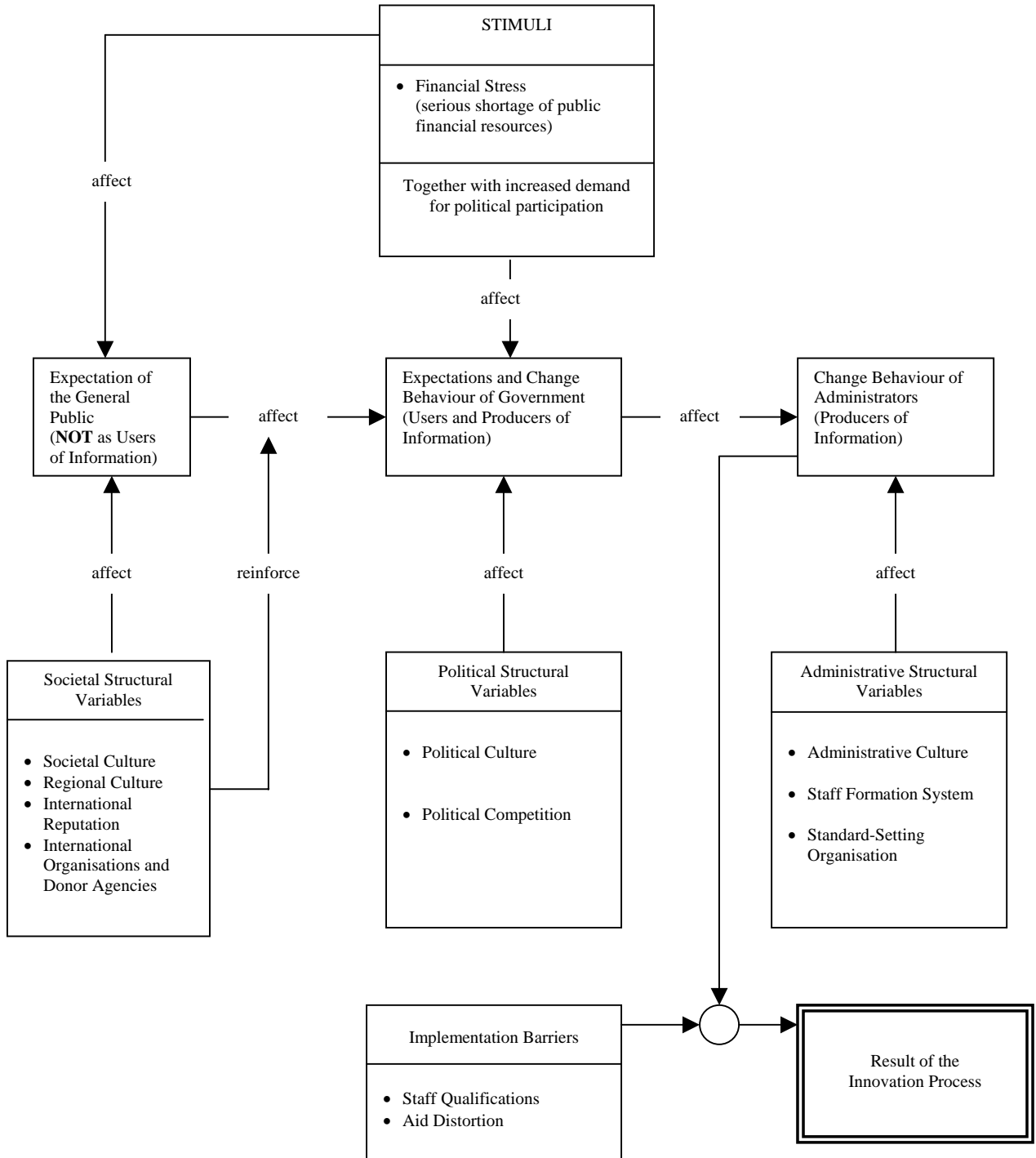


FIGURE II.7 – CONTINGENCY MODEL OF PUBLIC SECTOR ACCOUNTING IN LESS DEVELOPED COUNTRIES

(Godfrey *et al.*, 1995, p.6)

The main suggestions of these authors may be summarised as follows:

- It was recognised that the fiscal stress “together with increased demand for political participation” (more democracy) add more impetus for change in governmental accounting – these stimuli directly affect the general public (NOT as users of

information) expectations and government behaviour, but not administrators' behaviour, which is only indirectly affected;

- “Regional culture” was considered as a component of social structure – regional political-social-economic developments in the area, particular in neighbour countries, are considered to have often either favourable or adverse implications on governments of underdeveloped nations (Godfrey *et al.*, 1995, p.3);
- “International reputation”, as part of the social variables, is the country position internationally – it is considered to affect the availability of external resources, a critical requirement to support economic development in these countries (Godfrey *et al.*, 1995, p.4);
- The democratisation process leading to decentralisation of government machinery, liberalisation of prices, privatisation and restructuring of local government, results in demands for a more comprehensive disclosure of the financial situation, not by the general public as in developed countries, but by international organisations and donor agencies (Godfrey *et al.*, 1995, p.3) – it is considered that “international organisations and donor agencies” providing assistance play an instrumental role in demanding and sometimes financing changes in the beneficiaries nations governmental accounting systems (Chan *et al.*, 1996, p.7).

Moreover, financial resources and know-how provided by international organizations and donor agencies form an element of a developing country's social structure reinforcing the change process or even make it all possible. (Lüder, 2001, p.3)

- It was discovered a tribal identification and loyalty affecting people's attitudes towards government and consequently towards public finances (Chan *et al.*, 1996, p.7) – indeed, the existence of strong governments dominated by a particular tribe, ethnic or economic groups reluctant to share power, contributed to the weakness of the political culture; accordingly, expectations of the general public affect the governmental accounting change not because they are users of information, but because people identify themselves as being part of that system (tribe/group...);
- An “aid distortion” was added as a possible barrier to implement governmental accounting innovations. Like it is clarified by Lüder (2001, p.3),

Demands of international organizations and donor agencies providing assistance can directly or indirectly stimulate the change process. If those demands do not meet the needs of a developing country, they stimulate the wrong change and thus result in a barrier to the implementation of an adequate accounting system.

In other words,

By tying improvements in accounting (and financial management generally) to the award and renewal of financial assistance, donors and creditors substantially increase the effectiveness of their demand for reform and information. (Chan *et al.*, 1996, pp.7-8)

Because each supporter international organisation has its own list of conditions attached to its financial contributions, the result might be the implementation of hybrid governmental accounting systems (Godfrey *et al.*, 1995, p.4), once it is admitted that developing countries might mould their accounting systems in order to meet those requirements. Extending this idea of “aid distortion”, Lüder (2001, p.3) states that

(...) one might also expect that developing countries are tempted to change their accounting systems in order to meet perceived demands of the international community and thus improve their international reputation.

The major contribution of this study, from our point of view, was to prove that the Contingency Model could be applied to countries economically less developed and with less democratic political regimes. This allowed to surpass one of the shortcomings referred in section 4.2.2.2. Furthermore, the influence of international organisations and donor agencies was for the first time considered.

4.2.3.3.2. New Zealand

Other important modifications were suggested by Pallot (1995), after applying the Contingency Model to explain what happened in New Zealand. The model suggested is presented in Figure II.8.

Pallot (1995, p.25) recognised how the Contingency Model proved to have been a useful framework for analysing and explaining the New Zealand governmental accounting developments and, in particular, why they were able to be implemented with such rapidity. Nevertheless, considering the New Zealand example, some suggestions were made for eventual changes:

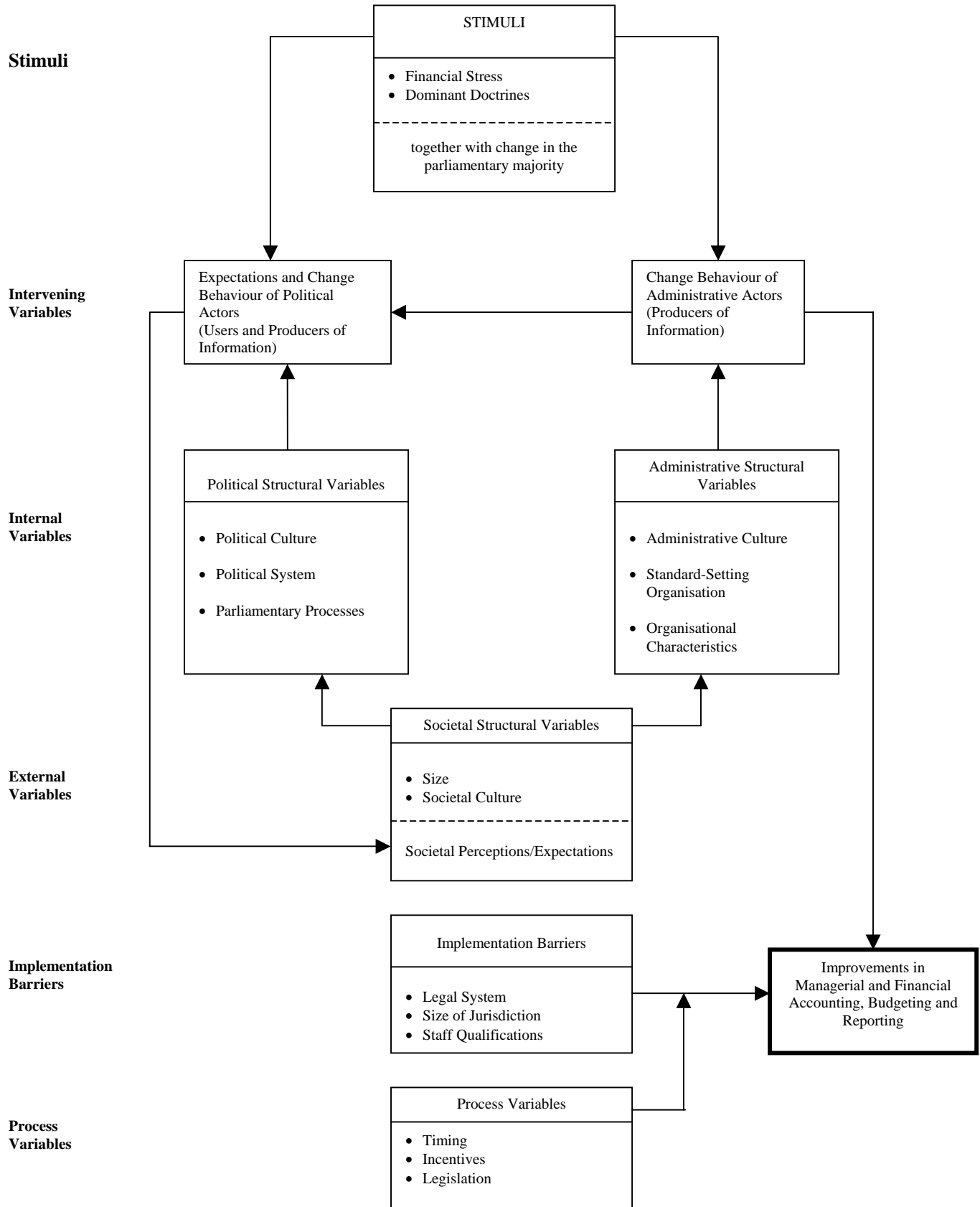


FIGURE II.8 – GOVERNMENTAL ACCOUNTING IN NEW ZEALAND

(Pallot, 1995, p.31)

- (...) severe fiscal stress or other emergency creates an opportunity for Executive action to override “normal” democratic processes. (Pallot, 1995, p.26)

This is considered because, in the particular case of New Zealand, rather than users affecting politicians who in turn affect administrative actors, the direction of influence seemed to be the opposite, i.e., administrative actors influence politicians who in turn try to shape the perceptions of users, employing financial statements as a tool in this process (Pallot, 1995, pp.25-26); additionally, she states that for this conclusion, the managerialism-driven approach of the model followed by New Zealand, with a closer look at theories of producer’s behaviour, was particularly important;

- The structural variables were divided between internal – political and administrative – and external – societal. Moreover, societal variables include the “size” of the country: larger countries tend to implement a governmental accounting reform user-oriented (accountabilism-driven), while smaller countries follow a producer-oriented approach (managerialism-driven). On the other hand, societal structural variables affect directly the political and the administrative structural variables. As Pallot (1995, p.26) explains,

In particular, organizational variables are affected by size: multiple professional bodies, separation of budget and accounting functions in government and separation of audit and advisory roles are more likely in larger jurisdictions. Small size also has an effect on political culture, being more amenable to direct democracy but (...) democratic processes seem to play a lesser role under a managerialism approach.

- “Process variables” related to management of the innovations implementation (timing, incentives and legislation) were added to the model. In fact, Pallot (1995, p.26) argues that contextual variables identified by the Contingency Model affect the probability of innovations taking place, but the success of its implementation however also depends on how well the process is managed.

In our opinion, the most important merit of this study was to consider, for the first time, **process variables**, stressing the importance of tying the success in implementing an innovation to the way the implementation process is managed. This might have been also an attempt of call attention to other than contextual variables.

4.2.3.3.3. Others

Apart from these studies, as was presented in section 4.2.3.2, many others authors applied the Contingency Model to their countries and/or did a critical analysis of the model itself. Some are worthy to be mentioned.

1. Chan (1994), as far as we know, was the first one to use the Contingency Model (initial version) to explain what had happened in the United States federal government, somehow extending Lüder's (1989) analysis. He explained that the passage of the CFOs Act and the formation of the FASAB in 1990 (two very important events in the US federal accounting and financial management reform) were consequences of the interaction of factors mainly included in "stimuli" and "producers of information" (Chan, 1994, p.17).

Additionally, the Congress was identified as main user of the federal accounting information, having also a positive impact on the reform process (Chan, 1994, p.35). Some barriers that had hindered the rapid introduction of accrual accounting and consolidated financial statements were also identified (Chan, 1994, p.36).

The author also described how the favourable "stimuli" were able to overcome unfavourable "barriers", producing the 1990 CFOs Act and almost simultaneously creating the FASAB (Chan, 1994, pp.29-37). Specifically the Act, up to a certain point the main cause for the FASAB creation, embodied major changes in institutional structural issues in US federal government. Still, due to the implementation barriers, it followed at first an experimental approach (pilot projects).

Additionally, he highlights:

The 1990 CFOs Act *was* a milestone toward the introduction of a more informative public sector accounting system in the US Government [italics provided]. In terms of the building blocks of the contingency model, the Act declared managers and Congress as the primary users of financial information, and empowered a cadre of fiscal officers to supply such information. (Chan, 1994, p.29)

From our point of view, this approach not only had the merit of detailing Lüder's (1989) study for US, but also highlighted the possibility of different weights for the factors within the Contingency Model. In particular, Chan (1994) showed that in the case of the US federal government accounting innovations, the favourable stimuli were relatively more important than the implementations barriers.

2. Mäder and Schedler (1994, pp.350-353) used the Contingency Model (revised version) to explain how and why the Swiss governmental accounting innovation process was suffering from "an almost unbearable ponderousness".

The frail financial situation of the Swiss public sector was demanding for quick and effective solutions. The one that was seen as the remaining solution was a consistent improvement in the administrative system, aiming at instituting a self-control

mechanism that would enable those involved to make efficient, affective and adequate decisions (Mäder and Schedler, 1994, p.350).

It had been recognised that the information provided by the existent governmental accounting system was not enough for that; a reform was acknowledged as urgent, particularly systematically recording data on performance and costs to be used by political decision-making bodies and the general public. Notwithstanding, the innovation process was foreseen as very slow.

Using the Contingency Model (revised version) allowed the authors to explain why that was expected to happen (prediction), considering the features of Switzerland environment and how they were being combined to affect the governmental accounting reforms in a less favourable way. Hence, the model clusters components were modified in order to reflect the Swiss situation. The most important alterations were (Mäder and Schedler, 1994, pp.351-353):

- A changing doctrine towards performance, together with a large state deficit, were considered to stimulate the innovation process;
- While the need for an urgent change had been recognised, and political agents had created high expectations, their behaviour change was expected to be slow, as it would be that of administrative agents;
- The contextual factors believed to be mainly responsible for the innovation process slowness were: conservative multilingual societal culture, strong democratic political culture – federalism, weak political competition – coalition system, bureaucratic administrative culture, poor personnel development and training system, weak standard-setting organisation, rigid legal system, and a high degree of non-professional administrators in communities. Additionally, no change of parliamentary majority was expected.

Mäder and Schedler (1994, p.352) argued that although this expected to be slow innovation process could ensure a certain continuity and stability, it also would effectively prevent revolutionary solutions.

Nevertheless, they concluded for some conditions favourable to change in Switzerland, particularly related to the introduction of a Performance Measurement System (Mäder and Schedler, 1994, p.362).

The main advantage of using the Contingency Model here seems to have been explaining which factors might be responsible for the slowness of a governmental accounting innovation process: when obstacles are provided by the political and administrative culture, slow progress is the only one allowed. Nevertheless, as the authors explained for the Swiss particular case,

If (...) those concerned can successfully be convinced of the value of the well-established Performance Measurement System, then the odds are in favour of the causality of the contingency model being turned around: an innovative financial and performance accounting system will provide information of high value, which will prompt those involved to change themselves and the existing system. (Mäder and Schedler, 1994, p.362)

3. Professor Lüder's studies did not involve **local governments**. This was a good motive for many scholars to extend the Contingency Model to this level of government.

A) Mussari (1995) briefly described and explained reforms that were happening in the Italian local government accounting system, namely trying to point out the main reasons underlying the significant process of change that was taking place. He also tried to identify how the accounting reforms regarding financial accounting and the introduction of management accounting were necessary and coherent with the Italian "new" model of local government that was arising (Mussari, 1995, p.3). The author used essentially the revised Contingency Model to do an *ex-post* analysis. Still, some then recently developed methodological approaches were also considered.

The main strong points of this study were:

- It complemented Lüder's (1994b) analysis for Italy. Indeed Mussari (1995) reached quite different conclusions comparatively to Professor Lüder, not only because his study was for local and not central government, but also because certain contextual changes carried out after Lüder's (1994b) study, were taken into consideration. Analysing changes in the local government accounting system was of primary importance to understand the whole Italian public sector accounting system reform, once this had followed a bottom-up approach (Mussari, 1995, p.5).
- An additional methodological framework (Catturi, 1995, p.22, quoted in Mussari, 1995, p.16) was used to help explaining the relation between societal structural variables and local government accounting systems. Although developed to explain the relation between accounting models, anthropological culture and company culture, Mussari (1995, footnote 36) believed that it could be used in reference to local government, at least as far as the relation between social culture and consequent adaptation of accounting instruments was concerned.

Mussari (1995, p.16) supported the use of this supplementary model because, in his opinion, the reforms that were happening in Italian local governments, particularly the accounting one,

(...) should be interpreted as an attempt by the legislator to find suitable solutions for favouring the "realignment" between the social culture and the organizational culture of these public institutions, thereby favouring the creation of new channels as well as, and above all, of new instruments of communication (*mainly new accounting systems*) [italics provided]. (Mussari, 1995, p.15)

Moreover, Mussari (1995, p.16), quoting Catturi (1994), considers that the change in accounting systems is a consequence of the change in the objectives of economic organisations, which in turn, is determined by a cultural change in the organisation and in the society.

From our perspective, the main advantage of this study dwells upon using an additional model to help explaining the relation between societal structural variables, in particular societal culture, and local governments accounting systems change.

Considering that it is not easy to exemplify the ways in which the changes in the social culture of a country affect the expectations of the general public and reinforce the expectancy of changes in the behaviour of political actors⁴⁹, using that framework seems to be interesting to better understand that the changes in the accounting systems of local governments might be a “natural and inevitable” consequence of greater and more significant anthropological and cultural changes.

Like Mussari (1995, p.14) himself states,

We can conclude that the establishment of a “new” model of local government and of a modern accounting system, may be interpreted as an attempt to promote a renewal process of such public organizations which is founded on a careful perception of the tendencies which are forming on the economic and social scenario in which they are called upon to operate (...).

B) Mellempvik and Monsen (1995) tried to use the Contingency Model to compare local governmental accounting regulations, focusing on consolidation issues, in a group of Scandinavian countries with similar cultural and historical traditions: Denmark, Norway and Sweden.

Arguing for “one world of accounting” – business and governmental organisations preparing similar financial statements – these authors refer to studies both of business and governmental accounting organisations (Mellempvik and Monsen, 1995, p.189).

They observe that, in particular for business organisations, accounting regulations harmonisation has been very difficult to achieve in the Nordic Countries, despite very similar cultural and historical traditions, as well as a joint law proposal.

⁴⁹ In reality, as it is clear by looking at Lüder’s model, the set of variables which, in different ways, compete for determining the change of accounting systems interact in a systematic way where, on the whole, it becomes difficult to establish the relative importance of each of them. (Mussari, 1995, p.14)

When they tried to use the Contingency Model to analyse the evolution of governmental accounting regulations for local government in the above-mentioned countries, Mellembvik and Monsen (1995, p. 202) found some problems:

- Considering the model assumption that contextual factors affect the change-conduciveness of governmental accounting systems in different countries but not its contents, it was expected that on the three countries, with similar contextual variables acting in the same way (same environmental conditions), the changing processes in governmental accounting were similar. Yet, different evolutions were found (changes in the accounting systems were diverging), contradicting this assumption:

In particular, it seemed as the development in Norway with regard to governmental accounting regulations *was* going in the opposite direction of the developments in the other two countries (...) [italics provided]. (Mellembvik and Monsen, 1995, p.202)

- Furthermore, the extension of that assumption states that information needs determine the appropriate contents of the governmental accounting system – any observable differences between governmental accounting features are attributable to differences in the change-conduciveness of environmental factors. In the countries studied here those needs were the same, so similar governmental accounting contents were expected. However, these authors found that the countries were facing different accounting systems. According to the Contingency Model, these should be explained by environmental conditions acting in different way. Still, as explained before, the contextual factors were acting in similar directions.

Consequently, they were not able to explain the differences among the local governments accounting systems of Denmark, Norway and Sweden in terms of the Contingency Model.

In our understanding, these results were very important, “knocking down” the main assumption of the model and subsequently jeopardising its explanatory power. Moreover, because they assume “one world of accounting”, Mellembvik and Monsen (1995, p.202) conclude extending the business accounting harmonisation difficulties to governmental accounting within a group of countries with similar environments. These difficulties, in their opinion, explain why international harmonisation of accounting standards has turned out to be a very slow process. Finally, observing that business and governmental organisations are becoming more similar, they suggest a new line of research – International Comparative Accounting Research (ICAR). Indeed, Mellembvik and Monsen (1995, pp.202-203)

(...) argue for more in-depth studies both of business and governmental organizations in one particular country and in groups of similar countries. Such studies could draw upon ICFAR and CIGAR research, helping to develop Regional Accounting Standards (RAS) applicable both to business and governmental organizations within a cultural region (...). Furthermore, if researchers and practitioners from different countries, familiar with their

own accounting technologies and contexts, cooperate, the prospect of bringing ICFAR and CIGAR research jointly ahead, looks promising.

C) Budäus and Buchholtz (1996a and 1996b) developed an international empirical study involving local governments from six countries: United States, New Zealand, United Kingdom, Netherlands, Finland and Germany. This study aimed

(...) to clarify the importance of controlling (*including internal reporting*) and *management accounting* for public management in practice and to develop basic guidelines for the design of controlling and public management accounting [italics provided]. (Budäus and Buchholtz, 1996a, p.33)

Concentrating on management accounting, they tried to offer a new dimension to CIGAR, which has been focused on financial accounting and reporting. Embracing the two accounting perspectives, in these authors point of view, allowed positioning CIGAR within a context of comprehensive public management (Budäus and Buchholtz, 1996a, p.36).

As conceptual basis for the study they used a framework integrating management, accountability and the 3-Es concept (Budäus and Buchholtz, 1996a, p.40). In addition, because they were discussing factors of influence and aspects of design of controlling (Budäus and Buchholtz, 1996a) and management accounting (Budäus and Buchholtz, 1996b) for local administration,

The use of Lüder's Contingency Model (...) seemed to be a logical procedure for gaining general statements about the probability of the introduction controlling system [italics provided]. (Budäus and Buchholtz, 1996a, p.41)

Additionally, it would allow

(...) to discuss the chances of introducing a managerial-oriented accounting system (...). (Budäus and Buchholtz, 1996b, p.103)

Budäus and Buchholtz (1996a and 1996b) modified the model adding to the stimuli and structural variables of the country, the environmental conditions of the communities in study.

Their main contributions were (Budäus and Buchholtz, 1996a, pp.41-47; and 1996b, pp.105-115):

- Comparatively to Lüder's analysis for central level, the likelihood for introducing controlling and management accounting seemed to be potentially greater at local level. This happened because the influence of societal structural variables is more pronounced due to the much greater involvement and closeness of the public at the local level.
- The Contingency Model proved to be a suitable basis for analysis of country-specific factors of influence on the introduction of controlling and management accounting at local level. Indeed, it seemed to have provided sufficient explanation of innovations and concepts of management accounting.

- Notwithstanding, being deductive oriented, the Contingency Model was not considered an adequate “comprehensive explanatory aid” for the empirical results at local level. Because the investigation revealed some unexpected results in the light of that model analysis, further research developments were needed to explain the various degrees of sophistication (scope and details) in controlling and management accounting at the local level. Therefore, in order to clarify the level of development in controlling and management accounting, two types (concepts) of communal administrative reforms were distinguished: internal oriented (concentrating in all activities that are aimed primarily at increasing efficiency and economy) and external oriented (aiming all measures that are directed towards an improvement in effectiveness).
- With the purpose of clarifying more accurately the significance of controlling and management accounting, in the internal oriented reform process of the communalities, “hard” (organisational structure, and procedures and instruments) and “soft” (organisational culture and staff qualification and skills) factors were separated based on Peters and Watermann (1982, quoted in Budäus and Buchholtz, 1996a and 1996b) 7-S model.

They concluded essentially that

There is a substitutive relationship between “hard” and “soft” factors in the implementation of internally oriented administrative reforms at the local level. Accordingly, the likelihood of finding a highly developed controlling and management accounting system is remote where a cultural and staff-oriented approach is pursued for internal reform. (Budäus and Buchholtz, 1996a, p.47)

In other words,

(...) the importance and, correspondingly, the level of sophistication of controlling *and management accounting* varies depending on the reform (i.e. change) approach undertaken [italics provided]. (Budäus and Buchholtz, 1996a, p.33)

Comparatively to the Contingency Model analysis, this shows that technical differences in reform approaches could not completely be explained by differences in environmental conditions: the dominance of “hard” factors (procedures and instruments) over “soft” factors (change of behaviour and attitude) and vice-versa is supposed to be a characteristic of the administrative culture of a government, conditioning the local governments accounting reform process.

D) Vela BARGUES (1996) developed a study establishing several comparisons regarding local governmental accounting systems in Germany, United Kingdom, France and Spain. He pursued an analytical approach using the revised Contingency Model to explain some differences in the politico-administrative environments of local governments in these countries.

As most important issues of this research we stress:

- It complemented Lüder’s (1989, 1992 and 1994b) analyses for France, Germany, United Kingdom and Spain. In fact, this study further clarified

Lüder's comparative analysis, not only strictly considering local government, but contextual changes meanwhile happened after Lüder's researches, as well. This led to some different conclusions regarding the influence of the independent variables of the Contingency Model on local government accounting innovations in the countries studied (Vela BARGUES, 1996, pp.50-54).

- The use of an analytical approach of the Contingency Model, opposing the descriptive one followed by the majority of the studies that have been using this framework. This allowed to conclude that

In spite of the differences affecting the politico-administrative environment in the four countries studied, one fact is clear. France, the United Kingdom and Spain have developed since the end of the eighties a clear innovation process that has affected their local government accounting system. Also Germany seems to be following at present a similar direction. But considering those countries, with the exception of Spain, the present evolution of governmental accounting is characterized by innovation processes that still maintain a rather traditional accounting system on the central level and that progressively are shifting their accounting system at local level to managerialist accounting. (Vela BARGUES, 1996, p.54)

- A descriptive analysis is added to the analytical one, trying to establish comparisons concerning the nature of the local government accounting innovation processes in the four countries in study.

Based on Lüder's (1995, quoted in Vela BARGUES, 1996, p.55) analysis, Vela BARGUES (1996, p.55) found that local government accounting reform processes in the four countries were following different patterns that were affecting its own configuration. Accordingly, he suggested a classification based on the distinction of innovation processes not mutually exclusive:

- A global innovation process – affecting local government as a whole, usually involving changes in financial accounting without modifying or introducing management accounting systems. These were, up to a certain point, the cases of Spain and France, although in these countries, the size of the jurisdiction was requiring the introduction of selective criteria of implementation. The innovation process in UK was found to be global in its general orientation, but somehow selective in its results.
 - A selective innovation process – not directed to local government as a whole, but inspired by a managerial orientation implemented through the development of pilot projects. A clear example of this was Germany.
- The “informative dimension” of the four countries local governments accounting systems was discussed. In particular, some rather debatable and subjective considerations were made about a few elements of a local governmental accounting system that the author considered to be helpful to assess its informative dimension:
 - Measurement Focus, Basis of Accounting and the relationship between budgetary and financial accounting information;
 - Financial Reporting;
 - The development of consolidation standards.
 - Considering the differences observed in the results of the analytical approach, Vela BARGUES (1996, p.66) also presents some considerations related to the difficulties of global harmonisation of local government accounting systems in Europe.

In our opinion, the main contributions can be summarised basically in two aspects. On one hand, it showed that the analytical approach of the Contingency Model could be used to explain why governmental accounting systems were following different directions at central and local level. Because in the majority of the countries studied the environmental conditions were acting differently for both levels of government, traditional accounting remained at central level of government, while managerial accounting was progressively being developed at local level. On another hand, the supplementary descriptive analysis allowed a step forward in the knowledge of local government innovation processes, considering the classification according to different configuration patterns. Particularly interesting in the latter case is the identification of selective innovation processes, like the German case. From a contingency perspective, as Vela Bagues (1996, p.56) emphasised,

(...) they enforce a singular relationship between the dependent variable and the independent variables of the contingency model. This relationship can be defined as a feed back effect of the accounting system on the politico-administrative environment (...).

E) Following the study developed in 1994 for the Swiss federal government accounting, two years later Schedler (1996) used again the revised Contingency Model to explain changes meanwhile happened in the Swiss local government (specifically at the cantonal level), despite the slow process at the federal level (see 2. above).

The ideas of the New Public Management approach were being very well accepted by the Swiss cantonal governments, which were developing instruments towards its implementation. However, the whole process was still in the very beginning.

Even so, as Schedler (1996, p.227) explained, the future of the Swiss governmental accounting at the cantonal level was expected to go far beyond the traditional financial perspective, considering the developments already happened towards cost, performance and effects accounting.

The Contingency Model was used to analyse the slight changes that had been put in place up to that moment and to give an outlook of the ideas and models that seemed to be affecting the cantonal government accounting changing process in Switzerland at that moment. Accordingly, Schedler (1996, pp.233-235) summarised the main features of the Swiss cantonal government accounting innovation process, highlighting: the dominating doctrine of the New Public Management as main stimulus; the general public not interfering in the reform process; and the

administrative actors as primary interventionists in the reform process, not only as producers but also as users of financial and management information.

As Schedler (1996, p.235) concluded,

As the emphasis *lied* on the administration at *that* moment, the accounting system *was* likely to be designed primarily with a weight on management accounting contents. It *was* foreseeable, however, that the political actors as users of information *would* define their own needs within a short period of time and the accounting and reporting system *would* have to provide for the relevant information [italics provided].

The most interesting point of this approach seemed to have been to highlight, within a context where the New Public Management ideas were being disseminated, the role of administrative managers as users of governmental accounting information. Additionally, the Contingency Model was used not only to explain changes already happening but others expected to take place in a near future, i.e. it was used for some prediction of future tendencies of the Swiss cantonal governmental accounting reform process.

F) Van Helden (2000) developed a different comparative study for eight Dutch municipalities. In particular, he empirically tested what he called the “financial stress hypothesis”: *Is financial stress an incentive for the adoption of businesslike management techniques (planning and control) in local government?*. He carried out what he considered the first micro-level test of that assumption, addressing individual municipalities. In his study the implications of that hypothesis for local government organisations were also taken into consideration.

Van Helden (2000) supported his research in Hood’s (1995, quoted in Van Helden, 2000, p.83) theory about New Public Management, which encompasses the “financial stress hypothesis”, although tested at a macro-level for some OECD countries. This theory basically suggests that reforms in public management are dependent on both motive (promise of resource saving – financial stress) and opportunity (the existence of an integrated public sector).

Explaining the relevance of testing that hypothesis for Dutch individual municipalities, Van Helden (2000, pp.86-87) states:

Because of *the* moderate fiscal stress and due to the fact that the central government could only encourage rather than force municipal authorities to adopt new public management tools, municipalities probably still had the discretion to introduce and apply these tools [italics provided]. This implies that an analysis of differences between individual municipal authorities may throw additional light on processes of adopting businesslike planning and control instruments.

In order to perform the test Van Helden (2000, pp.89-93) transformed into single indicators both the concept of financial stress (independent variable) and the

application of businesslike management instruments – progressiveness in planning and control (dependent variable).

On the basis of relative values, his results allowed conclusions to be drawn with respect to the relative financial position of municipalities and the existence of planning and control instruments. Nevertheless, most important, they did not allow confirming the “financial stress hypothesis” for Dutch municipalities. In fact, it was expected a negative relationship between municipalities financial position (represented by indicators that were classified) and the progressiveness of planning and control (Van Helden, 2000, p.93). For the sample used, this was confirmed only in three cases, being rejected in the remaining five cases. Accordingly, Van Helden (2000, p.96) clear concludes that

The investigations show that the financial stress hypothesis cannot be confirmed. However (...) this does not indicate a conclusive judgement about this hypothesis.

Accordingly, he critically reviewed the results of his study, discussing in detail some aspects that might have been responsible for his research controversial and/or somehow distorted results. Among other issues, Van Helden (2000, pp.96-98) highlighted: problems in the proxies used to transform concepts into measurable variables; a *ceteris paribus* clause assumed for independent variables other than motive an opportunity; and the small size of the sample used.

Van Helden’s (2000) refutation of the “financial stress hypothesis” for local government can lead to question one of the relations admitted in the Contingency Model – financial stress is one of the most important stimuli to trigger governmental accounting changes. Furthermore, as Lüder (2001, p.9) pointed out, some general remarks on the significance of single independent variables of the model might be raised as consequence of Van Helden (2000) research: 1) the list of independent variables is presumably incomplete; 2) the significance of the variables and thus their influence on the innovation process differ (all variables do not necessarily have to be present in every single innovation process; also variables significance may vary among countries); and 3) certain variables on the list that have never been observed in any innovation process have to be deleted.

However, considering empirical evidence found in other studies (e.g. Pallot, 1995) for the relevance of fiscal stress in governmental accounting reforms, this does not seem to be one of the variables to be abandoned. On the other hand, from our

perspective, the previous mentioned critical issues emphasised by Van Helden (2000) to justify his survey results made them become not so reliable.

Nevertheless, we think that Van Helden's (2000) approach had the merit of starting a statistical test, although very debatable, of a hypothesis that, even very evident in many situations, had never been tested at this or other level of government. This was also an attempt to do some quantitative research, which is still a great failure in CIGAR studies (Lüder, 2001, p.17).

4. Monsen and Näsi (1998) presented a discussion about CIGAR and the Contingency Model (initial version). They also provided some suggestions on how those could be developed.

Although they recognised the importance of the Contingency Model as an important instrument at service of CIGAR, they acknowledge that

(...) there are some critical issues to discuss within CIGAR research, implying that more comparative international governmental accounting research is urgently needed. (Monsen and Näsi, 1998, p.281)

Accordingly, they critically discussed three issues (Monsen and Näsi, pp.281-286):

- Further studies of the governmental accounting context

In spite of what Chan *et al.* (1996, p.11) stated regarding great amount of governmental accounting research have been devoted to contextual rather than to behavioural variables, Monsen and Näsi (1998, p.281) believe that it is still necessary a better understanding of the governmental accounting context itself and its relationship to governmental accounting. They argue that

The Contingency Model identifies contextual and behavioural variables potentially relevant in explaining the outcome of the governmental accounting innovation process, but it does not illustrate or describe the governmental accounting context itself.

(...) some important characteristics of the governmental accounting context are missing from the Contingency Model. (Monsen and Näsi, 1998, p.282)

Hence, they presented an Economic Process Model of Government⁵⁰ (Monsen and Näsi, pp.282-283), illustrating the governmental accounting context. In this model two process are distinguished for governmental units: the input-output process and the monetary process. While the first one is quite similar to that in firms' contexts, the second one is more complicated and with certain specificities rather different than firms.

⁵⁰ This is an extension of a corresponding model of the firm developed by Finish authors; during the 1960s and 1970s it was an important element in the Finish business economics curriculum (Monsen and Näsi, 1998, p.282).

Monsen and Näsi (1998, p.283) argued that the Economic Process Model of Government should complete the Contingency Model, allowing further CIGAR developments. Moreover, they suggested that a possible future incorporation of the first into the latter might help to understand what constitutes a governmental accounting innovation (Monsen and Näsi, 1998, p.287).

– The dichotomy of users and producers of accounting information

The authors also suggested further modifications on the Contingency Model initial dichotomy of users and producers of accounting information. In particular, they argued that some actors might occupy different roles simultaneously or in different time periods; this multitude of roles might affect the way a particular actor will operate in the accounting process (Monsen and Näsi, p.283)⁵¹. Since the Contingency Model had not considered this issue, they suggested an extension of the model dichotomy, using Ijiri's (1975, quoted in Monsen and Näsi, 1998, p.283) framework. Basically, this implies addressing the accountability relationships between the interested parties in the governmental accounting process: accountant, accountee and accountant.

– From cameral to accrual accounting?

With this topic Monsen and Näsi (1998, pp.284-286) intended to raise a debate on what is a governmental accounting innovation.

They argued that

Even though 'traditional government accounting' is not explicitly defined or explained in the CIGAR literature, this term most likely refers to 'cameral accounting', given the fact that cameral accounting thinking (*with a strong cash focus*) is the mode of accounting thought traditionally applied in government organizations [italics provided]. (Monsen and Näsi, 1998, p.284)

Additionally, they questioned whether the replacement of cameral accounting with accrual accounting (with its matching principle) constitutes, in fact, a governmental accounting innovation, as it is considered within the CIGAR literature.

Based on what they presented in the Economic Process Model of Government, arguing that the governmental accounting context is more complicated than the corresponding context of a business firm, Monsen and Näsi (1998, p.286) explained that it is more problematic to apply the matching concept in governmental accounting (although they recognised that it can be applied for certain activities

⁵¹ The authors refer to a study for local government accounting in Sweden (Brorström, 1982, quoted in Monsen and Näsi, 1998, p.283), where it was observed that the situation with unclear roles in the accounting process caused problems both with regard to the design and use of more informative accounting reports.

where the linkage between expenses sacrificed and revenues earned is direct or close enough, which are rare cases in governments). Hence, they clearly concluded that

(...) the adoption of accrual accounting as the main accounting model in governments does not represent an accounting innovation. (Monsen and Näsi, 1998, p.286)

In our opinion, the main value of this research is that it critically discusses very important aspects of the Contingency Model specifically and CIGAR in general. Indeed, instead of merely applying the Contingency Model as many did, Monsen and Näsi (1998) debated some of its most critical aspects. Notwithstanding the primary importance of everything that was discussed, the considerations around the concept of “governmental accounting innovations” seem to us of particular interest. As Lüder (2001, p.8) recognised, once central in the Contingency Model, this is a concept that is fundamental to be explained.

Even if these authors’ arguments might not be pacifically accepted (see, for example, Lüder, 2001, p.9), they certainly alerted for some confusion about governmental accounting innovations that should be clarified. This was later considered, as it will be presented, in the FMR Model.

5. Montesinos Julve and Vela BARGUES (1996) complemented the application of the Contingency Model (revised version) to Spain (Lüder, 1994b). In particular they presented some more details, considering innovations that were recently happening, especially as a consequence of: 1) the definition in 1992 of a new conceptual framework for Spanish governmental accounting, through the approval of eight pronouncements on accounting principles; 2) the publication in 1994 of a new chart of accounts at national level; and 3) the design of a new management information system (CANOA – Spanish abbreviation). In their opinion, these reforms

(...) evidenced the need of a further analysis to identify additional considerations on stimuli and variables that *could* enforce the understanding of those reforms [italics provided]. (Montesinos Julve and Vela BARGUES, 1996, p.233)

However, in our opinion, apart from increased level of detailed, which was expected once they are Spanish authors writing on their own country situation, no significant changes were made to Lüder’s analysis.

Nevertheless, some important aspects of the Spanish governmental accounting reforms were emphasised, which we think are the value added of this analysis, allowing CIGAR researchers to know more about the Spanish case (Montesinos Julve and Vela BARGUES, 1996, pp.233-236).

Among several issues discussed, we must highlight the analysis presented for Spanish Local Government – not embraced by Lüder (1994b) – and the emphasis on the still lack of development of management accounting systems, notwithstanding CANOA. As Montesinos Julve and Vela Bargues (1996, p.236) stated,

With few exceptions, management accounting systems remain obsolete, and even do not exist. This circumstance represents a clear orientation that future reform initiatives should encourage. In fact, the present environmental conditions seem to be quite favourable for introducing new developments in that field, specially considering the transition to an accrual based accounting system, the business influence, the fiscal stress that begins to be important in Spain and the managerialist culture that is invading the social and political debates.

This was somehow contradictory with Lüder's (1994b, p.13) managerialism-driven contingency model of government accounting innovations in Spain, where the output of the reform process was defined mainly as an improved managerial accounting; financial accounting and reporting improvements were just considered maybe possible to happen.

Later, these authors revised the former analysis, mainly clarifying some issues but with no consequences on the Contingency Model (Montesinos Julve and Vela Bargues, 2000, pp.136-138).

6. An important extension referred by Lüder (2001, p.5) was made by Laughlin and Pallot (1998), when reviewing the governmental accounting reform approaches and processes of eleven industrialised countries. These authors highlighted the importance of the so-called “**epistemic communities**”, not only in starting the governmental accounting reform process, but also influencing its direction and outcome. Accordingly, they suggested that those should be added as another contextual variable of the Contingency Model.

Lüder (2001, p.5) clarifies that

The particular characteristic of an epistemic community is that it is an informal, loose network of recognized experts with shared beliefs and convictions how to resolve a certain political or administrative problem.

All these works had been of an enormous importance, not only allowing the CIGAR community to know more about governmental accounting systems (both at central and local level) and their environments in various countries, but also developing the only theoretical framework that, up to now, might be used as common basis for comparative international research in governmental accounting. However, except perhaps some Pallot's (1995) and Godfrey *et al.*'s (1995) suggestions, we believe that

none of them represented substantial improvements to the modified Contingency Model.

There are though two other applications of the model that, from our point of view, represented some steps forward in the contingency approach of the governmental accounting innovations. Because of its importance, we think that they are worthy to be described separately, in the next two sections.

4.2.4. A General Model of Public Sector Accounting Innovations

In an attempt to contribute to the completion and precision of the Contingency Model, Jaruga *et al.* (1995) proposed the addition of “consequences in the real world” and a feedback loop, in order to a better description and explanation of the public sector accounting innovations. This approach revealed to be particularly adequate for countries where the reform process has been slow and stepwise, like in Poland, for example⁵², where those authors applied the Contingency Model resulting from the changes suggested (Jaruga *et al.*, 1995, pp.7-16).

Figure II.9 illustrates the model suggested by Jaruga and Nowak (1996, p.30) as the final version of the one proposed in Jaruga *et al.* (1995). Once it represents a considerable difference compared with the previous modifications, Chan *et al.* (1996, p.8) considered this to be the beginning of the “third generation of contingency models”.

The disposition of the clusters derived from a rearrangement of the model, for the reasons mentioned in section 4.2.3.1. Furthermore, it was conceived (Lüder, 2001, p.4)

(...) that an accounting reform is not a one-time event but runs through several phases or cycles and that the result of a prior phase triggers subsequent reform steps.

Jaruga and Nowak (1996) believed that governmental accounting and government itself have to be positioned in a broader social context. Aiming to do this, they applied different sociological theories to complement the contingency one. In particular, they used (Jaruga and Nowak, 1996, pp.23-29):

- Parsons’ Functional Theory of Social Systems (Turner, 1978, pp.39-68, quoted by Jaruga and Nowak, 1996, p.23);
- Krzyzanowski’s Organisation Theory of the State (Krzyzanowski, 1992, quoted by Jaruga and Nowak, 1996, p.26);

⁵² In the beginning of the 1990s Poland was starting a transition process to democracy and market economy. Consequently, the Polish governmental accounting system was starting to experience some changes.

- Gell-Mann’s Model of Complex Adaptive Systems (Gell-Mann, 1994, quoted by Jaruga and Nowak, 1996, p.26).

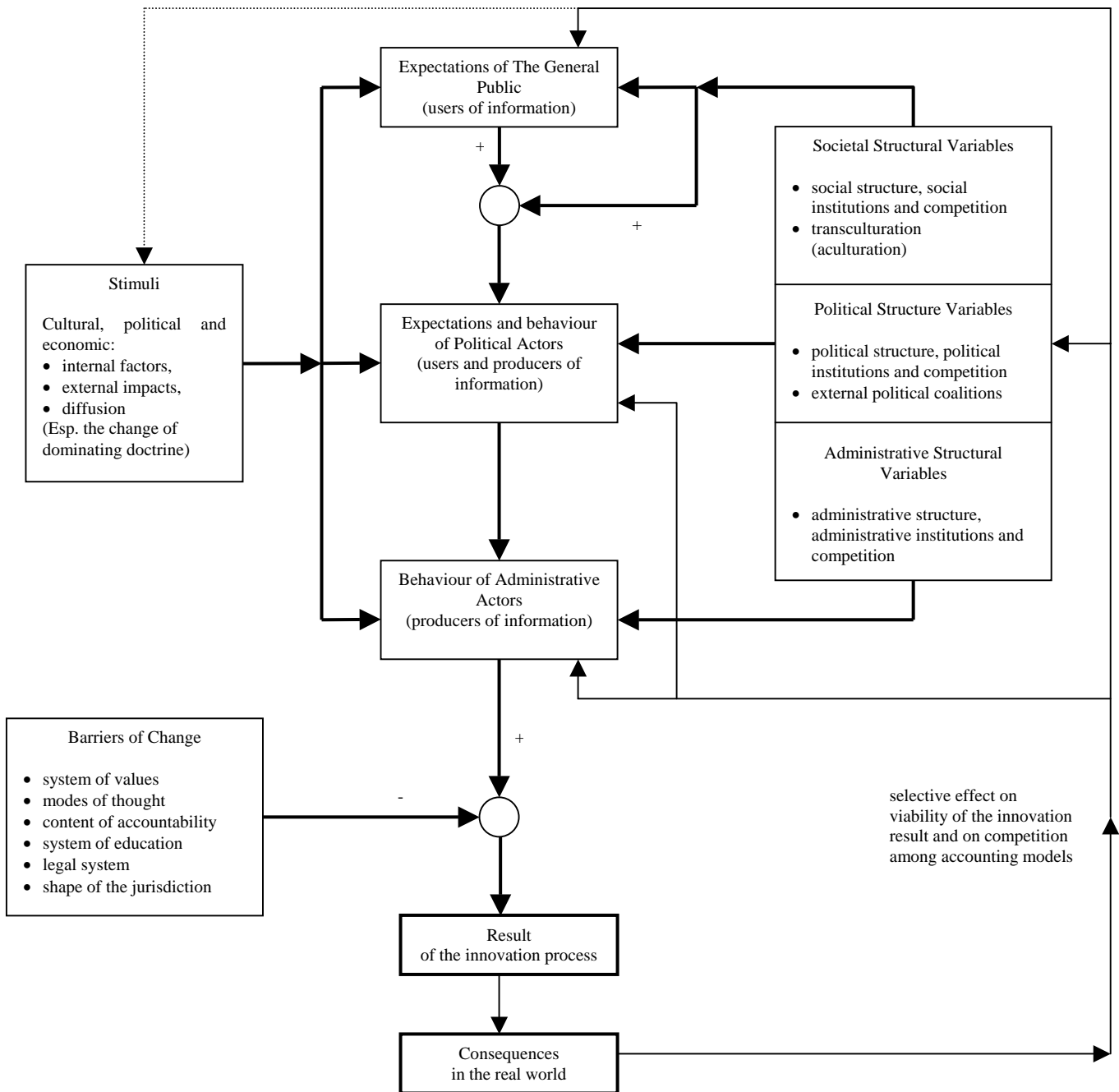


FIGURE II.9 – A GENERAL MODEL OF PUBLIC SECTOR ACCOUNTING INNOVATIONS
(Jaruga and Nowak, 1996, p.30)

The general model developed by Jaruga and Nowak (1996, pp.29-31) for governmental accounting innovations assumed that these might be conceptualised as

measures of adaptation or means of survival. Thus, they summarise the way they used the three above-mentioned approaches as follows:

Survival is a goal of most systems. Parsons' functional theory suggests that the survival of social action systems depends on adaptation, goal attainment, integration, and latency. Organization theorist Krzyzanowski offers a similar set of attributes for the state as an organization. We have also observed some striking similarities between the variables in the Contingency Model and the Krzyzanowski's model (...).

Gell-Mann proposed a dynamic model of organizations or systems, in which information plays an essential role. He linked adaptability with the ability to generate new information models that could describe the state of nature and predict consequences, thereby providing feedback to the system. This insight provides a theoretical basis for our suggestion to construct a more general model of public sector accounting innovations. (Jaruga and Nowak, 1996, pp.29-30)

Considering governmental accounting as a complex composite adaptive system, Jaruga and Nowak (1996, pp.30-31) believed that its place and function inside the government would be determined by the consequences of its outputs disseminated to its environment. Hence, they argued that the results of an innovation process are tangible outputs of the new system and need to be formally incorporated into the model. Moreover,

The consequences of innovation in the final analysis manifest themselves in the extent to which the new information affects the attitude and behaviour of the users and producers of such information. As to the structural variables in the current Contingency Model, at least in the short run, they are certainly much less susceptible to the influence of new information. However, in the long run such a possibility should not be ruled out. (Jaruga and Nowak, 1996, p.31)

In our understanding, the major contribution of these authors was **making the Contingency Model dynamic**, instead of the previous static framework. First of all, they called the researchers' attention for the importance of considering what difference the innovations are going to make in the world, i.e. in the context they are being implemented. Additionally, particularly admitting that the consequences of the governmental accounting innovations can affect attitudes and behaviours of users and producers of information, as well as the structural variables, these authors introduce for the first time the possibility of the model to explain governmental accounting reform processes that are rather cyclical. Accordingly, as Chan *et al.* (1996, p.9) explained, with a feedback loop, the model becomes a "cybernetic learning system".

Unfortunately, in spite of the enormous potential for research presented by these authors, as far as it is our knowledge, their research did not seem to have been followed, except for the case presented next. Thus, we may say as Chan *et al.* (1996, p.9) that

The full implications of such a dynamic model remain to be explored.

4.2.5. A Diffusion-Contingency Model for Government Accounting

The dynamic extension of the Contingency Model proposed by Jaruga and Nowak (1996) was recently continued and completed by Godfrey *et al.* (2001).

The first intention was to apply the Contingency Model recent developments to governmental accounting innovations in Albania. They were trying to fill the gap highlighted by Chan *et al.* (1996, p.10) related to the lack of knowledge about what have been happening in governmental accounting in the former Soviet Union and Eastern European (communist) countries.

However, they found that

(...) the model, whilst useful in forming a general understanding of the innovations taking place, failed to provide sufficient insight into the organizational processes of innovation. (Godfrey *et al.*, 2001, p.279)

Subsequently, they decided to combine elements of the Contingency Model with others from theories of diffusion of innovations, developing a “new hybrid model”.

Following the reasoning of Chan *et al.* (1996), we think this new model set the beginning of the “fourth generation of contingency models”. Indeed, it is the first time that someone complements the Contingency Model with a module aiming at the characterisation of the innovation decision process, trying with this to assess the organisational innovativeness.

The Diffusion-Contingency framework is pictured in Figure II.10.

Godfrey *et al.* (2001) major contributions may be stated as follows:

- Theories of diffusion of innovations are applied to complement the contingency approach.
- The use of a theoretical model of diffusion (Rogers, 1995, quoted by Godfrey *et al.*, 2001, p.280) allowed considering some factors, specifically internal and external “organisational structural characteristics”, affecting “organisational innovativeness”. Furthermore, aspects of the individuals’ roles within the diffusion process – both as internal and external “change agents and innovation champions (leaders)” – are seen as critical to understand accounting innovations.
- Roger’s (1995, quoted by Godfrey *et al.*, 2001, p.280) approach, also explains the lower part of the diagram, where the innovation process is separated into two phases: the “initiation” phase and the “implementation” phase, each of these consisting in several stages. Accordingly, the diffusion of innovation is not understood

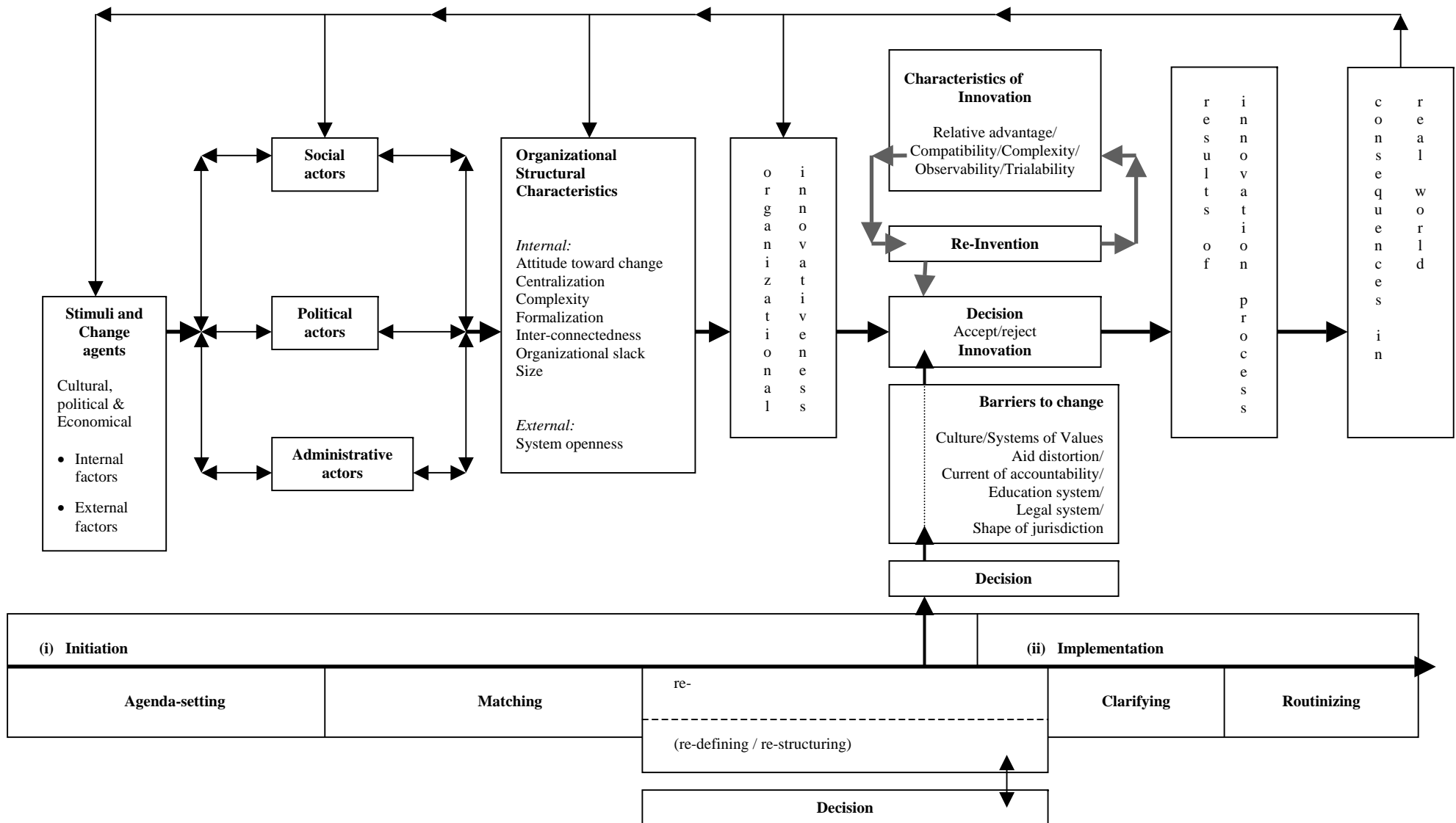


FIGURE II.10 – A DIFFUSION-CONTINGENCY MODEL FOR GOVERNMENT ACCOUNTING
(Godfrey *et al.*, 2001, p.282)

(...) as a simple linear communication system, but as an iterative social process, where the uncertainty associated with change is clarified over time through a convergent process of social construction. (Godfrey *et al.*, 2001, p.280)

The “agenda-setting” begins the “initiation” phase of the innovations diffusion process; it consists basically in defining organisational needs and problems as well as seeking for its solutions. In the “matching” stage an organisational problem is aligned carefully with an innovation; or alternatively, an innovation is perceived as a specific improvement to existing practice (Godfrey *et al.*, 2001, p.283).

The stages of “clarification” and “routinization” are very important processes for the innovations to pass from “new” to “routines” and thus become accepted as no longer innovations (Godfrey *et al.*, 2001, p.295).

– It is assumed that

(...) government accounting innovations in a country are the result of an iterative process whereby the interaction of political, administrative and social actors is conditioned and filtered by the organisational structural variables of the government (as an organization), which in turn affect the government’s organisational innovativeness. (Godfrey *et al.*, 2001, p.280)

– “Characteristics of the innovation” are considered an additional set of independent variables that affect the governmental accounting innovations process. Besides, those characteristics further constrain the decision to initiate and to implement an innovation.

– Potential “barriers to change”, together with above-mentioned characteristics of the innovation itself, affect the “decision to accept or reject” the innovation, through an iterative process of “re-invention (redefinition and restructuring)” (Godfrey *et al.*, 2001, p.295).

– The consequences of the governmental accounting innovation in the real world have further impact upon the positive stimuli emanating both from internal and external change agents, and upon the actions of political, social and administrative actors (Godfrey *et al.*, 2001, p.295). Moreover, they may also have a direct effect on the organisational structural characteristics and on the organisational innovativeness.

As the authors themselves summarise:

The Model, therefore, attempts to represent a complex situation where the organisational characteristics of government, which signal the level of innovativeness of the government, intertwine and interplay with characteristics of the innovation itself to determine the success or failure of both the innovation-initiation and the innovation-implementation processes. (Godfrey *et al.*, 2001, p.281)

From our point of view, the most important contribution of this approach lies upon bringing together elements of both the Contingency Model and the theories of

diffusion of innovations, providing a better insight into the social-political-economic, and above all, into the **organisational factors affecting the innovation process**. Additionally, **the innovation process is divided in several stages**, where innovations are diffused throughout time, considering the uncertainty normally associated to most of changing processes. It also has the merit of considering modifications in the Contingency Model suggested by other authors, like the above stated Pallot (1995) and Jaruga and Nowak (1996).

Additionally, Godfrey *et al.* (2001, pp.288-295) tested the diffusion-contingency model analysing its application to governmental accounting innovations in Albania, a former communist country, recently converted to democracy and experiencing profound economic and political changes, including in governmental accounting.

They not only could observe that the Albanian government level of organisational innovativeness was marginally positive, but also were able to identify the current position of the innovations process: it was in the clarifying stage of the implementation phase, which the authors consider a critical stage. In this, the new governmental accounting system has still little meaning within the government system.

Through social interaction, administrative actors in particular, but also political and social actors as stakeholders of the government organization, gradually gain a common understanding of the new system. This social construction is important in allaying uncertainties and answering questions. (Godfrey *et al.*, 2001, p.295)

On the other hand, the **possibility to identify the current position in the innovations process**, as it is done here, is another strength of this approach. Furthermore, **it is possible to identify specific stages of the governmental accounting reform process where the social interaction/construction is particularly important**, like seems to have been the case of Albania clarifying stage: there, the social interaction was fundamental to help surpassing the barrier to change – the culture under the old regime.

4.2.6. The Financial Management Reform Process Model

The FMR Model is a completely modified version of the 1994 revised Contingency Model. Lüder (2000, quoted in Lüder, 2001, p.10) himself, once again, developed this model not only adopting some of the former modifications and extensions, but also adding new ideas, brought about by discussions and other authors' critics. Besides, continuing the tendency of the model being drawn on case studies, new contributions from a research visit to Australia were taken into account.

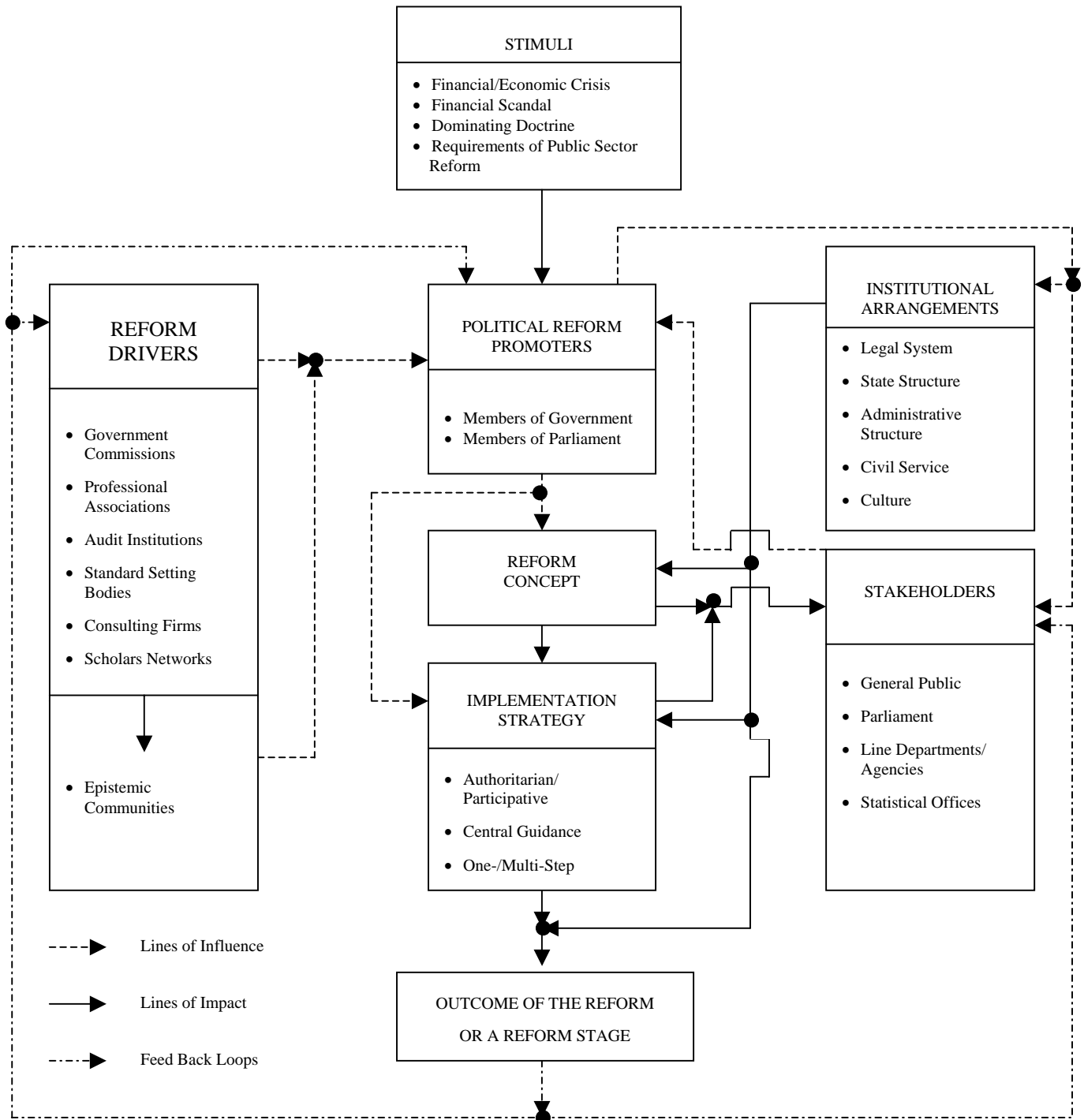


FIGURE II.11 – FINANCIAL MANAGEMENT REFORM PROCESS MODEL
(Lüder, 2001, p.24)

Figure II.11 displays the FMR Model as it is summarised by Lüder (2001, p.10):

The financial management reform process model (...) consists of two clusters of contextual variables (“stimuli” and “institutional arrangements”), three clusters of behavioural variables (“reform drivers”, “political reform promoters” and “stakeholders”) and two clusters of instrumental variables (“reform concept” and “implementation strategy”).

From our point of view, this model represents considerable changes relative to the previous versions. Because we believe that it will be the basis for the launch of a new set of “revolutionary” studies, we consider the FMR Model “the fifth generation Contingency Model”. In fact, although many differences exist from the prior “relatives”, a contingency approach still remains to be used.

Comparatively to the former version (Lüder, 1994b), some very important differences have to be highlighted:

1. The model formal structure is radically changed – although the FMR Model still displays a relation between contextual variables and the outcome of a reform process in governmental accounting, the modules were completely rearranged, and new ones were added:

- The contextual variables are now just included in the clusters “stimuli” and “institutional arrangements”;
- The behavioural variables, which in the previous version were considered as intervening (instrumental) variables between the contextual and the dependent ones, are now presented as behavioural clusters *stricto sensu*, correcting the emphasis of context over behaviour stressed by Chan *et al.* (1996, p.11);
- New instrumental variables are considered, with the addition of the “reform concept” and “implementation strategy” clusters.

2. The actors in the reform process are specified, aiming to shed some light into the understanding of the processes that generate and implement governmental accounting innovations.

3. There are changes in the clusters components and in the links between them (Lüder, 2001, pp.10-14):

- STIMULI (contextual variables) – Whilst they had remained by majority unchanged, the “fiscal or economic crisis”, usually underlying a “fiscal stress”, replaced the latter.

Additionally, “requirements of Public Sector reform” are added, to make clear that governmental accounting reform can be embedded in a larger reform of the Public Sector, particularly an administrative one. However, in our understanding, this is not a new feature of the FMR Model. In fact, even before, Lüder (1994b, p.7) admitted that

Fiscal stress may trigger an isolated governmental accounting reform but more likely a more general reform of the public sector which governmental accounting is only part of.

Furthermore, Lüder (2001, p.10) stresses that, for the specific case of developing countries, “endeavours to improve international reputation” must also be considered as a relevant stimulus for governmental accounting reforms.

The “stimuli” are considered to have a direct impact only on the politicians responsible for starting the reform.

- INSTITUTIONAL ARRANGEMENTS (contextual variables) – This cluster contains most of the components previously included in the (structural) societal, political and administrative variables, as well as in the implementation barriers. Although the categories are rather broad, Lüder (2001, pp.11-13) presents some additional remarks:

- “Legal systems” might be generally classified into civil law and common law systems – different legal systems may be linked to different types of governance (more or less flexible). The legal system also embraces the electoral system and the flexibility of the budget law;

- “State Structure”

(...) refers to such categories as “unitary/federal”, “cooperative federalism/competitive federalism”, “one chamber/two chamber parliament” and the division of power between the electorate, the (executive branch of) government and the directed elected bodies and officials. (Lüder, 2001, p.12);

- “Administrative Structure”

(...) refers to organizational characteristics (...) of the administration and the division of powers between organizational units such as “centralized/decentralized”, “concentration/fragmentation of financial management functions”, “existence of central organizational units at the different administrative levels” that are able to promote the reform in their area and “formal power position of the heads of central units and the heads of line units”. (Lüder, 2001, p.12);

- “Civil Service” – refers to the qualification of civil servants in general, accountancy staff in particular, which have a significant impact not only in the way governmental accounting reform is implemented, but also in the duration and the cost of that implementation;

- “Culture” refers to the national social, political and administrative culture, which can be specifically characterised as “risk taking/risk averse”, “individualism/collectivism”, the “degree of openness” of political and administrative processes and their “responsiveness” to the needs and demands of the general public.

Thus, the “institutional arrangements” are influenced directly by the “political reform promoters” behaviour, and indirectly (via those) by the “reform drivers” and the “stakeholders” behaviour. On the other hand, they have a direct impact on the “reform concept” and on the “implementation strategy”, which reinforces the direct force on the “outcome of the reform”.

- REFORM DRIVERS (behavioural variables) – Like Lüder (2001, p.10) states

These are recognized institutions and professionals in the reform field that promote the reform through oral and written publications aimed at making governmental accounting reform a political issue and influencing political decision makers in a specific way.

Accordingly, they suggest motives and ideas for political actors to engage in the reform. Subsequently, their behaviour influences all the reform process, while influencing the “political reform promoters”.

Different “reform drivers” may form an “epistemic community” of experts, if they share views on the main reform characteristics. These groups are assumed to strengthen the influence of the “reform drivers” on the reform process (Laughlin and Pallot, 1998, p.385, quoted by Lüder, 2001, p.11).

- POLITICAL REFORM PROMOTERS (behavioural variables) – These are the politicians, usually members of government, who initiate a reform and have the power to enforce it. In governmental accounting, as Lüder (2001, p.11) highlights, the minister of finance and the prime minister seem to play a key role. Particularly,

(...) the ministry of finance is an or even the key player in shaping the reform concept seeking the advise of reform drivers. (Lüder, 2001, p.11)

Hence, the “political reform promoters” behaviour not only directly influences the “reform concept” and the reform “implementation strategy”, but the “institutional arrangements” and the “stakeholders” as well.

Usually, the views of the “reform drivers” and the “political reform promoters” regarding the innovation process are coincident.

- STAKEHOLDERS (behavioural variables) – These

(...) are institutions or people positively or negatively affected by the reform that are neither drivers nor political reform promoters, such as the general public, the parliament, the administration (primarily line departments and agencies) and the statistical offices. In the case that the audit institutions are not reform drivers, they also belong to the stakeholders in the reform process. (Lüder, 2001, p.13)

Although “stakeholders” behaviour might be influenced by “political reform promoters”, and might also influence them, these actors’ views concerning the reform normally differ. As Lüder (2001, p.13) explains, some of the “stakeholders” may welcome the reform, expecting it to be in their interest, while others may opposing it, once they expect rather negative effects.

Moreover, it is assumed that

(...) stakeholders’ attitudes towards reform depend on the reform concept and the implementation strategy, on their chances to affect both, and that they are susceptible to political reform promoters’ influence. (Lüder, 2001, p.13)

For the reform process to be successful, “political reform promoters” must lead opposing “stakeholders”, especially those with key positions and powers within the process, to take at least a neutral position.

- REFORM CONCEPT (instrumental variables) – Innovations in order to allow the governmental accounting system to provide information useful for ensuring financial accountability and sound financial management – conceptually not merely procedural changes (Lüder, 2001, p.8). Innovative concepts underlying the innovation process (Lüder, 2001, p.9). It has a direct impact on the “implementation strategy”.
- IMPLEMENTATION STRATEGY (instrumental variables) – Includes components related to the way the reform is implemented, that directly affect its probability of failure or success (outcome).

4. Lines of influence, impact and feed back loops are identified, complementing and clarifying the links between the variables considered in the previous version (“affect”, “reinforce” and “impact” – see Figure II.6). In particular, the feed back loops (consequences on the real world) allow tying behaviour and attitudes of key actors in the innovation process to its results, taking into consideration the possibility of a multi-stage reform process (Lüder, 2001, p.10).

Depending on the size of a still existing gap between the outcome of the reform and the reform concept, the feed back either brings the process to an end or induces a subsequent reform loop with or without prior modification of the reform concept. (Lüder, 2001, p.14)

We think that the main virtues of this model can be summarised as follows:

a. It allows to surpass some weaknesses of the previous version:

- Insufficient explanatory power

As Lüder (2001, p.7) explains, the Contingency Model did not aim to explain the whole reform process including all relevant factors.

If the model is to explain the whole innovation process and the selection of a specific reform approach, it has to include additional variables such as behavioural, attitudinal and reform approach variables.

In the FMR Model, as it was presented, reform approach variables, as well as some specific environment configurations conducive to the implementation of specific reform concepts, are considered. This new construction of the model improved its explanatory power, once it becomes a representation

closer to the reality of governmental accounting reform processes that have been happening in many countries.

- Emphasis on context over behaviour (Chan *et al.*, 1996, p.11)

Even though it had not been enough, the specification of the actors involved in the governmental accounting reform process, as well as their behaviour, allows the FMR Model to step forward in understanding which attitudinal and behavioural variables are relevant to governmental accounting innovations.

- The notion of innovation (Chan *et al.*, 1996, pp.13-14; Monsen and Näsi, 1998, pp.248-286)

As mentioned, innovations in governmental accounting are considered to be conceptual changes of the accounting system, in order to make it better, i.e., more informative. However, since this seems to be a very broad definition, many authors – Lüder (2001, p.8) included – recognise the need for it to be clarified.

So as to avoid confusion about what governmental accounting innovations might be, Lüder (2001, p.9) suggests a distinction to be made between an **innovative concept** underlying a reform process, and the **outcome of the process**.

In the FMR Model a “reform concept” as a cluster of instrumental variables is clearly separated from the “outcome of the reform or a reform stage”. As Lüder (2001, p.9) admits, this can deviate from the concept and must not necessarily meet the requirements of an innovation. Moreover, we think that the cluster “reform concept” embraces somehow the characteristics of innovations, which Godfrey *et al.* (2001, p.295) consider affecting the innovations process.

Accordingly, we may say that, though maybe not sufficient, an attempt is made to clarify what we believe to be the most critical and controversial issue in governmental accounting reform: the reform concept itself.

b. It considers some suggestions from other authors’ researches:

- The process of innovation (Pallot, 1995, p.26)

Because in the previous model there was a great lack of specificity of the relevant behavioural variables, and also the innovation concept was still very

“cloudy”, little was known about how particular innovations are generated and implemented (Chan *et al.*, 1996, p.11). The need for more systematic analysis on the processes of generating and implementing governmental accounting innovations has been recognised as fundamental, considering that they may affect the failure or success of the whole reform process (Pallot, 1995, p.26). Furthermore, the Contingency Model is not very explicit about the decision processes through which innovations are adopted (Chan *et al.*, 1996, p.15).

The FMR Model tries to fill this gap, considering a cluster of instrumental variables concerning the “implementation strategy”, which embraces process variables, whilst the decision process underlying the reform is still not considered. This was done, as we presented, by Godfrey *et al.* (2001), where a module aimed at characterising the innovation decision process complements the contingency approach.

– Consequences in the real world

Jaruga and Nowak (1996, pp.30-31) suggested that the outputs of a governmental accounting reform have consequences disseminated to the environment, firstly affecting the behaviour of the actors involved in the reform, and later even the contextual variables. Accordingly, what they called the “consequences on the real world” must be considered somehow in the Contingency Model.

Through the feed back loops the FMR Model adds this suggestion, while the consequences are considered to be only on the reform actors’ behaviour. Therefore, as explained, the model, now more dynamic, allows not only tying behaviour and attitudes of key actors in the innovation process to its results, but also considering a governmental accounting reform process involving several stages, which is very useful once this has been the case in some countries (e.g. Poland and Portugal). However, some believe that this might not be enough. Chan *et al.* (1996, pp.15-16), for example, argue that

(...) the addition of this variable to the conceptual model should be accompanied by empirical research on the consequences of governmental accounting innovations. Why? The reason is that rational expectations about the consequences of accounting reforms might affect their success or failure.

– Epistemic communities

As mentioned, Laughlin and Pallot (1998, quoted by Lüder, 2001, p.5) considered that these communities of experts might have an important role not only in initiating a governmental accounting reform process, but also in influencing its direction and outcome.

Accordingly, considering that forming “epistemic communities” might be a possible grouping behaviour of “reform drivers”, reinforcing its influence on the innovation process, the FMR Model considers one that seems to be a progressively more important reform driver in industrialised countries⁵³.

In summary, the FMR Model has the great value of, on one hand, considering some critical issues and suggestions made by several authors as consequence of applications of (previous versions of) the Contingency Model; on the other hand, it takes into account new aspects developed from Professor Lüder’s own research and experience.

Notwithstanding, as Lüder (2001, pp.16-18) recognises, some problems still remain, which are not just weak points of the model itself, but of CIGAR in general as well.

4.3. Still some problems

This section aims to discuss a few problems that some recognise still exist, not only in the contingency approach previously presented, but also in CIGAR studies and literature.

In what respects to the contingency approach, we must highlight:

1) “Black-boxes”

The addition of more variables to the Contingency Model, as it is done in the FMR Model with behavioural, attitudinal and reform approach variables, has the great advantage of improving the model’s explanatory power. Nevertheless, we think that doing this there is the risk of creating “black-boxes”, i.e., variables that although known as affecting the governmental accounting reform process, one does not know exactly how they do it, to what extension or what are they precisely.

⁵³ Laughlin and Pallot (1998, quoted by Lüder, 2001, p.5) not only observed this importance, but even were able to identify more intellectual and more pragmatic epistemic communities.

In the particular case of the FMR Model, we believe that, in spite of all the above detailed endeavours for improvements, behavioural variables clusters, reform concept and innovation process are still “black-boxes”.

Indeed, we may extend to the FMR Model what Vela Bargues (1996, p.47) argued for the Contingency Model:

Governmental Accounting research using the Contingency Model would (...) admit a considerable descriptive dimension that characterises other studies following a “descriptive approach”. But the fact is that, considering the structure of the model and the relationship between its variables, such a descriptive approach would require to define more specifically the dependent variable, and to explain the elements or variables that define an “accounting system” and its “informative dimension”. The model has not yet fully developed those variables.

Accordingly, further research is needed to clarify and add explanations to these reform process interventionists, despite Godfrey *et al.*'s (2001) recent contributions to understand the innovation-diffusion process. Chan *et al.* (1996, pp.11, 14-16) suggested, for example:

- Studies on innovations implementation along with the consequences of adopting them, instead of assuming innovations as an identifiable event;
- Using literature on innovations to support research in order to access if governmental accounting reforms might be regarded as one category of innovations;
- Try to follow process-oriented research, where comparisons are made time-series (the core issue is the time sequence of innovation related events or activities) and not cross-section, as they have been made in variance research that still prevails in CIGAR;
- Because governmental accounting reforms have costs and benefits not only in economic but in political terms as well, the relationship between the information disclosed and power could also be an important area of research.

2) Complexity and speculation

Adding more variables, in our opinion, might also increase the complexity of a model that, although having the large merit of being the only framework presenting a contingency approach for the governmental financial management reform process⁵⁴, remains very difficult to test empirically. Consequently, it still contains speculative features.

As addressed, since the initial version, the complexity of multi-causal relationships between the variables in the framework makes it very difficult, if not

⁵⁴ Lüder (2001, pp.14-15) refers to a model of Public Management Reform developed by Pollit and Bouckaert (2000), which he admits to have a significant degree of correspondence with the FMR Model. However, he also emphasises important differences both in the focus and in the models construction and conception.

impossible to test statistically, though plausibility tests might be used. Consequently its empirical validity might be jeopardised.

3) The model basically explains only the governmental accounting context not contents

As explained, Professor Lüder's initial study had the purpose of comparatively analysing differences in governmental accounting systems contents in several countries, as well as potential contextual and behavioural factors that could affect them. However, this purpose was somehow deviated from when a contextual approach was developed, emphasising the conduciveness to governmental accounting reforms – the Contingency Model as a by-product of the Speyer study.

Indeed, as Lüder (2001, p.17) states, that study has not been continued by others. Additionally, as we also presented, no one seem to have been concerned about extending the model to include contents variables. Despite some arguments around the “black-box” of what the new governmental accounting system would be after the reform (outcome of the process), no author seems to have made any suggestions to be included in the model.

4) The model assumes the hypothesis that the environmental context does not determine the governmental accounting system contents

Since the beginning of his studies, Professor Lüder assumes that the information needed, not the environmental context, determines the appropriate contents for the governmental accounting system. No distinction between different accounting spheres is necessary in elaborating an appropriate conceptual framework for government accounting – one accounting system fits them all (Lüder, 1994b, p.1). As discussed in section 4.2.2.2, in the last instance, all the countries having the same information needs would have conceptually similar governmental accounting systems.

However, some evidence seems to exist to dispute this assertion. Godfrey *et al.* (1995, pp.25-26) explained that the influence of donor agencies and international organisations in underdeveloped countries governmental accounting often distort innovations, leading to hybrid systems that neither are simplistic cash-based, nor conform to the fundamental principles of governmental accounting. They conclude stating:

This perhaps reinforces much of the political economy of development literature which would dispute the assertion that one accounting system suits all countries. It would appear from our analysis that the accounting system cannot be effectively imposed by international organisations and donor agencies by ignoring key variables like the administrative culture, staff formation systems and the implementation barriers of staff qualifications and aid distortion. (Godfrey *et al.*, 1995, p.29)

Furthermore, concerning the aforementioned assumption, we argued that, even so, at least governmental accounting formal contents might differ, as consequence of different contextual variables.

Regarding CIGAR, it seems that the main problem is that, apart from descriptive studies on some countries individual situations, it has not been more than a set of critics of the Contingency Model, resulting from its discussions and above all, its applications to new realities. Therefore, as most important CIGAR problems, we stress:

1) Lack of studies using the Contingency/FMR Model in a probabilistic predictive way

As discussed, the studies using the Contingency Model to predict governmental accounting reforms tendencies are rare in CIGAR. Because the great majority of the analyses were made describing situations *ex-post* innovations and/or explaining those that were currently happening, one still know little about the Contingency Model's ability to predict. Subsequently, we may say the same about the FMR Model.

2) Excessive centralisation on Western European and Northern American countries

As highlighted, CIGAR needs to be extended to other countries, mainly from Asia, Africa and above all, Latin America. These extensions not only will enlighten CIGAR scholars on those countries governmental accounting systems, but also would allow verification of whether or not the ideas underlying the contingency approach can be generalised or have to be somehow modified. We intend in some way to contribute for this in Chapter IV, applying for the first time, the contingency approach to explain what has been happening in Portugal, as well as to predict the likelihood of future reform stages.

3) Lack of quantitative and field (comparative) studies

So far CIGAR studies have been almost exclusively non-quantitative. One exception was the above-referred Van Helden (2000) analysis of the “financial stress hypothesis”. Therefore studies involving more statistical analyses are desirable to assess, for example, the significance of the different structural, behavioural and instrumental variables involved in the governmental accounting reform process. Nevertheless, as Lüder (2001, p.17) stresses, researchers have to be prudent when using statistics, since many “traps” may appear, which they have to be aware of.

Even so, he also acknowledges that, for the time being, formally sophisticated statistical analyses are better to be postponed. For the moment, CIGAR must continue to

emphasise theoretical and non-statistical empirical studies, since governmental accounting (reform) theory still needs very important and deeper clarifications and empirical validations. These can only be done if efforts would be made in order to surpass the still great lack of funding for governmental accounting empirical research (Lüder, 2001, p.16-18).

4) Emphasis on studies of governmental accounting systems context over contents

Because CIGAR has been focused on the Contingency Model, which reflects only how governmental accounting context affects the conductivity to governmental accounting reforms, studies on governmental accounting systems contents have been neglected.

Moreover, as Chan *et al.* (1996, p.11) explained, this might have happened not only because accounting researchers might feel they know already about the accounting systems though they need to know more about its environment, but also because there might be more variability in the contexts than in the governmental accounting systems themselves. Thus, there is a significant lack of factual knowledge about governmental accounting systems over the countries.

We agree with Chan *et al.* (1996, p.11) when they explain that this is mainly due to the fact of a common research instrument for collecting internationally comparable data about governmental accounting systems, does not exist yet. This is also emphasised by Lüder (2001, p.17) when he recognises that a common framework for describing a governmental accounting system in a sufficient detailed and comparative way, still does not exist.

As Chan *et al.* (1996, p.17) also concluded,

(...) we suggest in the next stage of CIGAR research greater attention to be paid to content (i.e., the government accounting system) itself, the process of innovating, and the international diffusion of innovations.

As Lüder (2001, p.18), we believe that, considering the present CIGAR context of collaborative international research, most of the problems that we have just mentioned would be soon addressed.

5. FINAL COMMENTS

Finalising this chapter it is important to summarise some comments regarding the topics that were reviewed:

- International literature on Portuguese governmental accounting

This is very poor and has the weakness of concentrating on procedures and the “how” of accounting technique. Accordingly, there is no theory explaining the “why” of the Portuguese (local) governmental accounting or its evolution.

Subsequently, the existent literature offers little basis for judgements about future tendencies of the Portuguese governmental accounting system.

- Governmental accounting conceptual frameworks

The material on this has three major weaknesses:

- It tends to confuse “what is” with “what ought to be”, since many studies on accounting conceptual framework have been developed following deductive and normative approaches.
- It relates specifically to Anglo-American context. Since Anglo-American (governmental) accounting systems seem to be considerably different from those of Continental Europe, this literature is not of great help, if not seriously deficient, to understand the “why” of Continental European governmental accounting systems, such as the Portuguese. Additionally, this literature is typically written addressing financial reporting and not considering budgets (notwithstanding the British material on resource accounting and budgeting), which have a paramount role in Continental European accounting theory and practice.
- It results from studies either developed by academics or commissioned by standard-setting bodies. In any case, accounting policy-making is carried out in an environment where those defining the pronouncements have no power to enforce them. Accordingly, even if these frameworks might provide some explanation on the “why” (considering the components suggested for a governmental accounting conceptual framework), the lack of enforcement power seems to question the need for this theory as well as the amounts spent on its development.

- International Public Sector Accounting Standards

The literature here concerns in particular the IPSASs that have been developed by the IFAC-PSC. It also has some shortcomings:

- Notwithstanding some underlying theory, the IPSASs are essentially rules (standards) for practice, thus not explaining the “why”.
- As highlighted for the previous topic, the IPSASs have been developed within an Anglo-American accounting context, more specifically deriving from the IASs for business accounting. Therefore, they are essentially rules for accrual-based financial reporting, ignoring the consequences of using an accrual basis on the rest of the governmental accounting system (namely budgeting and finance).

However, as stated, budgets are central in Continental European governmental accounting systems. If a supposed theory on governmental accounting (as IPSASs might intend to be) does not address budgeting – a very important part of governmental entities financial management cycle – there is no point for accountability (financial reporting).

– CIGAR and the Contingency Model

The literature presented here is basically from Continental European comparative and country studies, derived from comparative international governmental accounting research. Neither of these though is convincing in explaining the “why” of existing Continental European governmental accounting systems, inasmuch as once again they essentially address the “how” of the accounting technique. Moreover, in general they do not provide a basis for explaining recent or future changes towards a certain orientation.

Nevertheless, the Contingency/FMR Model is an important comparative governmental accounting theory, already providing some explanation for the “why” of governmental accounting changing towards more informative resource accounting and budgeting systems. Yet, it addresses the effects of the governmental accounting context on the conduciveness to reform processes, not the accounting systems itself.

Portugal has not been considered in any of this literature.

In conclusion, in governmental accounting we still do not have a theoretical framework that could be commonly used to explain and describe, in a comparative-international perspective, the governmental accounting systems contents: why they are as they are different amongst countries (“what is”).

CHAPTER III

LOCAL GOVERNMENT ACCOUNTING IN PORTUGAL

Portugal has existed as an independent country since the XII century and from 1910 as a sovereign Republic. The Portuguese Republic Constitution (PRC) is the country's basic and highest law.

From the late 1920s until the beginning of the 1970s it was politically ruled by a fascist dictatorial government, under a regime set by the 1933 Constitution which guided all the national political life until 1974. This period was characterised by a strong centralised authoritarian political regime, with great economic interventionism by the Central Government. The State was highly centralist, reducing the role of Local Government to an extension or a “hand” of Central Government.

The 1974 military coup marked the beginning of the country's democratisation. The new political regime was set by the 1976 new Constitution, whose fundamental principles are still in force, despite four subsequent revisions.

Accordingly, the 1997 and latest PRC states that (article 2):

The Portuguese Republic is a State of democratic law, based on the people's sovereignty, on the pluralism of democratic expression and political organisation, on the respect and assurance of the effectiveness of the fundamental rights and freedoms, and on the separation of powers, aiming at achieving economic, social and cultural democracy as well as at deepening the participative democracy.

On the other hand, Portugal is also a unitary State, respecting in its organisation and functioning, the insular autonomous regime, as well as the principles of subsidiary entities, Local Government autonomy, and Public Administration democratic decentralisation (PRC, article 6, n.1).

Despite the privatisations that have occurred, the Portuguese Public Sector, as in other countries, is still a very large and heterogeneous reality, not only in terms of institutions it comprises (Central Government, Local Government, governmental business enterprises, public associations, public institutes, etc.) but also in respect to activities it develops and services it provides (some very much market oriented, following a private management philosophy, as television broadcasting or roads management; others clearly governmental-type activities, as education, health or administration itself).

As in many countries, although the boundaries of the Portuguese Public Sector are not so clear to define (inasmuch as there are “grey areas” and different criteria might be considered when classifying one entity as public or private), as we will present, some

distinction is possible between the Administrative Public Sector (APS) – commonly designated Public Administration – and the Managerial Public Sector (MPS), the latter comprising mainly governmental business enterprises.

This distinction is relevant since it has implicit different accounting systems. Hence, it is important to delimitate which public sector organisations must stay under the governmental accounting regime and which must follow the business accounting model. Accordingly, the APS follows the governmental accounting model, while the MPS uses the business accounting model, since the nature of most of the operations performed by the entities it includes is similar to private business organisations. Thus, the Portuguese public sector accounting comprises governmental and business accounting. However, since this chapter will focus on the APS, addressing Local Government in particular, our study is limited to governmental accounting,

As in other Western developed countries, the social and economic importance of the Portuguese APS is today exceedingly acknowledged, not only in terms of the resources it absorbs, but above all considering the services it provides. Indeed, it has been clear in the last forty years, mostly in the Western economies, an increasing of public expenditures, reaching in some countries more than 50% of the Gross Domestic Product.

Considering this noteworthy economic importance of public expenditures, in the last two decades there has been much concern at an international level, about the high public deficits and debt, leading Public Administrations to search for more efficiency, effectiveness and economy. The New Public Management philosophy has led governments to adopt private management models to a wide range of public services. Consequently, several reforms have been happening amongst different countries Public Administrations, in order to improve public services quality and promote modernisation, rationalisation, accountability and control.

Subsequently, across the EU, many countries have been compelled to financially discipline the whole Public Sector, and in particular Public Administration, managing the public accounts in a more integrated and efficient way. In this context, the importance of the information systems, mainly accounting systems, has been crucial. Following the modernisation process, the governmental accounting systems in many countries have been changing from those basically cash-based and oriented to the budget execution for more informative frameworks, in order to become decision-support instruments in addition to its main purposes of legal control and accountability.

Portugal has been within these trends. Particularly in the last ten years, the Portuguese APS has been under considerable reforms, embracing mainly administrative and financial aspects. Like Costa and Torres (1996, p.5) state:

After decades of impassiveness and country's political and economic isolation, *the Portuguese* [italics provided] Public Administration suffered, in the latest years, the impact of several factors of accelerated change: the democratisation process, the entrance for the EU, with the implicit convergence of policies and working methods, and, as well as the rest of the developed countries, profound technological changes that transformed the industrial society into the information society.

Additionally, since the beginning of the 1990s, Portugal has been through a period of modernisation of the State Financial Management Regime, including governmental accounting, given the passage of the first Public Accounting Basis Law (Law 8/90).

One other fact that reveals the great concern of the Portuguese rulers with these reforms was the creation in 1999 of the Ministry of the State and Public Administration Reform⁵⁵.

Although the governmental accounting reform had started at the Central Government level, it has been expanded into the Local Government. This is related to the decentralisation phenomenon, which has been a central issue in the political debate in many countries, supported by the principle that all the political decisions have to be taken the closest possible to the citizens. The European Charter for Local Autonomy, adopted by Portugal in 1990⁵⁶, reinforced the importance of devolving decision power to several administrative levels of governments inside countries. In this context, Portuguese local governments have increased their autonomy, not only widening their competencies (political and administrative decentralisation), but also through financial decentralisation. Unfortunately, the latter has been less than proportional to the former and consequently, local demand has increased above the efficient levels, becoming urgent to reduce the local expenditures as an alternative solution to insufficient revenues, in order to assure financial control. Local finances and accounting systems have here a crucial role as well.

Thus, the clearly top-down approach had allowed the governmental accounting reform to embrace the only two levels of Portuguese government: central (Republic Government and Autonomous Regions Governments) and local.

⁵⁵ Law-decree 474A/99 – law for the organisation of the fourteenth Portuguese constitutional government – article 28. Its mission is to promote the political as well as the Public Administration reform. The Secretary of State for Public Administration and Administrative Modernisation must support this Minister. Under the responsibility of the Secretary of State are, among others, the Public Administration General Department, and the Administrative Modernisation Secretariat.

⁵⁶ Republic Assembly Resolution n.28/90, October 23rd, quoted in Amaral (1993, p.427).

In particular, the recent developments of the Portuguese Local Government accounting have followed the international governmental accounting reform tendencies of the latest twenty years, where the main common points have been (Brusca Alijarde and Condor, 2002, p.158): moving from a cash-based to an accrual-based system, bringing governmental accounting near to business accounting, and a general concern to introduce techniques that allow improvements in managing the Public Administration.

In what concerns to governmental accounting research, as in many countries, in Portugal it has not been important, since the importance of governmental accounting itself has not been recognised. Nevertheless, great changes have been happening recently in this field as well: governmental accounting has been introduced in many courses, mainly in polytechnic institutes, but in universities as well, though here more at a post-graduate level; the accounting professional associations are also more interested in the subject; several meetings and conferences on governmental accounting have been organised; etc.

In spite of this, the number of nationally published studies is still very scarce, most of them mainly addressing technical issues. Regarding Local Government accounting in particular, the literature in Portuguese is even fewer, since the reform process is still happening. The international literature, as shown, is almost non-existent.

Therefore, in a context of such great changes, it is peremptory to systemise what has been happening in Portuguese governmental accounting, especially in Local Government, given its increase in political, social and economic importance.

In our understanding, these are reasons enough to justify this thesis in general and this chapter in particular, where we present an overview of Local Government accounting in Portugal, referring to Central Government too when necessary. The main purpose is to present and analyse the historical development as well as the current state of the Portuguese Local Government accounting system. At a more detailed level, we also describe how the whole system currently works. Subsequently, the chapter is divided in seven main sections.

The first generally characterises the Portuguese Public Sector, addressing its composition, the relationship between Central and Local Government, and the case of Local Government.

Then, the Portuguese governmental accounting is presented and discussed (as background for the Local Government accounting system): first we present a brief description of the evolution from public finances to governmental accounting; next we

discuss Local Government accounting within the context of the governmental accounting general framework – the official Chart of Accounts for Public Accounting (CAPA); finally we describe the first official Chart of Accounts for Local Government (CALG), not only emphasising its most important and innovative aspects, but highlighting some weak points as well. Legal statements are going to be referred to, considering the importance of legal requirements in regulating governmental accounting in Portugal.

The following section discusses the process of governmental accounting standard-setting in Portugal.

The last four sections describe in detail how the three accounting sub-systems – Budgetary Accounting, Financial Accounting and Cost Accounting, integrated as the whole current Local Government accounting system – relate to each other and work together, allowing not only budgetary control, but also disclosing economic, financial and cash information in order to assess the entity operational and financial performance, the value of its net worth, as well as to calculate the cost of the services provided.

The chapter finishes with some concluding remarks related to the future tendencies of Portuguese Local Government accounting.

1. THE PUBLIC SECTOR IN PORTUGAL

This section starts by describing the Portuguese Public Sector structure and economical importance. The relationship between Central and Local Government is discussed next, emphasising how it is related to the notion of autonomy and the decentralisation phenomenon. Finally, it describes in some detail the Local Government, starting from its history up to the current state.

1.1. Definition, composition and importance

The traditional vision of the Public Sector as *The State* was something inherited from the liberalism, where there was a simple view of a homogeneous State. However, in present times, in most of the countries, the Public Sector is much more complex, embracing several entities and institutions. Consequently, its diverse characteristics justify differences not only in financing but also in accounting terms.

The current structure of the Public Sector in Portugal reflects the need to define sub-sectors within the larger structure, identifying its legally attributed financial capacities.

Franco (1995, p. 143) defines Public Sector as

(...) the group of economic activities of any nature performed by the public entities (State, associations and public institutions, either based on the representatively and democratic decentralisation, or resulting from the technocratic functionality and decentralisation for effectiveness). *In an individuals' perspective, Public Sector* is the homogeneous set of economic agents that perform those activities [italics provided] – except the Public Sector employees, which integrate, as themselves, the private sector of the economy.

According to the PRC – article 82, n.2:

The Public Sector is constituted by the production means whose property and management belong to the State or other public entities.

In what its structure is concerned, following essentially a financial perspective, the Portuguese Public Sector is divided as stated into two main sub-sectors: the APS and the MPS⁵⁷.

The APS embraces the economic activities that, by their nature, are proper of the State and other public entities, performed according to non-entrepreneurial criteria⁵⁸.

According to Carvalho *et al.* (1999, p.15), the main purpose of these bodies is providing services to the community, free or semi-free of charge (with users sharing the payment), performing operations aiming at income redistribution. Their main financial resources come from the State or other public entities that, in turn, got them from taxpayers.

This sub-sector includes the Central, Regional (Regional Autonomous Governments) and Local Government. Social Security bodies, though might also be included in here, since their revenues come from compulsory contributions as well, usually are treated separately, with separate rules and legislation.

The MPS includes the activities dominated exclusively by economic criteria, namely production of goods and provision of services aiming at profit. It includes commercial, industrial, financial or other similar type organisations, whose main objective is to produce goods and services to be sold in the market. Its main financial resources proceed from sales (Carvalho *et al.*, 1999, p.15).

⁵⁷ According to Bernardes (2001, p.21) this is in harmony with the European System of Integrated Economic Accounts (ESA95).

⁵⁸ Franco (1995, p.144-145) discusses the difference between “Administrative Public Sector” and “Public Administration”, while commonly these terms are used indifferently, as we do here. Yet, in his point of view, although the Public Administration is the core of the APS, the latter includes not only administrative activities (governance in order to fulfil the society needs and interests) but also others, in order to produce goods and provide services out of the market, creating utilities. Accordingly, it includes administrative bodies, like the ministries, but others as well, like education, health and defence bodies.

It terms of accounting, there are two basic characteristics that make a clear distinction between APS and private companies: the non-profit orientation and the origin of its financial resources (Carvalho *et al.*, 1999, p.25).

While private companies’ management searches for profit, which is a good measure for its success, the APS management attempts to provide the best services with the available resources. Its performance cannot be objectively measured, since only the service provided itself or its quality can be used.

On another hand, the APS main financial resources come from taxes, which are compulsory without any direct counter contribution. According to Carvalho *et al.* (1999, p.26), this is the main reason why the APS has to be under a budgetary regime. In fact, the budget is the formalisation of the public policies, of the entities’ objectives and priorities, as well as an instrument for legal control. Subsequently, because the economic and financial activities of the bodies belonging to the APS depend on the budget, this has a very important role in the information those bodies report.

This explains why, in spite of all the changes that have been happening in the APS accounting in order to integrate Financial and Cost Accounting, the Budgetary Accounting is still the most important.

The Portuguese Public Sector composition may be summarised as follows.

Public Sector	Administrative Public Sector - APS (State <i>lato sensu</i>)	Central Administration	State <i>strito sensu</i> : integrated or simple public services
			Autonomous Central Administration
		Social Security	
		Regional Administration	Autonomous Regions: Azores and Madeira Archipelagos
		Local Administration	Parishes Municipalities Administrative Regions
	Managerial Public Sector - MPS (governmental business enterprises)		

TABLE III.1 – PORTUGUESE PUBLIC SECTOR COMPOSITION
(Adapted from Franco, 1995, p.145)

The **Central Administration** comprises the integrated or simple services, which are dependent from the State Budget and embraced by the State General Account, i.e., they do not have their own budget (they are integrated with or dependent on other entities, though have their own financial administration committee distinct from the

State financial administration) and all the expenses have to be superiorly authorised. In practice these are the ministers cabinets but also general departments (education, agriculture, finance, health, energy, ...) and other organisational units within the Central Administration.

On the other hand, it also includes entities that, although included in the State Budget, are autonomous, either only administratively or both administratively and financially.

According to the rules of the State Financial Management New Regime, addressed later, the first are designated as “services administratively autonomous” (general regime), once they just manage the financial appropriations they are granted. These amounts are within the State Budget global amounts. Every month, each entity Management Committee requires a portion of the entitled appropriation to be released for current use. This Committee is responsible for the entity’s financial management and accountable to the Treasury at the end of each year.

The second are “autonomous services” (exceptional regime⁵⁹), since they have property, budgetary, treasury and borrowing autonomy. This means that they own and decide on their property, they have their own budget, managing revenues and expenditures, they manage their own cash autonomously, and they can contract loans (within certain limits set by law), assuming the responsibilities independently. Therefore they are administratively and financially autonomous. Here are included hospitals and medical centres, military units, universities and other public schools, and the Parliament (Republic Assembly) itself, among others.

In addition, there are also autonomous funds, which are services/units dedicated exclusively to the management of financial resources, as for example the Tourism Fund and the Pensions General Fund.

Although the autonomous services, as well as the autonomous funds, *do not have budgetary independence*, they have their own private budget, published as a separate statement inside the State Budget. Moreover the State Budget might include financial transfers in their favour.

⁵⁹ According to the Public Accounting Basis Law (Law 8/90, article 6, n.2), the Central Administration services and institutions are considered financially and administratively autonomous only if both this autonomy reveals to be better adequate for its management, and its own revenues cover at least 2/3 of its total expenditures, excluding those co-financed by the European Community budget; unless this kind of autonomy is a constitutional imperative (as happens with public universities – PRC, article 76, n.2).

The entities belonging to the **Social Security** sub-sector have their own differentiated regime. According to Carvalho *et al.* (1999, p.40) they are considered institutions (either at central or regional level) providing services with *special budget* (following particular rules and procedures set by the Social Security Basis Law), published as a separate statement inside the State Budget and separately approved in the Parliament.

The **Regional Administration** consists of politically and administratively autonomous regions. According to the PRC – articles 6, n.2, and 225, n.1 – Azores and Madeira archipelagos are the only two Portuguese autonomous regions, which have their own political-administrative rules, due to their specific geographic, economic, social and cultural characteristics, as well as to the insular populations' historical aspirations to autonomy. Therefore, they have their own Regional Government and Parliament, independent from the continental Central Government. Additionally, they also have Local Government, with the same kind of organisation as Continental Portugal.

In relation to the State Budget, they include public services with *budgetary independence* – with particular rules for their own budget preparation and approval (Carvalho *et al.*, 1999, pp.39-41). In fact, the PRC – article 227 – defines as powers of the autonomous regions, among others, to manage and decide on their own property, define their own taxes, and approve the regional economic plan as well as the regional budget and accounts.

The **Local Administration** embraces every entity whose activities and decision power is separated from the Central Administration (both in Continental Portugal and in the autonomous regions)⁶⁰. Its services aim at satisfying the interests of a certain geographic territory, since they are a consequence of a process of administrative territorial decentralisation.

According to Amaral (1993, pp.393-394) four main features characterise the entities belonging to the Local (Autonomous) Administration:

- They pursue public interests proper to the population of its territory (not others' – such as the State – interests);

⁶⁰ One must not confuse Local Administration – politically, administratively and financially autonomous from the Central Government – with State's Local Administration. This refers to Central Government bodies whose activities are performed in certain (local) territorial areas, not embracing the whole national territory (Amaral, 1998, p.218, quoted in Bernardes, 2001, p.26).

- They are “self-administrated” in the sense that they do not obey to any orientations or directions from the Central Government to perform its activities;
- They are subject only to an “administrative tutelage power” from the Central Government (set by Law 27/96 – Juridical Regime of Administrative Tutelage), which consists not in a power for orientating, but basically in a power of fiscal and legal control, materialised in controlling the accomplishment of the law by local governments’ committees. It is therefore control of legality (inspecting and sanctioning) and not of merit;
- They are “collective entities of population and territory”, having a human substratum together with the geographic area.

The PRC (article 238, n.1) established that the entities belonging to the Local Administration have their own finances and property. Therefore, the services they provide have *budgetary independence* as well (Carvalho *et al.*, 1999, pp.39-41).

Given the emphasis here in Local Government, further developments on this will be presented later.

As to the MPS, any more details about it are outside the scope of this work. However, considering its business characteristics, it is easily understandable that it includes companies managed following a profit orientation, with an economic organisation very close to the private sector. Accordingly, they adopt the business accounting system and have *budgetary independence*⁶¹.

One other issue worthy to be mentioned is the powerful centralising tradition that still exists in Portugal, although recently, as Cravinho (2000, p.10) states, there is

⁶¹ Jones and Pendlebury (2000, p.128) explain that governmental business enterprises are not, by definition, strictly profit-oriented, so they do not belong to business private sector. On the other hand, its inclusion in the public sector, for what accounting is concerned, is not so clear as well. In fact, although they might receive capital resources that may come from sources of financing other than sales (e.g. capital grants from the government), they also receive a significant proportion of their current financial resources from the sale of goods and services rather than from taxes.

On the other hand, as Carvalho *et al.* (1999, p.21) explain, government business enterprises have resulted from more intervention of the State in the economy, broadening its functions and entering on the commercial and industrial fields. Though the objectives of a government business enterprise (see Carvalho *et al.*, 1999, p.19) are traditionally different than seeking profit, this does not mean that they might not be profitable. They provide services that for several reasons were found better to be provided by a business company, mostly not considering for the services prices-setting a free market logic. However, its transactions as well as the nature of most of its operations are very close to private business organisations.

This explains that, in broad terms, its accounts follow the business model, as Jones and Pendlebury (2000, p.128) emphasise.

Indeed, as Carvalho *et al.* (1999, p.21) make clear, from an accounting point of view, there are no significant differences that justify methodological changes to the business accounting model. Additionally, they state that the main reason why governmental business enterprises started to use business accounting model was because traditional (cash-based and budget oriented) governmental accounting was not adequate to reflect its transactions.

(...) the consensual verification that it is necessary to reverse the excess of centralism of our administrative public system, either through decentralisation or even through de-concentration.

The centralisation philosophy justifies the still considerable dimension and importance for national economy of the Portuguese APS.

This is discussed by Franco (1995, pp.147-148). In his opinion:

The Public Sector dimension is a doctrinal, ideological and political problem, par excellence: it derives from human societies' choice between resorting to the public or private activity (...). This choice, clearly bi-polar, follows a great range of separated choices, concerning the fulfilment of concrete needs. But, in global terms – therefore, in what concerns the whole Public Sector dimension – if it depends on each one of the separated choices, it assumes autonomy as political issue as well.

Assuming the dimension of the Public Sector as a political choice, Franco (1995, pp.148-149) recognises the need of using technical criteria to measure it, allowing not only analyses either in absolute or relative terms, but also time and space comparisons.

The more frequently used indicator is the percentage of the Public Sector Total Expenditures over the Gross/Liquid Domestic/National Product.

Accordingly, the following table illustrates the economic importance of the Portuguese APS.

	Public Expenditures 10 ⁶ Euro	%GDP	Public Expenditures (%)
ADMINISTRATIVE PUBLIC SECTOR	55,194	51.09%	100%
Central Administration	34,004	31.47%	61.61%
Regional and Local Administration	6,307	5.84%	11.43%
Regional Administration (Azores and Madeira)	1,366	1.27%	2.48%
Local Administration	4,941	4.57%	8.95%
Social Security	14,883	13.78%	26.96%
Gross Domestic Product (1999) – Current Prices (10 ⁶ Euro)	108,030		
Exchange Rate (1999): 1 Euro = 200.482 PTE			
Source: National Institute of Statistics (INE) – National Accounts 1995-1999			
Note: The flows between public administrations were consolidated at the level of each sub-sector			

**TABLE III.2 – PORTUGUESE PUBLIC EXPENDITURES (LIQUID FROM TRANSFERS)
BY GOVERNMENT LEVELS – 1999**

Table III.2 provides evidence of the high level of public expenditures centralisation in Portugal: according to the most updated published information from the National Accounts, the Central Administration together with the Social Security represented 88.57% of the Total Public Expenditures. This is understandable considering that the main public services, like health and education, are mostly provided at a central level.

Furthermore, the APS Total Expenditures represented 51.09% of the Gross Domestic Product (GDP). With respect to Local Administration Total Expenditures, these represented 4.57% of the GDP. According to Bernardes (2001, p.47), this is one of the lowest values within Europe, and it is a case for reflection on the effectiveness of the political, administrative and financial decentralisation.

1.2. Relationship between Central and Local Government

The Portuguese APS organisation and institutional functioning follows a hierarchical-centralised model. In terms of Government, there are only two hierarchical levels: central and local. However, from the previous section, it becomes clear that not all public entities depend on the Central Administration. This is the case of Local Government, designated before as the Local Administration.

Accordingly, Portugal is a State where two levels of political decision co-exist; in other words, there are two spheres of Public Administration, with their own capacities to legislate, collect taxes and use them in accordance with their own priorities, autonomously, i.e. independently from decision or control of an upper level government.

Therefore there is a **system of fiscal federalism** (Musgrave and Musgrave, 1989, and Stiglitz, 1988, in Carvalho, 1996, p.27). This means that the governance functions⁶², namely those of providing services to fulfil public needs, have to be shared by the two levels of government. Although the boundaries for the competencies of each level of government are not easy to define, according to Carvalho (1996, p.28) the model of distribution of fiscal responsibilities (within the theory of fiscal federalism) gives Central Government the stabilisation and distribution functions, while Local Government must promote activities providing goods and services of local character (allocation function), since this is closer to the citizens and thus can better assess their needs and preferences. Subsequently, while Central Government provide services essentially to fulfil collective national needs (e.g. national defence), Local Government must provide services in order to satisfy needs of citizens living in a certain localised

⁶² As Musgrave and Musgrave (1989, quoted in Carvalho, 1996, p.28) explain, the Public Sector functions relate to the use of macro-economic budgetary policy to:

- Assure the provision of public collective goods and services through the allocation of public resources (allocation function);
- Assure a fair income distribution through adjustments and redistributions (distribution function);
- Assure a macro-economic stabilisation, using budgetary policy to increase employment, to control prices and to reassure economic growth (stabilisation function).

area (local needs – e.g. infrastructures), which might be different from others living somewhere else.

Thus, as Carvalho (1996, p.31) states:

(...) Local Government economic activity might be defined as the one that promotes or assures the satisfaction of local needs, through the process of transforming economic resources that it withdraws from the economy or that are given by the State, thus assuring an adequate level of collective goods and services locally provided.

A system of fiscal federalism requires reinforcement of decentralisation and financial autonomy of Local Government, in order to have what Amaral (1993, p.424) designates “Local Power”. Nevertheless, this also raises some problems, as the aforementioned sharing of functions (competencies) and, more important, sharing of revenues.

In Carvalho’s (1996, p.28) opinion, these problems are the main causes for the complexity in the relationship between Central and Local Government. Indeed, in Portugal the decentralisation controversy has been the central issue in many inflamed political debates in the last five years, where the main questions relate precisely to how to divide competencies and resources among the levels of government, since there seems to be some agreement that Public Administration efficiency has been penalised by the excessive centralism.

According to Amaral (1993, p.422), the constitutional imperative for the Portuguese State to include an Autonomous Local Government in its organisation is the materialisation of the concepts of both juridical and political decentralisation: juridical in the sense that local governments are entities juridically different and independent from the State; political in the sense that their committees are directly elected by the respective populations⁶³. These two types of decentralisation allow us to speak of Local Government as “self-administration”: the populations administer themselves, pursuing their own interests. Yet, as the same author emphasises, something else is needed in order for Local Government to become “Local Power”, i.e., having some power in face of the State. Hence, Amaral (1993, p.424) states:

In our opinion, there is local power only when local governments are truly autonomous and have a large degree of administrative and financial autonomy: i.e., when its competencies and attributions would be wide enough, when they would be given the human and technical necessary means, as well as enough material resources, to pursue and exert those, and when they would not be excessively controlled by the administrative and financial tutelage of central power.

⁶³ During the dictatorship there was only juridical decentralisation. Nevertheless, as Amaral (1993, p.423) points out, under the appearance of decentralisation, there was a strongly centralised regime, since local governments pursued the interests of the State, having its president and committees nominated by the Central Government.

Although we might agree with this author saying that a true Local Power in Portugal is still an objective to reach (inasmuch as Central Government still interferes in many areas, providing centrally a large number of important public services as justice, health and education), the truth is that recent regulation, which we will refer to next, has been transferring competencies from Central to Local Government, representing for the latter a significant widening of functions together with some increase in human, technical and financial resources⁶⁴.

In fact, recently, after the administrative regions project has been denied by the people in a referendum occurred in 1998, the Portuguese rulers recognised that the only way to prevent the country continuing to be penalised by the excessive centralism of the Public Administration, is through a redistribution of competencies between Central and Local Government.

Cravinho (2000, pp.11-12) states that

At the present moment, all the decentralisation process as to be referred to the Local Government forms already existent as well as its associations. To reach that, the Government (...) has made great efforts renewing Local Government legal framework – namely through new tutelage laws, creation of municipal and inter-municipal business companies, Municipalities' and Parishes' Associations, and new attributions and competencies.

The Law 159/99, is a good example, setting the structure for the transfer of attributions and competencies to Local Government, at the same time as it delimitates both Central and Local Administration interference, materialising both principles of administrative decentralisation and Local Government autonomy.

This law continues emphasising the general principles (article 2):

1. The decentralisation of powers is made through the transfer of attributions and competencies to local governments, aiming at the reinforcement of national cohesion and inter-regional solidarity, as well as at the promotion of public management efficiency and effectiveness (...).
2. The administrative decentralisation assures the materialisation of the principle of subsidiary entities, and the attributions and competencies must be performed by the level of administration better placed to pursue them with rationality, effectiveness and closeness to the citizens.
3. Both Central and Local Administration should coordinate its interference, in the performance of proper competencies, (...) in order to assure the unity in the pursuance of public policies and to avoid actions overlapping.
4. (...)
5. The pursuance of the attributions and competencies is done according to the law and implies powers concessions to local governments committees, allowing them to perform in several areas, which nature may be: a) consultative; b) planning; c) management; d) investment; e) control (inspection); f) licensing.
6. (...)

⁶⁴ This transfer process of attributions and competencies particularly started in 1999 is supposed to be gradual, expected to be completed at the end of 2003.

Local Government administrative and financial autonomy, as well as decentralisation, is assured by the PRC. In its latest revision in 1997, modifications were made, considering the competencies redistribution between both levels of government.

As to the decentralisation, for example, article 6, n.1, states that although Portugal is a unitary State, the **Local Government autonomy**, as well as the Public Administration **democratic decentralisation, are respected**. Also article 237, n.1, states that the law, **in accordance with the administrative decentralisation principle**, regulates Local Government competencies and organisation.

In what respects to the recent tendencies of Public Administration structural reform, the PRC also presents guidelines to support decentralisation (article 267):

1. The Public Administration must be structured in order to **avoid bureaucratisation**, to **approach the services to the populations** and to assure the participation from those who are interested in its effective management, namely through public associations, residents' organisations and other forms of democratic representation.
2. Regarding what is stated in n.1, the law will establish **adequate types for administrative decentralisation and de-concentration**, considering, at the same time, the necessary effectiveness and Administration unity of action (...).
3. (...)

On the other hand, the Central Government interference in Local Government is limited and set by law, as is also declared in the PRC (article 242, n.1)⁶⁵:

The administrative tutelage over local governments consists in the verification of the accomplishment of the law by the local governments' committees, and it is performed in the cases and following the outlines defined by law.

Although we have already referred to the **financial autonomy**, it is worth adding here some explanations. "Financial autonomy" is opposed to the "financial sovereignty" and, though generally it is the attribution of financial powers to the under-State entities, it must be interpreted according to the several areas of financial activity (Franco, 1995, pp.152-153). Accordingly, public entities may have autonomy in one or more of the following areas: property, budget, treasury and borrowing. This happens, as we mentioned, with the Autonomous Central Administration, but also with Local Government (Bravo and Vasconcellos e Sá, pp.44-45).

Local finances law (Law 42/98), states about municipalities' and parishes' financial autonomy (article 2):

1. The municipalities and parishes have its own property and finances, whose management is due to the respective committees.

⁶⁵ This is the present situation. However, considering the Portuguese political history, in particular the dictatorship period, the State interference in Local Government used to be much more intense. For further details on this see Amaral (1993, pp.515-520) and Sousa (1993, pp.157-167).

2. The tutelage over local governments financial and property management is merely inspective and can only be performed according to the ways and in the cases admitted in the law, always assuring the democracy and the autonomy of local power.
3. The financial autonomy of municipalities and parishes is based, namely, in the following powers of its committees:
 - To prepare, approve and modify the options of the plan, budgets and other forecasted documents;
 - To prepare and approve the accounts;
 - To collect and use the revenues that they were entitled by law and to give orders for processing the expenditures legally authorised;
 - To manage the entities' own property as well as other that would be allocated to them.
4. Any deliberations of municipalities' and parishes' committees concerning the exercise of fiscal powers or the levy of fees and other taxes not previewed by law, are considered null.
5. Any deliberations of municipalities' and parishes' committees determining or authorising expenditures not allowed by law, are considered null.

The tutelage mentioned in n.2 refers to an **inspective tutelage** from Central Government over all aspects **related to local governments financial and property (patrimonial) management**. It is though different from the aforesaid administrative tutelage, though it is a consequence from that. Therefore, it aims at verifying legal accomplishment particularly in respect to (Carvalho, 1996, p.126): investments multi-annual plans, budget and budgetary execution, accounting, creating and collecting of revenues, authorisation and payment of expenditures, debt, property management, and fiscal obligations. In practical terms, Central Government intervention is summarised to formal (legal) control of the budgetary execution, not having any interference of economic or political nature. This control is performed normally by two Central Government bodies: the Finance General Inspection and the Territory Administration General Inspection.

Nevertheless, we may add that, in spite of being financially autonomous and budgetary independent, Local Government is still **financially** largely **dependent** from the Central Government. Indeed, as we will explain, on average almost half of Local Government total revenues have come from financial transfers from Central Government and the EU, so the proportion of revenues proper to Local Government has not been enough for this to be considered financially independent.

Thus, we agree with Carvalho (1996, p.41) when he explains that the division of competencies between Central and Local Government, within a decentralisation policy, though bound to contribute to increasing the autonomy for the latter, has had up to a certain point, the opposite effect, inasmuch as it has increased Local Government financial dependency. Indeed, in accordance with what we presented before, Local

Government autonomy results mainly from its autonomous capacity to collect revenues and allocate them to projects or actions to the benefit of local populations, without any direct or indirect interference of upper government in setting policies or defining priorities. Hence, in order for local governments to become a true “motor” for the local development process, they must have not only the adequate competencies, but also the proportional financial means, particularly some fiscal capacity allowing them to create their own revenues reducing financial dependency. Yet, what has been happening recently in Portugal is that the administrative autonomy in terms of freedom to perform their activities has not contributed to reduce financial dependency. In spite of the considerable positive evolution that has been happening in terms of Local Government **fiscal power**, this is **still very limited**. Thus, in terms of revenues, Local Government still seems to essentially work as the spender of resources collected by Central Government and then transferred according to several criteria (which we will refer to later). As long as local governments were not given enough fiscal power to increase their own revenues, local autonomy will tend to be lost, since Central Government, as the main provider of financial resources, will always tend to implicitly control the way they are applied.

The Portuguese Local Government has fiscal power given by the Constitution (PRC, article 238, n.4). Nevertheless, it is also assured that these powers are within the limits set by other more specific laws and regulations. This means that in practice, although local governments might have some fiscal powers over the taxes whose revenues they are entitled to (Law 42/98, article 4, n.1), these are very limited in the sense that most rates are in general centrally set, and the power to concede some fiscal benefits have also central interference. In terms of prices, rates, fees and fines, the fiscal capacity is total, but these are not so important within the total revenues proper to Local Government.

One other issue that changed recently, in order to reduce the Local Government financial dependency are the possibilities and rules for Local Government to contract debt (banks and other financial institutions loans, municipal bonds and financial leasing). Carvalho (1996, pp.70-71) relates this changes to the permanent problem of keeping the entities’ budget balanced. In fact, in a reality where the competencies are increasingly its diversity, meaning more intervention of Local Government in social and economic areas, the financial needs are growing at a proportion much higher than the resources. So the insufficiency of resources tends to be permanent. In view of this, debt

seems to be the last resort to assure the balance of the budget. However, it is important to keep in mind that financial indebtedness in Local Government is generally used for investments that, contrarily to companies, do not produce profit, thus a chronic debt must be avoided.

Hence, the Local Finances Law regulates the **debt regime for municipalities and parishes** (Law 42/98, articles 23 to 28), imposing some serious credit limitations, setting the particular situations when those entities are allowed to contract debt, and for what purposes. The only warranties local governments are allowed to provide for loans are their revenues, except grants and earmarked revenues; thus non-earmarked transfers from Central Government might serve as warranty as well (Law 42/98, article 24, n.7). Loans to be used in social housing might be warranted via the houses' mortgages (Law 42/98, article 24, n.8). Repayment of debt principal and interest are priority expenditures. Therefore, Local Government debt is not default free, despite it might be seen as of low-risk.

Although local governments might have some freedom to decide and approve (through the deliberative committees) short and/or long term loans, the truth is that Central Government has on this a high degree of intervention, exerting a ruled-based control with ceilings on debt ratios, and other constraints namely related to the purposes of the debt, set centrally, in the above-mentioned law. For example, short-term loans are allowed only to support treasury (cash) difficulties, while long-term loans are in general to finance capital investments (Law 42/98, article 24, n.1-2).

Unfortunately, the great majority of Portuguese local governments, namely municipalities, have been experiencing serious lack of financial resources, which had led to serious financial problems. Notwithstanding the possibility of contract debt, for many the debt capacity ratio was surpassed a long time ago, and the only way of continuing is either to develop contracts of technical and financial cooperation with Central Government for certain projects involving large sums of funds, or to keep a deficit to be negotiated with Central Government or to be absorbed by the State Budget. In any case, the dependence from Central Government is not reduced, on the contrary, so Local Government autonomy is seriously compromised.

According to Carvalho (1996, p.48), the solution advocated by local politicians, points to an increase of non-earmarked transfers from Central Government. This seems to be the easy way, but at a central level the answer unanimously tends to point to a redefinition of local choices, giving priority to programs that stimulate the growth of

local economy, with more accuracy in the way expenditures and revenues are forecasted.

At the moment we believe a compromise solution has been reached with some increasing in transfers, but also some commitment from the Local Government itself concerning efficiency improvements in its activities. Even so, as Carvalho (1996, p.38) also emphasises, there are some important factors that will always be a constraint for local autonomy: in Portugal, as we will present, there is a great diversity of local governments, with different financial capacities, and also very different needs. Some of them might be more independent than others, in spite of the criteria for transfers take into account equity criteria.

In this respect, Bernardes (2001, pp.44-50) discusses both principles of vertical financial equilibrium and horizontal financial equilibrium. Although we will come back to these when referring to Local Government finances, we believe they are important to be mentioned here, since they address the relationship between Local and Central Government.

Vertical financial equilibrium does this in a very direct way in the sense that it is materialised in three aspects: sharing attributions/competencies, sharing resources (though main taxes such as VAT and income tax are collected centrally, part of these must be redistributed locally – non-earmarked financial transfers), and solutions to assure a fair proportionality between decentralisation of competencies and financial resources (as it is expected from Local Finances Law 42/98, article 5, n.3).

Horizontal financial equilibrium emphasises that in sharing responsibilities and resources, inequalities among local governments at the same level have to be considered, protecting entities that might be weaker just because they have a great disproportion between its financial resources and the basic functions they are supposed to perform.

As to the link between autonomy and decentralisation, Franco (1995, pp.141-142) states that the financial and patrimonial (property) autonomy of certain public entities, local governments included, results from decentralisation. This might be a political decentralisation (as happened with the Portuguese Autonomous Regions – “Unitary Regional States”) or an administrative decentralisation.

The administrative decentralisation legally creates new collective entities of public law, performing functions inside the APS, but with relative autonomy. It may be

an institutional (horizontal) decentralisation, or a **geographical (territorial) decentralisation**, for reasons of effectiveness, rationality and decisions socialisation. Local Government materialises the latter type.

In Portugal, the Ministry of the State and Public Administration Reform has led the Public Administration modernisation process, in particular the Territorial Administration reform. The governmental programme set a priority of de-concentrating several components of the Central Administration, in order to improve their accountability to those entities responsible by the regional development.

Cravinho (2000, p.13) summarises that

(...) this new type of political intervention intends to establish a way of performing of Central Administration attentive to the aspirations and reactions of the regional and local development principal actors, offering the Government as a whole, the capacity of being personified in the territory where it is urgent to coordinate the agents and its policies.

According to Carvalho (1996, p.145), with the inclusion of the decentralisation principle in the PRC, the relationship between Central and Local Government came out to be regulated considering that entities at different level were together responsible for the fulfilment of collective needs. Consequently, local governments autonomy process has given the “Local Power” great importance in the recent social and economical changes. Furthermore it has contributed to the reinforcement of local democracy, as well as to the increasing of the freedom to decide in accordance with the specificities of each place. However, as that author also stated, this competencies enlargement, involving huge amounts of resources, may be used to justify management failures that might turn up.

Thus, although the Public Administration decentralisation has already started and will soon be a reality, the decentralisation *versus* centralisation controversy, in our opinion, will always be present in the Portuguese political life (as in other countries), once it is necessary to find a balance between strengthening the “Local Power” and assuring economic and financial solidarity that must exist amongst local governments at the same level. Concerning the latter, since the State will always continue to have the main role in assuring the fulfilment of fundamental rights as well as the income redistribution, there is a strong reason for a certain degree of centralism.

1.3. The Local Government

Two main subjects are approached here: the origins of Portuguese Local Government, mainly evidencing municipalities’ organisation and finances; and its

present state, characterising current local governments definition, types, competencies, structure and finances.

1.3.1. Brief history

The Portuguese Local Government history is inevitably related to its autonomy. Indeed, it seems that since ever, local governments have had in some way, their own “self-government”. However, local autonomy today seems to have little to do with the one from monarchic times. Furthermore, over time, it seems to have been an alternation between periods of strong power and independence, and others of more frailty and reinforced centralisation.

According to Sousa (1993, pp.23-26) the Portuguese Local Government origins ascend to the Iberian Peninsula Roman colonisation, centuries before the country foundation in the XII century. One type of Roman cities was *municipalities*, with proper laws and inhabited by non-roman citizens. Each municipality was like a “little Rome”, with a people’s assembly and a municipal senate.

Nevertheless with the centralised regime of the emperor Dioclecianus, these strong autonomous Iberian municipalities became mere administrative boundaries. They became even weaker with the Germanic invasions.

Later, in the Lusitanian times, it was another Roman emperor – Sertorius – that, once asked to be the leader of the Lusitanian people, brought in the Roman law, creating the municipalities in their territory. These were later adopted, with some modifications, by Portuguese monarchs.

When the people from the north came to south to “re-conquer”, they found in the Arabic cities, some self-government regulation. Once this was working very well, it was acknowledged by the rulers. But the immigration of northern people to colonise the south, with new styles of life, led to the need of approving new regulations – “the charters” (*forais*) conceded by kings and lords (nobles and clericals).

Subsequently, in the XII and XIII centuries, many “charters”⁶⁶ were given for the majority of the now “true” Portuguese cities and large villages (Portugal was founded in 1143). The King used “the charters”, as well as privileges concessions, to give municipalities some “freedom atmosphere”, reinforcing his power in relation to the feudal lords.

⁶⁶ Sousa (1993, p.25) explains that these Iberian “charters” were completely different from “the common charters” existent in other countries by then: they did not accept the principle of collective government, although admitting a limited self-government.

Indeed, these “new” Portuguese municipalities

(...) were born as centres where the shadow of the monarch power was projected, in attempt to establish himself opposing the territorial powers of the feudal lords (Sousa, 1993, p.79).

On the other hand, “Central Power” was then very badly organised, having two main concerns: war and taxes collection in order to finance it.

Meanwhile, the population became more dispersed, and there was an imperative need for spontaneously self-regulation of people living in towns and villages, especially considering the weakness of “Central Power”.

New forms of local governance then appeared: local communities – municipalities and parishes⁶⁷ – based on neighbourhood relationships (Carvalho, 1996, p.33).

Municipalities in particular, performed several public administration tasks, having powers to interfere in the management of collective issues, like common use property, borders defence, roads, markets, hygiene, festivals, among others. Later, they also started to interfere in matters of urban and economic planning. According to Sousa (1993, p.80) these were not decentralised, but proper powers. There was a democratic representative regime facilitating the self-management of current issues.

However, as time went by, the representative mechanisms were destroyed while some became King’s personal emissaries. Consequently, local autonomy became frail with the interference, in the King’s name, in those until then strictly local issues.

Through centuries XIII and XIV, the number of King’s representatives managing local governments increased and diversified, with the purpose of improving administration and justice. Their functions became more specialised and they could have assistants. In particular the XIV century was very important for the strengthening of the local administration, bringing considerable changes in the relationship between this and the Central Power (Sousa, 1993, p.27).

In the XV century however, Portugal became simply divided in six provinces, opposing the previous territorial complex division in several categories. According to

⁶⁷ The historical roots of the Portuguese parishes are in the religious (namely Christians) communities. Etymologically the word *parish* means “sons of the church”; so, parishes were the church territorial communities, under the action of one priest. Little by little, these communities started to regulate the relationships between its members, managing its common interests. However, it was not until the end of the XIX century that they were recognised as a type of Local Government. Even so, they had only a few powers and even less resources. Already in the XX century, parishes became administratively part of municipalities, although with their own committees (Sousa, 1993, pp.73-77). While recently (Laws 159/99 and 169/99) their competencies might have been reinforced, they continue to perform functions basically delegated by municipalities. Accordingly, the latter are, since ever, the most important Local Government entities.

Sousa (1993, p.27), this was already an anticipation of the Renaissance tendency to centralisation, regulation and royal interference. The King had a representative in each province, whose powers were increased to taxes collection. This “army” of royal representatives continued to grow throughout the XVI century, reinforcing their powers in several domains, like justice, for example.

After the XVI century though, in the same way that it happened all over Continental Europe, there was a considerable constraint to Portuguese municipal autonomy, based on restricting certain fundamental ideas, later developed from the period following the French Revolution until the beginning of the XX century, becoming the basis for the modern local autonomy: municipal power, communal association, decentralisation theory, and local governance theory (Sousa 1993, p.81-85).

Centuries XVII and XVIII were characterised by a full power centralisation. But because Portugal was under the domain of the Spanish monarchs during the first half of the XVII century, their more developed administration style brought great reforms into Portuguese governance methods that, as it is stated by Sousa (1993, p.28), lasted for a long time.

From here, the system was improved and the six provinces from the XV century were divided in smaller administrative territories; as a consequence of the demographic explosion, some cities like Lisbon were divided in neighbourhoods, and progress was made in street pavements and sewage.

Nevertheless, it is only with the “Liberal State” in the XIX century that Portuguese municipalities started to directly explore some public services, like water, gas and electricity distribution, and urban public transports.

In 1910 Portugal became a Republic and during the 1930s, following several weak Republican Governments, a dictatorial political regime started when António de Oliveira Salazar went to the Government in 1928. A Constitution was issued in 1933, approving a political regime characterised by authoritarianism and economic interventionism. From there, there was a clear and progressive prevalence of Central Government over Local Government. Local governments’ functions were very limited, as these were considered as Central Government extensions. Their revenues were coming from the State General Budget and local committees were also centrally nominated and dismissed. In summary, Carvalho (1996, p.34) stated:

(...) the evolution that followed the 1933 Constitution assumed a profound centralising character, withdrawing competencies from local governments leaving only merely administrative functions, dependent on Central Government that nominated the respective

presidents, having as main financing source the participations and grants transferred from the State General Budget, in relation to which there were not pre set criteria.

As to Portuguese municipal finances/accounting, according to Carvalho (1996, p.53), they did not seem to be important until the XV century, when there seem to have been a European generalised need to prepare municipal accounts, probably because cities became more complex and developed, some becoming important trading centres. With more people, more public services were needed, and more taxes could be collected. Consequently, all these cash flows needed to be recorded, in order to be kept under control.

Notwithstanding the importance of financial issues in municipalities, those were historical records, in order to allow verifying the money applications. The importance of budgetary accounting was recognised much later, only during the liberalism period⁶⁸. Indeed,

(...) the modern Budget results from parliamentary democracies, more specifically from the current of economic thought of the XVIII and XIX centuries, founded in the liberal ideology, according to which the State should limit freedom as less as possible. (Carvalho, 1996, p.51)

After the French Revolution in 1789, the liberal ideas were reflected in the public finances in general. The control over the taxes creation and later over the public expenditures was claimed. Some more democratic ideas, against the previous absolutist regime, were developed as well, namely towards the separation of powers. The Budget was then considered the instrument of control over the State's activities, which mainly concerned internal security and the assurance of individual rights. The Constituent Assembly born from the Revolution adopted some of those that are considered today the classic budgetary principles, specifically fiscal equity, taxes inspection and justification, and scrutiny of revenues application (Carvalho, 1996, p.52).

These liberal ideas also affected Portuguese public finances. In fact, in 1836 the first Portuguese Administrative Code was approved, stating public finances and budgetary accounting rules.

According to Carvalho (1996, pp.53-56), in what concerns the Portuguese municipalities' budgets in particular, the councils were compelled to pre-calculate their

⁶⁸ According to Carvalho (1996, p.51) many authors consider that Middle Age governments did not know the Budget, with its more recent purposes, once the monarch himself was identified with the State and all the public property was King's property. However, he also explains that other authors argue that the Budget origins are deemed to be in England in the XIII century, as a consequence of fighting the monarchy absolute power. More particular, it is believed that the first budget in history (under the King's power in fiscal aspects) was comprised within the "Magna Charter" imposed to the King by the feudal lords.

expenditures and, in view of these, to introduce the revenues they could use as resources to finance those. There was also an obligation of publication in public places.

Six years later, the new Administrative Code from 1842 represented great developments in municipal budgetary matters: the president should present a budget proposal for the following year (from July 1st until June 30th), to be discussed by the municipal council and assembly. A supplementary budget was authorised as well. The budget structure embraced compulsory and optional expenditures and revenues. Expenditures that were not either in the current or in the supplementary budget were expressly forbidden.

Another Administrative Code (known as Rodrigues Sampaio's Code) was issued in 1878. These new rules were already very close to the present ones: the economic year changed for the civil year (from January 1st until December 31st), allowing a supplementary period of three months for some late payments of expenditures already committed, and the budget scope became the calculation of expected revenues and the description of expected expenditures.

In 1886 there was a revision of the previous code where the budgetary balance principle is clearly stated, since budgets with deficit were strictly forbidden. The publication rule changed as well in a revision happened in 1896: budgets should be published before being approved, allowing alterations in consequence of citizens' complains.

After the Republic implementation in 1910, several laws were issued, recovering the principles and rules from the two latest Administrative Codes.

In 1940 a very innovative Administrative Code came out. This adopted a new systemisation, as well as new principles and rules reflecting the evolution that meanwhile happened in the Portuguese public finances. The idea of prevision is clear in the Budget definition; the expenditures and revenues were classified as ordinary and extraordinary. Principles like non-compensation (gross amount) and unity were also adopted, already with the present meaning.

These 100 years of budgetary rules evolution, allowed municipalities' budgets to become rather sophisticated and budgetary accounting became very important and technically up to date, at the level of the majority of the most developed European countries.

In spite of this, local finances were of little importance during the dictatorship period. In fact, despite the Local Government financial autonomy principle being

explicit since the first Administrative Code, the strong centralised regime did not allow municipalities to create their own revenues or to access loans directly. Central Government provided most of financial resources to municipalities that were supposed to accomplish locally the measures and policies defined centrally.

The Revolution of 25th of April 1974 broke this centralised regime and restored democracy. With the 1976 PRC local governments reached a totally different dimension: they started to have their own financial resources and the regulation of their financial and administrative capacities became Parliament's responsibility. The decentralisation principle became then constitutionally assured and the autonomy legally assumed.

Unfortunately, as we explained in the previous section, in practical terms, nowadays, the autonomy principle is not always applied, not only because many small municipalities cannot produce enough financial resources, but also because there are different investments needs among them (Carvalho, 1996, p.38 and p.56). Nevertheless, the local finances recent evolution, which we will refer to next, has enlarged local governments' revenues diversity, mainly those related to direct municipal taxes, in order to reinforce municipalities' financial power and to apply the autonomy principle. In fact, as that author also highlights, the fiscal reform happened in Portugal in 1989 led to changes in local finances, namely concerning direct taxes, somehow reinforcing Local Government financial power mainly via property taxes, which thus became the more important proper revenues particularly in urban centres.

These financial alterations demanded Local Government accounting changes as well, which will be referred to in section 2.2.2.

1.3.2. Current types, competencies, structure and finances

Beginning this section, and considering Portugal as a Roman Law country, we must start by referring to the basic legal framework that currently rules all the "life" within local governments, i.e., that defines local governments juridical and financial regime. These regulations are: the PRC (particularly in Title VIII – Local Power); a basic law establishing the framework of local governments' attributions and competencies (Law 159/99); a basic law establishing the competencies, as well as the juridical regime of functioning, for the municipalities' and parishes' committees (Law 169/99); and particularly concerning financial and property management, as well as

budgeting and accounting, the Local Finances Law (Law 42/98) and the CALG (Law-decree 54A/99).

According to the PRC (article 235 – n.2):

Local governments are territorial collective individuals with representative committees, which aim at the prosecution of the respective populations proper interests.

Amaral (1993, pp.418-422) discusses a more embraceable definition, comprising the one above, but especially emphasising what he considers to be the four essential elements for the concept of Local Government:

Local governments are public collective individuals of **population** and **territory**, corresponding to the groups of residents in several circumscribed areas of the national territory, and that assure the pursuance of **common interests** resulting from the neighbourhood, through **proper committees, representative** of the respective inhabitants. (Amaral, 1993, p.418)

According to this author, the local population is of seminal importance, since it is the human substratum for Local Government, allowing this to define its functions considering local interests; also the population has rights (namely the right to vote, directly electing the directive committees for municipalities and parishes) and obligations (namely those related to paying local taxes).

The territory has three main functions for local governments: to allow a designation, a name that identifies each entity individually; to allow circumscribing the respective population; and to delimitate local governments' competencies to that bounded area. All Portuguese territory is divided in circumscribed areas embraced by local governments.

The common interests are the foundation for local governments activities: these exist to pursue local interests, specific to people living in their territory.

The representative committees: rigorously, local governments do not exist if they are not managed by representative committees democratically, directly and freely elected by its populations.

In summary, local governments provide services constitutionally limited to their respective geographical area. They are considered entities with their own property and political and executive representative committees, which aim to accomplish their populations' best interests. In Portugal they are also an intrinsic element to the State democratic organisation, since they are forms of autonomous administration, as was stated before, juridical, administratively and politically independent from the State Administration. Furthermore, they are also part of the political power structure (Carvalho, 1996, p.35). In fact, Local Government evolution in the last two decades,

which began with the 1976 PRC, allow us to say that we are now closer to a “true Local Power” – local governments have increased not only their competencies, but also their capacities of generating proper revenues – though we have recognised that there is still some way to run.

Local Government current types are (PRC – article 236):

- The parishes;
- The municipalities;
- The administrative regions (only in Continental Portugal);
- Other forms of Local Government territorial organisations that may be set by law: metropolitan areas, district assemblies, and associations of parishes and municipalities.

In spite of administrative regions being constitutional imperatives since 1976, they have not been implemented yet, nor we think that will happen soon, considering the 1998 referendum results: 62% of the Portuguese electors vote against these regions. The political option after that seems to have been to “empower” municipalities.

As it becomes clear from the previous section, the municipalities have been always the main local entities both from administrative and financial points of view. In fact, they are responsible for providing a great range of public goods and services to the populations. Consequently they have more financial impact in terms of public expenditures, than any other type of Local Government.

As Bravo and Vasconcellos e Sá (2000, p.44) state,

In the non-existence of administrative regions, municipalities are *the type of Local Government* that assumes more importance [italics provided], either referring to political decision power or to financial expression. The parishes are small jurisdictions with few own competencies, performing tasks that are delegated from the respective municipalities.

However, the same authors also acknowledge that recently, the law that transfers competencies from Central Government to Local Government (Law 159/99), not only enlarged municipalities’ competencies to embrace areas where their previous intervention was null or not clarified (such as social housing, culture, social action, environment, and municipal police) but also allowed those to delegate much more **attributions to parishes**. Thus these are now increasing their importance, interfering in the following matters (Law 159/99 – article 14, n.1): rural and urban equipment; public supply (e.g. water); education; culture, entertainment and sports; primary health care; social action; civil protection; environment and sanitation; development; urban and rural arrangement; and protection of the community. As we will refer to next, this competencies enlargement had some consequences in parishes’ finances, namely in the

way financial transfers from Central Government are now distributed between municipalities and parishes.

The **municipalities' general competencies**, recently significantly enlarged as we mentioned, relate to several intervention areas (Law 159/99 – article 13, detailed on articles 16 to 31):

- a) Rural and urban equipment – namely gardens and green areas, streets and lanes, cemeteries and markets;
- b) Energy – public illumination (rural and urban), distribution of energy of low power, licenses to install petrol stations, licenses to install and scrutinise elevators, among others;
- c) Transports and telecommunications – urban transports network, structures to support road transports, municipal aerodromes, among several;
- d) Education – buildings and equipment for nursery schools, kindergartens and primary schools, assuring school transportation, supporting the development of teaching complementary activities in kindergartens and primary schools, etc;
- e) Patrimony, culture and science – cultural centres, libraries, museums, theatres, proposals for the classification for patrimony of municipal interest, etc;
- f) Leisure, recreation and sports – namely camping parks, gymnasiums and sports pavilions, and authorisation and inspection of venues for shows;
- g) Health – equipment and buildings for medical centres, participation in consultative committees to monitor and evaluate the National Health Service, setting policies and actions for public health together with the municipal health offices, managing thermal baths equipments, etc;
- h) Social action – buildings and equipment for handicapped people supporting centres, elderly homes, among others, as well as participation in social programs together with other municipalities, social solidarity and charity institutions, and/or the Central Government;
- i) Housing – providing land for social housing, promoting programs to renew and repair damaged houses, controlling costs for urban renovation, managing the network of social rented houses, etc;
- j) Civil protection – fire brigades, buildings and equipment for fire brigades headquarters, infrastructures to fire fighting in forests, development of programs for forests cleaning and maintenance, etc.
- k) Environment and basic sanitation – municipal systems of water supply and sewage treatment, garbage collection and streets cleaning, proposals for the creation of protected natural areas, among several;
- l) Consumer's defence – actions to inform and protect consumers' rights, creating systems (namely offices) to mediate legal conflicts related to consumers' rights, and supporting consumers' associations;
- m) Development promotion – creation and participation in municipal business companies, promotion of local initiatives to increase employment, promotion of local tourism, promotion of activities related to local handcraft and folklore, among many;
- n) Territory arrangement and urbanism – to elaborate and approve the municipal plan of territory arrangement (e.g. defining areas to gardens, buildings, industry, etc.), promoting renovation of degraded areas and historical centres, managing the National Ecological Reserve and the National Agricultural Reserve, etc;

- o) Municipal police – creating offices of municipal police, which intervention must be within certain limits set by specific laws and regulations;
- p) External cooperation – participating in projects and actions of decentralised cooperation, namely within the EU and the Community of Portuguese Speaking Countries.

As it was stated, the Central Government provides only administrative/inspective tutelage (guidance), verifying legal accomplishment.

Regarding **Local Government's present political structure**, according to the PRC (articles 239, 244 to 246, and 250 to 252) complemented by Law 169/99 (articles 2, 3, 23, 41 and 56) we can find both in municipalities and parishes an executive committee (*Câmara Municipal* for the municipalities and *Junta de Freguesia* for parishes) and a deliberative committee (council or assembly – *Assembleia Municipal* for municipalities and *Assembleia de Freguesia* for parishes). This organisation resembles the one for National Government, where there are The Executive and The Parliament.

Accordingly, both municipalities' and parishes' councils are political committees of deliberative nature, in the sense that they are responsible for the main decisions and for defining the main guidelines and policies orienting local governments' activities. If it becomes necessary for efficiently accomplishing their functions, they can be administratively supported by groups comprising officials and civil servants designated by the executive committees. Among their competencies clearly defined in Law 169/99 (articles 17 and 53), we must highlight some specifically concerning finances, budgeting and accounting, such as:

- To approve the options of the plan (strategic long-term activities plan), the budget proposal, and its revisions;
- To approve the activities report and the annual accounts – these have to be approved in ordinary meeting during April of the year following that they refer to (Local Finances Law 42/98, article 9, n.1);
- To approve and authorise loans contracts, as well as new fees and set fees rates;
- In municipalities, to set the annual rate for some property municipal taxes, as well as to deliberate in all issues related to municipalities' legal fiscal powers.

The executive committees are responsible for the current management of all local governments daily issues, applying the orientations set by the respective councils. Its competencies are also detailed in Law 169/99 (articles 33 to 37, and 64 to 67). Those related to finances, budgeting and accounting are mainly:

- To prepare and present to the council the options of the plan and the budget, its revisions, as well as the activities report and annual accounts;
- To send the annual accounts to The Court of Accounts (entity responsible for the *ex-post* control of local governments accounts) – these have to be sent until May 15th,

independently of being approved by the council, with copy to the Ministry of Finance as well as to the Ministry of Territory Arrangement (Local Finances Law 42/98, article 9, n.2);

- To pursue with the plan and budget approved by the council, defining the internal control system, i.e., the plan of control arrangement, policies, methods and procedures in order to assure that all activities within the entity are carried out with efficiency and integrity;
- In municipalities, to set prices and rates for the services provided by the units of Municipalized Services.

With regard to municipalities' executive committees in particular, according to Law 169/99, article 57, they comprise 4 to 16 councillors (depending on the number of electors) called *vereadores*, plus the president, which has the casting vote.

The president chooses a member to become vice-president, and decides on full-time and part-time members. Furthermore in some municipalities, mostly depending on the importance of certain matters in the electoral program, the president also might decide for some members to become responsible for those particular political areas, called *pelouros*; this means that the *vereador* is responsible for any decisions concerning that matters (e.g. culture, sports, environment, etc.). Apart from these, the president has many other important proper competencies and powers (around forty set in Law 169/99, article 68), as well as others delegated on him/her by the council (Law 169/99, article 65). This justifies why Amaral (1998, quoted in Carvalho, 1996, pp.40-41) considers that the President of the Municipality Executive Committee him/herself must be another executive "committee". The author explains that even if the President him/herself is not a constitutional municipal committee, the fact is that not only he/she is directly elected by the population, but also plays a very important role in:

- Political intermediation, both with Central Government and with regional and local development entities and agencies;
- Leadership of lobbies at the same time as he/she assures the current management of the municipality.

Therefore, this President's "natural power", once acknowledged by the other members of the committee, becomes determinant in conducting the whole municipality activities.

Regarding the **organisational structure**, one issue that is worthy to mention within municipalities are the so-called Municipalized Services. These are different from the municipal regular non-autonomous services, directly managed by the municipal committees. In fact, within the municipality's administration, they are autonomously organised, with their own Management Board (nominated and exonerated by the

executive committee – Law 169/99, article 64, n.1i). Bernardes (2001, pp.37-38) explains that their functioning is essentially regulated by the Portuguese Administrative Code (with some legal requirements dating from 1940) and they aim at exploring in an industrial business way, bearing all the risks involved, certain public services of local interest, such as water distribution, public illumination, sewage and garbage collection and treatment, public (urban) collective transports, among others. Accordingly, only for these the Local Finance Law allows charging rates and prices (Law 42/98, article 20).

Each unit of Municipalized Services is normally specialised in one type of activity, so thus municipalities can have several autonomous units of Municipalized Services. Hence, according to Bernardes (2001, p.38), each of these units might be considered a “true” municipal business company, though not juridically independent. Indeed, even if they prepare their own separate activities plan and budget (administrative and financial autonomy), these are then integrated within those from the whole municipality as the only juridical entity. Yet, Municipalized Services are financial reporting entities separate from the rest of the municipality, since consolidated accounts are still not prepared in Portuguese municipalities.

Furthermore, Bernardes (2001, p.38) states that Municipalized Services are a way that municipalities have found for management de-concentration (devolvement), keeping control over certain services. The municipal council has to approve which services might be municipalized⁶⁹.

Concerning other types of local governments that might exist according to the law, there will be created committees and boards in accordance with the eventual needs.

In Portugal, since the 25th of April 1974 Revolution, Local Government autonomy has been reinforced, as is clear from the previous sections. Though it might be noticed that the evolution of the financial regime has been much slower than the one regarding competencies, we may say that the **Local Government financial regime**, which has been set by several local finances laws, has contributed to reduce local governments financial dependence from the Central Government, contributing to increased financial autonomy. This process is undoubtedly related to the Local Administration decentralisation process towards more democracy.

⁶⁹ Within the recent trend of devolving competencies, many Portuguese municipalities have been transforming units of Municipalized Services in municipal business companies, namely after legislation on the latter was passed in 1998 (Law 58/98).

In this context, hitherto three Local Finances Laws were issued.

The first one (Law 1/79) was particularly considered a dramatic positive change in local governments finances, as it established for the first time several issues that could be considered a true local finances regime. It started recognising local governments' financial autonomy (in terms of what was defined in previous sections). It also established the local budget principles and rules. Furthermore, and even more important, it allowed local governments to have for the first time their own (proper) revenues, defining the taxes and fees that they could levy, as well as authorising local governments to contract loans within certain limits (articles 3,4 and 12 to 15)⁷⁰. Another important contribution of this law was setting for the first time the financial transfers from State General Budget to municipalities, representing a percentage entitlement from taxes (mainly income taxes) annually collected by Central Government. Those transfers – designated as “Financial Equilibrium Fund (FEF)” – aimed at correcting or at least minimising the regional asymmetries and the consequent imbalance amongst municipalities at the same level. Moreover, though that percentage was to be defined annually, it could not be lower than 18%. The criteria for distribution of that amount between municipalities were also defined, comprising among others: number of inhabitants, area, number of parishes, and certain shortage indicators, such as residential consumption of water and electricity, sewage network, and municipal roads (articles 5, 8 and 9).

As to parishes, this law established they were entitled to, among other proper revenues, a certain percentage (annually set but not lower than 5% of the municipal FEF) of the annual revenues of the municipality of the area they are comprised within. These funds were distributed following basically the same criteria as those for the FEF distribution. The parishes were then (and up to a certain point, still are) financially very dependent from municipalities (articles 4 and 11).

In order to assure local autonomy reducing central interventionism in the Local Government, this law also forbade any subsidies from Central or Regional Governments, except in very specific situations, such as public calamity (article 16).

With respect to accounting, by then only budgetary accounting, it was stated that the rules for the preparation of the State General Budget and Accounts should be followed for Local Government. Nevertheless, this was admitted as a temporary

⁷⁰ This is in accordance with the Local Government financial regime and fiscal powers allowed by the PRC since 1976. In the 1997 PRC these are particularly addressed in article 238.

situation, since the reform on Local Government accounting system was already anticipated (articles 19, 20 and 25).

The second Local Finances Law (Law 1/87), apart from some changes in some previous controversial points, enlarged the municipalities' revenues diversity, mainly including 37.5% of VAT revenues from tourism activities within the municipality area, and municipal bonds. This was because it was already recognised that eventual transfers of competencies should be followed by more financial means (articles 3, n.1, and 4). Also a criterion based on VAT global revenues was introduced to calculate the FEF percentage (article 9). The percentage of parishes' participation in municipalities' revenues was enlarged to no less than 10% of the municipality's FEF, and the distribution criteria were changed considering one part to be equally shared (article 20).

A summary of the Local Government accounting regime and purposes was then considered (articles 23 and 25), once the first laws for the reform, which we will refer to later, had already been issued.

The most important changes brought in by the latest Local Finances Law (Law 42/98) relate to the types of financial transfers from the State Budget: the "Municipal General Fund (MGF)", the "Municipal Cohesion Fund (MCF)" and the "Parishes Financing Fund (PFF)" replaced the former FEF. Beyond this obvious attempt to increase local governments financial independence, the local finances regime established in this law aims at a fair allocation of public resources between Central and Local Government (financial vertical equilibrium) and the correction of the disparities among local governments at the same level (financial horizontal equilibrium), always respecting what Bernardes (2001, p.42) considers the Local Government "principle of fundamental freedom" (freedom to set its own policies within its legal competencies). Among several slight changes to this law, we must refer to Law 94/2001 (quoted in Bernardes, 2001, p.21), which created the "Municipal Basis Fund (MBF)".

Currently, the annual financial transfers from Central to Local Government are 33% of the simple arithmetic average of revenues from income tax (individuals and companies) and VAT collected two years before the one which the budget is referred to (Law 42/98, article 5): 30.5% for municipalities and 2.5% for parishes (PFF). The municipalities' share is divided as follows (Law 42/98 article 10, and Law 94/2001):

- 4.5% as MBF – Equally divided by all Portuguese municipalities (currently 308) and aiming at providing everyone of them with a minimum financial capacity;

- 20.5% as MGF – Aiming at providing municipalities with the financial conditions and means adequate for them to accomplish their functions, considering different levels of functioning and investment. It has two sets of criteria for distribution: firstly it is distributed by three territorial areas (Continent, Azores and Madeira) considering area, population and number of municipalities; secondly, within each territorial area it is distributed following several criteria such as resident population, number of parishes, individual income tax collected in each municipality, among others (Law 42/98, articles 11 and 12)⁷¹;
- 5.5% as MCF – Aiming at reinforcing the municipal cohesion, promoting the asymmetries correction in favour of less developed municipalities, it is distributed on the basis of two indexes: the Index of Fiscal Insufficiency, and the Index of Opportunities Inequality (Law 42/98, articles 13 and 14).

Regarding the Local Government accounting system, article 6 refers to the CAPA, meanwhile issued in 1997. Further developments on this are presented in the following sections.

According to Bernardes (2001, pp.52-53) these financial transfers from the State Budget (non-earmarked transfers) are important financing sources for the Portuguese Local Government, covering around 1/3 of the total local expenditures. The remainder are covered by proper revenues (current and capital), earmarked transfers, and loans.

The main revenues (current and capital) set in Law 42/98 (article 16 for municipalities and 21 for parishes) may be grouped as follows:

⁷¹ These criteria are similar to those followed for the PFF distribution – see Law 42/98, article 15.

MUNICIPALITIES	PARISHES
Municipal taxes (Law 42/98, articles 17 and 18): – property taxes (<i>contribuição autárquica</i> ⁷² and SISA) – municipal automobile tax – <i>derrama</i> ⁷³	
Fees, rates and prices (Law 42/98, articles 19 and 20): – fees from licences to be conceded by municipalities (e.g. licences for buildings, parking meters, ...) – rates and prices from services provided	Fees, rates and prices (Law 42/98, articles 21 and 22): – fees from licences to be conceded by parishes (e.g. to use street markets and cemeteries, having dogs, ...) – rates and prices from services provided
Property revenues: – rents and sales of fixed non-financial assets – heritages and legacy, donations and other similar – income from financial participations in municipal business companies and other entities, as well as from other financial assets	Property revenues: – rents and sales of fixed non-financial assets – heritages and legacy, donations and other similar
Tickets and fines	Tickets and fines
Loans	Loans
Other set by law	Other set by law

TABLE III.3 – LOCAL GOVERNMENT MAIN REVENUES

Earmarked transfers are a way for Local Government to get additional financing for its activities. This technical and financial cooperation is also set in Local Finances Law 42/98 (article 7), and it is complemented by other regulations. The rules for this are strictly defined, once again to assure the accomplishment of the local autonomy principle. These transfers result from (Bernardes, 2001, pp.56-57):

- Inter-municipalities investments – Local investments important or with consequences for several municipalities. The technical and financial support for this has been provided by the Regional Commissions of Coordination (RCCs)⁷⁴. Recently the technical support has been replaced by more means provided to local governments. Yet, the financial dependency from Central Government was not reduced, inasmuch as the RCCs financial support has been replaced by other financial cooperation instruments next mentioned;
- Program-contracts and cooperation agreements – Particularly comprising investments of sectional or multi-sectional nature, involving one or more municipalities and Central Government departments. The (technical and/or financial) cooperation agreements in particular, relate to sectional investments, which complexity degree, cost and execution time do not justify a program-contract. Many local politicians find these instruments very controversial, explaining that they are used by Central Government to make Local Government pursue projects that should be the former responsibility (e.g. roads, schools, etc.);

⁷² This is equivalent to the English council tax.

⁷³ This is a tax that municipalities can optionally levy and is at maximum 10% of the companies income tax, for the proportion of income considered to be produced by companies in the municipality's geographical territory.

⁷⁴ These are public bodies belonging to the State Administration (government agencies), mainly responsible for the policy of territorial planning, development and arrangement, at a regional level. There are currently five RCCs in Continental Portugal: North, Centre, Lisbon and Tejo Vale, Alentejo, and Algarve.

- Communitarian Funds (EU) – These have become important in promoting municipal investments. Still, once they are generally paid against the presentation of the expenditures receipt, many municipalities have to first contract loans to pay for those, sometimes waiting a long time for the EU refund, thus creating serious financial problems.

In summary, Local Government income sources might be classified as (Bernardes, 2001, pp.52-53):

- Non-earmarked transfers (from the State Budget: MBF, MGF, MCF, and PFF);
- Proper (current and capital) revenues (Table III.3);
- Earmarked transfers (inter-municipalities investments, program-contracts and cooperation agreements with Central Government and/or other municipalities, and EU funds or grants);
- Loans.

Bravo and Vasconcellos e Sá (2000, pp.68-72) present an discuss Local Government revenues structure and evolution from 1990 to 1998, from which we must highlight the following:

- Local taxes, rates and prices have represented around 40% of the total revenues, and have not suffered significant changes during that period;
- State Budget financial transfers (non-earmarked) have been approximately 35% of the total revenues;
- EU transfers (grants) doubled from 1990 (5%) to 1991 (11%), had been relatively stable from there around 9.5%;
- The importance of other earmarked transfers has been decreasing, starting with 5.5% in 1990 and reducing to 2.2% in 1998;
- Loans have been increasing, more intensively in the last two years analysed, from 5.3% in 1990 to 9.3% in 1998;
- Though it can be noticed a minor decreasing of total transfers (earmarked plus non-earmarked) on total revenues, they still have great importance: slightly less than 50%⁷⁵.

Notwithstanding this financial dependence, we still may say that, at the present moment, Portuguese local governments have a considerable degree of financial autonomy (their own finances), since they are allowed to: prepare, approve and modify budgets and activity plans, prepare and approve balance sheets and accounts, collect and use proper revenues, perform expenditures without superior authorisation, and manage

⁷⁵ At this respect, Bernardes (2001, p.60) refers to a study developed in 1993 by the EU Council, where for example, transfers to Local Government in the UK were 77% of its total revenues; in The Netherlands those were 60%. These figures, in our understanding, reveal on one hand that Portugal might be better in terms of Central Government financial dependency and subsequently in terms of local autonomy. But, on another hand, they might also reveal how decentralisation of competencies in those countries has been followed by financial resources devolution, better than in Portugal. Additionally, in the UK for example, Local Government loans were 0% of the total revenues, while in Portugal were 6% in an increasing tendency, revealing in turn serious risks for local autonomy, inasmuch as the high debt ratios for several local governments has led them, as last resort, to search for Central Government support.

their own property (Carvalho, 1996, p.37). More developments on this are presented further in this chapter.

Yet, this autonomy does not prevent municipalities and parishes to see its actions under the State's general policies. In fact, as we have stated, the centrally established law sets its functions, and its resources have to be applied accordingly.

2. PORTUGUESE GOVERNMENTAL ACCOUNTING

In this section we present and discuss the Portuguese governmental accounting, firstly addressing the evolution from public finances to governmental accounting. Next, the latest developments in Portuguese Local Government accounting are presented, considering its position within the context of the CAPA. Finally we describe the first Portuguese CALG, emphasising its innovative aspects, but highlighting some shortcomings as well.

2.1. From Public Finances to Governmental Accounting⁷⁶

As in most countries' governmental accounts, accountability has been a constant concern for Portuguese Governments for many years. In fact, since the Monarchy until the Republic, passing through the political liberalism and the "New State" dictatorship, Portuguese rulers have been worried with public accounts, particularly in respect to public money control.

According to Freitas (1998), after the foundation of Portugal in the XII century, the first documents related to governmental accounting were the "charters" and "orders". They aimed basically to inspect the public expenditures and revenues. For more than one century, the Finances Regiment and Orders of King D. Manuel controlled the Portuguese governmental accounting.

From the XV century, the "Discovers" increased the kingdom's commercial activities raising the need for control of The Crown's revenues. Consequently, in the reign of D. José I (1761-1834), the "General Treasury" ("State Safe", gathering all payments and receipts) was created by his Finance Minister Sebastião José de Carvalho e Melo, very well known in Portugal as the Marquis of Pombal.

However, it was only after the 1791 Charters of Law (December 22nd 1791) that the beginning of the Portuguese governmental accounting could be recognised. These laws defined detailed rules for a great range of issues, including criteria for the type and

⁷⁶ For further details on public accounting until 1975 see Freitas (1998).

the number of people assuming the several positions, the bookkeeping method and the accounting books that should be used. This showed already some concern with the records standardisation and uniformity, and accountability – two balance sheets were supposed to be prepared per year: one in July, and another one in January, and compulsorily presented to the “Treasury General Inspector”. The double-entry bookkeeping method for expenditures and revenues was used, not only because it was being used in the most developed European countries, but also because it was considered to be the most adequate way of helping managing great sums of money, with more transparency.

In the beginning of the XIX century some problems arose: the Finance Ministry failed to control the State’s money, basically due to delays in records and lack of coordination. A civil war occurred from 1826 to 1834 helped increasing the chaos, since people, Treasury’s servants in particular, did not seem to care about finances rules.

A reform in the public finances and governmental accounting was urgent.

In 1832 Mouzinho da Silveira became Minister and Secretary of State of Fiscal Businesses and started a great reform of the Portuguese public finances. The main purpose was to create conditions that would allow Portugal to become a modern State, not only reorganising public finances, but also reforming Justice and Public Administration.

It was one period of the Portuguese governmental accounting when the main concern was to scrutinise the accounts legality. It was necessary to control the actual expenditures against the budget, as well as to present the accounts to the legislative bodies: these were supposed to have a complete picture of the revenues and expenditures of the State as a whole.

Accordingly, a decree from 1835 tried to standardise the accounting system followed by each ministry, using a double-entry bookkeeping method. After this first step, in 1839 another decree defined the bases for the State General Accounting and in 1843 the Public Treasury Accounting Regulation was published.

Meanwhile, the first Portuguese Administrative Code was issued in 1836, being revised in 1842. This set rules for public finances and budgetary accounting.

Nevertheless, this was not enough, since rules to control the budget execution had not been clearly defined. Only after the issuance of the Governmental Accounting General Regulation Decree, twenty years later, budget control was possible. In fact, only in this 1863 decree the need for accountability was recognised, as a consequence of

the development of a new representative system of power: all the Government's administrative actions should be published, as clear and evident as possible, showing accuracy in the public accounts.

Within this context, the Accounts Fiscal Committee had been created in 1844. The Public Treasury Court (later The Court of Accounts) had also been created in 1849, whose role was to control the integrity of governmental accounts.

Governmental accounting was then divided in three parts: legislative (laws for voting taxes and authorising public expenditures, scrutinising expenditures execution, regulating the accounts for the economic period, etc.), administrative (regulating, through official records, all the facts concerning the collections and applications of the State's income) and judiciary (setting, through sentences from The Court of Accounts, the responsibilities for all those who were managing public money; and controlling via authenticity declarations all the executed revenues and expenditures).

A modified cash perspective was used together with the notion of balance in the public accounts: according to Freitas (1998, footnote 17), each economic period lasted two years, starting in July, in order to consider in the same period the revenues and the related expenditures, even though the right to receive or the responsibility to pay were in different periods.

There was great concern with annuality, particularly in respect to revenues and expenditures, distinguishing these from payments and receipts.

The 1863 decree, apart from aggregating regulations previously diffused in several documents, also created one section for particular issues related to public debt, which was particularly relevant in Portugal in that period.

In 1878 the Rodrigues Sampaio's Administrative Code, already mentioned in section 1.3.1, brought in important innovations for budgetary rules. For example, the annual economic period was changed to the civil year, whereas previously it had begun in July.

In the last years of Monarchy (later XIX century until 1907) another reform of the governmental accounting occurred with the 1881 law for the Governmental Accounting Reform Plan. There was the need to centralise the State General Accounting in the Accounting General Department of the Ministry of Finance. Its competencies were to guide and standardise the governmental accounting services, to control all the divisions dealing with public money, and to develop the State Central Budget. The competencies of The Court of (Governmental) Accounts were defined as well.

It created the (Governmental) Accounting Permanent Commission whose main functions were to share some accounting tasks together with The Court of Accounts, in order to simplify some services and keep a strict inspection of all public resources applications.

This 1881 law not only made significant alterations in the governmental accounts inspection process, but also in the bookkeeping method: although continuing to be a cash-based system, the double-entry bookkeeping method was replaced by the single-entry, towards more simplification.

The State General Account contents and statements were defined: Administration Account (*Conta de Gerência*), Economic Period Account (*Conta do Exercício*), Treasury Operations Account (*Conta de Operações de Tesouraria*), and Public Debt Account (*Conta da Dívida Pública*).

For the first time, rules to list the public property, namely fixed assets and inventory, were set: two large groups were distinguished – assets aiming to provide public services, and assets which were an income source.

The public expenditures and revenues were comprehensively regulated and classified: ordinary/extraordinary and fixed/variable.

In 1907 another law came to replace the one from 1881, starting another reform process of the governmental accounting. New rules for governmental accounts accountability were defined. Governmental accounts began being presented to the Parliament every 5 years. In fact, one of the main innovations was the creation of a Parliamentary Commission for Governmental Accounts, which should: verify all the allocations; give opinion on the budget execution, indicating mistakes and frauds and holding responsibility to the transgressors; receive through The Court of Accounts the “declaration of conformity” and the “declaration and report on the State General Accounting”, presenting these to the Parliament, together with its own judgement.

Another law issued in 1919, which claimed for more simplification, changed the process of “Accountability of The State’s Accounts”. Also the period of accountability was reduced from 5 to 3 years, intensifying scrutiny in order to facilitate budgetary execution.

Meanwhile in 1910, Portugal became a Republic. However, this new political system did not seem to have brought significant changes in the governmental accounting.

The beginning of the dictatorship in 1928 brought in other changes to the Portuguese governmental accounting: the governmental accounts basic principles were renewed (Decree 15465, May 14th 1928) considering the previous lack of order, homogeneity and clearness, which was a stimulus for bad governance. From then, the State's Accounts held also the Local Government and colonies' accounts. The State General Budget was the main centre of the governmental accounting. However, governmental accounts were organised reflecting the several ministries and divisions within the Public Administration, and governmental business companies, Local Government and colonies were distinguished as well.

The lack of homogeneity among the principles that ruled the budgets preparation for the different ministries was recognised as due to inadequate classification of the public expenditures. Accordingly, in 1929 the previous regulation was complemented (Decree 16670, March 27th 1929), focusing on the expenditures methodology and control, instead of on the revenues.

There was already some explicit reference to efficiency in public spending: for the first time laws referred to the need for a parsimonious application of the public money.

Trying to answer the demanding of 1928 decree, in 1930 another one was issued (Decree 18381, May 2nd 1930) raising the problem of relating public revenues and expenditures for the same period: it was allowed a 45 days period of slack (equivalent to the current so-called “complementary period”⁷⁷), in order to surpass the non coincidence of the revenues and expenditures period (modified cash basis, considering commitments for expenditures, with annuality). The accountability period was reduced to one year.

Nevertheless, there was still a great range of laws, leading to significant complexity, lack of coherence, and not all the procedures were accomplished. Furthermore, all the hard work of preparing the State General Account was worthless, because the responsible bodies, and even the Parliament, did not seem to care about public finances. There was a great disorder in the Public Administration and civil servants were not given orientation for their services performance; those who performed accounting tasks did not have adequate training. For these reasons, governmental accounting could not reveal reliable information and a true and fair view of the State's Accounts.

⁷⁷ The “complementary period” is currently allowed in Law-decree 155/92, article 7, n.1, for the closing of the State General Account, thus for all entities comprised in it. It is a period set by the budgetary execution law beyond December 31st (normally until February 15th of the following year) during which payments regarding the previous year can be made.

In 1936, under a dictatorial political regime, another regulation (Decree 27223, November 21st 1936) redefined the statements that were part of the State General Account (which should disclose a balance between assets and liabilities) and ruled the treasury operations. Also the revenues and expenditures classification was changed: these are now divided in ordinary/extraordinary and current/capital; the latter classification enhanced its economical nature.

From this decree until the end of the 1970s, the main concern was with uniformity of the accounting information that the different ministries and departments should provide. This justified the issuance in 1944 of further rules (Decree 34332, December 27th 1944), in order to harmonise the procedures, mainly those related to expenditures recording, imposing the use of certain books whose models were defined in the law. During this period, the unique purpose of governmental accounting was to serve Central Government; the only interest was the budget control and execution.

It was Budgetary Accounting, the main purpose of which was rendering accounts to the Central Administration, for control, ignoring other objectives of different nature. It was also designated “Administrative Accounting”, because the accounting procedures were based on Administrative Codes.

The 25th of April Revolution (military coup), a radical change in Portugal history, introduced a whole series of alterations towards a democratic political regime. The approval of a new PRC in 1976 was the starting point, changing the previous one from 1933, which has ruled all the political life in Portugal during the “New State” dictatorship. The Public Sector that hitherto was essentially the APS became much larger. Considering the several nationalisations that had occurred, it reached an important role in the Portuguese economy. However no significant changes happened in governmental accounting.

Except for the increasing details in financial statements and reports, helped by some developments in computers and information systems, government accounting continued to be mainly a cash-based system, basically budget-oriented and concerned with an overall purpose of legal accountability of the sources and uses of financial resources. A single-entry method of bookkeeping continued to be used.

Furthermore, some laws and regulations from the XIX century continued to be used as well, for at least 10 years more. Consequently, until the beginning of the 1990s, the governmental accounting system was essentially the one resulting from the 1928-29 and 1930-36 reforms.

Yet, the fact that Portugal had become a member of the EU (then EEC) in 1986 created the necessary conditions for a true reform of governmental accounting, following the models adopted in more developed countries.

In fact, the 1990s brought in what we, as many, call an “authentic revolution” in the Portuguese governmental accounting and financial management. Since then, Portuguese Governments have been greatly concerned with improving quality in public services and promoting modernisation of the Public Administration, within the New Public Management trends.

According to Carvalho (2000), the Governmental Accounting and Financial Management Reform initiated in Portugal in 1990, has shown the recent Governments’ concerns, namely with Public Administration rationalisation, efficiency, legal accountability and control, considering the increasing of diversity amongst public institutions.

This structural changing process started with some legal alterations, beginning with the PRC. In fact, this was revised in 1989, modifying the basic rules for the structure of the State Budget, as well as the budgetary management principles and methods. As Caiado and Pinto (1997, p.27) state,

The new governmental accounting regime meets what is defined in the PRC, which claims that *public* services should work in a decentralisation basis [italics provided]. The idea is providing more power to the services allowing them to solve its own problems, (...).

The Public Accounting Basis Law (Law 8/90) set the governmental accounting basis and regimes. These were later developed by rules regarding the legal standards for the development of the State Financial Management Regime (Law-decree 155/92). The most important topics in the latter were related to conditions of efficiency, effectiveness and economy demanded for expenditures authorisation, while accomplishing requirements of legal, budgetary and financial consistency. Furthermore, it defined the accounting regimes used by the several (administrative) governmental bodies and institutions depending on the State Budget.

Meanwhile in 1991 new rules for the State Budget Framework were defined. Law 6/91, considered the general budgetary law, set: budgetary principles and rules (articles 2 to 8); procedures for the budget preparation and organisation (articles 9 to 15); rules and procedures for the budget execution and budgetary alterations (articles 16 to 20); and rules for budgetary responsibility and control (articles 21 to 29). Hence, the budget execution system was converted and the responsibility for the budget execution was enhanced. A new structure was set for the State General Account, which became similar

to the State Budget, allowing easier and clearer interpretation and therefore a better political analysis by the Parliament (Caiado and Pinto, 1997, p.28).

Within this new Financial Regime applicable only to services, bodies and institutions that somehow depend on the Central Administration, i.e., that are under the State Budget, two regimes were established: general regime (administrative autonomy) and exceptional regime (financial and administrative autonomy).

The accounting system becomes different according to these regimes (Law 8/90 – articles 14 and 15, and Law-decree 155/92 – articles 9, 10, 15, 16 and 45):

- General Regime – A Budgetary Accounting is compulsory, using a single-entry bookkeeping method and a modified cash basis (cash basis with commitments for expenditures⁷⁸). A Cost Accounting should be organised as well, since it is considered as fundamental for the evaluation of the management outputs;
- Exceptional Regime – The autonomous bodies comprised within this regime (e.g. universities, hospitals, ...) have to use two compulsory accounting systems: together with a Budgetary Accounting, as in the general regime, they have to adopt a Financial Accounting shaped according to the Chart of Accounts for Business Accounting (double-entry bookkeeping method and accruals basis system).

As to the budgetary management control (Law 8/90 – articles 10 and 11), for governmental entities included both in the general and exceptional regimes, a systematic and successive control has to be carried out, which includes inspecting expenditures legal conformity and financial regularity, as well as analysis of its efficiency and effectiveness. Moreover, three forms of control are required (Law-decree 155/92 – article 53):

- Self-control – Performed by the entities themselves, through internal committees responsible for that⁷⁹;
- Internal control – Systematic and successive management control, normally through inspections to be carried out by inspective administrative external governmental bodies, namely The Finance General Inspection and/or The Budget General Department, under the Ministry of Finance;
- External control – Carried out by The Court of Accounts (the independent supreme audit institution) according to appropriate laws and regulations⁸⁰.

⁷⁸ Law-decree 155/92, article 15, n.1, explains that cash accounting consists in registering all payments by activities or projects as well as by budgetary items. Furthermore, n.2 requires that no payments can be made unless the respective commitment had been previously registered.

On the other hand, article 10, n.1, explains that commitment accounting consists in registering obligations already assumed, by activities indicating the corresponding item in the economic (budgetary) classification.

⁷⁹ Carvalho (1996, pp.123-125) refers to a “political control” performed by the members of management committees, and an “administrative control” carried out by civil servants and officials, exerting their duties with technical independence in relation to power, having thus a special statute considering their control responsibilities. Further developments on this are going to be presented ahead.

However, since local governments have budgetary independence they were not included in these reforms. Nevertheless, as we will explain, its financial regime also passed through important changes in the last years. Moreover, there were also important alterations in its accounting system.

Inspired particularly in the 1989 Chart of Accounts for Business Accounting (*Plano Oficial de Contabilidade*), after 1992 several charts of accounts were published, reflecting the public services diversity (administrative and financial autonomous institutions): for Health Services, for Public Institutions of Social Security and for Public Institutions of Higher Education⁸¹. In this context, Municipalized Services, being autonomous and business oriented though explored by municipalities, adopted their own chart of accounts as well (Law-decree 226/93).

Despite several public services having adopted a chart of accounts following the same model (generally a direct adaptation to each sector of the Chart of Accounts for Business Accounting, not including specific accounts for budgetary control in a cash and commitments accounting basis), each of them had its own particularities. Hence, any comparisons were difficult to make and, above all, the lack of uniformity made it impossible to obtain consolidated financial information for the Public Sector as a whole.

It was urgent to define a basic framework that could become a reference for the whole APS accounting, allowing at the same time, filling the gaps of the previous system. Consequently, in 1997 the CAPA (*Plano Oficial de Contabilidade Pública*) was approved (Law-decree 232/97).

According to Aibar Gúzman and Fernandes (1999, p.152), this framework

(...) appears in the context of the State Financial Management reform and its publication intended to bring some consistency among the different information needs expressed by

⁸⁰ Carvalho (1996, pp.129-131) distinguishes *ex-ante* and *ex-post* control. The first basically consists of verifying the expenditures legality before its execution, checking if those are previewed within the budget. If those are conforming to the law, a “visa” (*visto*) is given, legally authorising the expenditure to be carried out. Moreover, in particular for certain contracts, The Court of Accounts might also control economy, verifying which are the most advantageous conditions for the State.

The *ex-post* control consists in auditing and judging the entity financial reporting, which comprises statements from budgetary execution, as well as financial statements (the latter especially for entities within the autonomous Public Administration). This type of control, allowing enhancing financial errors on the budgetary execution, leads to the attribution of responsibilities (only of financial nature) to those involved in that. Further details on *ex-post* control in particular for local governments, are presented in section 5.3.

Bernardes (2001, p.206) additionally refers to “concomitant control”. This is performed through financial inspections that The Court of Accounts might do to the entities, before the final accounts are prepared and presented.

⁸¹ For further on these see Bernardes (2001, pp.208-209) and Caiado and Pinto (1997, pp.135-140).

The Court of Accounts, The Finance General Inspection and The Budget General Department⁸².

The CAPA assumes an historical significance in the Portuguese governmental accounting reform because, once it was issued within a wider reform process of the State financial management, it became an essential instrument to provide the State with an accounting system more suitable for the needs of a modern Public Administration (Law-decree 232/97, foreword, n.2).

Indeed, it overcomes the objectives of the Portuguese traditional governmental accounting (to demonstrate legal and budgetary accomplishment, being the whole system totally subordinated to the budget), providing an accounting information system that allows analysing public expenditures according to not only legal criteria, but to economy, efficiency and effectiveness criteria as well. Thus, it increases clarity and transparency on the management of public resources.

Furthermore it recognises the need to have uniform procedures in order to allow (future) accounts consolidation for the whole Public Sector.

On the other hand, as Aibar Gúzman and Fernandes (1999, p.152) also state,

(...) at an international level, the CAPA represents a very useful tool considering Portugal agreement process to the Euro, which requires accomplishment of convergence criteria, like top limits for the budgetary deficit and the percentage of public expenditure over the GDP.

Law-decree 232/97 – CAPA – foreword, n.6, states:

The main goal of the CAPA (...) is to create the conditions for the integration of different accounting perspectives – budgetary, patrimonial and cost accounting – in a modern governmental accounting system, which is a fundamental instrument to support governmental entities' management and evaluation.

These sub-systems, though integrated, are autonomous. The Budgetary Accounting uses a modified cash basis system (commitments for expenditures) with a financial measurement focus. On the other hand, Financial Accounting (*Contabilidade Patrimonial*) and Cost Accounting have a clear economic perspective: an accruals basis system providing information about the entity's economic and financial situation. For the three of them a double-entry method is compulsory.

The Portuguese governmental accounting standardisation process started with this CAPA is to be extended to the whole APS, Local Government included. Yet, this has an exceptional regime, certainly related to its budgetary independence.

In fact, the Law-decree 232/97 (article 2) states that the CAPA has a compulsory application to all public services, bodies and institutions belonging to the Central,

⁸² These are three public bodies whose main competencies are related to the governmental accounts inspection and control.

Regional and Local Administration, as well as Social Security, except for those that by their nature, legal form or designation are governmental business enterprises. Furthermore, it is also applicable to private non-profit organisations whose main revenues come from the State Budget.

Furthermore, this document also allows its contents to be adapted, through legal instructions, to the sectional charts of accounts that had existed or to others to be created.

Nevertheless, in article 5, n.2, it also states that

In what respects to local governments, the standards, rules and other adaptations *from the CAPA* have to be set by law-decree [italics provided].

According to the law, we may summarise that the CAPA allows improving:

- Budgetary strategic decision-making – namely long-term budgeting, considering the accomplishment of commitments that have future consequences;
- Information disclosure and accountability to
 - Support financial control by the legally competent authorities;
 - Reinforce the Public Administration financial transparency, namely through monitoring the budget execution, using a modified cash basis;
 - Show the entities' economic and financial situation, using an accruals basis;
 - Clarify the State financial relations;
 - Obtain essential elements in order to calculate the Public Administration values to National Accounting – very important to support the calculation and assessment of the EU convergence criteria.

According to Law-decree 232/97, foreword, n.7, these are the objectives complementary to the above-mentioned CAPA main goal.

Finally, the CAPA

(...) allows the development of financial and performance indicators to evaluate economy, efficiency and effectiveness in the use of public money, and the establishment of the conditions to prepare a State Balance Sheet (Almeida and Correia, 1999, p.41).

2.2. Accounting for Central and Local Government

Here first we systematise the Portuguese governmental accounting framework context, within which Local Government accounting has been built in. Then, we address the recent evolution and current state of Local Government accounting in Portugal.

2.2.1. Governmental accounting

The CAPA is a set of accounting general principles, as well as detailed standards and rules aimed at the integration and consolidation of the APS accounts, not only in a Governmental (micro) Accounting perspective, but in a National (macro) Accounting perspective too. Nevertheless, as stated, it was inspired in the Chart of Accounts for

Business Accounting, also considering the traditional influence of Continental Europe, namely France.

Indeed, Portugal belongs to the group of Western European so-called “civil law” countries, where the influences not only from the Roman Law but also from the Napoleonic Codes of Law are remarkable, leading to a strong centralising tradition.

Thus, the Portuguese legal system is primarily based on codified law (opposing the unwritten “common law” predominant in many Anglo-Saxon countries), with the Government and/or the Parliament producing all the laws and rules.

Within this context, it is expected Portuguese governmental accounting system to be based on a unified and detailed legal basis – the CAPA.

In fact, as Caperchione (1999, p.79) explains, the legal validity of accounting standards and rules depends very much on each country’s legal system, the choice being between whether they become compulsory or its application is simply suggested and recommended.

Inasmuch as Portugal chose the first alternative, the charts of accounts assure information reliability, terminological homogeneity, and uniformity in rules for accounts classification, recognition and measurement.

The use of charts of accounts (accounting plans) was a way in which countries could assure accounting uniformity. This was a main concern in Central European Countries that, from World War II started to use them mainly in consequence of the Germanic occupation. As Nobes and Parker (2000, pp.40-41) explain, France was the country where the influence was more obvious, which since then has been a reference⁸³, mainly for Iberian Countries, which due to dictatorial political regimes, adopted charts of accounts only from the 1970s.

Hence, the first Portuguese Chart of Accounts for Business Accounting was issued in 1977, and revised in 1989 (after the entrance of Portugal to the EEC in 1986) according to the EEC IV Directive. In 1991 it had a second revision following the EEC VII Directive. A Business Accounting Standardisation Commission was created very similar to the French one.

⁸³ The main components of the French chart of accounts are: the chart (list) of accounts itself, definitions and terms, models to the financial statements, and measurement and valuation criteria. It can be noticed that these are very close to those we present in section 2.3.2 particularly for the Portuguese CALG. Additionally, as Nobes and Parker (2000, p.41) also explain, the influence of the German chart of accounts (the first one in the world dated from 1911) was lost when it was abolished after the World War II.

The CAPA pursues this tendency. In fact, as it is presented by Freitas and Góis (2000), there are great similarities between the governmental and business accounting framework. Even a Public Administration Accounting Standardisation Commission – PAASC (*Comissão de Normalização Contabilística da Administração Pública*) was created (Law-decree 232/97, article 4) whose functions we will refer to later.

The issuance of the CAPA in 1997, inside the State Financial Management Regime reform process, is a consequence of the lack of accounting information standardised treatment for all Central Administration services and bodies (integrated or autonomous), Regional and Local Administration, and Social Security. Accordingly, all entities within the APS must use the CAPA or specific/sectional charts of accounts adapted from it. Nevertheless, up to the moment, it has been applied only to the autonomous Public Administration⁸⁴, as is shown in Figure III.1.

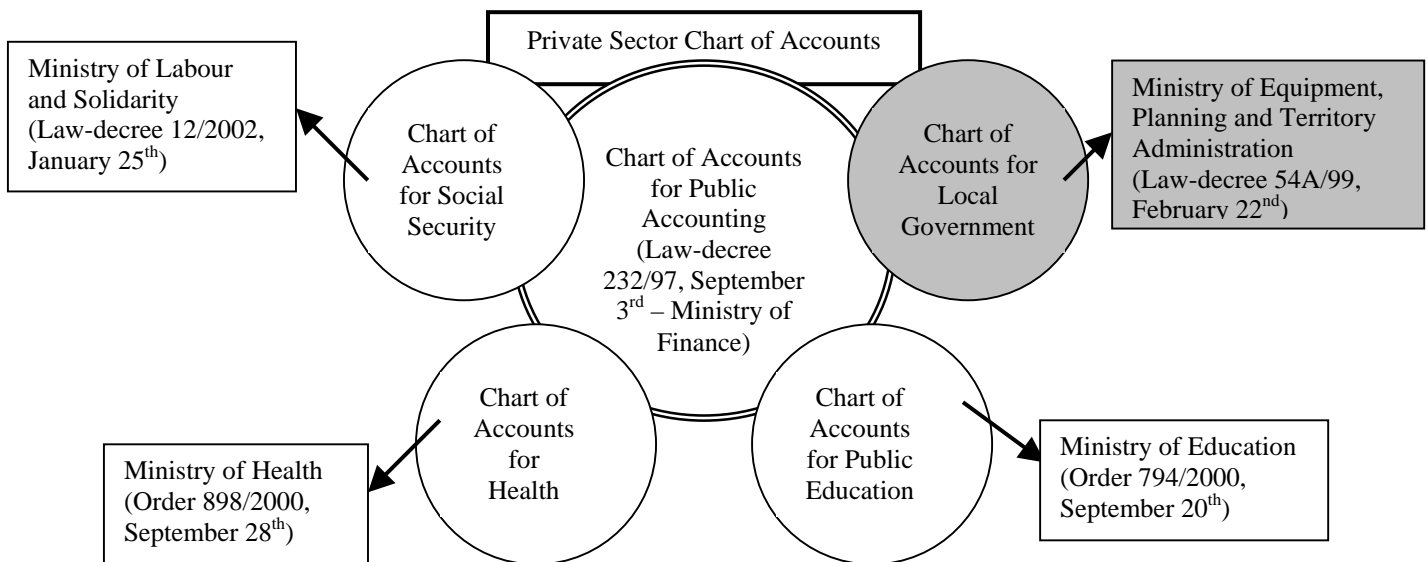


FIGURE III.1 – PORTUGUESE GOVERNMENTAL ACCOUNTING FRAMEWORK
(Adapted from Carvalho, 2000)

⁸⁴ The Portuguese autonomous Public Administration comprises:

- Public bodies constitutionally autonomous and independent from the State Budget – Local Government;
- Public bodies with a special budget, approved and published separately inside the State Budget – Social Security;
- Public bodies belonging to the Autonomous Central Administration, considered financially and administratively autonomous according to the rules set in the 1990 Public Accounting Basis Law. Although under the State Budget, these are included in an accounting and financial management exceptional regime, given its patrimonial, budgetary, treasury and borrowing autonomy – Health and Education Institutions, notwithstanding universities autonomy is set in the Constitution.

The State itself (Non-autonomous Central Administration – integrated services) has not been embraced by the accounting and financial management reform up to the moment. Therefore, here the accounting system is still essentially traditional budgetary modified cash-based single-entry accounting.

This is applied not only to the Republic Government (Continental Portugal), but also to the Regional Governments (Autonomous Regions), with some adaptations that might be necessary.

For the APS sub-sectors where a sectional chart of accounts based on the CAPA was not worthy, the general framework is used. It was expected, by the end of 2001, all the sectional charts of accounts would be issued, covering the whole APS with the new accounting system. We may say that this timing target was reached, as the last sectional chart of accounts, though published in January 2002, was passed in December 2001.

In Table III.4 we present an overview of the relationship between the Public Sector composition and the charts of accounts used by the different institutions.

PUBLIC SECTOR COMPOSITION			CHARTS OF ACCOUNTS (CA)		
Public Sector	Administrative Public Sector - APS (State <i>lato sensu</i>)	Central Administration	Education	Chart of Accounts for Public Accounting (CAPA)	CAEducation
			Health		CAHealth
			Economy		CAPA
			Defence		
			(...)		
	Social Security		CASocialSecurity		
	Regional Administration				
Local Administration		CALG			
Managerial Public Sector - MPS (Governmental Business Companies)	State Business Companies		Chart of Accounts for Business Accounting		
	Municipal Business Companies				

TABLE III.4 – PORTUGUESE PUBLIC SECTOR CHARTS OF ACCOUNTS
(Adapted from Fernandes and Carvalho, 2001, p.6)

In both Figure III.1 and Table III.4 Local Government is highlighted, since its accounting system, once the main concern in this chapter, is going to be developed in the following sections.

2.2.2. Local Government accounting

From what was presented in section 1.3.1, we may say that Portuguese Local Government accounting's recent evolution has followed the changes in its political-administrative and economic importance, thus it is closely related to the reinforcement of "Local Power".

Accordingly, it was not until the 25th of April 1974 Revolution and the 1976 PRC, when Local Government's political merit was recognised, that one can speak about a true Local Government accounting. Indeed, after this historical turn, the Local Government's political and financial autonomy demanded for a specific accounting regime started, as we mentioned, with the first Local Finances Law in 1979.

Before this, as it was also explained, Local Government accounting was ruled by a regime in force since 1933. Additionally it was merely a budgetary system, based in several Administrative Codes (functioning laws), ruling only the budgetary obligations. Local governments' budgets were prepared in accordance with the law for the State General Budget, although it can be noticed that, since the middle of the XIX century, significant improvements have been made in respect to budgetary principles and rules.

With the Local Finances Law 1/79 a reform was claimed for Local Government accounting. Article 25, n.1, stated that

After the approval of the 1979 law for the State General Budget, the Central Government will be publishing a law-decree concerning the Local Government accounting reform, namely aiming at its uniformity, standardisation, simplification and adequacy to the respective categories.

In order to accomplish this regulation, three documents were issued: **1)** Law-decree 243/79; **2)** Law-decree 341/83; and **3)** Regulator-decree 92C/84.

The first one had the main objective of bringing the Local Government accounting system closer to the budgetary accounting then in force for the rest of the Public Administration, though separate and with specificities adequate to Local Government's functions. Subsequently, it set new principles, rules and procedures to the budgets' preparation, approval, execution and alterations (revisions). The local budget structure was also defined, and two budgetary classifications were set: an economic classification (for revenues and expenditures) and a departmental classification – *classificação orgânica* (for expenditures), the latter allowing identifying sections or departments within each entity organisational structure.

Thus, an “accounts plan” for Local Government was set, additionally defining rules for the preparation, approval and control/inspection of the Administration Account (*Conta de Gerência*) – summary of the budget execution according to the budgetary classifications.

This regulation also addressed the technical support that Central and Regional Governments should provide to Local Government, in order to accomplish the accounting changes.

An accounting simplified regime was already set for parishes with revenues or expenditures lower than 2,000,000 PTE (Law-decree 243/79, article 18): a simple sequential record of revenues and expenditures (budgeted and executed).

Although the legislators had recognised that this was not exactly what the 1979 Local Finances Law claimed, they also understood the urgent need for an accounting change towards the Local Government new management objectives. Hence, it was decided for a progressive application of that law, starting with this law-decree, the seminal importance of which led it to be considered the beginning of the Portuguese Local Government accounting system.

Four years later it was replaced by Law-decree 341/83, which brought in significant innovations, particularly related to the activities annual plan and the expenditures functional classification.

Accordingly, the existent Local Government accounting system was reinforced, introducing rules for the preparation, approval and execution of an activities annual plan, which became then compulsory. A model was defined for its structure by objectives, programmes, projects and actions.

The functional classification for expenditures, allowing allocating budgeted and executed expenditures to functional areas, made it possible not only to know the destination to which resources were allocated, but also to obtain information in order to evaluate political choices made by the administration with budgetary consequences (Carvalho, 1996, p.165).

An internal control system for the entity's financial activities, mainly the budget execution, was also institutionalised (Law-decree 341/83, article 37) and several budgetary statements were developed.

For the first time the “rule of publicity” was introduced, requiring budgets to be published after being approved by the deliberative committee (Law-decree 341/83, article 14).

Models for the Budget and Administration Account of small parishes within the accounting simplified regime were presented.

Also for the first time local governments were required to send financial elements (namely the Administration Account) to the National Institute of Statistics (Law-decree 341/83, article 45).

With these changes, the Plan, the Budget, the Administration Account and the Activities Report became important municipal financial management tools, allowing an easier analysis and improving efficiency in its use.

Finally, in 1984 another document (Regulator-decree 92C/84) came to complete this one, defining the specific accounting procedures and documents (including contents and circulation) for the Local Government accounting pursuance: rules to register revenues collection, expenditures execution, and treasury operations⁸⁵, among others. There was already some concern related to managing local governments activities in a more economic, efficient and effective way, demanding though for an accurate and complete information about each entity's patrimony composition (which assets and liabilities, as well as net worth, and for which value). Additionally it would also be important to know how that patrimony could contribute for the development of local communities.

Searching for these objectives, the second Local Finances Law (1987) set a true Local Government accounting regime. It was recognised as an instrument to support economic and financial management, and to allow evaluating budgetary and patrimonial execution. Two accounting regimes were then set (Law 1/87, article 23):

- The General Regime – a budgetary, single-entry and modified cash-based system (commitments for expenditures) in force for municipalities, parishes⁸⁶, metropolitan areas and other similar entities, like county assemblies;
- The Exceptional Regime – a double-entry accruals-based system, similar to that used by the business sector, including cost accounting. This was allowed only for Municipalized Services (autonomous and business oriented units, though within the municipalities) and federations of municipalities. Accordingly, these should use an adaptation of the business chart of accounts⁸⁷.

Though allowing an exception for Municipalized Services and Municipalities' Federations, Local Government accounting continued to be essentially cash-based,

⁸⁵ These were defined in Law-decree 341/83, article 36, n.1, as cash movements (inflows and outflows) from:

- Short-term loans;
- Permanent Funds (e.g. working capitals);
- Cash collected for third parties (e.g. social security contributions retained from employees);
- Cash bails and deposits;
- Others with the same nature.

N.2 states that these are not considered budgetary operations, thus must not be recorded in the budget.

⁸⁶ For these a simplified regime was anticipated. If the annual global amounts operated did not exceed 250 times the national minimum wage for industrial workers, parishes could keep only simple records for the expenditures and revenues, budgeted and executed (Law 1/87, article 23, n.3, and article 25, n.2).

⁸⁷ For example, it was required the preparation of an Investments Multi-annual Plan. The financial budget was in fact an accrual-based forecasted statement of origins and applications of funds. There was also an accrual-based Results Statement (forecasted and actual). For further details see Law-decree 226/93.

single-entry and budget oriented. In effect, since the budget simply recorded information related to receipts and payments, the annual monetary variations were the only ones that could be perceived. Local governments' financial and economic situation continued to be a secondary matter, until the third Local Finances Law (1998) publication. Indeed, Law 42/98 (article 6) defines that:

1 – The Local Government accounting regime aims its uniformity, standardisation and simplification, in order not only to be a financial and economic management tool, but also to allow the complete knowledge of local governments patrimony book value, and the analysis and evaluation of the local governments activities annual result.

2 – The Local Government accounting is based on the CAPA, with the needed adaptations, being anticipated a simplified regime for the parishes whose accounts do not need to be compulsorily submitted to control/inspection, in accordance with The Court of Accounts Organisation and Process Law⁸⁸.

This is in accordance with what had already been set by the 1997 CAPA (article 5, n.2): there was a clear anticipation for the publication of a chart of accounts specifically for Local Government. Consequently, in 1999, the CALG (*Plano Oficial de Contabilidade das Autarquias Locais*) was finally issued (Law-decree 54A/99), finishing a twenty years “long walk” in which the search for improvements in Local Government accounting and financial management was a constant⁸⁹.

2.3. The Chart of Accounts for Local Government

The 1999 CALG allowed Portuguese Local Administration to move towards a more informative Local Government accounting system. Its main motivations might be summarised as follows:

- The need for Local Government accounting uniformity, standardisation and simplification;
- Local Government's increasing complexity, demanding more accounting information;
- Limitations and weaknesses from the previous (budgetary) accounting system; and
- The need to control the financial equilibrium and efficiency, in addition to legality.

It was indeed an important initiative for Local Government's financial management and, since it is based in the CAPA principles, it endorses a global vision for the whole Public Administration.

⁸⁸ As we will explain later, the Law 162/99 changed the requirements for this simplified regime.

⁸⁹ Bernardes (2001, p.209) explains that the first working group for the reform of Local Government accounting to include financial accounting was created in 1982. This presented a project in 1983 for the chart of accounts for Municipalized Services, which according to Carvalho (1996, p.187) only in 1989 became a proposal for a law-decree finally passed in 1993. A project for a chart of accounts for Local Government financial accounting was also presented in 1993, but this was set aside. A new group was formed that presented a different project in 1995, which was also set aside considering the anticipation of the CAPA as basic accounting framework for the whole APS.

2.3.1. General characteristics and objectives

The CALG defines the accounting regime that Local Government should submit to. Accordingly, it is compulsorily applicable for all local governments and similar entities, such as metropolitan areas, county assemblies, and parishes and municipalities' associations. The Municipalized Services, part of the municipality structure, have to apply the CALG as well (Law-decree 226/93 has been revoked). Therefore, conditions for consolidation of municipal accounts are created, though specific rules have not been defined yet.

Considering that in Portugal there are around 4,300 parishes, very diverse in terms of dimension and other particular characteristics, the CALG (in accordance with the Local Finances Law 42/98 – article 6, n.2) also allows a simplified accounting system for these entities.

At first the criterion was for those parishes that did not have to present their accounts to The Court of Accounts⁹⁰, they should have a modified cash-based budgetary accounting, being excused from preparing some financial statements, namely the balance sheet and the results statement⁹¹. However, the Law 162/99, that made the first alteration to the CALG, also changed the requirements for the simplified regime: it is applied now for parishes and small municipalities with annual revenue lower than 5000 times the salary associated to the level 100 in the general regime of the civil servants' career, rounded for thousands of PTE.

The CALG main purpose is to create conditions for the consistent integration of three accounting sub-systems – budgetary, patrimonial (financial) and cost accounting – in a modern accounting system, which becomes a fundamental instrument to support Local Government management. Thus it allows (Law-decree 54A/99, foreword):

- Financial control and availability of information to local governments' committees, specifically following the budget execution in a cash and commitments perspective;
- Establishing specific rules and procedures for the budget execution and budgetary documents alterations, in order to assure for those documents, the integrated accomplishment of budgetary principles and rules;
- Considering the accounting principles defined in the CAPA taking into account, at the same time, the budgetary principles set by the State Budget

⁹⁰ This happened for parishes whose value for revenues or expenditures in the Administration Account was lower than or equal to PTE 130 millions – The Court of Accounts Resolution 12/98.

⁹¹ Resolution 4/2001 from The Court of Accounts sets the documents that have to be prepared by the entities under the CALG. Two groups are distinguished: general *versus* simplified regime.

Framework Law⁹², namely in the revenues and expenditures provisions and in the receipts and payments execution;

- In the budgetary execution, always to consider principles of the most possible rational use for resources provisions and the best treasury management;
- Better uniformity for the forecasting criteria, setting rules for the budget preparation, in particular in what relates to the main revenues, but to the local governments most relevant expenditures as well;
- Getting prompt information about the essential elements for the calculation of National Accounting relevant sums;
- Obtaining information about each entity's patrimonial (assets, liabilities and net worth) situation, and how it contributes to local communities development;
- Providing information for decision-making (namely those related to pricing the services) by local governments' committees, which will be based on uniform forecasted statements and accounts, prepared according to common methods and procedures.

These objectives can be summarised in three main groups: management, control and analysis, and disclosure.

Since the Budgetary Accounting was the only one in force until the CALG, the integration of two more accounting sub-systems is an innovation. Moreover, the Budgetary Accounting itself will work differently than before, once it will be integrated with the other two in the same framework.

These new accounts sub-systems provide information on the resources origins and needs, since they regulate the services functioning and, at the same time, the funds applications. Therefore they allow obtaining information in order to define the entity financial-economic situation and to identify how the several resources lead to a certain result.

For the **Budgetary Accounting** the Class 0 from the chart of accounts is used, as well as Account 25 – *Debtors and creditors from the budget execution*. This account links this sub-system to the Patrimonial (Financial) Accounting.

The main purpose of this sub-system is to register and control the budget. Accordingly, there is a clear distinction between internal operations (its effects are exclusively internal to the entity, being recorded in Class 0) and others that lead to external rights or obligations, with consequences in financial accounting. Thus, such operations as budget approval, alterations in expenditures and revenues estimates, and

⁹² Meanwhile, the State Budget Framework Law 6/91 was replaced by a new Budgetary Framework (General) Law – Law 91/2001 – in which the budgetary principles and rules (Title II, articles 4 to 11) remained basically without changes, apart from some additional explanations. Article 2, n.5, emphasises that these principles and rules also apply to Local Government, notwithstanding its budgetary independence (stated in article 5, n.2).

expenditures designated amounts (*cabimentos*) and commitments⁹³, are recorded in this sub-system in a modified cash basis. Payments and receipts are also recorded in this sub-system, but in Account 25.

A new economic classification is defined distinguishing current and capital expenditures and revenues: the former are periodically renewed, normally with consequences in the short-term assets and liabilities, and generally associated with the entity's operational functioning; the latter have occasional character, normally associated with investment/de-investment activities, with consequences for the long-term assets and liabilities⁹⁴. Budgetary expenditures might also follow a departmental classification (*classificação orgânica*), depending on each entity structure.

With the purpose of identifying the expenditures for each function inside local governments, a functional classification was set for expenditures: general, social, economical and other functions. Accordingly, expenditures are then aggregated considering common purposes or objectives of different nature.

Carvalho *et al.* (2002, p.62) additionally explain that budgeted expenditures, even those that are not investments, might also be structured (totally or partially) by objectives, programmes, projects and actions, thus integrating the Big Options of the Plan. This organisation allows not only rationalising the budget preparation, but also reinforcing control in the budgetary management and execution. In a limit situation, where all expenditures are allocated to projects according to pre-set criteria, the values both from the Budget and from the Big Options of the Plan are coincident.

The most important budgetary statements are the Big Options of the Plan (entity main strategic development lines, including the Investments Multi-annual Plan and a statement comprising other relevant non-investment activities) and the Budget. In relation to budgetary execution others are used: Statement of Annual Execution of the

⁹³ CALG section 2.6.1 explains that “designation” (*cabimento*) and “commitment” are two stages to be recorded during the expenditures execution. The “designation” is recorded on the basis of an expenditure proposal, which implies an intention to commitment thus implying the designation of the amount reserved to be spent on that. The “commitment” though is posterior; the amount is written-off from “designation” to become “commitment” from the moment a responsibility is assumed say through and order sent to the good/service provider.

Before the “designation” is recorded, it has to be legally verified, meaning that it has to be checked not only if the expenditure was forecasted within the budget, but also if the budgeted amount for that item is enough to comprise that expenditure. This has to be done both internally (administrative procedures carried out normally by people responsible for the budget/accounting) and above all externally (an expenditure proposal is sent to The Court of Accounts to get the “visa” – see footnote 80). Further explanations on these are going to be presented in following sections.

⁹⁴ From January 2003 this classification has been replaced by a new one presented in Law-decree 26/2002, keeping the current/capital distinction but changing some groups within those, and adding a third type: extra-budgetary revenues and expenditures, mainly those embracing treasury operations.

Investments Multi-annual Plan, Budgetary Control Statements (Expenditures and Revenues), Cash-Flow Statement, and Treasury Operations Statement.

The **Financial Accounting** embraces Classes 1 to 8 and follows a model very close to business accounting. In these accounts, obligations to and rights over third parties (such as debts and credits) are recognised on an accrual basis, under the historical cost convention (modified to include revaluation of some fixed assets, as well as other exceptions for infrastructure and heritage assets). The most important financial statements are the Balance Sheet, the Results Statement by Nature (Expenses and Revenues)⁹⁵ and the Appendix (notes) to the Financial Statements. In this sub-system, valuation criteria are set, which we will refer to later. The major problem implementing this seems to have been elaborating the entity's first balance sheet, namely because there were several problems related to public domain assets (infrastructures and heritage). In our opinion this was the main reason why, as we will explain, the CALG compulsory application was firstly postponed.

Although no classes have been set⁹⁶, **Cost Accounting** is defined as the third sub-system. Its use is compulsory in order to calculate not only the costs underlying the services rates and prices, but also to compute cost by functions, taking into account the above-mentioned functional classification that assumes here a crucial importance – it is compulsorily used.

Some compulsory statements are presented, namely those used to calculate costs for materials, labour, machinery and vehicles, indirect costs (overhead), total cost for goods and services, total cost by functions (functional classification), among others. This sub-system is the recognition of how important is to understand the cost structure and to calculate costs as accurately as possible (not only for service pricing decisions, but also for the better management of all the services provided for many of which there

⁹⁵ CALG section 2.2 states that the preparation of a Results Statement by Functions is optional. Yet, this does not relate to the aforementioned functional classification, but to the classification of costs and revenues according to operational, financing and investment activities, following a model very close to that from business accounting. Carvalho *et al.* (2002, p.49) argue for that statement to be compulsory, in order to have some usefulness for efficiency assessment. In fact, the Cost Accounting sub-system obliges only to calculate costs, thus not compelling its comparison with revenues by functions, products or services.

⁹⁶ The CALG just states that this sub-system must be developed according to the entity needs, although in other charts of accounts, like the one for business accounting, it is common to use Class 9 for Cost Accounting. Yet, cost cards are specifically suggested and required to be used. Almeida and Correia (1999, pp.218-231) suggest a configuration for this group of accounts, trying to accomplish with the CALG objectives.

As far as we know, some of the local governments already implementing the CALG are simply considering using an Excel spreadsheet. Subsequently, in these cases, it does not make any sense to discuss a bookkeeping method for Cost Accounting.

is no direct price to be set), with the purpose of management control and analysis, eventually calculating efficiency, effectiveness and economy indicators.

Another innovative characteristic brought in by the CALG is a double-entry bookkeeping method for the whole accounting system. In fact, if the existence of financial and cost accounting together with budgeting did not change the essential rules of local governments expenditures and revenues execution, previously set by other laws, it did change its bookkeeping method.

Table III.5 summarises what we have just presented for the CALG integrated accounting system.

	BUDGETARY ACCOUNTING	FINANCIAL (PATRIMONIAL) ACCOUNTING	COST ACCOUNTING
Main outputs	<ul style="list-style-type: none"> – Budgetary Control – Revenues and expenditures economical classification – Expenditures functional classification (departmental classification optional) – Budgetary Statements 	<ul style="list-style-type: none"> – Book value for the fixed assets – Economic result – Debts value – Stocks value – Costs and revenues by nature – Balance sheets 	<ul style="list-style-type: none"> – Expenses (revenues and results are optional) by functions, activities, services, products, departments...
Accounts	Classes 0 and Account 25- <i>Debtors and creditors from the budget execution</i>	Classes 1 to 8	Class 9 (free) ⁹⁷
Bookkeeping method	Double-entry	Double-entry	Double or single entry (free) ⁹⁸

TABLE III.5 – NEW LOCAL GOVERNMENT ACCOUNTING SYSTEM
(Adapted from Fernandes and Carvalho, 1999)

Further details on the way each sub-system works are going to be presented in sections 4 to 7. Still, we must add here that, though integrated to present accounting information in different perspectives and according to different bases, the three sub-systems are independent, being handled separately, inasmuch as each operation, as we will show, is recorded in each one of them following different stages, from the budget approval to costs allocation.

2.3.2. Contents

According to the CALG Law-decree 54A/99, article 3,

⁹⁷ This is the only sub-system for which freedom is given to each entity to create its own accounts system, suitable to record and allocate costs to functions and activities, as well as to calculate costs underlying prices and rates of services provided, notwithstanding the aforementioned cost cards.

⁹⁸ See previous note.

Local Government accounting embraces the technical considerations, the accounting principles and rules, the valuation criteria, the previsions documents, the chart of accounts, the accounting and the internal control systems, the reporting statements and the specific criteria and methods.

In order to specify this composition, the CALG itself starts explaining (CALG, Introduction, n.1):

The present accounting regime is innovative as a whole to local governments. It integrates the budgetary and accounting principles, the previsions rules, the valuation criteria, the balance sheet and the results statement, as well as the previsions and reporting statements. (...)

This regime also comprises the boards (*lists*), codes and explanatory notes for the functional, economic, budgetary and patrimonial classifications, the accounting system⁹⁹ (from which the inventory and the cost accounting are highlighted) and finally the management report. [italics provided]

Therefore, the CALG can be defined as a “code of practices”, a very comprehensive framework, divided in thirteen parts, which we now briefly describe¹⁰⁰.

1 – INTRODUCTION

A general overview of the CALG is presented here. Special references are made to:

- The forecasted budgetary statements – Based namely on the Big Options of the Plan (comprising the Investments Multi-annual Plan and the statement of the more relevant non-investment activities) and the Budget;
- The reporting statements – Accounts comprising Budgetary Execution Statements, Statement of Annual Execution of the Investments Multi-annual Plan, Cash-Flow Statement, Balance Sheet, Results Statement, Appendix to Financial Statements, and Management Report;
- Internal Control System;
- Accounting documents and books; and
- The compulsory use of Cost Accounting.

⁹⁹ The accounting system is specifically defined (CALG section 2.8) as the whole set of tasks and registrations to process operations in order to keep financial information up to dated. It involves, for all the operations, identifying, aggregating, analysing, calculating, classifying, registering in the accounts, and preparing the summary report.

The Inventory is included here inasmuch as it lists (identifying and valuating) all goods and rights (assets) and obligations (liabilities) that constitute the entity property (patrimony) – CALG section 2.8.1.

Cost Accounting is also included here as a set of techniques to calculate costs by functions, as well as the cost underlying prices and rates for goods and services provided (CALG section 2.8.3).

¹⁰⁰ Bernardes (2001, pp.227-228) emphasises that the **CALG is NOT a conceptual framework** for the Portuguese Local Government accounting, since it does not comprise the components proper to a conceptual framework. Indeed, though it establishes valuation criteria, it DOES NOT:

- Characterise local governments activities environment;
- Identify accounting information users and their needs;
- Set the financial statements objectives – The CALG imposes the preparation of the Balance Sheet and the Results Statement (calculating the annual economic result) but it does not explain the need and usefulness of this information;
- Explain the financial information qualitative characteristics – The CALG (section 3.2) simply states that the application of the accounting principles should lead to a “true and fair view” of the entity’s financial situation, results and budgetary execution; for this, financial information qualitative characteristics (such as comprehensiveness, relevance, reliability and comparability) are also fundamental;
- Establish the main concepts underlying the financial statements (assets, liabilities, patrimonial fund – equity, capital, capital maintenance, among others).

The three sub-systems interest is enhanced, referring in particular to the importance of knowing how the entities' patrimony and results contribute to regional and national economic development through local resources rational management. It also emphasises the need for local governments to establish policies for depreciation and provisions to cover potential expenses.

2 – TECHNICAL CONSIDERATIONS

This is the most all-embracing section in the CALG. Rules and technical specifications for the budgetary and financial statements preparation are described here in detail, emphasising its interest. Some comparisons with the CAPA are made, explaining the main differences.

According to particularities in some accounting operations, specific procedures are explained, as those for budgetary operations, for example (CALG section 2.6). Depreciation and provisions criteria are established as well (CALG sections 2.7.1 and 2.7.2). Possible applications for the annual net result are also defined (CALG section 2.7.3). A general overview of all accounting documents and Cost Accounting procedures is presented (CALG section 2.8).

This section also presents the set of documents to be sent to The Court of Accounts by local governments: Balance Sheet, Results Statement, Budgetary Execution Statements, Appendix to the Financial Statements, and Management Report. Parishes and small municipalities inside the simplified regime only have to prepare the budgetary statements: Budget Execution (Revenues and Expenditures), Statement of Annual Execution of the Investment Multi-annual Plan, Order Accounts¹⁰¹, Cash Flow Statement and Treasury Operations, Loans and Other Debts, and Management Report¹⁰².

Special emphasis is given to the Internal Control System¹⁰³. Several details are presented concerning to what it has to embrace, who are the entity's responsible

¹⁰¹ These are used mainly to record values related to warranties and bails provided by the entity or by third entities, not in cash but simply represented by contracts. Receipts pending receiving are also registered in these accounts. Although they do not refer to patrimonial elements, they record facts that frequently imply future responsibilities or rights. Hence, these must be reflected somehow in the accounts in order to assure a "true and fair" view. These eventual responsibilities or rights have also to be mentioned in the Appendix to the Financial Statements – CALG section 8.2.26.

¹⁰² No reference is made to the previsionsal budgetary statements to be sent to The Court of Accounts. Yet, these are mentioned in the CALG approval Law-decree 54A/99 (articles 4 and 6) as to be published and sent to the RCCs (see footnote 74) for them to monitor local finances. Further clarification was needed. The Court of Accounts issued Resolution 04/2001 listing which documents (previsionsal budgetary statements, and accounts including financial statements) are to be sent for inspection, both for local governments in the general and in the simplified regime. According to Local Finances Law (Law 42/98 – article 9, n.2), these have to be sent until Mat 15th of the following year, after being completed by the executive committee, regardless its approval by the deliberative committee.

¹⁰³ According to CALG section 2.9.1, the internal control system embraces namely the plan of control arrangement, policies, methods and procedures, as well as all other methods and procedures defined by those who are responsible for the entities. These aim to assure activities order and efficiency, including: assets safeguard, prevention and detection of illegal, fraud and error situations, accuracy and integrity of the accounting records, and reliable financial information to be prepared on time.

Carvalho *et al.* (2002, pp.134-135) explain that the Internal Control System comprises the following elements:

- Internal Control Norm – Comprising methods and procedures to control cash and equivalents, third parties accounts – debts and credits – stocks, and fixed assets (CALG section 2.9.10);
- Organisational Plan – Structure, emphasising departments related to accounting and finances;
- Specific (internal) Regulations;
- Accounts Boards (lists);

committees, which control methods and procedures must be used, and what are the control documents, among others. These are only general lines to be followed by each entity, which in turn have to prepare its own Internal Control System. Once defined and published this is of compulsory application.

3 – PRINCIPLES AND RULES

When preparing and organising the budget, several principles and rules have to be followed. Those used for the preparation of the State Budget are taken into account for the Local Government model. On the other hand, considering the accounting standardisation, accounting principles have also to be followed by local governments accounting system.

Accordingly, the principles and rules set in this section make it the most important part of the CALG. Indeed, they form the core of what can be considered the beginning of a conceptual framework for Portuguese Local Government accounting.

The budgetary principles, derived from the “classic rules” of budgetary theory, are:

- Independence;
- Annuality (Jan 1st to Dec 31st);
- Unity;
- Universality;
- Balance;
- Specification;
- Non-allocation (of revenues);
- Non-compensation (gross amounts).

These are indeed also stated on the new Budgetary Framework (General) Law – Law 91/2001, Title II – which additionally refers to the “publicity rule”, not mentioned in the previous State Budget Framework Law, as valid to Local Government. Nevertheless, this rule had already been addressed before, both by Local Finances Law 42/98 (article 3, n.2) and the CALG Law-decree 54A/99 (article 4): after the deliberative committee approval, local governments should publish within 30 days, all the forecasted (namely the Big Options of the Plan and the Budget) and financial statements (accounts including the budget execution), as well as the Management Report for that year.

Almeida and Correia (1999, p.52) explain that this aims at more proximity between Local Administration and the populations. Since the main communication instrument is the Budget and its execution, all the budgetary statements must be prepared and presented in a clear and simple way, in order to facilitate citizens’ understanding of the performed activities *versus* amounts spent.

The CALG also states other budgetary rules concerning particular procedures to be taken into consideration when the budget is being prepared. They refer to methods of previewing revenues (direct evaluation or average from previous years) and expenditures, namely for taxes, fees, financial current/capital transfers, loans and personnel expenditures. The emphasis given to revenues shows some prudence and good sense as crucial rules to be considered in their forecasting (Carvalho *et al.*, 2002, p.69), not to exaggerate in counting the resources that have not to yet come into effect.

As to accounting principles, these were aimed at obtaining a true and fair view of the entity’s financial situation:

- Reporting entity;

– Accounting Procedures Manual;
– Internal (control) Auditing Procedures Manual.

- Continuity (going concern);
- Consistency;
- Specialisation or accruals;
- Historical cost;
- Prudence (conservatism);
- Materiality (relevance);
- Non-compensation.

These are not merely General Accepted Accounting Principles (GAAP), as in the majority of the Anglo-Saxon countries. Instead they are legal compulsory principles, both used in the business and governmental accounting frameworks, though with a few differences, some of which are worthy of mention.

The first one relates to the *reporting entity* principle. CALG (section 3.2. a)) states that:

Reporting entity is every entity of public or private law to which the preparation and presentation of the accounts according to the present Chart is compulsory. When the organisational structures and the management and information needs require, accounting sub-entities might be created, since the coordination with the central system is assured.

According to Caiado and Pinto (1997, p.162), this principle comes from the need to define the organisational limits in terms of accounting information and financial reporting, very important in the present APS decentralisation context.

It appears in first place, since its main importance comes from the need to extend the CALG application to a maximum number possible of Local Government entities. Indeed, in an environment each day more diversified, it is though important to consider the organisational boundaries within which budgetary and accounting information is to be prepared according to the CALG rules.

Carvalho *et al.* (1999, p.187) explain that though this principle in Portugal is stated only in the CAPA, CALG and other governmental sectional charts of accounts, it is not exclusive to governmental accounting. In fact, the 1998 Directive 23 from the Business Accounting Standardisation Commission, concerning the relationships between accounting entities belonging to the same juridical entity, states the concept (principle) of the reporting entity for business accounting.

Another important difference relates to the *substance over juridical form* principle. This states that “the accounting operations must be recorded considering its substance and financial reality and not only its legal form”.

Considering the legality importance in the governmental accounts, it was considered not to include this principle in governmental accounting (Caiado and Pinto, 1997, p.159). Notwithstanding, although as exceptions, situations where the substance prevails over the legal form are allowed in the CALG, and must be indicated in the Appendix (CALG section 8.2.13). Examples of these situations are financial leasing contracts for physical fixed assets that though not being legally property of the entity, are in fact used as though they were. Carvalho *et al.* (2002, p.185) also refer to the public domain goods (infrastructures and heritage) required to be recorded in the entity’s assets, even if they are not legally its property, but just under its control or management. Also in this case the economic criterion is allowed to prevail over the legal one.

This is related to Carvalho *et al.*’s (1999, pp.194-195) explanation, when they say that the *legality principle* always implicit in governmental accounts sometimes is not compatible with the “true and fair view”, inasmuch as legal requirements are always a

priority in the Public Sector. In one word, to obtain a “true and fair view” from the entity’s accounts cannot prevail over legality in governmental accounting, though that might happen in business accounting.

4 – VALUATION CRITERIA

In this section several valuation criteria to be used in accounting records are defined, considering groups of accounts from the financial accounting sub-system:

- Fixed Assets – The general rule is to disclose on the balance sheet all fixed assets – intangible and tangible (operational, financial investments and public domain goods¹⁰⁴) which are legally property of the entity, plus those in financial leasing, as well as public domain goods that are not its property but are under the entity’s control and management.

The general criterion is to use the purchase or production (historical) cost, including direct and indirect costs incurred to bring the assets to its present situation. CALG section 4.1.12 allows that interest from borrowed capital to finance the assets purchasing/production might be included in its purchase/production cost, but only for the period while the assets are being completed.

For assets gratuitously obtained, the acquisition/production cost is unknown. Therefore, other valuation criteria have to be used: the value obtained from the evaluation or patrimonial/financial value legally defined (namely in the Assessment and Inventory of Public Property), or in the case of non-existence of any applicable legal pronouncement, a technical evaluation in order to gauge the assets value. In any of these cases, the valuation criteria used has to be stated and justified in the Appendix to the Financial Statements (CALG section 8.2.3).

Carvalho *et al.* (2002, p.181) state as the criteria to be used when assets are obtained gratuitously or its acquisition/production cost is unknown (which has been a common problem faced by entities preparing the first initial balance sheet) the following:

- Comparative method – to compare with the known acquisition value of an asset with similar characteristics;
- Current insurance value – namely for insured assets, as those belonging to historical, artistic and cultural heritage;
- Income value – net present value for cases of assets that yield a constant income;
- Replacement cost – namely for buildings not to be sold;

¹⁰⁴ For further details see PRC – article 84, and Order 671/2000 – Assessment and Inventory of Public Property (rules for recording, evaluating and depreciating the State property). The inclusion in the balance sheet of certain type of this kind of goods is very controversial. Caiado and Pinto (1997, p.266) argue that those not used to the entity’s activity should not be included. Carvalho *et al.* (1999, p.377) present arguments in accordance, defending that if these items cannot be sold, it is very difficult to give them some market value.

A more pacific solution was adopted, for example, in 1994 by the Spanish Chart of Accounts for Public Accounting: it was decided to include in the balance sheet the investments for public general use (basically infrastructures), only while these are being built. Once concluded, they are written-off (expensed); consequently, they are not depreciated.

In Portugal, it was considered as important to emphasise the entity’s (public) patrimony, regardless its destination. Thus, it was decided to include those elements in the balance, allowing different valuation and depreciation criteria, defined in the Order 671/2000. However, we agree with Fernandes and Carvalho (2001), defending that the designation should be “Public Usage Goods”. In our understanding this had been much more objective and also more adequate to what, in reality, this group of accounts wants to disclose.

- Net realisable value – for assets possible to be sold.

The latter two notions are current market values. The replacement cost is that to be incurred to replace the assets in the same conditions, quality, quantity and local of acquisition and use (CALG section 4.2.7). The net realisable value is the expected selling price deducting the expected selling expenses (CALG section 4.2.8).

For situations where assets are transferred from other entities also using the CALG or the CAPA, they must be valued at the value they had in the entity they are being transferred from, except if there is a different value agreed in the transfer contract (CALG section 4.1.6).

If neither of the above mentioned criteria could be applied, because either they are not adequate or they are too subjective, then the assets are given the value “zero”¹⁰⁵ until they have to be repaired, after which the repair value is considered as the assets book value.

Consequently, as Carvalho *et al.* (2002, p.180) highlight, the value “zero” is an exception within the CALG. Furthermore, in any case where it is possible to use any valuation criteria, in accordance with the prudence principle, it must be chosen the one that offers lower value.

All fixed assets with limited “useful life” must be systematically depreciated during that period. CALG section 4.1.10 addresses the possibility of an extraordinary depreciation (recorded as an extraordinary cost) if at the end of the year, the asset’s market value is lower than its book value. This depreciation has to be suppressed when the motives that led to it no longer exist. It is allowed for assets (intangible and tangible) either with limited “useful life” or not. In particular for the first case, the assessment is done after the normal annual depreciation is considered, thus in this case comparing the market value with the net book value.

Settlement and R&D expenses (intangible assets) must be depreciated within a maximum five years period.

Provisions for financial investments are set as well, in accordance with the prudence principle: when the market value is lower than the book value, there is a potential loss to be recognised at the end of the year. Once this potential loss no longer exists, provisions have to be suppressed.

As general rule, fixed assets cannot be revaluated, except if there are rules (laws) authorising this and setting the revaluation criteria. When a revaluation occurs a revaluation reserve is created in the entity’s equity.

- Stocks – As for the fixed assets, the general criterion is the purchase or the production cost. However, some exceptions are considered: for by-products, residuals and wasting, the net realisable value might be used (CALG section 4.2.5). Long-term in-process multi-annual activities value (like for some roads and bridges being constructed) must be calculated considering the degree of completion at the end of the year, calculated by dividing the total cost incurred up to the moment over the sum of this with the estimated amount to complete the asset (CALG sections 4.2.11 and 4.2.12). Sold stocks must be recorded when going out of the storehouse considering the specific cost or the weighted average cost.

¹⁰⁵ This means, for the particular item, listing in the inventory, not include in the balance sheet, but mention in the Appendix to the Financial Statements – CALG sections 8.2.14 and 8.2.15: list of all fixed assets that were not possible to value and/or depreciate; explanations why this valuation and/or depreciation was not possible have to be provided as well.

Provisions are also admitted to be considered (created or reinforced) at the end of the year, if the market value is lower than the book value, if the goods are physically damaged, obsolete or for some similar reason, they cannot be sold at their book value. These provisions have to be suppressed once the facts that cause them no longer exist. The market value might be the replacement cost or the net realisable value as defined for fixed assets.

- Credits and Debts – These are recorded at the values from the respective documents (face value).

Special evidence is given to credits and debts in foreign currency. These are recorded at the exchange rate of the operation date, except if another one had been agreed before. At the end of the year, credits and debts must be updated according to the exchange rate at the moment. The eventual exchange rate differences are considered financial expenses or revenues of the year. However, there is a special situation for the favourable exchange rate differences: if there is a medium-long term debt whose positive differences can be reversible, they must be deferred.

Provisions for contingencies and expenses related to credits (namely bad credits) may be created, reinforced or annulled according to the entity's needs and following the criteria established in the CALG section 2.7.1.

- Cash, deposits and short-term financial investments – Cash on hand and deposits are valued counting the cash amount and the bank accounts balances.

If there is cash in foreign currency, its value has to be up dated at the end of the year. Exchange rate differences are financial expenses or revenues of the year.

Short-term financial investments are recorded at their purchasing cost. If the market value is lower than the book value, provisions must be created or reinforced, being suppressed once that situation is reversed.

5 – BALANCE SHEET

The Balance Sheet structure is similar to that defined by the CAPA. Some alterations were made, considering Local Government's specific nature and competencies. For the initial balance sheet, local governments have to prepare first a list (including valuation) of all goods, rights and responsibilities that are part of its patrimony, i.e., the inventory.

The balance sheet model is arranged horizontally, grouping the accounts according to categories. It can be more or less detailed. Apart from the values for the present year, previous year values are presented, mainly for comparability effects. Within assets, gross values, depreciation and provisions, and net values are distinguished. A summary model is presented in Appendix III.1.

6 – RESULTS STATEMENT

The Results Statement has a vertical structure and displays expenses and revenues by nature. Results are classified in current (operational plus financial) and extraordinary. As mentioned, it is allowed for those entities that find it useful, to prepare a Results Statement by Functions (see footnote 95). The structure for the Results Statement by Nature is presented in Appendix III.2. This is considered a summary model, though a more analytical one can be prepared.

Carvalho *et al.* (2002, p.47) explain that since this statement displays the entity's results by economic operations (costs and revenues) during one year, its purpose is to evaluate

how the resources were used and consequently the performance of those responsible for the entity management¹⁰⁶.

7 – BUDGETARY EXECUTION STATEMENTS

This section presents the structure and contents, as well as some supplementary notes, for several statements: Investments Multi-annual Plan, Budget, Budget Execution Statements (Expenditures and Revenues), Statement of Annual Execution of the Investments Multi-annual Plan, Cash-Flow Statement, Treasury Operations, and summary Statement of Order Accounts.

The Budget is one of the main statements in this section. It resumes the financial activity (annual forecasts for expenditures and revenues) to be developed by the entity and it must be prepared following the budgetary principles and rules, and articulated with the Investments Multi-annual Plan.

It comprises two types of documents (CALG sections 2.3.2 and 7.2): one separating budgeted expenditures and revenues according to the compulsory economic classification (for expenditures a departmental classification might also be followed); and another one summarising those only distinguishing current from capital.

If the entity is a municipality, budgets for each unit of Municipalized Services should be separately presented and included in the summary for the whole entity.

Both documents are arranged horizontally in models according to those presented in Appendix III.3.

8 – APPENDIX TO THE FINANCIAL STATEMENTS

The objective of this section is to define the contents for several notes whose purpose is to enlarge and comment on the information contained in the financial statements. These notes may include all the information necessary to present a true and fair view of the entity's equity (Proper Funds), financial position, economic result and budget execution. Nevertheless, the CALG suggests this information to be organised in three points:

- 1. Entity's characterisation (identification, organisational structure, human resources, main activities and accounting organisation);
- 2. Notes to explain the balance sheet and the results statement (valuation criteria, accounts contents that cannot be compared to previous years, alterations in some particular accounts, mainly related to fixed assets, depreciation and provisions, revaluation, leasing, among others; illustrative variation tables are suggested to be used);
- 3. Notes concerning the budgetary process and its execution (budget and investments multi-annual plan alterations, administrative contracting, transfers and grants, financial investments, and debts; explanatory tables to be used are suggested as well).

9 – CHARTS OF ACCOUNTS

In this section three classifications for the boards (lists) of accounts are presented: functional classification (general functions, social functions, economic functions and

¹⁰⁶ From our point of view, using the economic result as a performance measure, though possible, is controversial in administrative governmental entities, considering the lack of a causal relationship between costs and revenues, leading to problems concerning measuring efficiency in an objective way. Accordingly, though the CALG promoters' intentions behind the Results Statement seem to have been to provide an efficiency measure, we argue that instead that statement only shows if the entity is "living within its means". Perhaps this shortcoming is now being recognised, once performance measurements systems are now being considered within the Portuguese Public Administration.

other), economic classification (capital and current revenues/expenditures), and budgetary and patrimonial classification. These are used together: for example, the economic classification is only used inside Class 0 – budgetary classification – and within Account 25 from the patrimonial classification.

10 – ACCOUNTS CODES

Three lists of accounts and respective codes are presented here, in accordance with the classifications presented in the previous section. The accounts codes range from 1 to 6 digits; the first digit correspond to the Class (budgetary and patrimonial) or Group (functional) code.

Table III.6 presents the CALG accounts structure for the three sub-systems.

Class 0 Account 25	Order and Budgetary Control Accounts <i>Debtors and creditors from the budget execution</i>	Budgetary Accounting
Class 1	Cash, deposits and short-term investments	Financial Accounting
Class 2	Third Entities (Credits and Debts – long and short term), including account 25 that links to Budgetary Accounting	
Class 3	Stocks	
Class 4	Fixed Assets	
Class 5	Proper Funds (Equity)	
Class 6	Expenses and Losses	
Class 7	Revenues and Gains	
Class 8	Results	
Class 9	(not defined)	Cost Accounting

TABLE III.6 – ACCOUNTS STRUCTURE WITHIN THE CALG

11 – EXPLANATORY NOTES

This is a very important part for the CALG, since it is a guide for its correct use. Considering once again the classification presented in section 9, detailed supplementary explanations about the contents for each account at the lowest level are presented here (bookkeeping rules). The main purpose is to clarify the accounting records for each account, given that some times the account designation is not so obvious.

12 – ACCOUNTING SYSTEM – DOCUMENTS AND RECORDS

This section concerns specific procedures about documents. Several types of documents used by the inventory and the three accounting sub-systems are specified. Details about its form and contents are given.

13 – MANAGEMENT REPORT

This section explains the contents for the Management Report that the executive has to present to the deliberative committee. Basically it must embrace information about:

- Annual economic situation – analysis of the management evolution, mainly with respect to investments, functioning conditions, and costs and revenues;
- Financial situation summary – financial management ratios in order to facilitate balance sheets and results statements analysis;
- Evolution of the short and long-term debts and credits;
- Justified proposals for the application of the annual economic net result;
- Relevant facts that occurred after the close of the economic period.

2.3.3. Applicability

According to the Law-decree 54A/99 – article 11, the CALG should have been in force from January 1st 2000. Since the law approval until that moment (the implementation period), local governments should list and evaluate their property, as well as define the Internal Control System. Besides, they should prepare all the budgetary statements (including the investments multi-annual plan) and the initial balance sheet. Also from 2000 local governments accounts should be prepared according to the accounting regime set in the CALG.

Due to several reasons, mainly related to problems that entities found when adapting the new accounting system, that date was postponed. Bernardes (2001, p.18) refers namely to difficulties that administrative servants, people responsible for accounting, and managers within local governments, have found in adapting themselves to new accounting principles, rules and procedures, which they were totally unfamiliar with (inasmuch as they only used to deal with budgeting).

Thus the Law 162/99, rewrote article 11 from Law-decree 54A/99, postponing that date to January 1st 2001, except for the investments multi-annual plan that should be compulsory from January 1st 2002. Moreover, it stated that, during this transition period, supposed to last until January 1st 2001, local governments could choose between preparing their accounts according to the previous accounting system and the CALG.

Nevertheless, with the Law-decree 315/2000, a new definite date for the CALG to be in force was set: January 1st 2002. By that time, all local governments should list and evaluate their property, and prepare the initial balance sheet, the budgetary statements and the Internal Control System. Until then, local governments might have continued to choose between elaborating their accounts according to the previous accounting system and the CALG. Meanwhile, those local governments that were already using the CALG, apart from those statements, could choose between preparing the activities plan from the previous regime and the investments multi-annual plan from the CALG.

This last postponement was due in particular to the fact that the new economic classification for public expenditures and revenues (expected to be used in Budgetary Accounting, not only by Central Government but by Local Government and other sub-sectors of the APS as well) would be in force from 2002 budgets¹⁰⁷. Considering the

¹⁰⁷ Although it has been approved by Law-decree 562/99, Law-decree 321/2000 made some changes with respect to the future application of this new economic classification. While the first required the new classification to be applied to Central and Local Government entities' budgets from 2001 onwards (with

profound changes brought in by the CALG, using simultaneously different classifications for budgetary statements, reporting statements (accounts), and budget execution would be almost impossible, apart from bringing considerable software problems (Law-decree 315/2000, foreword).

Hence, during the transition period that, at least theoretically, lasted from Law-decree 54A/99 issuance up to the end of 2001, two accounting systems existed for Portuguese local governments: the previous budgetary modified cash-based single-entry system (Law-decree 341/83, Regulator Decree 92C/84) with the exceptional accrual-based business-type accounting regime for the Municipalized Services and federations of municipalities (Law-decree 226/93 for); and the CALG.

As to the currency unit, according to the Law-decree 138/98 (article 9), until December 2001 entities could choose between PTE and Euros; after January 1st 2002, everything is to be recorded in Euros.

2.3.4. Innovations versus weak points

It is undeniable that the CALG was a true revolution in the Portuguese local government accounting. Indeed this framework allows (Almeida and Correia, 1999, p.234):

- To support budgetary decision-making, namely related to multi-annual budgets, since it is possible to monitor the responsibilities with future consequences;
- The responsible bodies for controlling the Public Administration financial activities, to have enough financial and budgetary information, reinforcing the local governments financial and patrimonial transparency;
- To provide information for the calculation of National Accounting elements;
- A continuous and integrated budgetary management;
- Public managers to become more responsible.

However, it is also true that some problems have been arisen, justifying that the CALG compulsory application had been postponed twice. In fact, the transition period had to be enlarged due particularly to:

- The computer system is not completely implemented yet in many entities, especially in the smallest ones. Further developments are still needed, also considering the simplified accounting regime;

exception of other governmental services with specific charts of accounts, for which was required from 2002 budgets), the latter postponed the date to 2002 budgets.

The reasons for this postponing are related to the need of more time to adapt the systems in order to reach uniformity and consolidated information for the whole APS. In particular, local governments were having doubts in the use of this new classification and specific instructions were still being prepared. Furthermore, most of the entities were already preparing the 2001 budget, which could not wait for further information.

- The accounting personnel’s background on the new accounting principles and methods has not been sufficient. Additional investment still has to be made in order improve their competence;
- A legalistic culture among accounting information users (giving more importance to legality control) still prevails over a managerial perspective. Budgetary accounting continues to be considered the most important comparatively to the other sub-systems;
- There have been some delays in setting implementation rules (e.g. the public expenditures and revenues economic classification);
- Some difficulties have been faced while listing and evaluating the State’s patrimony, as well as defining its control. The issuance of the Assessment and Inventory of Public Property helped to solve the majority of the problems. However, further explanations have to be considered in particular related to the public domain goods. The role of the PAASC is crucial here.

In spite of these problems, the new system has been reasonably accepted (by July 2001 19 out of the 308 existing municipalities were already implementing the CALG, notwithstanding it was not supposed to be in force before January 2002). Improvements particularly related to computer systems and the education and training of staff have been made. Great efforts have been joined together by several authorities in order for the CALG to become a successful initiative¹⁰⁸.

3. GOVERNMENTAL ACCOUNTING STANDARD-SETTING

Portugal is a parliamentary Republic in which the legislative power is shared between the Republic Assembly (unicameral Parliament) and the Government¹⁰⁹. All the aspects of the political and administrative life are regulated by laws, law-decrees and regulations, as is set by the Constitution (IGAE, 1995, p.285).

Furthermore,

The validity of the laws and other acts from the State, the autonomous regions, the local power and other governmental entities depends on its conformity with the Constitution (PRC, article 3, n.3).

¹⁰⁸ It is worthy to mention here that two particular working structures were created to support the CALG implementation (in accordance with the Law 162/99 – article n.1): the Technical Support Subgroup for the CALG Application (SATAPOCAL – Portuguese abbreviation) and the Sub-group for Professional Training on the CALG. While the main objective for the latter is assessing the training needs, as well as searching for uniformity of the CALG training courses contents, the SATAPOCAL aims to assure uniformity in answering the questions raised by local governments, suggesting technical notes and proposals for legal alterations, in accordance with the orientations given by the PAASC. The technical support is provided in particular on subjects related to inventory and entity’s patrimony, internal control, and the accounting system itself.

Additionally, the Centre for Local Government Studies and Training (*CEFA – Centro de Estudos e Formação Autárquica*) has been playing a crucial role, mainly in what concerns to accounting professional training coordination.

¹⁰⁹ The legislative competencies are defined in the PRC: articles 161 to 170 for the Republic Assembly, and articles 197 to 201 for the Government.

According to this strong legal tradition, as we already emphasised in section 2.2.1, accounting standards (both for governmental and business sector) are set by law and consequently compulsory. The influence of the accounting profession is still very weak.

The process of standard-setting in Portuguese APS might be illustrated as follows.

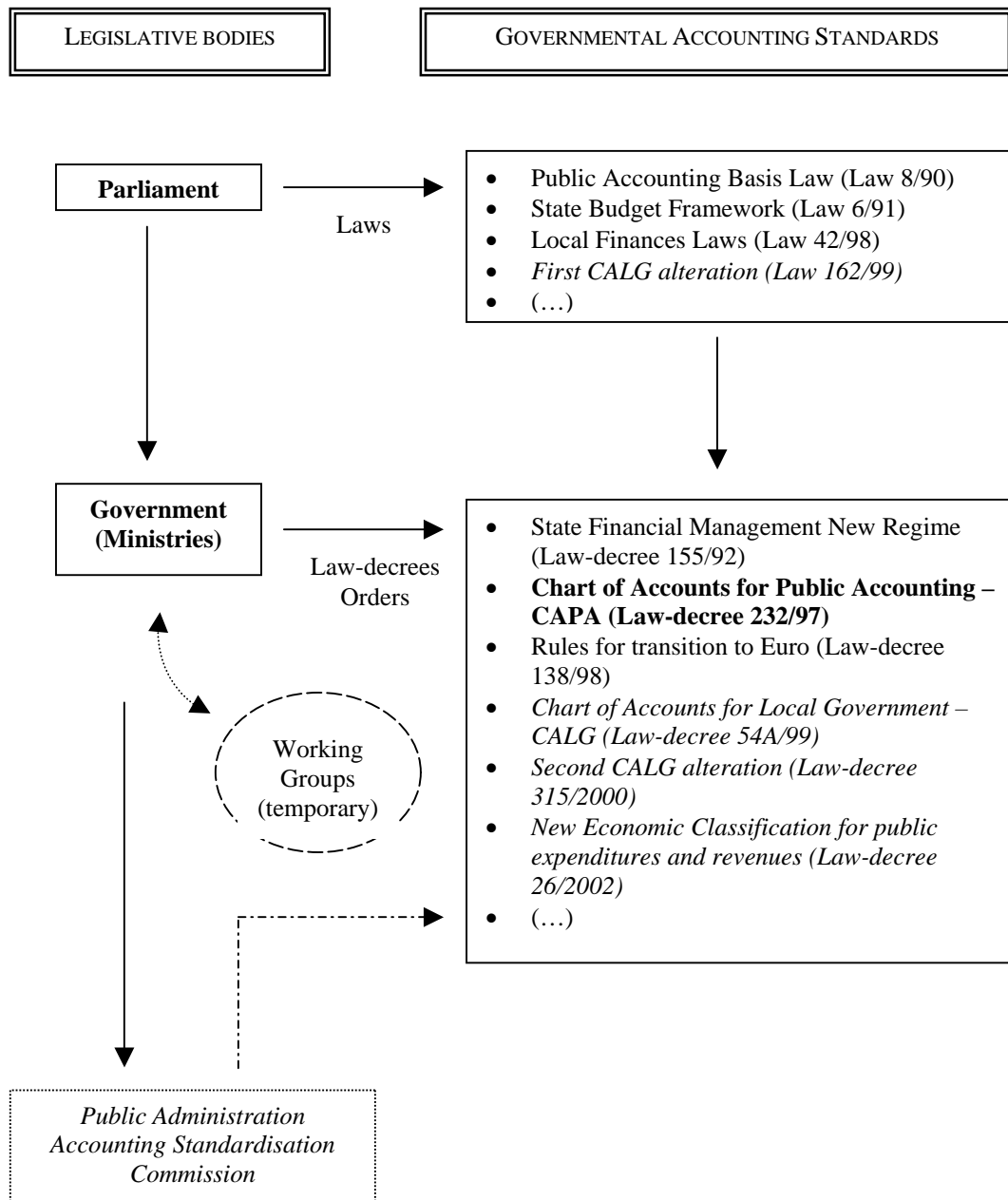


FIGURE III.2 – THE PROCESS OF PORTUGUESE GOVERNMENTAL ACCOUNTING STANDARD-SETTING

The **Parliament** approves the basic laws, which set the general standards and principles. Within this broader context, the **Government** issues more specific rules or standards.

With respect to the CAPA and the CALG, working groups were temporary designated by the Government, through the Minister of Finance and the Local Administration Secretary of State respectively, in order to prepare proposals for these systems, that later became the respective law-decrees.

For the CAPA, according to Caiado and Pinto (1997, p.40) in 1995 the Ministry of Finance nominated a “mission structure” whose functions were

(...) to prepare the general chart of accounts, the principal recording rules, the main statements with compulsory publication, as well as the adaptation to the public services with commercial, industrial and credit activities, and to the social security.

In the CALG case, an internal working group was also designated in 1995, by instruction of the Local Administration Secretary of State. The project from this group was rather independent, due to the Local Government independence. However, once ready, it was set aside since the CAPA was about to be issued. Moreover, the Local Finances Law itself was modified in 1998. Subsequently, a new group presented the project that was issued as the law-decree presently in force.

The Ministry of Equipment, Planning and Territory Administration was then the responsible for the CALG law-decree issuance, as it was presented in Figure III.1. By that time, the Local Administration State Office, which was the leader for the CALG whole process, was included in this. Presently, after some governmental reformations, it is included in the Ministry for Environment and Territory Arrangement.

Currently, the body responsible for Local Government financial and accounting management is the Local Government General Department (*DGAL – Direcção Geral das Autarquias Locais*), through a specific local finances office. This body belongs to the Local Administration State Office.

In brief, for all APS sub-sectors, the respective ministries are responsible for the issuance of the respective chart of accounts. Nevertheless, the principal and oversight role of the Ministry of Finance as the main regulatory body for the whole governmental accounting system demands it to participate in all those regulations.

For all the rules related to Local Government accounting, the Municipalities’ National Association and the Parishes’ National Association are always consulted.

As happen to business accounting, there is a body with authoritative status to give orientations on governmental accounting standards and procedures (though without enforcement power): the aforementioned PAASC.

This is a consultative (non-professional) body, depending on the Ministry of Finance, that was created by the CAPA law-decree (Law-decree 232/97 – article 4). It integrates an executive commission and an accounting standards council. The first is responsible for the coordination of the CAPA application and improvement. The latter coordinates the CAPA application to the APS sub-sectors, Local Government included. Law-decree 68/98 defines the PAASC specific competencies and composition.

In broad terms, it produces general orientations in terms of governmental accounting, such as interpretative standards and instructions for practice (*Directrizes Contabilísticas*). Although these do not have legal force, they are generally accomplished and some of them might later become laws or lead to legal alterations. It has orientated the CAPA implementation phase, as well as the application of the law regarding the Assessment and Inventory of Public Property (Order 671/2000).

The PAASC includes members from several ministries, from the Regional Governments, from the Business Accounting Standardisation Commission, from The Court of Accounts, and from the National Institute of Statistics. The president of the executive commission is the State Budget General Director.

Although they are not regulatory bodies, we think it is worthy referring to the external inspective bodies that the APS institutions have to report to. In fact they play an important role, assuring that the laws are accomplished. Thus, in our understanding, they are in some way complementary to the standard-setting bodies.

These are:

- The Court of Accounts (General Audit Office) – as the supreme audit institution, its mission is to assure the expenditures legality and the budget control; it performs both *ex-ante* (preventive – mainly to check expenditures budgetary inclusion, indispensable for these to be “accepted”) and *ex-post* (successive – after the budget execution, normally a general and exhaustive control) inspection; further details on this will be presented in following sections;
- The Finances General Inspection – controls the fiscal responsibilities (e.g. VAT), based in the financial accounting statements.

On the other hand, as Carvalho *et al.* (1999, p.17) state, governmental accounting is also subject to the National Accounting requirements, in order to allow a homogeneous classification for revenues and expenditures. This might be one reason for the existence of three separated although integrated governmental accounting sub-systems.

4. LOCAL GOVERNMENT ACTIVITIES AND EFFECTS ON ACCOUNTING

According to Bernardes (2001, pp.50-51), when performing its competencies local governments carry out:

- Production activities – Especially those of providing services such as public transportation, water distribution, sewage treatment, among others, generally organised in units of Municipalized Services. The entities behaviour here is very similar to that from any other production economic unity, with services to be paid a price for, with the particularity that here these are provided aiming at satisfying public (local) needs;
- Consumption activities – Simply spending resources. In this case, activities carried out imply getting *revenues* (as the monetary equivalent from providing certain services – e.g. fees from licences – or from exercising fiscal power – taxes) and incurring in *costs* (as the monetary equivalent from purchasing a large diversity of resources fundamental for the entity's functioning).

These are economic concepts derived from real (economic) flows that have associated concepts within the financial cycle – *revenues* and *expenditures* – which in turn will be converted in cash flows – *receipts* and *payments* – within the cash cycle.

Local Government economic, financial and cash cycles can be represented as follows.

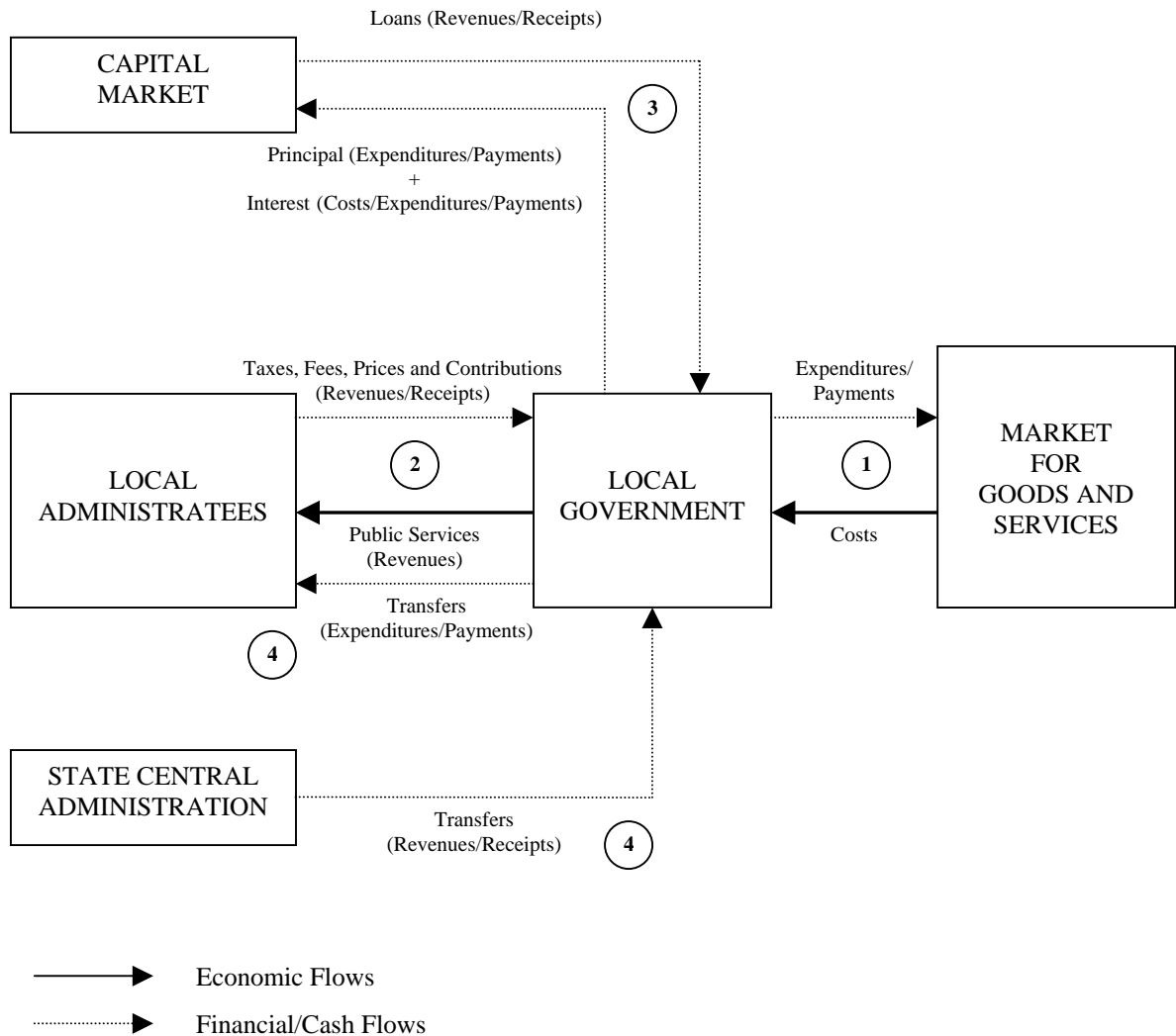


FIGURE III.3 – LOCAL GOVERNMENT ECONOMIC, FINANCIAL AND CASH CYCLES
 (Adapted from Bernardes, 2001, p.51)

In the diagram there are three types of bilateral flows (Bernardes, 2001, p.52):

- 1) To the MARKET OF GOODS AND SERVICES – there is the real acquisition of goods and services, which have **costs** as monetary equivalent; the obligations incurred from here are expressed as **expenditures** that have associated cash-outflows as **payments**;
- 2) To the LOCAL ADMINISTREES (population) – there is the real provision of public services within Local Government competencies, which have **revenues** as monetary equivalent; the rights obtained from here are expressed as **revenues** that have associated cash-inflows **receipts**;
- 3) To the CAPITAL MARKET – consisting in contracting loans (as **revenues** and **receipts**) and repaying them (principal plus interest); these are strictly within the financial and cash cycles, since there are not real flows of goods/services.

Unilateral flows are also represented: financial transfers in general, also strictly within the financial and cash cycles, both to and from Local Government (4).

As Bernardes (2001, p.52) summarises:

Local Government withdraws (...) its resources from the economy through fees, rates or prices as well as local taxes, with financial autonomy to conform its own fundamental economic action that consists in seeking to get the optimal production of local goods and services, to generate and increase the collective well being, through the satisfaction of public needs; and doing this in order to reach the maximum benefit with the minimum spending of resources.

It is therefore understandable that this extensive network of activities brings complexity to the management of public local resources, thus emphasising the accounting and financial management system's role as essential in not only recording and analysing any variations in those resources, but also as an important forecasting instrument.

Nowadays, those responsible for Local Government's current/daily management have to face the hard task of allocating scarce available resources to productive activities, searching at the same time for increasing their value in order to multiply the outcomes.

Hence, new demands are required from the accounting system, which must now provide information to allow knowing if the resources are being used according to the objectives set to fulfil the local needs.

Traditionally this "efficiency dimension" was not covered by governmental accounting, which focused on describing how public resources were used, just following the budget previously approved.

Despite the changes, as Freitas (2000, p.5) explains, the reality of administrative governmental entities will always be different from the private business ones, namely concerning the financing sources, but also with respect to the management culture intrinsic to administrative governmental managers. Accordingly,

Since the Budget is a document basis for *local governments* reality, it will determine the way its managers act; since intimately linked to the patrimonial *consequences*, it cannot be forgotten and its control *is* one fundamental objective of any financial information system within those entities. [italics provided] (Freitas, 2000, p.5)

Thus, as CALG section 7.2 states, the financial activity to be performed by local governments for forecasting is based on the budget: budgetary activities implying budgetary operations (revenues and expenditures).

There are though some additional extra-budgetary activities/operations, described in Law-decree 26/2002 as those not considered budgetary revenues/expenditures, but with consequences on the cash (treasury). Therefore, the main extra-budgetary operations are **treasury operations**, defined as amounts from retentions of third parties

funds that later will be given to them (e.g. income taxes and other contributions retained from employees to be paid to Central Government)¹¹⁰.

For Local Government accounting in particular, treasury operations are inflows and outflows (receipts and payments) apart from the budget, only being recorded in the financial accounting sub-system.

CALG section 7.6 brought in some changes relative to the previous regulation (see footnote 85) for which are considered treasury operations: only collections that local government services do on behalf of third parties. Hence, short-term loans are now considered budgetary operations, and working capitals are just sums of cash normally at the custody of treasury chiefs (just recorded in the Treasury Diary at the moment of its constitution). As far as cash bails and deposits are concerned, Carvalho *et al.* (2002, p.230) argue that they must continue to be considered treasury operations recorded in the financial accounting sub-system, since from the moment the entity receives those amounts it becomes debtor to those who pay them, so these debts must be reflected in the Balance Sheet.

In spite of Law-decree 26/2002, the CALG seems to forgo the extra-budgetary classifications for treasury operations, since they are already recorded only in the financial accounting sub-system.

Notwithstanding treasury operations, the most important ones are certainly budgetary operations: expenditures and revenues, on which we are going to concentrate next.

The EXPENDITURES ACCOUNTING RECORDING CYCLE involves the following sequential stages:

¹¹⁰ For further see Law-decree 26/2002, explanatory notes to accounts 17.00.00 to 17.04.00 for revenues and 12.00.00 to 12.03.00 for expenditures.

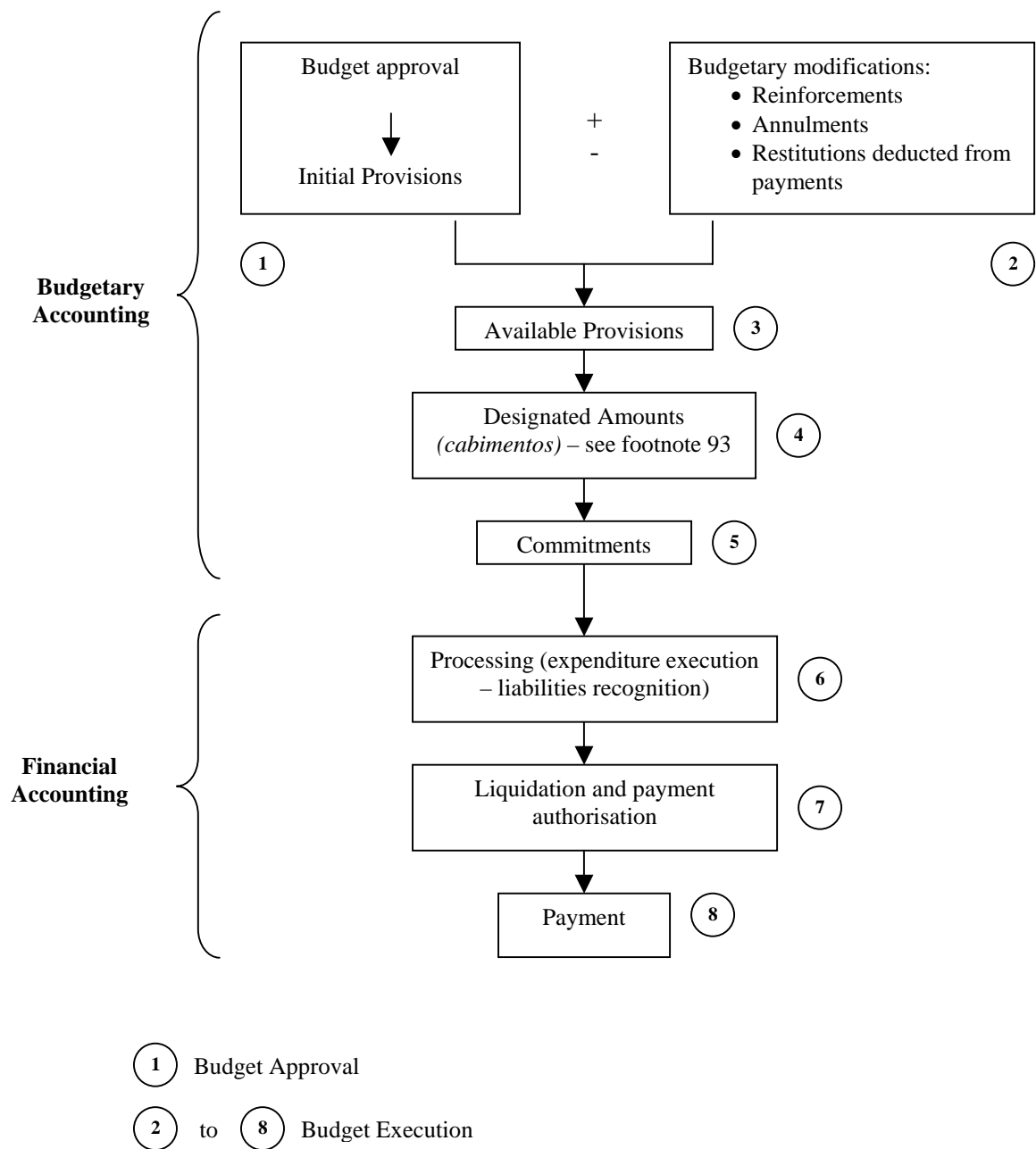


FIGURE III.4 – EXPENDITURES ACCOUNTING RECORDING CYCLE

The REVENUES ACCOUNTING RECORDING CYCLE is simpler:

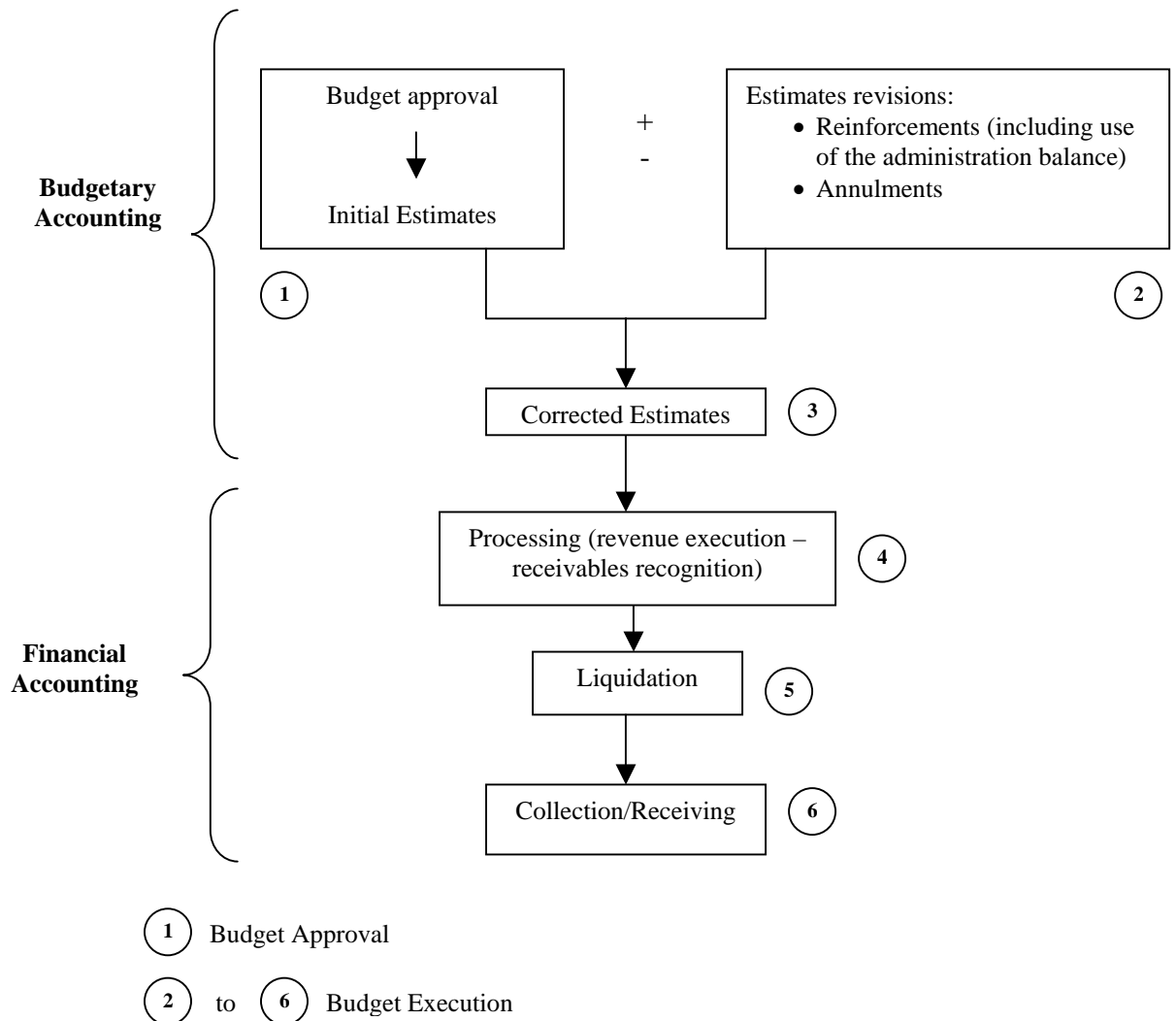


FIGURE III.5 – REVENUES ACCOUNTING RECORDING CYCLE

As both Figure III.4 and Figure III.5 show, records in the Budgetary Accounting sub-system concern strictly internal operations, finishing with the “commitments” stage for expenditures, and with the available estimates after budgetary corrections for revenues (“corrected estimates”). From here, operations continue to be recorded in the Financial Accounting sub-system, starting with the “processing” stage, inasmuch as they bring rights and/or obligations to the entity with consequences in third parties patrimony.

Further explanations on what each stage/operation consists, as well as specific supporting documents, accounts and accounting records, are presented in the next sections. For reasons concerning simplification, VAT is going to be ignored.

5. BUDGETARY ACCOUNTING

The previous section emphasised how the budget is the driver for all activities within local governments, influencing the way they are managed. Subsequently, financial accounting is determined by budgetary accounting, inasmuch as the great majority of patrimonial/financial variations (operations) are consequence of the budget execution – budgetary operations (Freitas, 2000, p.6).

Carvalho (1996, p.58) defines local governments budget as

(...) the document that displays the annual prevision of the expenditures to be carried out by the entity, its anticipated applications, and the origin of the resources to cover them, incorporating the authorisation given to the executive to collect revenues and carry out expenditures.

This definition embraces three fundamental budgetary elements, which have associated similar budgetary functions (Carvalho, 1996, pp.59-62):

- The **economic** element – The budget is a forecast of revenues and expenditures. On the other hand, the whole of Local Government's activities comprises an economic element/function materialised in allocating resources (spending) to fulfil local needs. Thus, the budget emphasises the relationship between local governments' financial capacity and the provisions allocated to each service (that are the top limits up to which budgetary credits might be used), i.e. it sets local governments' charges within the limits of the revenue forecasted. Additionally, the budget intends to assure that the resources allocation is done pursuing objectives of economic rationality, efficiency and effectiveness, in order to maximise the social utility. Furthermore, the budget discloses the entity's financial plan, since it reveals not only where it intends to apply the financial resources mobilised, but also the origins of these, i.e., the contributions that are going to be demanded from citizens to finance the entity.
- The **political** element – The budget is the general orientation to be followed in the entity's management, as well as the political authorisation given from the deliberative committee to the executive for this to collect financial means and allocate them to the programmed actions. Thus it reflects the (political) orientation that the entity intends to pursue, both for revenues and expenditures, setting the directives for its actions. Accordingly, the budget has a political function, inasmuch as it is not only the best indicator for the political orientation to be followed, but it also determines that local governments actions must be developed within those limits. It also reveals to what degree the entity intends to interfere in the local wealth redistribution. Finally, considering that resources are scarce, the budget reflects priorities, political choices and tendencies made by the committees responsible for the entity's

management, since the financial issues are always constraints to local governments actions.

- The **juridical** element – The budget regulates and limits the power of the executive committee, once it is imposed as the law regulating the entity's whole financial activity (including not only the revenues and expenditures amounts and economic distribution, but also the rules for its execution). It is a programme of financial management, based on the activities plan (Big Options of the Plan); a set of calculations for total revenues and expenditures in one year; a periodic authorisation of powers, as well as the basis for financial control/scrutiny. The juridical function is therefore expressed, in relation to each economic (civil) year, in: authorising collecting revenues and carrying out expenditures up to the forecasted limits, thus imposing a serious financial constraint to those responsible for local governments; and regulating the administration financial competencies, namely concerning expenditures execution and payments resolution.

Within the budget, revenues and expenditures obey, as mentioned, an economic classification, being grouped as current and capital. Additionally expenditures also follow a functional and a departmental classification.

Local governments' revenues can be generally defined as funds inflows that increase the entity patrimony (wealth), are effectively available, and are meant to satisfy public local needs¹¹¹. Carvalho (1996, p.78) refers to two criteria to distinguish between current and capital revenues: incidence on the entity's patrimony, and regularity or normality of its collection. Thus he defines **current revenues** as

(...) those that have consequences in the entity's non-lasting patrimony and come from earnings in the budgetary period, either from increasing the financial assets, or reducing non-lasting patrimony, its collecting process being finished within the annual financial period. (Carvalho, 1996, p.78)

In turn, **capital revenues** are

(...) all revenues collected by the entity that modify its lasting patrimony, because they increase both medium and long-term assets and liabilities or reduce the entity's lasting patrimony. (Carvalho, 1996, p.78)

Expenditures in general terms are allocations of sums of money, spent by local governments entities to satisfy local needs. Carvalho (1996, p.81) also refers to particular criteria to distinguish current from capital expenditures: regularity (considering the probable duration of underlying goods/services), associated operations (investment or consumption), productivity (productive or non-productive), and incidence on the entity's patrimony. Accordingly he states (Carvalho, 1996, p.80):

¹¹¹ According to Carvalho (1996, pp.77-78) this is a financial concept of public revenues, opposing the cash concept that accepts as public revenues any funds inflows independently from its origin or purpose. However, local governments might receive funds that cannot be used to finance its activities, such as income taxes retained from employees, which we already refer to as treasury operations, not (budgetary) revenues.

Current expenditures are those that reveal a permanent character and affect the entity's non-lasting patrimony, determining the reduction of net assets. (...) That is, all the expenditures with goods and services of current consumption, object of a final use, including also debt charges and attribution of subsidies for immediate utilisation.

Capital expenditures are all those that modify the entity's lasting patrimony, determining its increasing as they contribute to technical or fixed capital formation and to the collective well being.

CALG section 3.1.1 states the budgetary principles already mentioned which the budgetary preparation and execution have to obey. The *balance principle* is one that we believe is worthy of some comments. It states that (CALG section 3.1.1 e)):

The budget estimates the necessary resources to cover all expenditures, and the current revenues must be at least equal to the current expenditures.

Hence, the text imposes a double balance: the global budget balance and the current budget balance.

As Carvalho (1996, p.66) states, the global budget financial balance consists in total expenditures equalising total revenues, thus formally there are not budgets with deficits. Indeed, as the author continues to explain, there are not budgets where revenues are lower than expenditures, since they would reveal an over-allocation of resources and/or a clear impossibility of the entity to demand more sacrifices from the populations. On the other hand, the opposite situation with revenues exceeding the estimated expenditures, would express a situation where too much and useless sacrifice was being required from the population, who were providing more financial resources than those necessary for their needs.

However, the global balance might be reached with external financing, namely loans. Even so, it must not be forgotten that loans increase revenues but also increase obligations, so they are not effective revenues.

Carvalho (1996, p.67) adds that, because of this, some argue for global budget balance only when effective revenues equalise effective expenditures (cash perspective). Notwithstanding, he also argues that loans might be considered effective revenues if they are for medium and long term, intended for investment financing, and its contracting results from a cautious evaluation both of estimated resources and of the degree of intended development. Furthermore, even in a cash perspective, if paying back the loans implies cash outflows, the entity keeps the same value in the assets financed with those resources (it does not have the cash but it keeps its applications).

Even so, in the long run, local governments must seek to balance their global accounts with as little debt as possible, inasmuch as this creates charges considered

priority expenditures to be covered and thus preventing resources to be used in more fruitful activities, as well as burdening future generations.

In order to avoid this situation, the current budget balance has to be assured, meaning that current revenues have to be at least enough to cover current expenditures; if they exceed the expenditures, there is a “current positive saving” that might be used to finance capital expenditures. In other words, capital expenditures (investment) have to be financed with the total capital revenues plus the “current positive saving”, if it exists.

If a deficit would be allowed in the current budget, meaning current expenditures to be financed with capital (long-term) revenues, the consequence would be a progressive de-capitalisation of the entity.

As explained in section 2.3.1, the budgetary accounting sub-system comprises accounts from Class 0, designated in the CALG as “budgetary control and order accounts”. As Freitas (2000, pp.6-7) explains, it is expected that these accounts allow monitoring the budget execution, providing at each moment, information on the stages of accomplishment of revenues and expenditures; they record and control, **in a modified cash basis**, both revenues for the current year, and expenditures for the current and future years.

Class 0 structure is presented in the CALG as follows. Further levels of detail are allowed according to the entities’ needs.

ACCOUNTS CODES			ACCOUNTS DESIGNATIONS
01			Budget – Current exercise
02			Expenditures:
	021		Initial provisions
	022		Budgetary modifications
		0221	Provisions transfers:
		02211	Reinforcements
		02212	Annulments
		0224	Restitutions deducted from payments
	023		Available provisions
	026		Designated Amounts (<i>cabimentos</i>)
	027		Commitments
03			Revenues:
	031		Initial estimates
	032		Estimates revisions:
		0321	Reinforcements
		03211	Use of the administration balance
	

		0322	Annulments
04	034		Corrected estimates
			Budget – Future exercises
	041		Exercise (n + 1)
	042		Exercise (n + 2)
	043		Exercise (n + 3)
05	044		Exercises (n + 4) and following
			Commitments – Future exercises
	051		Exercise (n + 1)
	052		Exercise (n + 2)
	053		Exercise (n + 3)
09	054		Exercises (n + 4) and following
			Order accounts

TABLE III.7 – BUDGETARY CONTROL AND ORDER ACCOUNTS

In section 11.3 CALG explains that each account within this class is to be divided according to the economic classification, except accounts *03211 – Use of the administration balance*, and *09 – Order accounts*.

Accounts *04 – Budget-Future exercises* and *05 – Commitments-Future exercises* were created in order to keep up to dated the commitments assumed for future years, also allowing to know the future effects of present operations and surpassing the short-term budgetary horizon¹¹². Thus they relate only to expenditures expected to be incurred according to the investments multi-annual plan. Records in these accounts are written only against each other.

5.1. Budget preparation and approval

The budgetary process starts with what Carvalho (1996, p.83) calls the “**budgetary initiative**”. The initiative to organise and prepare local governments’ budgets comes from the president of the executive committee, who is the responsible for transmitting to all departments the political and administrative guidelines to be followed when preparing next year’s estimates.

At this stage the president sends memos communicating to all departments within the entity, instructions to be followed when determining their needs in modified cash

¹¹² Carvalho *et al.* (2002, p.61) explain that, apart from the annual compulsory budget, it is desirable to prepare multi-annual budgets in consonance with the Big Options of the Plan (namely the Investments Multi-annual Plan), in order to help the records of future commitments on budgetary accounting. Those must be prepared attending the legislature term, following a rolling time horizon of four years.

terms (expenditures), and demanding those needs to be properly supported, using justifying documents. Political intentions regarding revenues must be communicated as well, namely concerning prices, rates and fees adjustments, possible assets sales, loans to be contracted, cooperation agreements and other with consequences on the revenues to be collected (Carvalho, 1996, p.84).

All this information is gathered by the section responsible for preparing the budget (normally the “budget and accounting division”), which

(...) verifies the conformity of the departmental budgets with the objectives set by the administration and observes if the expenditures prevision fits within the revenues amount meanwhile previewed. (Carvalho, 1996, p.84)

A **first draft for the budget** is then prepared, normally after a period of political negotiations between the entity’s leaders (namely departments chiefs) until a consensus of interests is reached. From here, the following very important operation is to **balance the budget**. As Carvalho (1996, p.84) explains, this implies taking some political decisions in order to define priorities either to cut expenditures and subsequent actions or/and to create new sources of financing, so that the budget proposal to be presented and discussed within the executive (and later to be presented to the deliberative committee) assures that there are enough revenues to cover all expenditures.

The balance principle, addressed in the previous section, once one of the main budgetary requirements, is the main cause for the budgetary rules (see section 2.3.2) to be followed in the budget preparation: it is important to forecast as accurately as possible both for expenditures and above all for revenues, balancing the budget in the most “honest” way. In fact, it might be easy to reach that balance through arithmetic manipulations creating artificial balances and thus causing serious disturbances in local governments finances. The consequences will be as serious as it reduces the control during the budget execution and the absence of external scrutiny on the public money applications (Carvalho, 1996, p.69).

The **budget proposal** prepared by the “budget and accounting division” is then adopted as a reference framework by the **president, who presents it to the executive committee**. This examines the whole proposal, specifically with respect to the political implications of the options underlying the financial evaluations.

The next stage is the **budget proposal presentation** by the executive committee **to the deliberative committee** (council or assembly) **for approval**. Law 169/99 (articles 13, 49 and 88) states that, in the last ordinary meeting happening in November or December every year, the deliberative committee has to approve the options of the

plan and the budget proposal, so thus the budget for next year can be in force from January 1st. An exception to this situation takes place for years following local elections: in these cases, the options of the plan and the budget have to be approved in a meeting (ordinary or extraordinary) of the new elected deliberative committee to happen until the end of April of the year those documents are referred to¹¹³.

The budget proposal is normally presented 15 days before that meeting.

Carvalho *et al.* (2002, pp.63-66) explain that the budget proposal consists of a set of documents (*articulado do orçamento*):

- Forecasted statements approval proposal – Basically is a text requiring the deliberative committee to approve what is being proposed;
- Budgetary statements – Namely revenues and expenditures budgets and the summary (see section 2.3.2 and Appendix III.3). Those authors also suggest that the budgetary statements within the budget proposal should include: a multi-annual statement for the most relevant (non-investment) activities, the Big Options of the Plan, an annual Treasury (Cash) Budget by months, and forecasted balance sheet and results statement;
- Budget proposal report – It provides additional elements explaining and justifying the information included in the budgetary statements, in order to support its analysis;
- Rules regulating the budget execution – Is a document aggregating all general instructions concerning collecting revenues, carrying out expenditures, movements in treasury operations, and the entity's responsibilities and operations to control those. Accounting procedures might be established, as well as people responsible for its execution might be defined. In one word, it is a document that annually specifies all the rules and particular conditions for the budget execution.

Both the Big Options of the Plan and the Budget cannot be changed by the deliberative committee, though they might not be (totally or partially) approved (Law 169/99, articles 17, n.4 and 53, n.6). That is why, before being voted for approval there is a **debate in public session**¹¹⁴, where local councils deputies discuss the estimates for revenues and expenditures, mainly considering the objectives set by the administration to pursue local needs with scarce resources (Carvalho, 1996, p.105). The **voting for**

¹¹³ CALG section 2.3 explains that in situations where the options of the plan and the budget approval are delayed, those documents from the previous year (with the modifications meanwhile introduced) continue to be in force until the approval takes place. The estimates finally approved during the economic year they relate to, have then to include the part of the estimates already executed up to the moment they become in force.

¹¹⁴ Carvalho (1996, pp.105-106) explains that this is a way of assuring the participation of those populations interested in the process of discussion and voting on the local budget and plan. It seems that the intention underlying the law is calling the citizens to cooperate and scrutinise local governments' activities. However, in practical terms, this resolution does not produce the desired effects. In fact, the number of people attending these sessions is generally very small and the participation of those few does not have any interference in the contents and approval of the documents discussed.

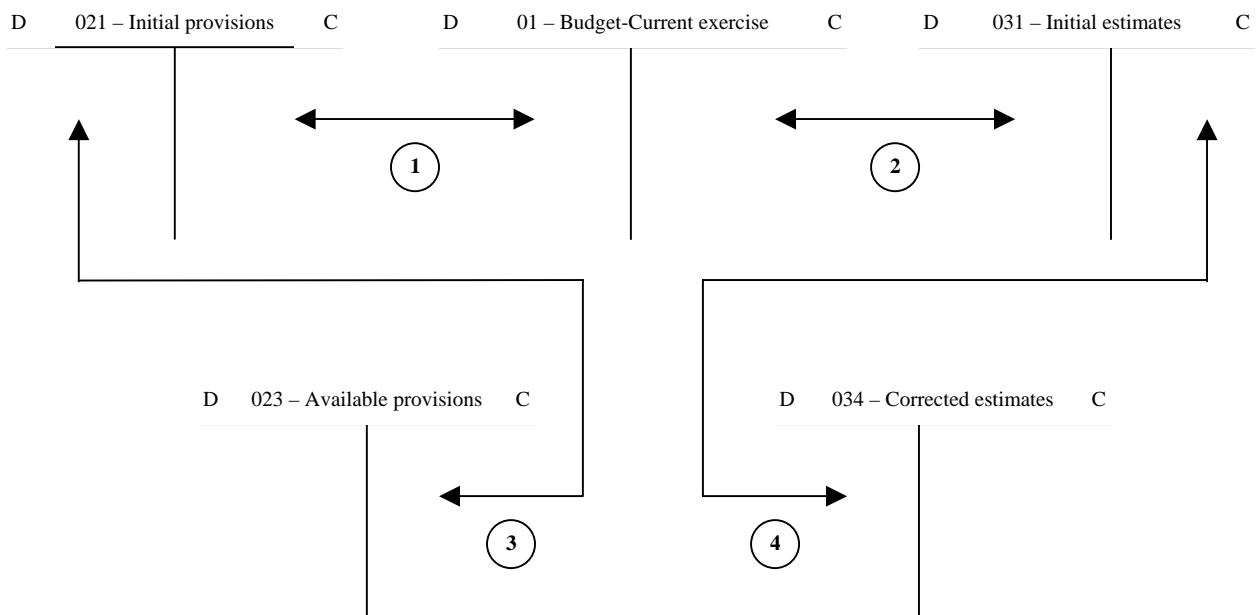
approval follows this debate for which the intervention of executive committee members is fundamental.

Finally, the **documents approved have to be published**. The “publicity rule” was already addressed to in section 2.3.2.

As shown in Figures III.4 and III.5, the budget approval starts the records on the budgetary accounting sub-system each year.

Accordingly, the first operation to be recorded is the “budget opening”, reflecting in the budgetary control accounts both expenditures and revenues initial estimates, approved in the initial budget (the document supporting the accounting records). At the same time, the availability for these estimates to be executed has to be recognised as available provisions for expenditures and corrected estimates for revenues.

These records are shown in the following diagram.



- ① Accounting record of the expenditures approved
- ② Accounting record of the revenues approved
- ③ Accounting record of expenditures available provisions
- ④ Accounting record of revenues corrected estimates

FIGURE III.6 – BUDGET APPROVAL

Once the double-entry bookkeeping method is used, debit records have credits as counterparts in all accounts within Class 0 except account 09 – *Order Accounts*, where single-entry might be used considering the account nature (see footnote 101)¹¹⁵.

As stated, each account is then divided according to the economic classification, with expenditures also following a departmental classification.

5.2. Budget Execution

The budget execution expresses the actions developed by the administration to collect the revenues and carry out the expenditures inscribed on that document. It is a responsibility of the executive committee in general and of its president in particular, as head coordinator of every action within each local government.

According to Carvalho (1996, p.107) the process of budget execution involves a great variety of technical-administrative functions, namely financial organisation, accounting operations, treasury management, and control mechanisms (both to measure accomplishments against objectives and to verify legality).

The author also highlights the role of the “budget and accounting division” in following and controlling the entity’s financial function, mainly preparing proposals leading to reformulating the objectives in order to adjust the budget to priorities, within the legal framework.

The guiding general procedures for the budget execution are internally set and included as a separated element in the budget proposal (see section 5.1).

Following Figures III.4 and III.5, this section describes the accounting records (and supporting documents) for the operations of budgetary execution, within the budgetary accounting sub-system, starting from the budget modifications. We finish presenting the budgetary closing operations, due to be recorded at the end of each economic (civil) year.

¹¹⁵ Carvalho *et al.* (2002, p.349) explain that the “Order Accounts” aim at recording facts that do not change the entity’s patrimony but represent future possibilities for that to happen. Therefore 09 – *Order Accounts* contains additional information recorded from situations:

- When revenues are virtually collected (receipts issued and not collected or received);
- When there are warranties and bails, not in cash but simply represented by contracts, both in favour of the entity and/or in favour of third parties.

Hence, it is not written against any other account and either double entry or single-entry bookkeeping method might be used.

5.2.1. Budget modifications

CALG section 2.3.4.2 explains some rules to be followed in the budget execution.

Some more relevant are:

- a) The revenues can only be liquidated and collected if they had been the object of adequate budgetary inscription;
- b) The collection of revenues can nevertheless be executed beyond the values inscribed in the budget;
- c) (...)
- d) The expenditures can only be designated, committed, authorised and paid if, apart from being legal, would be inscribed in the budget with provision equal to or higher than respectively the designated amount (*cabimento*) and the commitment;
- e) The expenditures budgetary provisions are the maximum limit to be used in its execution;
- f) (...)

Accordingly, while the budgetary credits are the top limits for expenditures within each specific category, the revenues forecasts might be surpassed, meaning that these are just estimated non-bounded values.

However, as we will explain, not all situations where revenues collected exceed their estimates require reinforcements of the budget global amount (Carvalho *et al.*, 2002, p.76).

Notwithstanding, during the budget execution, which the executive committee is responsible for, some needs to modify the initial budget might arise, requiring it to be revised and/or altered, generally depending if those modifications imply respectively changing or not the budget total.

Indeed, CALG section 8.3.1.2 explains that, despite the budgetary principles and rules to be accomplished during the budget preparation, the budget might be subject to revisions and/or alterations, namely to embrace expenditures non-predicted or with insufficient provisions. On the other hand, also new revenues might come up, namely resulting from new contracts and generally earmarked to cover certain expenditures. The budgetary positive balance (surplus) from the previous year, not known when the budget was being prepared, might also later be included in the current year budget, increasing revenues. Even the budgetary surplus from the current year up to the moment of the modifications might be included. These surpluses are recorded as revisions to revenues provisions in the account 03211 – *Use of the administration balance*.

Additionally, budgetary modifications might result from modifications (revisions and/or alterations) in the investments multi-annual plan, meaning that some projects might be added and/or cancelled.

Carvalho *et al.* (2002, p.249) summarise the types of modifications possible to happen in the local budget, according to the CALG:

- Increasing the global amount
 - New expenditures non-predicted in the initial budget
 - a) If they result from incorporating/applying new revenues legally earmarked, new medium and long term loans contracted for the purpose of those specific new expenditures, or a new list for public servants' salaries published after the initial budget – **Budget alterations** (CALG sections 8.3.1.3 and 8.3.1.5)
 - b) If they result from incorporating the previous year budgetary surplus, the current year surplus up to the moment, or new fees and taxes that the entity is entitled to collect – **Budget revisions** (CALG section 8.3.1.4)
 - Expenditures with insufficient provisions (similar to above)
- Maintaining the global amount, just redistributing the expenditures provisions
 - Moving from items/actions over-estimated and/or cancelled to others under-estimated (“virement”) – **Budget alterations** (CALG section 8.3.1.5)
 - Creating new expenditures, moving amounts from items over-estimated and/or cancelled – **Budget revisions** (CALG section 8.3.1.4)
- Reducing the global amount – Resulting from reducing revenues estimates (e.g. legal alterations in requirements underlying their estimates), cancelling projects in the investments multi-annual plan with earmarked revenues, among others – **Budget revisions** (CALG 8.3.1.4)

As for the initial budget, the president of the executive committee has the initiative for budgetary modifications, proposing these to be discussed and approved first within the executive committee. Budget revisions have to be discussed and approved by the deliberative committee (council)¹¹⁶.

Carvalho (1996, p.113) explains in particular for the “virement” that it has the advantage of increasing flexibility and rationality during the budget execution.

Also Carvalho *et al.* (2002, p.248) emphasise the importance of the budgetary modifications, namely because, even if the budgetary principles and rules are rigorously followed, there are always unpredicted situations only faced during the budget execution.

Nevertheless, those authors also recognise how careful, legally justified and supported by documents, the budget modifications must be, in particular modifications increasing expenditures global amounts, once financing must be assured. Indeed, all budget modifications have to respect legal framework dispositions, as well as be kept consistent with the budgetary principles and rules, namely the current budget balance principle.

¹¹⁶ The same procedure happens for modifications in the investments multi-annual plan, which have to be supported by a proper statement presented at the end of the year (CALG section 8.3.2).

If the “virement” in particular is an instrument to better manage the budget, allowing it to be permanently adequate to the entity’s reality, it is important keeping those alterations within certain limits, preventing misrepresentation of the budget and the plan approved by the deliberative committee. Indeed, Carvalho (1996, p.116) states:

(...) this instrument that allows changes to the budget and to the plan can express, at the level of its utilisation, strong political incoherence or great absence of rigour while preparing the initial forecast, jeopardising the trust on the estimates and on the conceded authorisation (...)

He also highlights that the “virement” is a way of disrespecting the specification principle, in the sense that the deliberative committee approves amounts for certain purposes that are then used for different ones. Thus, although it is necessary, the “virement” must not be abused. As the author well explains (Carvalho, 1996, p.117), this reflects the paradox that to the need of altering the budget is the opposite requirement of keeping these alterations very limited, so the budget would not lose both effectiveness as a disciplinary instrument of the administration, and credibility for the economic agents.

In fact, within local governments, since the “virement” is not required to be approved by the deliberative committee, if there are not serious limits to its use, the local executive might change expenditures in such a way that the final budget has nothing to do with that initially approved, meaning provisions allocated to totally different purposes. This is why Carvalho (1996, p.118) also emphasises the need for the powers to approve and change the budget to be coincident, implying giving more powers concerning budget alterations to local councils.

Regardless if they are alterations or revisions, the fact is that any budget modifications imply records on the budgetary sub-system accounts as follows.

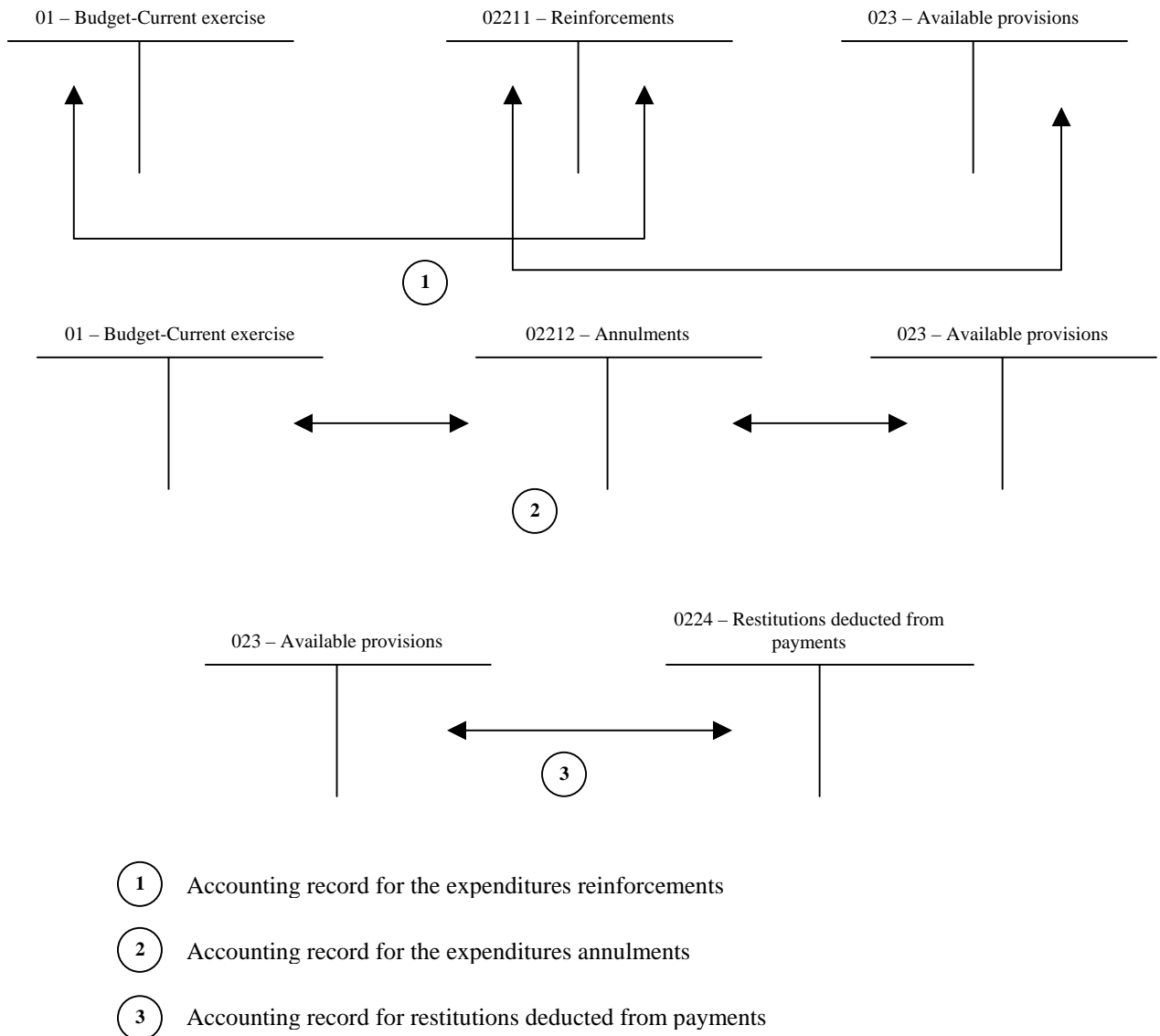


FIGURE III.7 – EXPENDITURES BUDGET MODIFICATIONS

With respect to “restitutions deducted from payments” further explanations are important. These are refunds of undue payments done during the current year¹¹⁷. Basically they are corrections (increases) made to the expenditures available provisions.

Carvalho *et al.* (2002, pp.335-338) explain that, although the CALG does not give any instructions in this direction, restitutions deducted from payments should imply corrections in other accounts, not only in the budgetary accounting sub-system, but in

¹¹⁷ As the CALG also clarifies in the explanatory note to account 0224 – *Restitutions deducted from payments*, if the refunds concern undue payments done in previous years, they must be recorded as normal budgetary revenues (budgetary revenues reinforcements) within the economical classification revenue item 14 – *Restitutions not deducted from payments* (according to the new economic classification – Law-decree 26/2002 – revenues account 15.01.01).

the financial accounting sub-system as well¹¹⁸. Hence, they suggest that accounts 026 – *Designated Amounts* and 027 – *Commitments* should be corrected (reduced) too, so thus they could provide information on the amounts that should have been correctly designated and committed.

However, since this is not recommended in the CALG, the values concerning these operations presented on the statement of expenditures budget modifications (CALG statement 8.3.1.2) might be inflated. Additionally, they argue for these restitutions not to be included in this statement, once they are not modifications to the budget, but only corrections to the expenditures available provisions. Accordingly, they should be included in the statement of Budgetary Control – Expenditure – CALG section 7.3.1 (Carvalho *et al.*, 2002, pp.218-219 and p.253).

Accounting records of restitutions deducted from payments are supported by a specific document – *guia de reposições abatidas aos pagamentos* – CALG section 12.2.7.

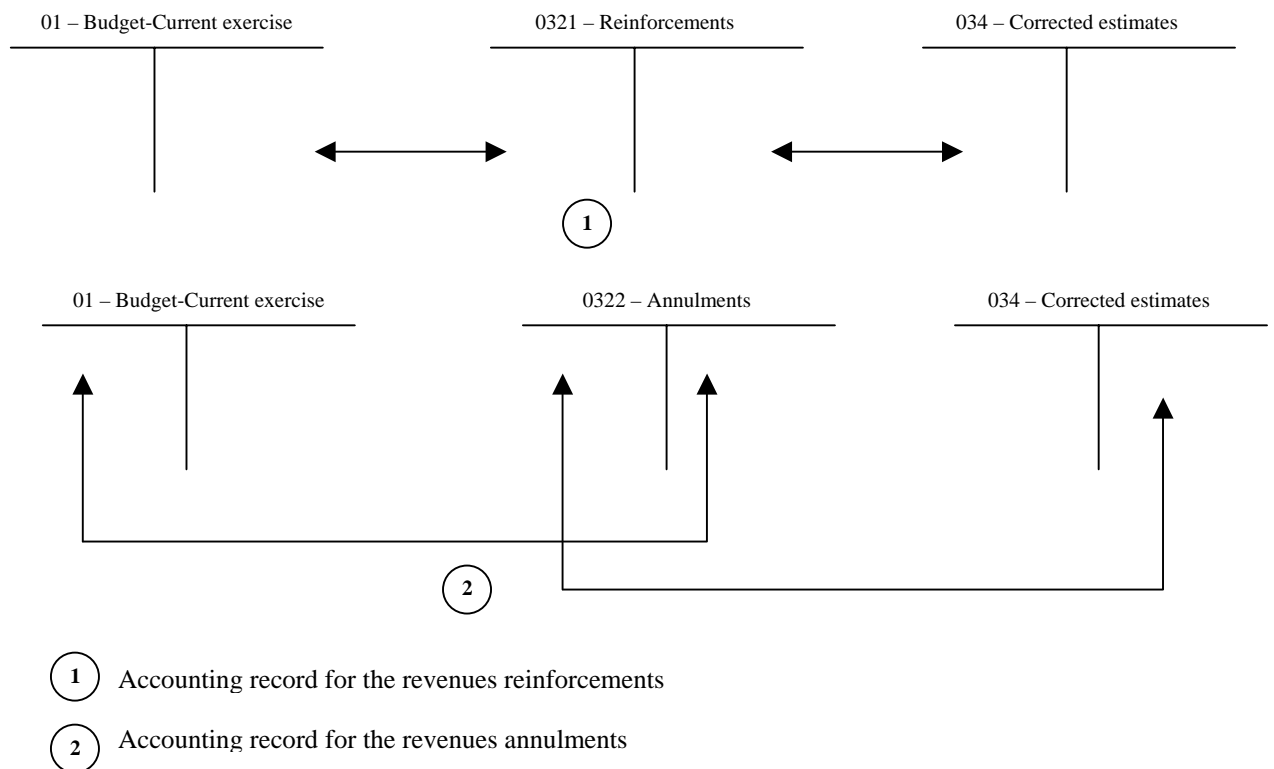


FIGURE III.8 – REVENUES BUDGET MODIFICATIONS

¹¹⁸ In the financial accounting sub-system, restitutions deducted from payments imply namely increasing (debits) the accounts of cash or equivalents and reducing (credits) the accounts of costs, fixed assets or stocks.

Regarding revenues reinforcements, in the particular case of using the previous year administration balance, the accounting record is very similar to (1) in Figure III.8, with the exception of using account 03211 – *Use of the administration balance*. This situation can happen only after the respective Cash Flow Statement is approved and implies, as explained, a budget revision. The revenues budgetary modifications are summarised on the CALG statement 8.3.1.1.

Obviously, if there are no budgetary modifications, the expenditures available provisions are equal to its initial provisions, as the revenues corrected estimates equalise the initial ones.

The documents where these budgetary modifications are recorded are the so-called “current accounts” both for expenditures and revenues separately (CALG sections 12.2.10 and 12.2.11). At the end of the year they are summarised in budgetary modifications statements also both for expenditures and revenues separately (CALG sections 8.3.1.1 and 8.3.1.2).

Carvalho *et al.* (2002, pp.250-254) additionally explain that statements similar to these have to be prepared supporting each budgetary alteration and/or revision during the year, including just the items to be changed and having the last modification as reference.

5.2.2. Expenditures

As depicted in Figures III.4 and III.5, the process of expenditures budget execution is different from that for revenues, the former being more complex, namely considering the authorisation requirements as well as the ceilings.

Additionally, expenditures execution demands for underlying political, economic and social objectives, so allocating public money according to the budget items means a spending limit authorisation but not an obligation.

When considering an expenditure accomplishment there are several administrative steps to be carried out, not all of them having accounting implications.

The first procedure is an “**internal requisition**” (CALG section 12.2.3). Any department within each local government, when needing goods/services to perform its activities, prepares a request to be handed in to the warehouse or to the stewardship office (*economato*). If the request is for something not in stock or for a service to be contracted out, an expenditure has to be incurred, and the internal requisition becomes the support for an extended document (expenditure proposal) specifying and justifying

(opportunity and destination) the goods/services to be acquired, in order to get the expenditure authorisation. This extended document is sent to the “planning and internal control division”, which assesses the need for that supply or investment, taking into account for the latter in particular the investments plan.

Together with the “budget and accounting division”, that division is also responsible for **verifying the expenditure legal conditions**, which consists of observing if its purpose stays within the entity’s competencies as well as if it is forecasted in the budget and in the investments plan or the statement of relevant non-investment activities. It involves also checking if the expenditure follows other regulations and legal requirements regarding, for example, contract work (*empreitadas*), leasing and other purchases by governmental entities, which local governments have also to obey¹¹⁹.

Once there is already an intention for commitment, at this stage **the “designation” (*cabimento*) has also to be verified** (if the budgeted amount is enough to cover the expenditure at stake¹²⁰), which is a necessary condition for any commitment to be assumed (see footnote 93). This scrutiny is done both internally and externally – getting the “visa” from The Court of Accounts. More on the scrutiny issue is discussed in section 5.3 on the budgetary control.

The “designation” is then recorded on the budgetary sub-system having as basis document the expenditure proposal eventually still in estimated values.

¹¹⁹ Carvalho *et al.* (2002, p.720) refer to several regulations concerning contracting out and acquisitions in local governments, from which we highlight: Law-decree 59/99 – New juridical regime of public works contracting; and Law-decree 197/99 – Transfers to the national regulations EU directives concerning leasing of public expenditures and contracting out.

¹²⁰ As Carvalho (1996, pp.168-170) explains, the designation verification has to attend to the fact that the provision available to be used for certain expenditure might not be equal to the budgeted provision, as a consequence of the rules to manage the budget. In fact, for prudence reasons, those rules might restrict the use of the credits available, specially for some items, in order to attend for example to unpredicted situations that might happen during the budget execution. Some large municipalities might have a ceiling of 90% in the use of current expenditures budgeted amounts. Accordingly, the usable provision might equal the budgeted provision less the budgeted restriction. Therefore, verifying (and also recording) the designation requires knowing the available usable provision from each budget item current account. In practical terms, verifying the designation means comparing the available usable balance in each budget item with the estimated value of the expenditure to be incurred.

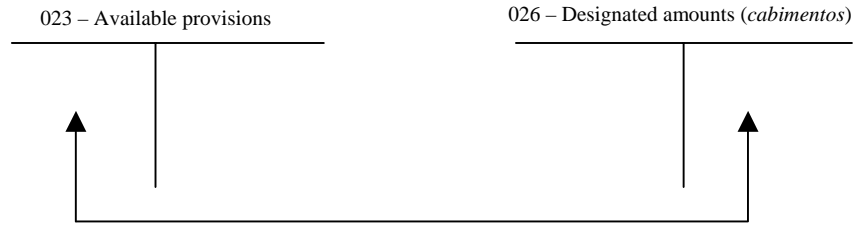


FIGURE III.9 – DESIGNATION

CALG section 2.6.1 defines “designation” as the reserve of certain provision aiming at carrying out certain expenditure, meaning that the amount is booked for that particular purpose.

After the entire legal requirements are considered the **expenditure is authorised** by the executive committee¹²¹ and an **acquisition proposal** specifying the goods/services characteristics is prepared. If the case is for small supplies there is a so-called “previous consultation” with at least three potential suppliers, sending the acquisition proposal and asking for a supplying proposal. However, for larger supplies and particularly for investments (public contract works) involving large amounts of money, the law requires those to be open at so-called “public competitions” (*concurso públicos*) – public bids. In these cases, the acquisition proposal additionally includes a basis value that each supplier takes as reference to price the services/goods. The acquisition proposal is then published in the State Bulletin (*Diário da República*) and in two or three of the most important national newspapers. The bid is open for a limited period of time to any supplier that can fulfil its requirements. In some situations (namely large investments but of smaller amounts than those involved in public bids) the law requires a “limited competition” – limited bid (*concurso limitado*), which involves sending the acquisition proposal to some suppliers in particular, inviting them to present supplying proposals¹²².

The next step consists in **analysing the supplying proposals**. This is generally a financial-economic analysis¹²³ carried out by technical staff (namely economists) within

¹²¹ Minor expenditures with top limits set by law are authorised by the president of the executive committee, or by any other person responsible with delegated competencies on that matter.

¹²² About the notions and legal procedures of public bids, limited bids and direct negotiations for governmental entities, Carvalho (1996, p.168) recommends SILVA, JORGE ANDRADE, *Regime Jurídico das Empreitadas de Obras Públicas*, Ed. Almedina, 1992.

¹²³ There are some legal procedures that have to be followed in this analysis, for example, calculating some ratios concerning the financial-economic situation of the supplier. The law establishes limit values for these ratios, which accomplishment is a necessary condition for that supplier’s proposal to be selected.

the “planning and internal control division”, which also prepares the acquisition proposals. From this analysis a document – basis for the expenditure decision – is issued supporting each proposal and recommending one, justifying the decision regarding its effectiveness and economic rationality (Carvalho, 1996, p.171).

This is the document to be considered by the executive committee (or its president for minor expenditures), which **decides on the expenditure (*adjudicação*)**, generally choosing the economically most advantageous proposal. If necessary, the **recorded “designation” might be revised or corrected here.**

Then an “external requisition” (CALG section 12.2.4) is sent to the supplier ordering the goods/services and/or a supplying contract is signed, marking the assumption of a commitment to a third party. These acquisition documents or any other equivalent are the basis to **the “commitment” accounting record.**

CALG section 2.6.1 describes “commitment” as the assumption to third parties of a responsibility to carry out certain expenditure. The amount designated is then written-off from “designation” to become “committed”.

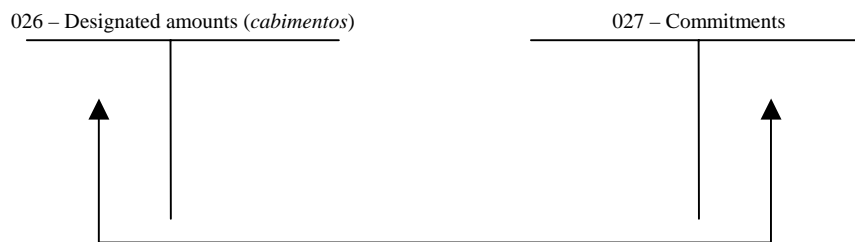


FIGURE III.10 – COMMITMENT

The entity must keep a “current account” for expenditures (CALG section 12.2.11) where records for “capacities” and “commitments” (as well as other operations recorded in the financial accounting sub-system) are kept updated, following a chronological order (CALG section 2.8.2.9).

As Freitas (2000, p.16, footnote 7) explains, for a particular expenditure, the designation and commitment have the same values. Furthermore the entity must adopt a numbering system that allows linking each capacity to the respective commitment, in order to identify at each moment the acquisition processes already “designated” but not yet “committed”.

Carvalho (1996, p.110) refers to the importance of recording “designated amounts” and “commitments” in the accounting, inasmuch as they not only affect the following expenditures stages, but also allow assessing the pace of the (expenditures) budget execution. For example, calculating the amount of commitments over the total provisions evaluates the degree of assumed commitments in relation to the forecast. The amount of commitments might also indicate values to be paid in the future.

He continues to explain (Carvalho, 1996, p.170) that evidencing the “designation” for expenditures is one of the most important procedures for governmental accounting in general and Local Government accounting in particular, to accomplish one of its main functions: legality and budgetary control. Therefore he argues that it is understandable the responsibility given by law and statute to those (generally administrative services responsible for the internal control) responsible for expenditures verification (legality and designation) and classification, from whose information depends the expenditure authorisation. Normally, if the information from those politically independent services is not favourable (because the expenditure is not legal or there is not enough provision to cover it) the expenditure is not carried out, except if the executive committee assumes the political responsibility for that. In this case, the civil servants are freed from any responsibility concerning that matter.

One very important issue concerns recognising future commitments within the budgetary accounting sub-system.

CALG section 2.6.1 states that the information concerning commitments with consequences in following years’ budgets is essential for the budgetary control of multi-annual programmes. Additionally it is an indispensable support in preparing and managing budgets for future years. Therefore, the CALG admits recording information on budgetary accounting sub-system concerning future commitments, yet only for expenditures. The accounts used are 04 – *Budget-Future exercises* and 05 – *Commitments-Future exercises*, divided per years as showed in Table III.7, and written only against each other.

Accordingly, during the budget execution, commitments with consequences beyond the current year might be assumed, which have to be evidenced within the budgetary accounting records as follows (considering the expiring dates n+1, n+2, etc., as well as the economical classification):

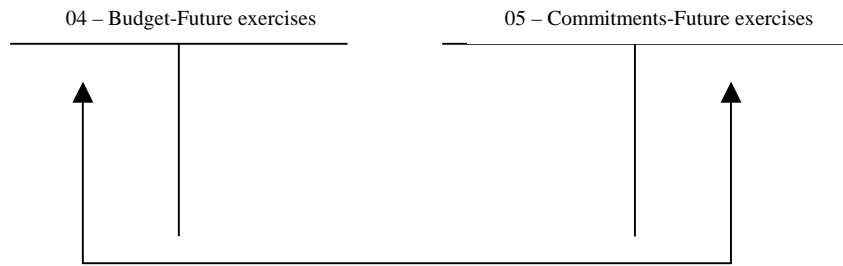
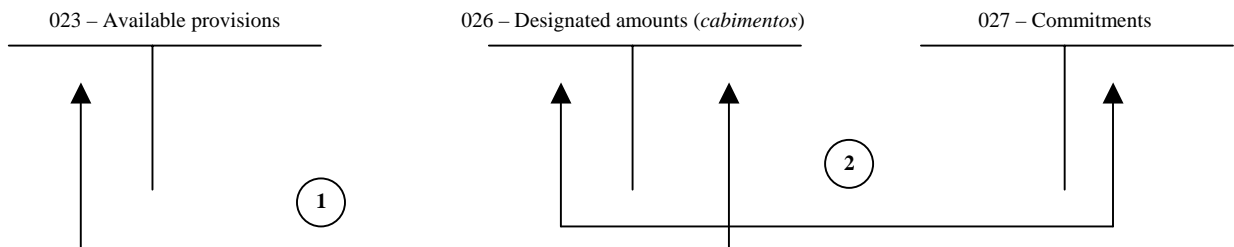


FIGURE III.11 – FUTURE COMMITMENTS

If any reductions or annulments are to be made, the opposite record must be done.

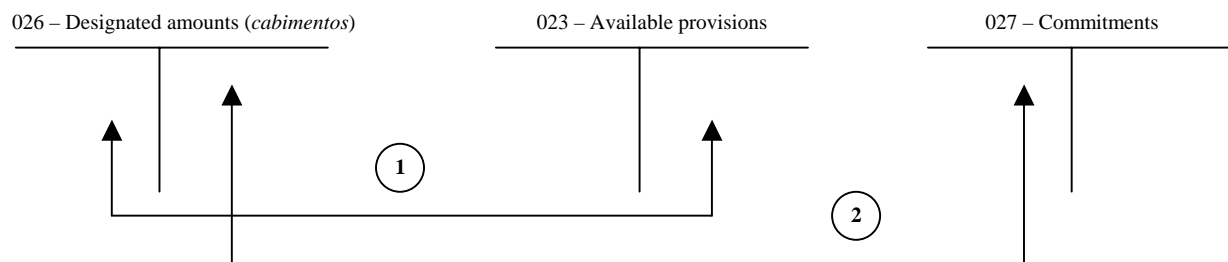
The balances of these accounts represent the net amount of commitments for future years.

Finalising this section it is important to mention the fact that the current value of the expenditure at the moment of the acquisition (amount written on the invoice, which will be recorded in the financial accounting) might be different from that “designated” and “committed”. If this is the case, those estimated values have then to be corrected, as follows.



- ① Positive difference between the invoice amount and the “designated” amount
- ② Transferring the increase in “designated amounts” to “commitments”

FIGURE III.12 – UNDER-ESTIMATION – INCREASE THE AMOUNT INITIALLY “DESIGNATED”



- ① Negative difference between the invoice amount and the “designated” amount, which becomes available for other expenditures
- ② Transferring the decrease in “designated amounts” to “commitments”

FIGURE III.13 – OVER-ESTIMATION – DECREASE THE AMOUNT INITIALLY “DESIGNATED”

5.2.3. Revenues

The revenues collection does not have the same characteristics as the expenditures authorisation. In fact, while this is a ceiling for the administration to assume commitments, but not an obligation, the revenues inscribed within the budget is an obligation for the administration to collect at least that amount.

Indeed, as CALG sections 2.3.4.2 a) and b) explain, although no revenues (type) can be computed (liquidated) and collected if they are not budgeted, the amounts collected can go beyond the budgeted amounts.

The more important revenues accounting operations are the “liquidation” and “collection”, which are due to be recorded only in the financial accounting sub-system which we will address in section 6.

Thus, the accounting procedures to be recorded in the budgetary accounting sub-system are just those concerning the budget approval and modifications, already explained in sections 5.1 and 5.2.1 respectively.

5.2.4. Closing

At the end of the (civil) year there are some accounting procedures to be recorded within the budgetary accounting sub-system, apart from preparing budgetary statements, namely those reporting the budget execution (CALG section 7.3) – see section 2.3.2.

CALG section 2.6.1 refers in particular to the special treatment to be given to commitments related to futures exercises: these are important specially in preparing the budget for the next year.

At the closing moment the amounts to be considered as future commitments (also following an economical classification) are those incurred in the current exercise that did not originate any effective expenditures (liabilities). Hence, the closing operations within the Class 0 accounts involve the following sequence (CALG section 2.6.1):

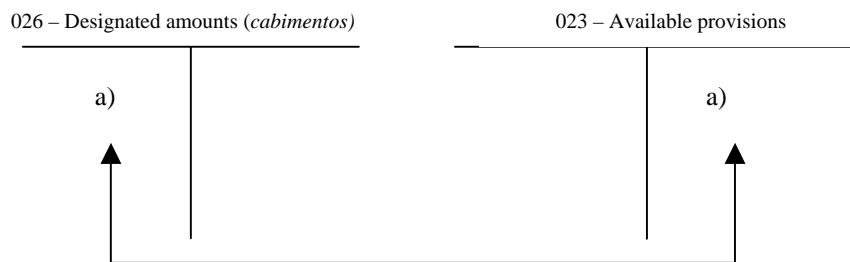


FIGURE III.14 – ANNULING THE “DESIGNATED AMOUNTS” THAT DID NOT BECOME “COMMITMENTS”

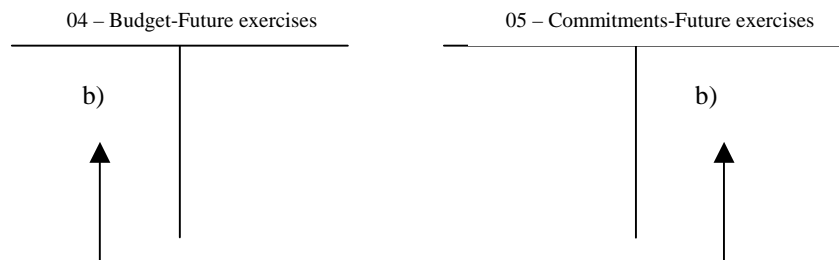


FIGURE III.15 – EVIDENCING AS FUTURE COMMITMENTS THOSE ASSUMED IN THE CURRENT YEAR THAT DID NOT BECOME LIABILITIES

Before this record, an administrative procedure (that might be automatic within the budgetary accounting computing system) has to be done in order to identify the expenditures committed but not in fact accomplished.

The next step consists of closing every account related to the current year’s budget which balances are not zero, against the account *01 – Budget-Current exercise*. For example:

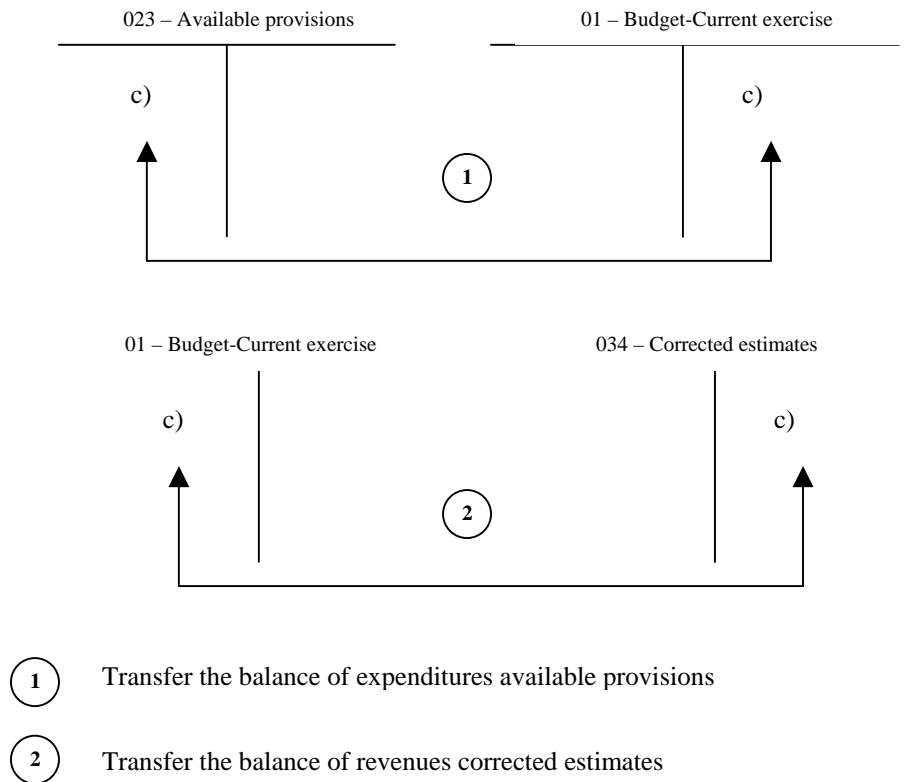


FIGURE III.16 – CLOSING BUDGETARY ACCOUNTS RELATED TO THE CURRENT YEAR’S BUDGET

Finally, at the end of each year, the accounts concerning future commitments have also to be closed, once again written-off against each other.

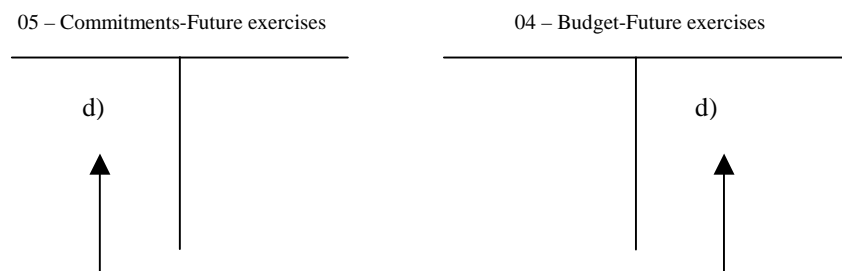


FIGURE III.17 – CLOSING BUDGETARY ACCOUNTS RELATED TO FUTURE COMMITMENTS

Carvalho *et al.* (2002, p.100) refer to other values regarding future years that must also be considered at the closing moment: the commitments that became obligations but remain to be paid. This information is important namely to prepare the debts statement (CALG section 8.3.6.2). These amounts have to be included in the following year budget being prepared, and its capacity and commitment have to be immediately recorded when that budget is approved.

Furthermore, when opening the next year budget, the future commitments have to be analysed concerning their expiry date, in order to be transferred to the accounts of the year when they are expected to take place.

5.3. Budgetary control

The control of the budget execution during the period is summarised in two main statements (CALG sections 7.3.1 and 7.3.2): budgetary control – expenditure, and budgetary control – revenue. In both statements, items must follow an economical classification identical to the budget, except for the “previous administration balance” within the revenues. The models for these statements are presented in Appendix III.4.

The data to prepare these documents are provided from budgetary and financial accounts balances, as well as from “current accounts”.

One of the most important items of information they convey concerns the degree (percentage) of budgetary execution per item. Moreover, a general index (percentage) – Degree of Budgetary Execution (DBE) – can be obtained both for expenditures (E) and revenues (R):

$$DBE_E = \frac{\text{Total Expenditures Paid in the Year}}{\text{Total Corrected (available) Provisions}} * 100$$

$$DBE_R = \frac{\text{Total Net Collected Revenues}}{\text{Total Corrected Estimates}} * 100$$

As important as the control of the budget execution is controlling the investments multi-annual plan (annual) execution. Accordingly, a statement summarising this is also prepared at the end of each year, following the model presented in CALG section 7.4. This must embrace, for each investment action/project, information regarding ways of accomplishment (direct administration, contracting out or other type of supply), financing sources (Central Government, Local Government or EU funds), dates of beginning and finishing, amounts forecasted and executed up to the moment. Two final indexes are computed (per item and in global terms):

– The level (%) of financial execution in the current year

$$\frac{\text{Total amount executed in the current year}}{\text{Total amount forecasted for the year}} * 100$$

– The global level (%) of financial execution

$$\frac{\text{Total amount executed up to the moment}}{\text{Total amount forecasted}} * 100$$

Finally, of no less importance is the Cash Flow Statement summarising every payments and receipts of the year, both concerning budget execution and treasury operations¹²⁴, as shown in Table III.8. This must also comprise a statement of variations in the receipts pending collection, and warranties and bails provided by third parties and represented by contracts – Order Accounts (CALG section 7.5).

CASH FLOW STATEMENT

		Year <input type="text"/>
(Entity designation)		(Unit: 10 ³ EURO)
RECEIPTS		PAYMENTS
Previous administration balance.....		Budgetary expenditures.....
Budgetary execution.....		Current.....
Treasury operations.....		Capital.....
Budgetary revenues.....		Treasury Operations.....
Current.....		Balance to the next administration.....
Capital.....		Budgetary execution.....
Treasury operations.....		Treasury operations.....
<i>Total</i>		<i>Total</i>

ORDER ACCOUNTS

Previous administration balance.....		Warranties and bails executed.....	
Warranties and bails.....		Warranties and bails returned.....	
Receipts pending collection....		Collected virtual revenues.....	
Warranties and bails provided.....		Annulled virtual revenues.....	
Liquidated virtual revenues.....		Balance to the next administration.....	
		Warranties and bails.....	
		Receipts pending collection.....	
<i>Total</i>		<i>Total</i>	

Executive Committee
Date _____

Deliberative Committee
Date _____

TABLE III.8 – CASH FLOW STATEMENT AND ORDER ACCOUNTS

¹²⁴ Variations in treasury operations, namely amounts received on behalf of third parties, must be summarised in a separate statement (CALG section 7.6).

In the first part of this statement we must highlight the information conveyed on the balance to the next administration. In fact, with respect particularly to budgetary execution, it shows if the budget now closing was managed more or less successfully, presenting respectively a cash surplus or deficit.

Since the CALG is an adaptation of the CAPA, which in turn is inspired in the Chart of Accounts for Business Accounting, it could be expected that the Cash Flow Statement would follow the same model as that for companies. However, in governmental accounting this document is included in the budgetary accounting sub-system, not the financial accounting. Thus, instead of providing information on the entity's capacity to generate cash flows or equivalents from operational, investment or financing activities (allowing assessing the need for external financing), the statement in Table III.8 compares receipts with payments, only distinguishing those related to the budget execution from treasury operations. Consequently, it does not allow evaluating the contribution of each type of activity (functions) within the entity for creating cash flows. Additionally, it includes information on Order Accounts, not considered in the model used in business accounting. As Freitas and Góis (2000, p.785) summarise,

When we compare the “Cash Flow Statement” prepared within the governmental financial information and that prepared within the business financial information, we find only a coincidence on the name, since its structure, utility and the basic reason for its preparation do not have any similarity between one and another *accounting* framework [italics provided].

Another important issue concerning budgetary control relates to the bodies, committees and/or individuals responsible for it.

Carvalho (1996, pp.123-134) addresses this matter for the Portuguese Local Government, firstly separating between internal and external control¹²⁵.

The **internal control** carried out by committees and/or individuals from inside the entity, involves operations regarding political control and administrative (or current) control.

The political control is assured by those responsible for the entity's administration – both executive and deliberative committees.

¹²⁵ The criterion for this classification is simply considering if the body carrying out the control is internal or external to the entity being controlled.

This is different from the criterion set on the Law-decree 155/92 within the State Financial Management Regime, for entities and institutions depending on the State Budget. As explained in section 2.1, the so-called self-control is here classified as internal. The internal control for those entities is performed inside them though carried out by external bodies (e.g. external audits). In turn, only The Court of Accounts control is considered external.

Accordingly, CALG section 2.9.3 explains that the executive committee approves and keeps on running the Internal Control System (see footnote 103) suitable for the activities of each local government, assuring these are monitored and permanently evaluated. Furthermore, CALG section 2.9.7 states that the deliberative committee might establish control mechanisms (temporary or permanent) allowing it to control its competencies. The executive committee must then provide the means and necessary information for these objectives to be accomplished (CALG section 2.9.8).

On the other hand, the competencies law clearly states that the deliberative committee is responsible for monitoring and controlling the activities performed by the executive committee (Law 169/99, articles 17 e) and 53 c)).

Thus, Carvalho (1996, p.124) states

(...) the internal (financial) control is hold cumulatively by the two committees, which is understandable considering the role each one performs within the process of the budget preparation, approval and execution.

If the deliberative committee approves the budget (and the big options of the plan) it is logical that it has also some interference controlling the financial activity derived from its execution. This interference is materialised mainly through the approval of the financial and management reporting, which includes statements of budgetary execution.

The administrative control is assured by local civil servants, which must act with technical independence in relation to the political power. A special statute must be given them, considering their control responsibilities (Carvalho, 1996, p.123).

The particular operations performed within this type of control were already addressed in section 5.2.2 on the expenditures budget execution. Nevertheless, we must highlight here how essential this is considering that the other type of internal control is mainly political. Indeed, as Carvalho (1996, p.124) states,

(...) local governments need to have an internal control service, which analyses and verifies issues of juridical nature and the form to be followed by the budgetary operations, as well as the acts generating revenues and payments, in order to ensure that the assumed rights and obligations are within the Budget limits and the guiding rules of the good financial management.

The author continues explaining that for this control to be effective it has to be *ex-ante*, i.e., before the commitments are assumed. Moreover he adds that the success of the internal control service will always depend on its political independence, prestige and authority within the entity, as well as on the legal statute that covers, protects and holds responsibility for its actions, namely concerning budgetary execution and patrimonial (property) management (Carvalho, 1996, p.125).

Regarding the **external control** Carvalho (1996, p.125) summarises that it results from the law and it is logically performed by entities external to the Local Government, though it does not express any hierarchical relationship between the Local Government and the entity responsible for this control.

Accordingly, the external control over local governments is special, being different from that over for example governmental business enterprises, not only because it involves different aspects, but also because it is carried out by different bodies. Hence, Carvalho (1996, pp.125-131) distinguishes inspective tutelage by Central Government from jurisdictional control carried out by The Court of Accounts. Although these subjects were addressed to some extent before in this chapter (section 1.2 for the former and footnote 80 for the latter), some points must be added.

In spite of the large scope of intervention within the inspective tutelage (basically every issue concerning financial and property management) this is resumed to the formal control of the budget execution, inasmuch as the law imposes it strictly to aim at verifying legal accomplishment. Thus, Central Government has no responsibility concerning Local Government political or economic control and local autonomy is assured.

While recognising that formally this inspection is no more than verifying the legality of actions underlying the expenditures accomplishment and the revenues collection, Carvalho (1996, p.127) argues for this control to go further, covering matters such as assumptions underlying revenues forecasts. This would allow preventing financial unbalance situations many times created by unrealistic estimates. As he emphasises

(...) if there is no accuracy in evaluating the revenues, it is relatively easy to adjust the values to be budgeted to the political objectives of the management committees. (Carvalho, 1996, p.127)

Additionally he stands for an external control over aspects of economic nature: if traditionally the inspection is over the expenditures – it is important to know how the public money is spent – it is today also very important to control actions that though not creating a financial/cash flow, have consequences on the entity's assets and liabilities (patrimony). Therefore,

(...) the control should be over all management actions, and in particular at the level of property management, because it will always be through monitoring the evolution of each local government assets and the financial means they create, that the quality of local governments management and the rigour in the public money application will be effectively known. (Carvalho, 1996, pp.128-129)

As to the jurisdictional control it was explained that it is carried out at two different stages: *ex-ante* – before the expenditures to be committed (“visa” – legal authorisation); and *ex-post* – over the budgetary and financial annual reports.

Concerning the *ex-ante* control Carvalho (1996, p.129) explains its fundamental importance considering that, even if the budgetary rules and principles are violated, the actions incurred are not cancelled, inasmuch as they have consequences to third parties. So, even if there are expenditures committed with no budgetary credits, thus violating the law, they have to be paid regardless the subsequent punishment (associated to their individual financial responsibility) of those people who authorise these expenditures.

Accordingly, as explained, although the *ex-ante* control might also comprise economy issues, it mainly embraces verifying legal (namely budgetary) background and budgetary capacity. Therefore, it is a formal and juridical control, not evaluating the opportunity for the expenditures nor the responsibility of the agents involved in the actions being previously controlled (Carvalho, 1996, p.133). The Court of Accounts (as the General Audit Office) is the independent body responsible for this, which might refuse the “visa”. If this is the case, expenditures cannot be carried out.

Ex-ante control requires local governments to send to The Court of Accounts forecasted budgetary statements, such as the Budget and the Investments Multi-annual Plan (The Court of Accounts – Resolution 04/2001).

With the purpose of the *ex-post* control, local governments are obliged to send every year the budgetary and financial reports (including financial statements, such as the Balance Sheet, the Results Statement and Notes) to The Court of Accounts for consideration (CALG section 2 (4); Local Finances Law 42/98 – article 9, n.2; The Court of Accounts – Resolution 04/2001).

A report on the accounts’ consideration is sent later (thus not included in the entity’s financial reporting) to the local governments’ committees, as well as to the Ministry of Finance and the Ministry of the Territory Administration (Law 42/98, article 9, n.3). If it disapproves the accounts, the people responsible for the illegalities are individually punished and condemned to pay the amounts due. The Public Ministry (also an independent body) is responsible for carrying out the punishment.

Carvalho (1996, p.131) highlights that The Court of Accounts infers responsibilities only of a financial nature, namely those resulting from the violation of Local Government budgeting and accounting principles and rules (CALG and Local Finances Law), so thus its consideration regards always the undue or over use of public

money. Nevertheless, local governments accounts (including budgetary and financial statements) are now analysed not only on the compliance with the law, but also on the true and fair view considering, as explained, that legality overrides. Therefore, the *ex-post* control goes beyond budgetary control *stricto sensu*, since financial statements are inspected/audited as well.

Many politicians within the Local Government seem to believe that the jurisdictional control should be essentially *ex-post*, arguing that the *ex-ante*, although aiming at avoiding illegal decisions, might interfere with the Local Government competencies. In fact, many consider the maximum period of 30 days admitted for getting the “visa” as an obstruction or at least a serious constraint to the administrators’ actions (Carvalho, 1996, pp.133-134).

Still on the external control, Carvalho (1996, p.132) refers also to the role of the citizens-voters, addressing in particular the publicity rule for local governments budget and accounts (see section 2.3.2). He explains that the publicity rule is imposed for all public acts as a mean not only for transparency but also for bringing local public administration closer to the populations. Thus, the larger the public knowledge of local governments’ actions, their financial sources, and the application of their resources, the greater will be the control by the citizens-voters-taxpayers.

The former Portuguese Administrative Code recognised as a lawful right to any citizen (individually or collectively) to contest the legality of local governments’ actions, namely formally complaining about the use of budgeted amounts opposing the plan approved. This institutionalised the populations’ participation in monitoring and controlling the entity’s management. Notwithstanding, we believe that most citizens have not been exercising this right, even if there have been reasons for it. This might be because they do not know about it, they do not know how to claim, they do not think it is worthwhile (their complains are not going to be taken in consideration) or simply because they have not been interested in local governments’ accounts.

6. FINANCIAL ACCOUNTING

As explained, expenditures and revenues are recorded in the financial accounting sub-system in a **full accruals basis**, so thus they are recognised at the moment they are expensed/benefited, regardless of the payment/receipt.

This section continues to describe the process of budgetary execution, following the financial accounting operations represented in Figures III.4 and III.5.

We are going to address also some operations particularly concerning expenses that can only be recognised in an accrual basis, inasmuch as they do not create any cash flow. Accordingly, they can only be recorded in the financial accounting sub-system.

Firstly though we will start by referring to Account 25 – *Debtors and creditors from the budget execution*, as the link between the budgetary and financial accounting sub-systems.

6.1. Account 25

Although records within Class 0 of the budgetary accounting sub-system are not written against accounts of the financial accounting sub-system, as had been made clear, these sub-systems are not totally independent – they are linked by Account 25 – *Debtors and creditors from the budget execution*.

CALG section 11.3 explains that this account registers operations associated with liquidations of credits and debts¹²⁶ from the entity relatively to third parties, as well as the subsequent receipts and payments, including those referring to advanced receipts/payments, refunds and restitutions.

It is separated in two main sub-accounts concerning debtors (revenues liquidations) and creditors (expenditures liquidations). Both are then divided according to the economical classification used in the budget; the one regarding creditors is optionally divided also according to a departmental classification.

The rationale of this account has not been by far pacific. On the contrary, there is great controversy around it, some demanding clarifications from the PAASC.

There is though one point of general agreement: the main purpose of Account 25 is to allow the budgetary control statements, namely the Cash Flow Statement – receipts and payments according to the economical classification for revenues and expenditures, to be obtained.

Therefore, if it belongs to the budgetary accounting sub-system, as shown in Table III.5, this means that it allows the recording in this sub-system of operations such as expenditures and revenues processing, liquidation and payments/receipts. However, since Class 0 must embrace only internal operations with no consequences for third parties, it was decided that the CALG accounting operations recorded in that class

¹²⁶ Law-decree 155/92 (article 28) defines expenditures liquidation as the calculation/determination of the exact amount for the obligation that arises from that moment, so that the respective payment may be allowed. We believe this definition might be adapted for revenues as well.

should finish with expenditures commitments and revenues corrected estimates. Hence, the following stages are to be recorded only in the financial accounting sub-system.

Indeed, CALG section 2.6.1 makes this clear stating that expenditures and revenues liquidation and payment/receipt are not recorded in Class 0 but in other classes, namely 1 and 2. This explains why Account 25 was included within the accounts of the financial accounting sub-system and not in Class 0.

However, as we are about to explain, many criticise this decision, suggesting alternatives because of some of the problems that have arisen in using the CALG integrated accounting system.

Bernardes (2001, pp.255-256) summarises one of the most frequent criticisms addressed to the CAPA and consequently to the CALG: how to reconcile, without losing relevant information, the main concerns of budgetary control with those of financial control, within a framework of two separated (though related) sub-systems. In fact, if the first aims at controlling expenditures and revenues processing and liquidation, following a compulsory economic classification for payments and receipts and preparing the Cash Flow Statement, the second intends rather to control each one of the creditors/debtors.

Account 25 has been in the centre of this criticism, inasmuch as it is within it that the budgetary economic classified control has to be reconciled with the financial one.

Adding to the confusion is the fact that, when explaining the contents of Account 25, while the CALG clearly states liquidation and payments/receipts, the CAPA states that expenditures processing might also be recorded in this account. Accordingly, at least in the CAPA, the two following possible situations are allowed for expenditures (Bernardes, 2001, pp.254-255; Carvalho *et al.*, 1999, pp.244-245).

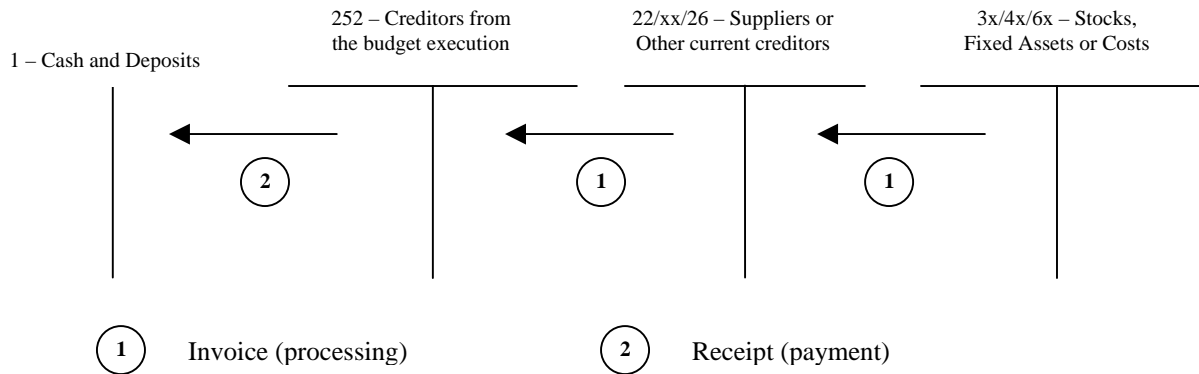


FIGURE III.18 – ACCOUNT 252 – CREDITORS FROM THE BUDGET EXECUTION RECORDED AT THE MOMENT OF EXPENDITURES PROCESSING (LIABILITY)

At the moment of processing, the accounts recording the debts to third parties (accounts 22/xx/26 divided per creditors) would have a null balance, thus not allowing the financial control of the debts per creditor. Additionally, the payment orders already issued (payments authorised) but not yet paid could not be controlled. Nevertheless, the expenditures already processed but not yet paid could be controlled per economical classification in Account 252.

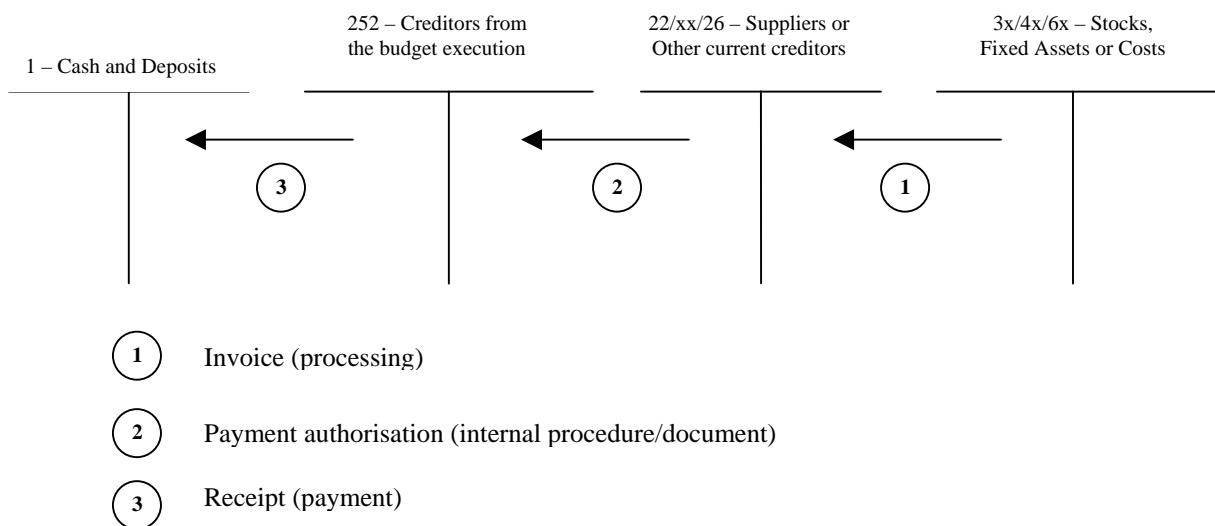


FIGURE III.19 – ACCOUNT 252 – CREDITORS FROM THE BUDGET EXECUTION RECORDED ONLY AT THE MOMENT OF EXPENDITURES LIQUIDATION/PAYMENT AUTHORISATION

In the latter case, clearly established in the CALG, the balance in Account 252 would provide at each moment the payments authorised but not yet paid, allowing

controlling the payment orders issued but not yet paid¹²⁷, which is compulsory in the CALG. However, the debts associated with those authorisations once again would be annulled without being effectively paid, and the balance on the normal creditors accounts would provide information not on liabilities not yet paid but on liabilities waiting for payment authorisation. Additionally there is the inconvenience of not having the information on processed expenditures (liabilities) per economic classification, i.e. expenditures processed not yet paid (debts) are classified only per suppliers/creditors and not per economical nature. Furthermore, Carvalho *et al.* (1999, p.245) highlight that the “payment authorisation” is an internal procedure that, if entities choose to record it, should be in Class 0 for internal operations and not in Account 25 created particularly to record budgetary external operations (both for expenditures and revenues invoices and payments/receipts).

On the other hand, considering the use of Account 25 information for the Cash Flow Statement, regarding revenues, even those immediately collected (no invoice issued) must be recorded in that account, which does not seem technically correct, as Bernardes (2001, p.255) explains, because the CALG clearly refers to credits, thus implying records in accounts of third parties assuming a certain length of time for the receivables to be collected¹²⁸.

In summary, the fact is that the main reason why the debts pass from normal creditors to Account 252 (as the credits pass from normal debtors to account 251 – *Debtors from the budget execution*) is only because an economical classification has to be used in the budgetary control statements, namely in the preparation of the Cash Flow Statement. However, when that happens, the control of the debts/credits per creditor/debtor is lost, unless a classification per supplier/client, for example, is used together with the economical one, making the system very burdensome to operate. Moreover, Account 25 seems to reflect concerns regarding strictly internal management (e.g. controlling of payments authorisations), not related to external parties.

¹²⁷ At the end of the year, Account 252 must have a null balance though, considering the CALG instruction that all payment orders issued but not paid at December 31st must be cancelled, transferring the amounts to creditors accounts 22/xx/26 again. At the beginning of the next year, they must be designated and committed on the budgetary accounting sub-system and new payment orders have to be issued (CALG section 2.3.4.2 g) and Carvalho *et al.*, 2002, pp.80-81).

¹²⁸ CALG section 2.6.2 states that local governments revenues might be collected virtually or immediately. The former imply receipts issued and pending collection at the responsibility of the treasury chief. Bernardes (2001, pp.271-272) argues that immediate revenues should not be recorded in clients or other debtors' accounts. Further on this matter is discussed in section 6.3.

Thus Bernardes (2001, p.227 and pp.257-258) as well as Carvalho *et al.* (1999, p.245 and pp.247-248) argue for eliminating Account 25 from the financial accounting sub-system, since it is more adequate to include in Class 0 the records of operations comprised within that account. This means that sub-accounts would have to be created. For example, for expenditures, including recording the “payment authorisation”, it could be (Carvalho *et al.*, 1999, p.247):

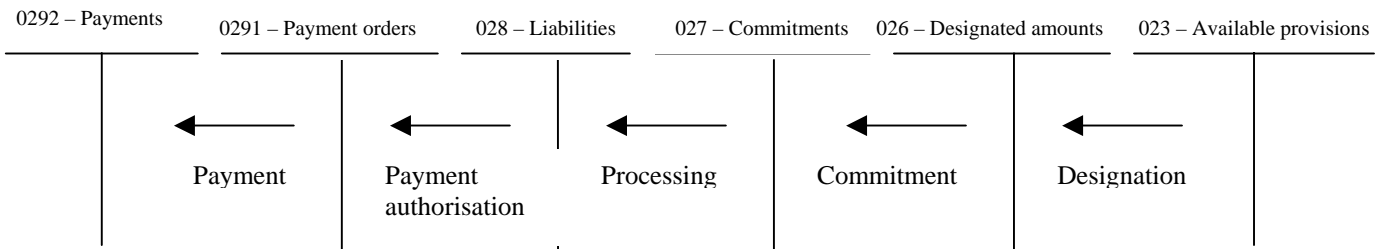


FIGURE III.20 – OPERATIONS OF ACCOUNT 252 RECORDED WITHIN CLASS 0 (INCLUDING PAYMENT AUTHORISATION)

Something similar could be done for revenues, using for example 038 – *Liquidated revenues (receivables)* and 039 – *Receipts*. This is also suggested in Carvalho *et al.* (2002, p.87 and p.404).

Additionally Bernardes (2001, pp.257-258) suggests a second record for the payment/receipt, written accounts 0292 – *Payments* and 039 – *Receipts* against another account to be created in Class 0: 08 – *Cash Flows*. The author explains that this method would have the great advantage of eliminating from the financial accounting sub-system one “out of context” account (that in fact does not relate to third parties but only concerns budgetary control), as well as integrating within the budgetary accounting all the stages of the budgetary cycle, totally separated from the financial accounting. However, maintaining the double-entry bookkeeping method in the budgetary accounting embracing all the operations would have the inconvenience of bringing this sub-system to be very heavy, demanding large capacity databases. To surpass this inconvenience, he suggests another solution combining operations until processing within the budgetary sub-system, followed by operations recorded in cash or deposits accounts (Class 1), dividing these according to the economical classification, so thus the information for the Cash Flow Statement would come from them instead of from Account 25.

Notwithstanding, the fact is that within the CALG framework, Account 25 has to be used. Consequently, considering all the criticisms, doubts and suggestions, the PAASC issued an instruction in order to clarify how to deal with this account so the entity's accounts provide a true and fair view of its financial situation, results and budgetary execution: Interpretative Standard N.2/2001, May 3rd – Records on Account 25 of the CAPA (presented in Carvalho *et al.*, 2002, pp.401-402, valid for all governmental charts of accounts). This instruction basically states that the issuance of a “payment authorisation” for expenditures and a “revenue bill” for revenues must be considered merely an administrative procedure, without consequences for accounting. Accordingly, “liquidation/revenue bill” and “collection/receiving” for revenues, as well as “liquidation/payment authorisation” and “payment” for expenditures, should be recorded at the same time, more specifically at the moment of receiving/payment. This implies Account 25 (each sub-account in particular) to be debited and credited simultaneously at the moment financial means are effectively received or paid.

The accounting records consequent from this orientation are going to be addressed in the following two sections.

6.2. Expenditures

Going back to Figure III.4 and considering the above-mentioned instruction for accounting operations within account 252 – *Creditors from the budget execution*, the next step is recording the expenditure processing, recognising an external liability.

Before this there are some formal procedures to be carried out. As Carvalho (1996, p.172) explains, the supply of goods or services contracted out has to be verified by the entity's internal departments/divisions, particularly concerning quality, quantity, terms and other conditions, assuring the contracts good accomplishment. If everything is correct, the invoice is then given approval to be recorded in the accounting. The “budget and accounting division” must then perform an “accounting control” verifying the amount committed with that from the invoice. Corrections might have to be made to the designated amounts and commitments as explained in Figures III.12 and III.13.

The “liability”¹²⁹ is recorded only after these procedures.

¹²⁹ For simplification reasons we did not consider VAT or discounts that might be obtained.



FIGURE III.21 – LIABILITY

The liabilities (invoices) are recorded on the “Entities’ Current Account” – one per supplier entity (CALG section 12.2.13 and Carvalho *et al.*, 2002, pp.599-600), as well as daily on the “Entities’ Diary” (*Diário de Entidades*), together with liquidations/payment authorisations and payments in relation to the entities operated. The diary provides information on the amount of commitments accomplished (CALG section 12.2.14 and Carvalho *et al.*, 2002, pp.601-602).

The next procedure is the “liquidation/payment authorisation” at the same time as the “payment”; steps (7) and (8) in Figure III.4 are thus recorded together. However, in terms of administrative procedures, there might be some time between them.

Carvalho (1996, p.172) states

The expenditure liquidation is the accounting operation through which one analyse the correction of the expenditure allocation to the respective item in the budgetary classification – departmental, economical and functional – the credit availability within the same item, and one compute the exact amount of the expenditure to be paid (...)

Further strictly financial analyses are also made, namely concerning the conformity with the approved budget and the funds availability (treasury situation). If no irregularities are detected and there are funds available, a payment order is issued (CALG section 12.2.5 and Carvalho *et al.*, 2002, pp.577-581) supporting the “payment authorisation”. Within this document, the net amount to be paid is obtained considering deductions, discounts and/or retentions to the gross amount. Also the method of payment is here defined: cash, cheque or direct debit.

The net amount is that to be authorised by signature of the president of the executive committee.

The “payment”, against which the entity is given a receipt by the supplier, is a responsibility of the treasury services, considering the conditions in the payment order. These services are also responsible for preparing the Cash Sheet (*Folha de Caixa*) summarising the cash and equivalents outflows (and inflows from revenues) for each

day, both budgetary and extra-budgetary – from treasury operations (CALG section 12.2.8 and Carvalho *et al.*, 2002, pp.588-589).

On the basis of this daily sheet, the accounting services prepare then the Treasury Daily Summary (*Resumo Diário de Tesouraria*) basically summarising the treasury situation to the following day, also considering the previous day's balance (CALG section 12.2.9 and Carvalho *et al.*, 2002, pp.590-591). This is an essential document to follow the budget execution, so it must be presented daily to the president of the executive committee.

Carvalho (1996, p.173) summarises that each of the above expenditures essential operations (liquidation, payment authorisation, and payment)

(...) corresponds to the distribution of procedures that the entity must adopt in what concerns expenditures (...) as a basic condition for the control mechanisms to work and for accounting properly assuring its role, mainly regarding transparency, accuracy, and actuality of the accounting records. (Carvalho, 1996, p.173)

The accounting records required at the time of payment are as follows.

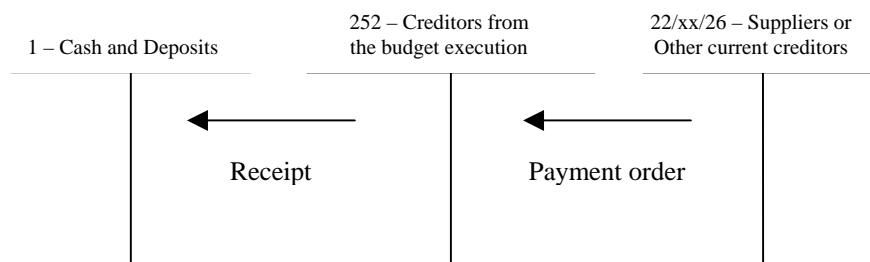


FIGURE III.22 – LIQUIDATION/PAYMENT AUTHORISATION AND PAYMENT

Figures III.21 and III.22 show separately the accounting operations represented in Figure III.19. Hence, although the PAASC instruction had clarified the moment when Account 252 must be written, some of the former problems still remain, namely the fact that expenditures processed but not yet paid (debts) can only be controlled per creditors but not per economical classification.

Carvalho *et al.* (2002, p.401) explain that though some local governments follow that instruction, others have found a way to solve the problem, while not obeying with CALG requirements¹³⁰: records are made on Account 252 not against creditors accounts 22/xx/26, but against a control auxiliary account – 252x9x – *Creditors from the budget*

¹³⁰ CALG section 11.3 states that Account 252 must be credited by the amount of liquidated expenditures only against Class 2 accounts, and debited by the payments only against Class 1 accounts.

execution per creditors, for example. This allows getting information on the expenditures processed not yet paid per creditors and per economical nature.

Accordingly, at the moment of recognising the obligation, apart from the record in Figure III.21, a parallel record is made within account 252 to recognise the liabilities per economical classification, i.e. within the budgetary accounting sub-system.

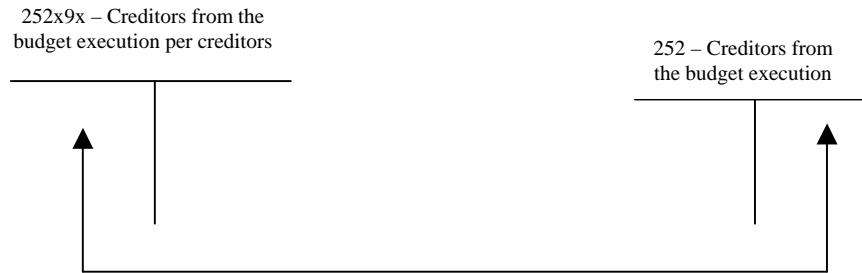
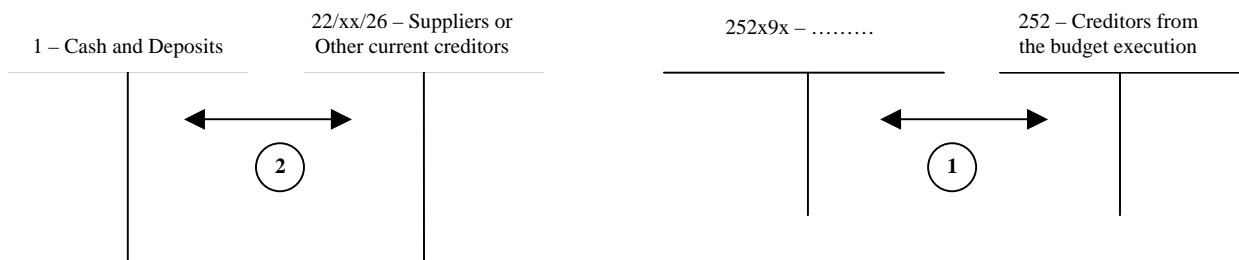


FIGURE III.23 – SUPPLEMENTARY RECORD – LIABILITY

At the moment of “liquidation/payment authorisation” and “payment”, two parallel records are also produced.



- ① Payment order and receipt (payment) within the budgetary accounting sub-system
- ② Payment within the financial accounting sub-system

FIGURE III.24 – SUPPLEMENTARY RECORD – LIQUIDATION/PAYMENT AUTHORISATION AND PAYMENT

This method of using control auxiliary accounts is supported by Bernardes (2001, p.256) and Carvalho *et al.* (1999, pp.245-248), arguing that it can also be used for revenues, as we will explain later.

Yet, considering the PAASC instruction, the Account 25 will have always a null balance since, both for creditors and debtors, it is credited and debited at the same moment.

According to Carvalho *et al.* (2002, p.402), if that instruction is to be followed in the Local Government accounting framework, some alterations have necessarily to be

done to the CALG: within the Balance Sheet there is no point of including accounts 251 – Debtors from the budget execution in assets and 252 – Creditors from the budget execution in liabilities; also the explanatory notes to these accounts should be changed.

On the other hand, bearing in mind the possibility of creating new accounts according to the entity’s needs, both within budgetary and financial accounting sub-systems (CALG section 2.5), those authors suggest creating within Class 0 the accounts below, thus allowing recognition of expenditures processed and liquidated but not yet paid per economic classification (Carvalho *et al.*, 2002, p.404).

- 028 – Liquidated expenditures (liabilities)
 - 0281 – Current exercise
 - 0282 – Previous exercises
 - 0289 – Reflected accounts

Hence, apart from the financial accounting record in Figure III.21, a parallel record would be done.



FIGURE III.25 – LIABILITY PER ECONOMIC CLASSIFICATION

At the moment of “payment authorisation” and “payment”, the opposite record would be done, plus the payment within the financial accounting sub-system as in Figure III.24 (2).

Those accounts would also be of great help preparing the statement of Budgetary Control – Expenditure (Appendix III.4). Carvalho *et al.* (2002, pp.218-219 and p.406) suggest some columns to be added to this statement, namely separating expenditures processed and/or liquidated (liabilities) and/or paid between the current exercise and previous ones. Hence, they argue for sub-accounts to be created within the sub-account 252 evidencing these situations¹³¹:

- 02521 – Creditors from the budget execution – Year n (current)
- 02522 – Creditors from the budget execution – Previous years

¹³¹ According to Freitas (2000, p.19), this is already considered in the CAPA due to the “complementary period” – see footnote 77 – that does not exists for Local Government.

6.3. Revenues

Following Figure III.5, the first operation concerning revenues to be recorded in the financial accounting sub-system (recognised on an accrual basis) is the “processing”, recognising a right over third parties to receive/collect a certain amount.

Nevertheless, according to CALG section 2.6.2, in local governments there are some revenues whose right to be collected can be recognised prior to their collection, while for others recognition and collection are simultaneous (steps (4) and (5) in Figure III.5 are coincident). In the first case they are so-called revenues virtually collected, whereas in the second they are revenues immediately collected.

Immediate revenues are effectively collected by the services responsible for collection (internal – treasury – or external to the entity – generally through the Finance Offices around the country – *Fazenda Pública*); virtual revenues are debited to the treasury chief, pending collection. Accordingly, it is possible to separate “processing” from “liquidation” for the latter, but they are simultaneous for the former.

Yet, as explained in section 6.1, for reasons concerning how accounting records must be done in account 251 – *Debtors from the budget execution*, all revenues have to be passed on to third parties accounts¹³².



FIGURE III.26 – REVENUES PROCESSING

According to the PAASC instruction for accounting operations within Account 251, regardless of whether they are virtual or immediate, revenues “liquidation” and “collection” are recorded simultaneously at the time of receipt (so thus steps (5) and (6) in Figure III.5 are recorded together).

Both imply a revenue bill/receipt (*Guia de Recebimento*) to be issued in duplicate by the collecting services; the original is to be given to the user of the public services

¹³² CALG section 11.3 states that Account 251 must be debited by the amount of liquidated revenues only against Class 2 accounts, and credited by the collections only against Class 1 accounts. Opposing this, Bernardes (2001, p.272) argues that it is not technically correct to consider eventual revenues as a credit, suggesting recording processing/liquidation debiting account 251 directly against Class 7 accounts.

(CALG section 12.2.1 and Carvalho *et al.*, 2002, pp.560-563). In the frequent case of virtual collection, an additional document has to be issued summarising all the revenue bills charged to the treasury chief – *Guia de Débito ao Tesoureiro* (CALG section 12.2.2 and Carvalho *et al.*, 2002, pp.564-565). These documents support the following accounting records.

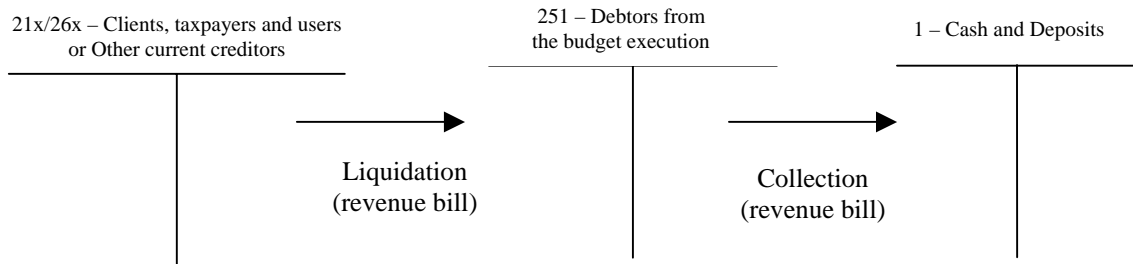


FIGURE III.27 – LIQUIDATION AND COLLECTION

In the case of virtual collection, an additional record has to be made within *09 – Order Accounts*. For example (Bernardes, 2001, p.269 and p.272):

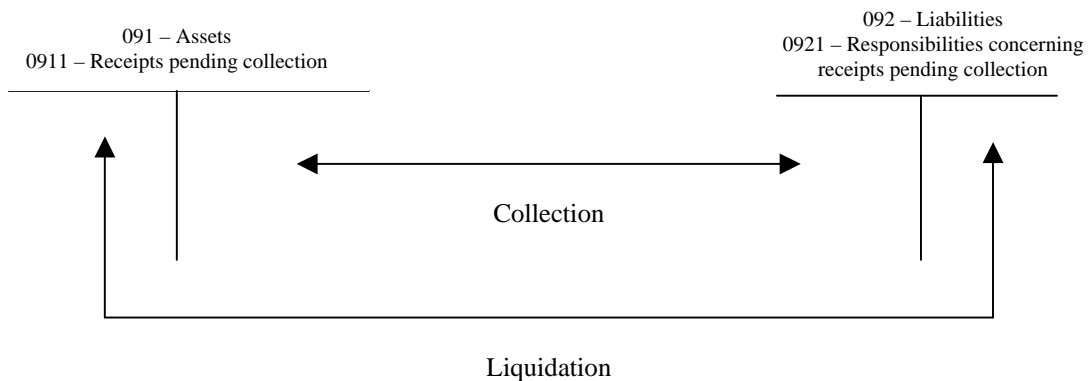


FIGURE III.28 – DEBIT TO THE TREASURY CHIEF

Yet, as happens for expenditures, following the PAASC instruction, accounts 21x/26x balances will provide information of revenues processed but not yet liquidated and collected per debtor, but not per economical classification. This creates problems in preparing the statement of Budgetary Control – Revenue (Appendix III.4).

Furthermore, because Account 251 is debited and credited at the same time, information on revenues liquidated but not effectively collected, which is also necessary for that statement, is lost.

As for expenditures, Bernardes (2001, p.272) and Carvalho *et al.* (1999, p.320) suggest the use of control auxiliary accounts in order to get information on revenues

processed but not yet liquidated nor collected per debtors, and per economical classification.

Accordingly, at the moment of processing, apart from the record in Figure III.26, a parallel record would be made within Account 251 to recognise the collection right per economical classification within the budgetary accounting sub-system.

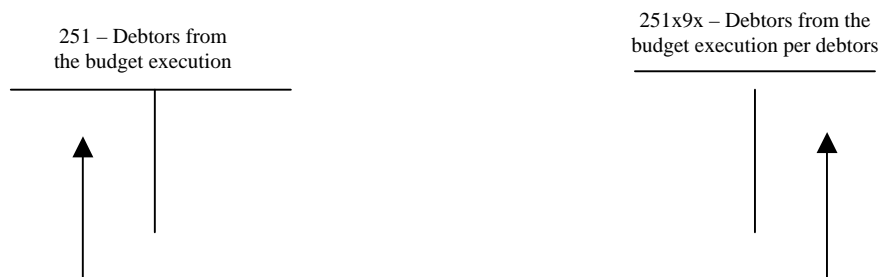
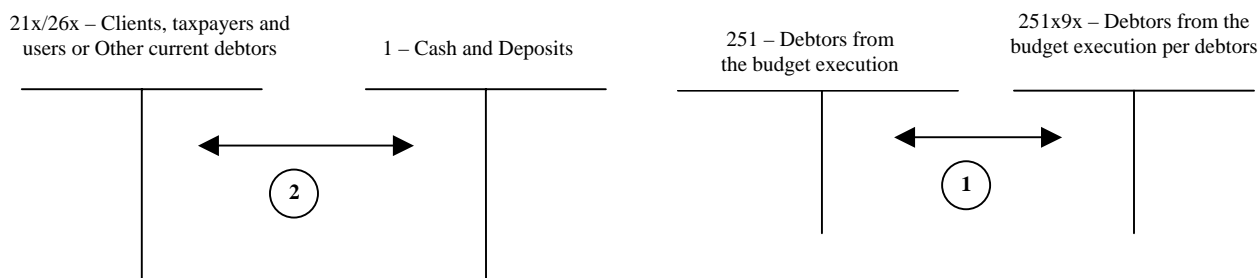


FIGURE III.29 – SUPPLEMENTARY RECORD – PROCESSING

At the moment of “liquidation” and “collection”, two parallel records would be also done.



- ① Liquidation and collection within the budgetary accounting sub-system
- ② Collection within the financial accounting sub-system

FIGURE III.30 – SUPPLEMENTARY RECORD – LIQUIDATION AND COLLECTION

Account 251 would have information on economical classification, possibly combined with other types of classifications relevant for budgetary accounting (as Carvalho *et al.*, 1999, p.318, suggest, sub-accounts could also be per year, per type of financing resources, among others).

In turn, for the information on revenues processed and liquidated but not yet collected per economical classification, as they did for expenditures, Carvalho *et al.* (2002, p.404) suggest using sub-accounts of Class 0 to control this information within budgetary accounting:

- 038 – Liquidated revenues (receivables)
 - 0381 – Current exercise
 - 0382 – Previous exercises
 - 0389 – Reflected accounts

Hence, apart from the processing in Figure III.26, the following parallel record would be done.



FIGURE III.31 – PROCESSING PER ECONOMIC CLASSIFICATION

At the moment of “liquidation” and “collection”, the opposite record would be done, plus the collection within the financial accounting sub-system as in Figure III.30 (2).

6.4. Closing

The financial accounting closing operations within the CALG are very similar to those performed for business accounting. They aim basically at calculating the annual economic net result for the year, as well as at preparing the Results Statement by Nature, the final Balance Sheet and the Appendix to the Financial Statements (section 2.3.2). Before this though, there are some operations normally only recorded at the end of the year that have also to be considered.

First of all, there are expenses only recorded in the financial accounting sub-system, inasmuch as they do not imply cash flows, so they cannot be recorded on a cash basis but demand for an accruals basis. The most typical non-budgetary operations in the CALG (apart from treasury operations – see section 4) regarding costs, are **depreciation** and **provisions**. In a very similar way to business accounting, these are to be recorded at the end of the year, when closing the financial accounting sub-system.

Annual depreciation aims at reflecting on the accounts the monetary erosion in the gross book value of fixed assets to be depreciated, so as the net value represents the

more up-to-date one. Accordingly, both the period costs (Results Statement) and the Balance Sheet values are affected.



FIGURE III.32 – DEPRECIATION

Provisions must be created/reinforced in order to comply with the prudence principle, i.e. to reflect in the accounts any potential losses even if there are no payments to be made. Accordingly, as explained in section 2.3.2, they might be created for: short term financial applications (account 19), credits where the amounts to be received are uncertain (account 291), other contingencies and expenses (account 292), stocks whose value might corrode (account 39), and long term financial investments whose value might decrease (account 49).



FIGURE III.33 – PROVISIONS

On another hand, there are also accrued expenses and revenues that have to be recognised, although they are going to be paid or received in the following years (e.g. staff’s holiday grants).

Moreover, if the entity decides to use the intermittent inventory system for stocks (*Sistema de Inventário Intermitente*) instead of the perpetual one, the account “61 – Cost of Sold Commodities and Used Materials”, is not written up throughout the year but only at the end of the year, when stocks are physically counted up. Thus its balance (the Cost of Sold Commodities and Used Materials – CSCUM) has to be calculated separately:

CSCUM = Initial stock + Purchases ± Stocks regularisations (offers, damages and excesses) – Final stock

Additionally, the “Production Variation” (PV) for “finished and intermediate products”, “by-products, residuals and wasting”, and “products-in-process”, has to be computed as well, also considering the respective “stocks regularisations”:

PV = Final stock ± Stocks regularisations (offers, damages and excesses) – Initial stock

The process of calculating the Annual Net Result involves several stages, starting from writing off the balances of all accounts regarding operational costs (61 to 67) and revenues (71 to 76) against account 81; the balance of this account (operational revenues less operational costs) gives the “Operational Result” for the year, which also includes Production Variation (see Appendix III.2). It might be then transferred to accounts “83 – Current Result” (which is not of compulsory use) or directly to account “88 – Net Result of the Year”. The same process has to be done in order to calculate financial results: the balances of accounts “68 – Financial expenses and losses” and “78 – Financial revenues and gains”, are written-off against account 82, which balance (financial revenues less financial costs) is the “Financial Result”. This is then transferred as the Operational Result either to account 83 or directly to account 88. Finally, the “Extraordinary Result” (extraordinary revenues less extraordinary costs) has also to be computed writing-off accounts 69 and 79 balances against account 84; the balance of the latter is then transferred to account 88.

In summary, all accounts regarding costs, revenues and results for the year have to have a null balance, except account 88, which gives the annual net result. The reason why one calculates other types of results concerns the nature of costs and revenues, namely separating those related to the entity’s normal activities from others regarding financial issues and extraordinary events.

After closing operations, the financial statements are arranged together with the budgetary statements in the entity’s annual report to be approved and sent to The Court of Accounts, as explained.

7. COST ACCOUNTING

This section describes how cost accounting works within the CALG. Additionally, some problems are pointed out, which might contribute to the many difficulties surrounding its implementation in the Portuguese Local Government.

7.1. General description

As explained in section 2.3.1, the CALG recognises the importance of Cost Accounting as a financial management instrument. However, strictly applying what is set in the Local Finances Law (Law 42/98, article 20, n.3), the CALG merely establishes a series of compulsory accounting procedures to compute costs per functions (functional classification) as well as to determine costs underlying the establishment of rates and prices for goods and services to be provided (CALG Introduction 5.).

Opposing Budgetary Accounting and Financial Accounting, for which accounts are defined and every accounting operation must be recorded following a double-entry bookkeeping method, nothing is set in the CALG concerning the organisation of the Cost Accounting sub-system. In fact, this is basically developed through the preparation of several statements (more specifically cost cards – *fichas de custos*) in which costs of functions, goods and services are computed. It is particularly linked to the financial accounting sub-system, from which it uses, and to which it provides, some information. Moreover, it works outside the double-entry bookkeeping method¹³³, though entities are allowed to use it, defining their own list of accounts for Cost Accounting within Class 9.

CALG section 2.8.3 summarises the instructions and procedures for the Cost Accounting sub-system:

- 1) Cost accounting must be used in computing costs of functions and costs underlying the establishment of rates and prices for goods and services provided.
- 2) The cost of functions, goods and services corresponds to the respective direct and indirect costs related to production, distribution, general administration, and financing. This means that the CALG forces the use of “full costing” and “absorption costing”, despite all the problems that this might cause, which we will address in the next section. Additionally, all costs by nature from the financial accounting have to be reclassified by function, as well as by goods and services, in a process as follows:

¹³³ Bernardes (2001, p.409) explains this as a “radical dualism” between financial and cost accounting opposing the “accounting dualism” frequent within the business accounting, through which accounts with double-entry are used in cost accounting, although they are not written against financial accounting accounts.

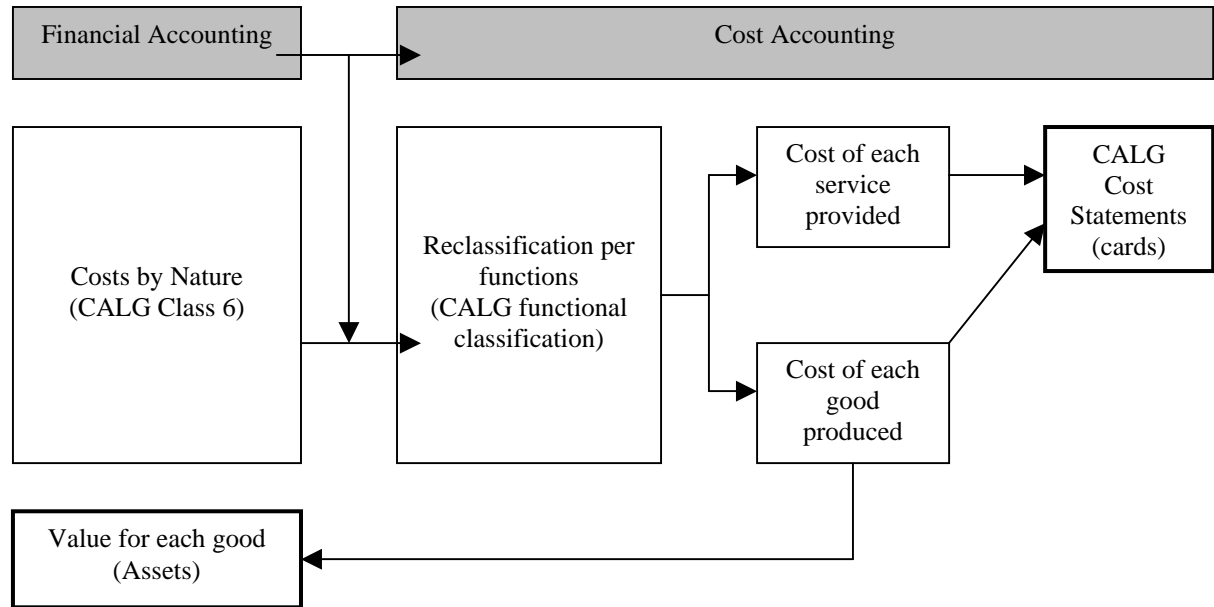


FIGURE III.34 – COSTS RECLASSIFICATION
(Adapted from Carvalho *et al.*, 2002, p.119)

Yet, Carvalho *et al.* (2002, p.121) explain that there might be some costs that cannot be incorporated to any function, good or service. A typical example concerns those considered as extraordinary costs within the financial accounting.

3) Indirect costs allocation is made through coefficients, after computing direct costs per function:

- a) The coefficient to allocate indirect costs to each function is the percentage of the total direct costs for that function, over the total direct costs for all functions;
- b) The coefficient to allocate indirect costs to each good or service is the percentage of the total direct costs for that good/service, over the total direct costs of the function it is comprised within.

In other words, a single basis for allocating indirect costs to functions, goods and services is set, more specifically indirect costs are conventionally allocated as a proportion of direct costs.

Additionally, functions comprise several goods and/or services. Therefore, costs of functions have to be divided by the goods and/or services comprised within each function.

4) The indirect costs for each function are the result of applying the allocation coefficient to the total of indirect costs computed.

The indirect costs for each good/service are obtained applying the allocation coefficient to the total of indirect costs of the function within which the good/service is comprised.

5) The (total) cost for each function, good or service is calculated adding to the respective direct costs, the indirect costs computed as explained in 4).

6) The documents used in cost accounting, which compulsory contents are set in CALG section 12.3, are materialised in the following costs cards – CC (Carvalho *et al.*, 2002, pp.610-621; Bernardes, 2001, pp.411-413):

a) Materials (CC1)

This card is prepared monthly for each function, good or service consuming direct materials. It receives information on consumptions from the stocks ledger (CALG section 12.1.11).

b) Computation of the cost/hour of direct labour (CC2)

This card is prepared every year, preferably at the beginning of the year, based on estimations that might be eventually modified with new recruitments or departures of employees as well as with salaries changes. The cost/labour hour is computed for each worker in particular, which in Bernardes' (2001, p.412) opinion is excessive, since it could be enough to calculate an average hourly rate per worker category, for example.

The formula is

$$\text{Cost/Labour hour} = [\text{Total annual personnel costs}/52]^* (n - y)$$

n = number of working hours per week

y = number of lost hours per week (e.g. sick leave, public holidays, and holidays)

– it is computed dividing the annual total of lost hours over 52 weeks

c) Labour (CC3)

As for materials, this card is prepared monthly for each function, good or service using direct labour. It receives information from card CC2.

d) Computation of the cost/hour of machinery and vehicles (CC4)

This card is prepared yearly, preferably at the beginning of the year, based on estimated values that might eventually change with new machinery and/or vehicles, as well as new hourly salary of the operator, which must not be included in card CC3. It is assumed that every machine and vehicle are used for the same number of hours throughout the year, which considering the formula for CC2 and the fact that these equipments use an operator, varies between $(52*n)$ and $[52*(n - y)]$. As for labour, the cost/machine hour is computed for each unit of equipment, which could be simplified using average rates per type of equipment, for example (Bernardes, 2001, p.412).

e) Machinery and vehicles (CC5)

Like cards CC1 and CC3, this is prepared monthly for each function, good or service, using information from card CC4.

Carvalho *et al.* (2002, p.125) explain that there might be other direct costs for each function, good or service not comprised in the former cards (namely if they are neither materials nor measured in labour hours or machine hours) which must also be considered in calculating their costs.

f) Computation of indirect costs (CC6)

Indirect costs are overhead, common to several functions, goods or services. They are calculated monthly, so thus card CC6 is prepared monthly.

g) Computation of total (direct plus indirect) costs of each good or service (CC7)

– every month one card per good/service is prepared, using information from cards CC1 to CC5, CC8 and CC9.

h) Computation of direct costs of each function (CC8) – every month one card per function is prepared, using information from cards CC1 to CC5.

i) Computation of total (direct plus indirect) costs per function (CC9) – every month one card per function is prepared, using information from cards CC6 and CC8.

From the analysis of these instructions and particularly from the cards established, it seems that the first procedure is separating the costs between direct and indirect in relation to each function, good or service.

According to Carvalho *et al.* (1999, p.536) and Carvalho *et al.* (2002, pp.123-126), after this, two situations could happen:

- **Either** the cost of the good or service is computed monthly within card CC7 – This would be the case if not all services were to be included within the functions of the CALG functional classification. Consequently, for those not included within any function, the total cost would include only direct costs, considering the CALG allocation basis for indirect costs;
- **Or** the total cost of the function is computed monthly on card CC9 (using the information from cards CC6 and CC8), and only after this the total (direct plus indirect) costs of goods and/or services comprised within each function are calculated – card CC7. This is the CALG procedure (though debatable if not difficult to implement in practice), obliging all goods and services (so thus its costs) to be comprised within the functions of the functional classification.

Accordingly, in order to calculate the COSTS OF FUNCTIONS the CALG imposes cost cards CC8 (using information from cards CC1 to CC5), CC6 and CC9 to be used. Bernardes (2001, p.409) supports that costs must be calculated per each elementary function, i.e., at the third level of detail within the functional classification. The following example from Bernardes (2001, pp.409-411) illustrates how it can be done.

EXAMPLE

A) Direct costs of each function – Card CC8 – within the following table, each line corresponds to a card to be prepared monthly for each function in particular.

Function (Cards CC8)	Product/service direct costs (a)		Other direct costs (a)		TOTAL		AC (%) (b)
	Month	Accumulated	Month	Accumulated	Month	Accumulated	
General Administration			5,000	60,000	5,000	60,000	0.6
Civil Protection, ...			1,500	10,000	1,500	10,000	0.1
.....
Housing	60,000	400,000	10,000	80,000	70,000	480,000	4.8
.....
Sewage treatment	100,000	800,000	30,000	170,000	130,000	970,000	9.7
Water provision	150,000	900,000	50,000	250,000	200,000	1,150,000	11.5
Solid residuals	80,000	600,000	30,000	200,000	110,000	800,000	8.0
.....
Others non-specified			2,000	15,000	2,000	15,000	1.5
TOTAL	600,000	6,000,000	400,000	4,000,000	1,000,000	10,000,000	100.0

(a) This is admitting that some functions might not comprise specific goods or services for which to calculate costs (e.g. general administration).

(b) AC (%) is the Allocation Coefficient computed dividing the total accumulated over the total. It must not be included on card CC8, but calculated separately; we included it here for presentation reasons. The CALG does not state whether it is computed for monthly or accumulated values. The author argues that the latter is more correct.

B) Indirect costs – Card CC6 prepared monthly.

COSTS BY NATURE (Class 6 – financial accounting)	TOTAL OF THE MONTH	ACCUMULATED	
		PREVIOUS MONTH	CURRENT MONTH
61 – Costs of sold commodities and used materials	10,000	80,000	90,000
621 – Contracting out	30,000	250,000	280,000
622 – Supplies and services			
62211 – Electricity	20,000	180,000	200,000
.....
63 – Current transfers and subsidies conceded and social grants	6,000	50,000	56,000
64 – Personnel expenses	40,000	350,000	390,000
65 – Other operating expenses and losses	4,000	25,000	29,000
66 – Fixed assets depreciation of the year	10,000	100,000	110,000
67 – Provisions of the year	4,000	40,000	44,000
68 – Financial expenses and losses	6,000	10,000	16,000
TOTAL	130,000	1,085,000	1,215,000

C) (Total) Costs per Function – Card CC9, using information from cards CC8 (total direct costs) and CC6 (total indirect costs), as well as the allocation coefficients; this

card includes accumulated information until the current month. As in card CC8, each line corresponds to a card to be prepared monthly for each function.

FUNCTION	TOTAL DIRECT COSTS		ALLOCATED INDIRECT COSTS		TOTAL COSTS	
	Month	Accumulated	Month	Accumulated	Month	Accumulated
General Administration	5,000	60,000	780	7,290	5,780	67,290
Civil Protection, ...	1,500	10,000	130	1,215	1,630	11,215
.....
Housing	70,000	480,000	6,240	58,320	76,240	538,320
.....
Sewage treatment	130,000	970,000	12,610	117,855	142,610	1,087,855
Water provision	200,000	1,150,000	14,950	139,725	214,950	1,289,725
Solid residuals	110,000	800,000	10,400	97,200	120,400	897,200
.....
Others non-specified	2,000	15,000	1,950	18,225	3,950	33,225
TOTAL	1,000,000	10,000,000	130,000	1,215,000	1,130,000	11,215,000

To calculate the COSTS OF GOODS OR SERVICES, apart from cards CC1 to CC5 also used for functions, information from card CC9 is used together with an allocation coefficient for each good/service indirect costs. The total costs for each good or service is then calculated monthly in card CC7, which also calculates the same using accumulated values.

Continuing with the example (Bernardes, 2001, p.413):

D) (Total) Costs per Good/Service – Card CC7 – Suppose that we want to calculate the (accumulated) cost of the water (good) within the function of water provision.

Direct costs of the good (cards CC1, CC3 and CC5)	900,000
Allocation of the indirect costs	
- Allocation Coefficient	= [900,000/1,150,000] (CC8) = 0.78
- Function Indirect Costs	= 139,725 (CC9)
- Indirect Costs of the Good	= 0.78 * 139,725 = 108,986
Total Costs of the Good (900,000 + 108,986)	1,008,986

As to the Municipalized Services, the procedure is similar. What usually happens here is that these company-type autonomous units within the municipality (see section 1.3.2) provide specific services many times coincident with functions (at the third level of the functional classification). For example, in many Portuguese municipalities,

sewage treatment, water provision and solid residuals (waste) collection are three (social) functions corresponding to three types of services provided by a unit of Municipalized Services commonly designated by *Municipalized Services of Water and Sewage*.

Even though no reference is made in the CALG to any class of accounts to be used in Cost Accounting, Carvalho *et al.* (2002, pp.126-128) among others, suggest that an accounts plan should also be developed within Class 9, since this is permitted in the CALG, using the double-entry bookkeeping method (accounting dualism) and facilitating the preparation of the compulsory costs cards. They not only suggest the accounts structure presented below, but also explain how the accounts should be recorded against each other, starting from the costs values from Class 6 (Expenses and Losses by Nature) within the financial accounting sub-system, which must be recorded here as reflected accounts. Additionally, they imply for estimated costs to be computed as well at the beginning of each year in order to be compared at the end with actual costs for the purpose of calculating variances and carry out corrective actions.

Main account	Second level accounts	Third level accounts	Fourth level accounts
91 – Reflected costs	9161 - ... 9162 - 9169 - ...		
92 – Reclassification of costs	921 – Incorporated costs	9211 – Direct costs	92111 – Materials 92112 – Direct labour 92113 – Machinery and vehicles 92114 – Others
		9212 – Indirect costs	
	928 – Non-incorporated costs	9281 – Reclassification of costs 9284 – Functions	
94 – Functions	941 – General functions ... 942 – Social functions ... 943 – Economical functions ... 944 – Others ...	94...1 – Direct costs for goods and services 94...2 – Indirect costs for goods and services 94...8 – Non-incorporated costs	94...15 – Goods to be inventoried ... 94...16 – Services ...
95 – Goods to be inventoried	95xx – Goods identification	95xx1 – Direct costs	95xx11 – Materials 95xx12 – Direct labour 95xx13 – Machinery and vehicles 95xx14 – Others

Main account	Second level accounts	Third level accounts	Fourth level accounts
		95xx2 – Indirect costs	
96 – Services	96xx – Services identification	96xx1 – Direct costs	96xx11 – Materials 96xx12 – Direct labour 96xx13 – Machinery and vehicles 96xx14 – Others
		96xx2 – Indirect costs	
97 – Estimated costs	975 – Goods to be inventoried 975xx - ... 976 – Services 976xx - ...	97(5)(6)xx1 – Direct costs	97xxx11 – Materials 97xxx12 – Direct labour 97xxx13 – Machinery and vehicles 97xxx14 – Others
		97(5)(6)xx2 – Indirect costs	
98 – Variances	985 – Goods to be inventoried 985xx - ... 986 – Services 986xx - ...	98(5)(6)xx1 – Direct costs	98xxx11 – Materials 98xxx12 – Direct labour 98xxx13 – Machinery and vehicles 98xxx14 – Others
		98(5)(6)xx2 – Indirect costs	

TABLE III.9 – CLASS 9
(Adapted from Carvalho *et al.*, 2002, p.127)

Notwithstanding, the main purpose of the CALG Cost Accounting sub-system is calculating costs, which is very modest and even less ambitious when compared to what is stated in the Public Accounting Basic Law (Law 8/90, article 14, n.1), the State Financial Management Regime (Law-decree 155/92, article 16), and the Local Finances Law (Law 42/98, article 6, n.1). Indeed, all these regulations emphasise the role of Cost Accounting as indispensable to evaluate the management results. Unfortunately, this is not possible only with the Cost Accounting sub-system in the terms and conditions set within the CALG, namely because comparison with revenues is not required.

As Bernardes (2001, pp.402-404) explains, instead of Cost Accounting – corresponding to the minimum objective of local governments to justify, on the basis of cost, prices and rates for the goods/services provided – the system should be of management accounting, inasmuch as this is the one that, concerning the management process of obtaining and using resources adequately, might help analysing if the entity's resources are being effectively used or not. Taking as reference the IFAC international recommendation on Management Accounting, the author clarifies that in terms of operational control, a Management Accounting System would help for example:

- Establishing criteria and performance measures related to the strategic success and to the financial and operational processes;
- Designing and operating information systems to support operations, performance measures, control and responsibilities;
- Creating responsibilities related to risk management, and operational and strategic performance – responsibility accounting.

Even if it may be insufficient for the purpose of management evaluation, as Fernandes (1999, quoted in Carvalho *et al.*, 1999, p.546) makes clear, it may not be forgotten that Cost Accounting in Portuguese local governments is a rather new system, thus of difficult and slow implementation, particularly considering the diversity and specificity of products and services those entities provide.

When it will be successfully operating, the rates and prices for the public goods/services can be set, in principle, in order not to be lower than the costs directly or indirectly incurred in providing them (as the Local Finances Law determines – Law 42/98, article 20, n.3). Moreover, rates/prices can be compared with costs so the entity might use the former as an instrument to encourage/de-encourage populations for demanding certain activities (Carvalho, 1996, pp.108-109).

Additionally, an accurate system of fees and prices can be very useful, within the trend of open markets for public services, for Portuguese local governments to decide which services have to be provided free of charge, and which should follow a market logic. As Carvalho (1996, p.206) states

This tendency increasingly opposes the idea that local public services must be free of charge or tend to be free of charge, once *the social-economic* system must create compensation mechanisms, in order to keep the social character of certain services, or to set fees adequate to the users' real capacity, taking into account the cost factor and the incentive/benefit relation to establish the service price (...) or fee to apply. [italics provided]

In fact, if before it was believed that, since public services were for the general welfare, this was enough justification for all the resources used to provide them, we may say that today the importance of cost control as an essential management supporting element is generally understood. Hence, it is acknowledged that an accurate system of rates and prices can have several advantages, namely (Carvalho, 1996, pp.208-209):

- Striving against the waste associated to providing services total or partial free of charge;
- Treating differently those that use goods and equipments in a rational way and those who use them abnormally;

- Conducting certain users for the average cost – for example, companies choosing between paying a disincentive fee and changing their production processes;
- Allowing evaluating the social cost of the services provided, inasmuch as fees and prices for local public services might be determined considering not only cost factors (real costs), but also variables of benefit and incentive/disincentive.

7.2. Some problems

Although it might be insufficient, as we have just emphasised, when the Cost Accounting sub-system starts working properly, it will be of great value added for the Local Government accounting framework.

However, there are still some problems intrinsic to the system that is now imposed by the CALG. Bernardes (2001, pp.404-409) addresses these:

- The functions are those from the functional classification, and the goods and services are those from code *06 – current revenues* of the economical classification – in many cases there is a total coincidence between the (elementary) function and the goods or services for which the costs are being computed, thus not justifying the separation¹³⁴;
- Cost accounting in the CALG does not establish for a reclassification of costs and revenues per departments (departmental classification), although this is allowed for expenditures within the budgetary accounting. Therefore, performance and efficiency analyses per responsibility centres are impossible to carry out;
- The use of “full costing” within an “absorption logic”, embracing not only production but also distribution, administrative and financial costs, might not be suitable for valuating goods to be inventoried. For these the valuation criteria comprises only production (or acquisition) costs, though for some assets, such as social housing, it might be debatable if other non-industrial costs should be included in the production costs (e.g. those involved in preparing and analysing the public bids);
- The CALG does not explain if all costs from financial accounting must be considered also for cost accounting – some costs as the afore-mentioned extraordinary, must not affect the costs of functions, goods or services. Thus, costs must firstly be divided in incorporated versus non-incorporated (as it is suggested in Table III.9);

¹³⁴ As explained, this is common for the units of Municipalized Services.

- It also does not clarify if costs with different nature than those in financial accounting (e.g. opportunity costs) or different amounts (e.g. decreasing instead of linear depreciation) might be considered. However, given that cost accounting within the CALG does not concern management performance evaluation, it is very likely that it does not consider these aspects;
- Given the “full costing”, if the rates and prices are set on the basis of having to recover the total inputs, they will comprise for sure a certain part of inefficiency costs, as well as costs of resources available (under-activity), badly or insufficiently used. On the other hand, if for social reasons, the goods or services have to be under priced/rated (not covering the total costs) this might be a motive for justifying compensations or additional loans and grants, but it does not reveal the unnecessary costs;
- Despite several possible classifications, costs are classified as direct and indirect. This is particularly interesting in a context of responsibility accounting, where managers can somehow control and decide on the costs, within the “contribution logic”. The “absorption logic” established within the CALG supports costs having to be incurred by “someone”, thus they must be divided and allocated. Perhaps the division between fixed (structural) and variable costs could be more adequate?;
- The division of costs imposed by the CALG implies those to be direct and indirect in relation to a function or a good/service. On the other hand, some fixed costs might be direct and not all variable costs are necessarily direct. Thus, that distinction is essentially associated to the problem of collecting information, which depends on the aggregation level that is required. The lower the level, more direct costs become indirect, i.e., less costs can be directly allocated. The CALG is not clear on the level of aggregation for the costs of functions, and as it is understandable, direct costs at an upper level do not necessarily correspond to the aggregation of the direct costs at the immediate level. Therefore, costs must be calculated at the lowest level (elementary function) since consolidating total costs at an upper level is not correct;
- The allocation of indirect costs is controversial, being much criticised by those who support “direct costing” (mainly the French orientation); while direct costs can be unambiguously allocated, indirect costs can be allocated only through conventional bases (as the direct costs within the CALG). These are very debatable and ambiguous, since no causal relationships exist. Maybe the best way of having an

unambiguous cost of functions and goods/services would be not to allocate indirect costs, but to consider these as period costs, though their allocation might be convenient (a relationship is somehow assumed);

- While not requiring a departmental classification for costs, as well as the analysis of activities costs, CALG uses the direct allocation for those traceable costs as materials, direct labour and direct equipment. Additionally, it avoids indirect costs analysis and allocates them using a conventional quite arbitrary basis. Perhaps that classification would allow using costs centres to allocate overhead on the basis of a more accurate absorption rate.

Despite these drawbacks, the author also highlights that the CALG does not prevent local governments from expanding Cost Accounting (for example calculating results per functions) for other purposes, as long as what is required is accomplished. For this purpose, Fernandes (1999, quoted in Carvalho *et al.*, 1999, pp.547-559) suggests for example the use of Activity Based Costing as an instrument to better assess local governments' efficiency, effectiveness and economy.

Additionally, Carvalho (1996, p.207) also refers to other difficulties in determining the costs of goods and services provided:

- Technical resistances associated with public goods characteristics, namely indivisibility which often prevents the individual accounting record;
- Obstacles of economic nature – Calculating and analysing costs is itself often a very costly procedure;
- Problems of mentality and capacity of technicians and, above all, of politicians for approaching management in a perspective of costs analysis (the concept of cost, associated to the accrual concept, is difficult to understand) and associated responsibilities – responsibility accounting seems still very difficult to implement in the Portuguese Local Government;
- Barriers of socio-juridical character – In spite of the CALG (as the other governmental sectional charts of accounts) encouraging and imposing costs calculation, as well as the preparation of financial accounting, the Budget arranged in a modified cash-basis (not in terms of accruals) is still the central piece for Local Government accounting, as it is for Portuguese governmental accounting in general. Accordingly, the main purpose of budgetary and legal control that restricts

governmental accounting in Portugal, seems to be unavoidable in continuing to do it, notwithstanding the importance already recognised for the control of the appropriateness in using public money.

On the other hand, it seems that within the socio-juridical establishment, calculating costs implies the idea of profitability, which is a concept traditionally non-existent within the Public Administration, inasmuch as it represents a renouncement of the mission of public service. If principles of gratuitously, equity, and continuity were to be fulfilled in providing public goods and services, they would have to be provided regardless of costs, the calculation of which would be therefore irrelevant.

Nevertheless, in the more recent tendencies of the New Public Management, it seems that a new concept of public service has been searched for. Calculating costs is now important in helping, for example, to decide if the services should be provided directly by the public entity or contracted out and regulated.

8. FINAL REMARKS

This chapter presented an overview of governmental accounting in Portugal, paying special attention to the Local Government situation.

In the first section we described the Portuguese Public Sector, evidencing the relationship between Central and Local Government as well as introducing a detailed description of Local Government.

The second section focused specifically on governmental accounting. We started explaining how this has been evolving in general terms. From here we referred to Local Government accounting in particular, evidencing the latest developments. The section concluded with a comprehensive presentation of the CALG, the main consequence of the recent Local Government accounting reform.

Next we offered a general overview of the governmental accounting standards-setting process in Portugal, referring to auditing bodies as well.

Finally, in the last four sections, we made a detailed presentation on how the current Local Government accounting system works, namely addressing the three sub-systems separately: Budgetary Accounting, Financial Accounting and Cost Accounting.

At this point it is clear that Local Government in Portugal is considerably autonomous. This autonomy assumes the decentralisation of decision powers, which in turn implies that local governments are the only entities responsible for assessing their

projects appropriateness and social-economic return, as well as for controlling all their economical-financial execution process. As Carvalho (1996, p.134) states, this means that

The management control, in the perspective of the utility reached by the application of available resources, is the exclusive responsibility of Local Administration (...).

Local Government technical reinforcement, first through the creation of Technical Support Offices¹³⁵ and recently through recruiting more technical staff, has allowed an assessment of the needs and objectives to support the resources application. Thus, it is expected that economic rationality prevails over political criteria.

On the other hand, Local Government competencies' enlargement demands for an internal control reinforcement, which is reflected by the importance given to the internal control system in the new accounting framework.

In our opinion, this internal control system, in some way, is an answer to the importance given to the management control, considered as important as the juridical one. It helps assuring not only decisions transparency, but also activities order and efficiency. In other words, it monitors the management quality and regularity.

Therefore, management control is here implicitly considered, since it evaluates the consequences of the decisions taken by Local Government executives, mainly assessing expenditures appropriateness, both measuring (qualitatively and quantitatively) the implementation level of programmes, and the consequences of those programmes in general objectives (Carvalho, 1996, p.135).

The recent developments of Local Government accounting, as they were presented, in particular the CALG, are a great contribution for producing financial information available for management control. In fact, the new accounting system is expected to allow management control to be a decision support instrument, as well as a tool to evaluate the effectiveness and efficiency of the objectives set by the administration.

However, it is our understanding that this new accounting environment is not yet completely adequate for these purposes.

¹³⁵ According to Carvalho (1996, p.36, footnote 39), these are Central Government institutions, firstly created in 1979, with the purpose of provide technical and administrative support in order to help local governments perform their functions effectively. They were a consequence of recognising the lack of technical means in local governments, considering the enlargement of their competences not only by the 1976 PRC, but above all, by the 1979 Local Finances Law. At the present moment, some Technical Support Offices are still functioning. However, considering that local governments have been reinforcing their own technical staff, some local politicians think those offices are just a way for Central Government to control and interfere in Local Government, using economic rationality as an excuse.

Although assessing the results from CALG implementation seems to be still premature, we think it is already possible to identify some improvements that need to be made:

- Consolidation rules – Although the CALG had brought in consolidation conditions, more specifications have to be issued. In fact, considering that local governments (municipalities in particular) had increased their peripheral sector, an overall picture of the economic-financial position of the entity as a whole (namely embracing Municipalized Services and Municipal Business Enterprises) is becoming more important;
- Performance reporting – Developing performance measurements, namely using financial and non-financial performance indicators (budgeted and actual) in order to support the assessment of public services economy, efficiency and effectiveness;
- Simplified regime – Review the present rules, in particular the procedures that local governments have to carry on once within this regime. Considering the characteristics of many small local governments (namely parishes with very basic organisation, providing very simple services), the present regime does not seem to be simplified enough;
- Revise the CALG – As a procedure that is understandable after the first experience with the new system, revealing the need for improvements;
- Management accounting – Developing the Cost Accounting sub-system to become a better instrument to support Local Government management. A system of management (internal) accounting would also be important for performance evaluation, inasmuch as it would support evaluating management results. We believe this is the best way towards efficiency, effectiveness and economy in the resources application, allowing a more suitable mechanism for a better use of taxpayers' money.

These issues have been recently considered in Portugal, explaining why, in our opinion, they will be the future directions for Portuguese Local Government accounting system.

CHAPTER IV

A CONTINGENCY APPROACH FOR PORTUGUESE GOVERNMENTAL ACCOUNTING INNOVATIONS

As stated, governmental accounting in Portugal has recently engaged in a radical process of change, clearly of a normative non-conceptual character. This process has been part of a wider reform: the State Financial Management New Regime.

One of the main consequences for governmental accounting was the 1997 CAPA. Up to the moment this has been applied only to the main sub-sectors of the autonomous APS, though it is to be extended to the whole Public Administration.

It might be said that, in the last instance, this reform was a consequence of a more general social, and above all, political and economic change: the change from a dictatorship (known as the “New State” regime) to a democratic political regime, in 1974.

Yet, there is still no empirical study about what has been happening in terms of governmental financial management and accounting innovations in Portugal.

The Contingency Model presented and discussed in the literature review, is a framework that explains the relationship between contextual and behavioural variables and the conduciveness to innovations in one country governmental accounting system, in order for this become more informative.

In this chapter, with the help of the latest version of the Contingency Model – the FMR Model, we offer some explanations for the recent innovations that are still happening in Portuguese governmental accounting, at the same time as we describe the context within which this reform has been taking place. Moreover, from the overall assessment of the contextual effects on conducting the reform so far, we provide some insights into the probability of further steps, using the same model to predict the conduciveness to future developments. The analysis will mainly focus on the central government situation, since the reform has been following a “top-down” approach. Still, some particularities of the local governments accounting innovations process will also be addressed.

Therefore, our main purposes are: to describe which contextual, behavioural and instrumental variables have interfered in the Portuguese governmental accounting reform, to explain how they have impacted on the recent innovations process, and to predict how and which of those will affect further stages of the reform. Thus, we

critically review and consider the applicability of the model to Portugal reality, where the Contingency Model was never applied.

Finally, considering the similarities between the governmental accounting reform processes, as well as the innovations diffusion given the regional proximity, we suggest an adaptation of the model to explain governmental accounting innovations that have been happening in the Iberian countries.

1. USING THE FMR MODEL IN PORTUGAL

This section, which is going to be the main one in the chapter, aims at applying the FMR Model to analyse the contextual, behavioural and instrumental variables underlying the Portuguese governmental accounting reform process. Our choice for this version of the Contingency Model relates to the fact that it is the later one, so more up to date, including not only the basic ideas from the initial model, but also new features, correcting former problems and adding new potentialities.

Because governmental accounting reform in Portugal has been following a clearly “top-down” approach, local government accounting innovations process has been developed in the same context as the reform at central level. Accordingly, since the same variables seem to have interfered in the process in a very similar way, we will just highlight some slight differences that seem to have been occurring. We continue suggesting some modifications of the FMR Model, considering the new information on the Portuguese case. Finally, we introduce the FMR Model prediction for the future of the Portuguese governmental accounting.

1.1. Portuguese Governmental Accounting Reform Process

The FMR Model components are reviewed essentially in the light of its applicability to the Portuguese autonomous Central Administration. This analysis of the economic, political, administrative and social-cultural variables underlying the Portuguese governmental accounting developments draws mainly on secondary sources referred to in Chapter III. Consequently, it is a “desk study” rather than an empirical one, since it relies on written material (specially in Portuguese), though very frequently completed by personal knowledge as an observer very interested in the subject.

In order to do that, we will follow a description and examination for each module or cluster of variables, as Lüder (2001, pp.10-14) did for the general presentation of the model.

1.1.1. Contextual Variables

STIMULI

As mentioned before, we believe that the “new” Portuguese governmental accounting might have begun with a special political-economical situation faced by Portugal in the middle of the 1970s – the change from dictatorship to democracy. In fact, in the wake of 1976 new PRC, there was the need to elaborate a new governmental accounting system. A new law for the State General Budget Framework (Law 64/77) was issued in order to meet the objectives of a much larger Public Sector. Although no significant conceptual changes happened in governmental accounting (it remained cash-based, budget oriented, and mainly concerned with an overall purpose of legal accountability of the sources and uses of financial resources, using a single-entry bookkeeping method), some formal modifications were done mostly aiming at increasing the details in the financial statements. In our view, this was the “kick-off” for a reform process that is still happening. We believe that the new democratic political regime led rulers to realise that more and different governmental accounting information was needed, considering the disclosure process that was involving the whole country.

After almost four decades of impassiveness and political and economic isolation, Portugal was far behind most Western European Countries in terms of economic development, whilst the State gold reserves had increased significantly as a result of a long period of “compelled savings”. Yet, the democratisation process radically changed this scenario. In fact, in the following decade, as public investment significantly increased aiming at economic growth, public debt amplified dangerously and the gold reserves reduced below the “break-even”. The country’s financial situation was in such a chaos, worsened by the political instability that followed the 1974 military coup, that Portugal had to appeal for international aid; in 1979 some considerable amounts were received from the International Monetary Fund. Fortunately, the country could achieve some financial and economic recovery, and political stability was assured by the middle 1980s, anticipating the entrance to the then European Economic Community (EEC) in 1986.

Thus, we may say that the reform started having as first stimulus **changes in the political regime**. In the early days after the revolution, financial problems did not seem to be important. But other stimuli followed. A serious **financial/economic crisis** soon

started, although with no immediate impact on governmental accounting, given the country's economic and political disorder.

This explains why the most “revolutionary” changes in governmental accounting had started in the beginning of the 1990s, with the issuance of the Public Accounting Basis Law (Law 8/90), a new law for the State General Budget Framework (Law 6/91) and the State Financial Management New Regime (Law-decree 155/92).

However, by the beginning of the 1990s, after the 1986 entrance to the EEC and the 1991 subscription to the Maastricht Treaty, Portugal was going through a period of relative economic prosperity. Therefore, we believe that, at this stage, financial crisis was no longer a stimulus. Yet, some fiscal stress continued stimulating governmental accounting changes, inasmuch as there were financial pressures to reduce public debt and keep within certain economic standards, especially in seeking to form part of the Economic and Monetary Union (EMU), so thus trying to reach the convergence criteria. Consequently, we may say that, more recently, **financial pressures** replaced financial/economic crisis in supporting fiscal stress as a stimulus for governmental accounting innovations.

Moreover, those pressures have remained until today and possibly for future stages of the reform (as we will explain in section 1.3) since a certain governmental economic and above all financial discipline is necessary to remain within the EMU convergence process, especially after the 1997 Amsterdam Pact of Stability and Growth.

Additionally, there were two other stimuli, at least as important as financial pressures (if not more important) for the recent governmental accounting innovations in Portugal.

First, **requirements of an overall reform of the whole Public Administration**, embracing both administrative and financial management and accounting issues. In fact, after Portugal joined the EEC, there was great endeavour, as well as some political interest, in catching up with the most developed member-States, showing clear signs of a modern and unprejudiced country, open to new ideas and investments, and demonstrating economic growth and, above all, sound financial situation. These efforts were stressed when there was the need to reach convergence criteria, with the perspective of Portugal agreement to the Euro.

In this context, a general reform of the Public Administration was an imperative, not only towards an administrative modernisation, but also aiming at a new financial organisation and management, in which accounting plays a central role.

In our opinion, this general reform tended to have started with the financial area, since the administrative reform seems to have begun only in the late 1990s, when some laws related to innovations in administrative organisation and procedures were issued (e.g. Law-decree 135/99). Additionally, we are aware that the so-called “Process of Administrative Modernisation” of the Portuguese Public Administration is now starting to be implemented.

Accordingly, from the State Financial Management New Regime in the beginning of the 1990s, conditions were created for a new governmental accounting system that officially started with the CAPA issuance in 1997. This is supposed to adjust governmental accounting to a more modern organisation intended for the Portuguese Public Administration.

Another very important stimulus was a **dominating doctrine of superiority of business accounting**. As a member-State of the EEC, Portugal had to start following business accounting directives. Moreover, it was seeking to follow governmental accounting models adopted in more developed partner-countries.

On the other hand, the New Public Management philosophy, generalised at an international level, led many governments to adopt private management models and practices to a wide range of public services. Also the economic importance of high public debt and public expenses in many developed countries led governments to be concerned with increasing Public Sector efficiency, effectiveness and economy. The use of an accounting system close to the one used in the business sector seems to have been one of the instruments useful to reach that objective, inasmuch as overcame problems of traditional cash-based governmental accounting, namely the control of non-monetary items.

Therefore, once this tendency was also notable in Portugal, the strong influence of commercial accounting has favoured the introduction of reforms, namely accrual-based financial accounting, and the approval of a chart of accounts as well as a model for financial reporting including balance sheet, income statement and other financial statements prepared according to the accounting principles underlying business accounting. Moreover, as has been mentioned, Portugal has also a strong centralisation cultural tradition, which implies a constant look for full harmonisation of practices. This

is evident considering that the 1997 CAPA was clearly inspired in the 1989 Chart of Accounts for Business Accounting. Indeed, there have been efforts to implement a business-type accounting concept in governmental activities, which we believe will continue to exist in future reform stages.

These STIMULI have had an impact mainly on the political reform promoters, affecting politicians' decision for incurring a governmental reform process. However, we also think that, in particular the dominating doctrine might also have influenced the ideas and behaviour of reform drivers, as well as stakeholders' expectations towards the reform outcome.

INSTITUTIONAL ARRANGEMENTS

The legal system may affect the flexibility of the governmental accounting system; the tendency is for less flexible legal systems to be less conducive to reforms or at least slow down the reform process.

In Portugal the **legal system** is very important in guiding administrative actions (roman civil law country). Nevertheless, we believe that it cannot be considered as unfavourable to changes in governmental accounting. This is mainly due to two reasons. First of all, all the reforms have been developed by the Central Government itself, via new and revoked laws. Furthermore, the State General Budget Framework Law is rather flexible, just defining the basic procedures to Public Administration entities' budgets and accounting, and admitting the issuance of other specific laws with particular governmental accounting rules. In turn these laws, although comprehensive, allow and sometimes even demand, for further (legal) instructions.

On the other hand, one may argue that, when further instructions are required or the rules need to be changed, this implies laws to be revoked, which might slightly slow down the reform process. One example of this happened with the postponing of the CALG compulsory application: because CALG implementation was somehow dependent on other procedures to be defined by law, delays on the latter led to delays on the first (Chapter III, section 2.3.3).

In other words, we may say that the Portuguese legal system, although tending to be favourable to governmental accounting innovations, might sometimes be responsible for delays in its implementation, mainly due to all the bureaucratic process underlying issuance of regulations.

As to the **State structure**, Portugal is a unitary State with a unicameral Parliament – the Republic Assembly. The general principles for political power organisation are defined on the PRC (articles 108 to 119); the most important are:

- The political power belongs to the people and is carried out in terms defined by the Constitution (article 108);
- The sovereign bodies are the Republic President, the Republic Assembly, the Government and the Courts (article 110, n.1);
- The sovereign bodies must observe the separation and interdependence set in the Constitution (article 111, n.1).

Accordingly, the division of power in Portugal is rather balanced. Elements of direct democracy, such as direct local, legislative and presidential elections, play an important role in the present Portuguese political system.

However, regarding governmental accounting innovations, we may say that there are some asymmetries in favour of Government, since this is the one leading the whole process. In fact, although the Parliament is responsible for the issuance of basic laws, all the other rules to complement and regulate governmental accounting are Government's responsibility.

On the other hand, in periods when the Government's political party has parliamentary absolute majority, as was the case in Portugal at the beginning of the 1990s, any problems that could occur regarding the passage of laws in the Republic Assembly might have become irrelevant.

The Portuguese **administrative structure** is strongly hierarchical. Each Ministry is divided into State Offices that in turn have several General Departments. Each General Department normally embraces several Divisions, taking into account different competencies and decision responsibilities, and sometimes according to geographical areas as well. The State Offices or, in some cases, the General Departments, are central units that are able to promote the reform in their area.

For example, the Local Administration State Office through the Local Government General Department has conducted the Local Government accounting and financial management reform process. Though regulations have to be issued at an upper level, the proposals come mainly from this bureau.

Moreover, the Public Administration administrative reform have been towards decentralisation, and even de-concentration of some services, remaining the main financial functions concentrated in central units. Once again Local Government is a good example, with the recent reinforcement of competencies (Chapter III, section 1.2),

although the function of management the Local Government finances had remained under the responsibility of Local Government General Department – Local Government Finances Division.

At central level, there is a unit responsible for centralising most governmental (budgetary) accounting issues – the Governmental Accounting General Department, included in the Ministry of Finance.

In this context, the organisational characteristics of the Portuguese Public Administration seem to us to have been favourable to the governmental accounting innovations process, being recently more favourable to Local Government accounting innovations in particular.

Regarding the features of the Portuguese **civil service**, particularly civil servants' and accountants' qualifications, the tendency has been moving towards characteristics more favourable to governmental accounting innovations.

In fact, at the beginning of the reform process, the lack of certain general skills in the accounting field, or lack of knowledge required to implement new procedures, may have hampered attempts to introduce certain innovations in particular towards more informative accounting systems. Many civil servants responsible for the accounting services, because of their background in law, public administration or public finances (degrees in Law have been very typical among treasurers and controllers), were not so familiar with certain accounting practices, in particular those closer to business accounting (e.g. double-entry bookkeeping method and the accrual concept). Before the reform, their main responsibility concerned merely with the budget (legal) execution.

However, particularly after the 1997 CAPA, this scenario changed significantly, with heavy investment recently done by the Portuguese Central Government in programmes for accounting staff training and education. One example of these actions was the creation in 1999 of the Sub-group for Professional Training on the CALG, specifically for Local Government (Chapter III, section 2.3.4).

With respect to (social, political and administrative) **culture** we believe that, in spite of the forty-year dictatorship, there is now in Portugal a climate generally favourable to reforms. In fact, there is a democratic structure, where governments tend to respond to general public needs and demands, following the tendency of most Western developed countries. In the last twenty-five years, the elected governments can somehow be situated in the “central block” (political coalition in the beginning of the eighties, central-right wing from the middle 1980s until the middle 1990s, and central-

left wing since then until the beginning of 2002, when a new central-right wing government was elected), which might indicate a culture that though not collectivist, it is not entirely individualist as well.

On the other hand, we also think there is a certain degree of risk-aversion considering not only that political parties in the government have remained more or less the same, but observing that Portugal has not been marked by very radical changes, apart from the military coup. Even in this case, the process was rather pacific, once the militaries took the power from a Government that was already in decadency.

This risk-aversion might up to a certain point explain why Public Administration reform in general, and governmental accounting reform in particular, has been multi-step. It might also justify why this has been essentially accountabilism-driven, since more individualist and risk-taking cultures seem to favour reforms towards managerialism (Lüder, 1994a).

One other variable that we think is also important in determining the Portuguese governmental accounting reform is the **regional development**.

As Godfrey *et al.* (1995, p.4) explained about the variables included in the societal structural cluster of the Contingency Model,

The regional variable refers to the fact that any development, economic and/or political in one country will ultimately have implications on the other (...) *neighbour* countries [italics provided].

Between Portugal and Spain, although it might not always be true, this was most likely the situation in governmental accounting reforms. In fact, in spite of differences in terms of political system (Portugal is a Republic while Spain is a Monarchy) and in Public Sector administrative organisation (Spain has administrative regions, thus there is a Regional Government in-between Central and Local Government), Portugal has closely followed the Spanish governmental accounting innovations process, which has been therefore very important in moulding the Portuguese reforms.

1.1.2. Behavioural Variables

REFORM DRIVERS

There are some bodies and institutions that have helped to shape the governmental accounting innovations in Portugal, particularly influencing politicians, which are the most important decision-makers in promoting the reform, as we will shortly explain.

Some of those are **government commissions**. It was explained (Chapter III, section 3) that the main innovations in the Portuguese governmental accounting (as the

CAPA, for example, but also all the sub-sectional charts of accounts that have been following) resulted from proposals elaborated by working groups, specifically and temporarily created for this purpose. These proposals were presented and discussed with members of the government particularly responsible for areas of the APS that were about to be affected by the framework to be issued (e.g. Local Administration Secretary of State, for local government accounting system innovations). Only after this process, the innovations were finally accepted and issued as laws of compulsory application. Therefore, it is easy to understand that these commissions have been having a very important role in the Portuguese governmental accounting reform process, being its prime drivers.

However, it seems that in Portugal there is this tradition of creating governmental commissions to study particular issues, not only because they are not easy to be solved, but also because sometimes there is a certain political interest in delaying their solutions. In fact, commissions need time to be created: their members have to be carefully chosen, (many times by personal invitation) and their formal constitution has also to be approved by law. Accordingly, these commissions (working groups) in the case of governmental accounting may have been responsible for some delays in the reform.

Also **professional associations** might have influenced the reform, although in a very weak way. In fact, we may say that the influence of these institutions has been generally rather weak in Portugal. This can be partially explained by the fact that they are very recent, resulting from the democratisation process. Moreover, the legalistic tradition has resulted in accountants being seen as those whose main function is to apply the legal accounting principles and procedures and not to discuss them. On another hand, the existent associations have been including essentially business accounting professionals.

Recently this tendency has been changing, since many governmental accounting professionals have become involved in academic research activities (particularly in polytechnic institutes – the institutions traditionally responsible for teaching accounting in Portugal) and now belong to both professional associations and accounting standard setting bodies.

Accounting **standard setting bodies**, as with professional associations, are relatively recent in Portugal, and do not have an influence in governmental accounting so strong as in other countries (e.g. United Kingdom). A standard setting body for

business accounting has existed in Portugal since the beginning of the 1980s. Since governmental accounting reform aims to bring it closer to business accounting, through the CAPA law-decree a standard setting body for governmental accounting was created as well, very similar to the one that exists for the private sector: the PAASC, depending on the Ministry of Finance (Chapter III, section 3).

Consequently, only from 1998 this body started to have an important interference in the governmental accounting reform process: it produces instructions, which may later become laws, orientating governmental accounting procedures; its intervention is important in conducting the innovations implementation. Up to the moment, its main functions have been orientating the CAPA implementation phase (together with the sub-sectional charts of accounts), as well as the application of the Assessment and Inventory of Public Property.

The recent reform might also have been very weakly influenced by a **scholars network** in governmental accounting. Particularly since the 1997 CAPA, the number of academic researchers in governmental accounting has been increasing: as it has been happening internationally, governmental accounting has become a topic of interest for teaching and researching in Portugal, leading to the creation of new courses, as well as to other initiatives of academic character (e.g. seminars and conferences) related to governmental accounting. Therefore, despite the still very small number of academic researchers, we believe it can be said that a scholars network is starting to exist in Portugal.

Nevertheless, the interference of these scholars in the reform so far has been weak, even though they might have been discussing important issues in governmental accounting, calling the attention of government commissions and standard setting bodies for the need to address certain matters in the proposals and instructions for regulations.

POLITICAL REFORM PROMOTERS

Members of Parliament, and above all **Members of Government**, have been the reform promoters in Portugal, since they are those who have the power to create laws to enforce it.

However, as was mentioned in the previous section, Government has been leading the whole process. The Ministry of Finance in particular, is the key player, shaping the reform under the influence of the reform drivers, mainly working groups (government

commissions) and the PAASC. In fact, although for all Public Administration autonomous sub-sectors, the respective ministries are responsible for the issuance of the particular charts of accounts, the Ministry of Finance is the main regulatory body for the whole governmental accounting system (Chapter III, section 3).

In conclusion, we may say that the Portuguese governmental accounting reform has been mainly promoted by the will of politicians, though this has been affected by both reform drivers and stakeholders.

STAKEHOLDERS

We believe that the Portuguese **Parliament** (Republic Assembly) has been important in the governmental accounting reform process, not only as promoter, but also as a stakeholder. As the latter, its influence has been favourable to innovations, once these are going towards more transparent, embraceable and reliable budgetary, financial and accounting information. In fact, as stakeholder, the Republic Assembly is both a public body as many others using the system, and also the body that every entity belonging to the Public Administration has to be accountable to in the last instance. In both positions, it has an interest in using a more informative accounting system.

Audit institutions (The Court of Accounts – General Audit Office, and the Finances General Inspection) have always played an important role in shaping governmental accounting in Portugal. The main audit institution in Portugal is The Court of Accounts, as the body to which every public organisation has to present its accounts to be audited. It has been very important to the recent governmental accounting innovations process, namely considering the benefits it perceived from a more informative and transparent governmental accounting system. Accordingly, we believe it has interfered in the innovations process mainly as a stakeholder, in spite of some actions that could lead us to include it as a reform driver. Indeed, it has issued some important instructions relating to which documents governmental entities have to present. For example, one of the recent ones (Resolution 4/2001) provides instructions for local governments and similar entities under the CALG to organise their financial reporting to be inspected. However, those instructions are in the light of the CAPA and other sub-sectional charts of accounts, simply supporting its application with respect to documents to be sent for auditing.

Line offices, departments and divisions include people that have been affected by the reform, in particular those that have to deal with accounting functions.

As has been stated, the Portuguese reform represents a radical change in governmental accounting, particularly with the introduction of double-entry accrual-based financial accounting, with principles and procedures that most of the accountants in governmental accounting were not so familiar with. This might have created some resistance to changes, particularly in some of the civil servants that believe the reforms will represent a significant increasing of useless work. In fact, what seems to have been a barrier difficult to overcome within governmental organisations is the problem of implementing a management culture, within a deep rooted juridical-formal culture of budgetary accomplishment.

Nevertheless, so far, apart from the aforementioned problems related to the civil servants' qualifications, governmental accounting innovations apparently are being implemented as it would be expected, obviously helped by the staff training programmes that have been taking place.

The **statistical offices** have had also an important and favourable role in the actual reform. In Portugal the main statistical office is the National Institute of Statistics (*Instituto Nacional de Estatística*), which is responsible for all the national statistics, including those from the APS. Moreover, it is also the institution responsible for preparing the National Accounts.

The features of the former accounting system were creating some problems in calculating the Public Administration values for the National Accounts, since governmental accounting and national accounting were following different criteria and measurement bases. Indeed, after the 1995 European System of Accounts, Portugal as a EU member-State has been compulsorily using an accrual-based system of National Accounts¹³⁶, while the governmental (micro) accounting system (main source of Public Administration accounting information for the National Accounts) was still cash-based. Thus, there was interest in aligning the two systems, in order to improve reliability in the National Accounts. This is very important particularly considering that they are the basis for gauging a country's international performance. This was especially important in a context where Portugal was trying to achieve the convergence criteria for the Euro agreement.

¹³⁶ The 1995 revised European System of (National) Accounts demands for balance sheets showing the sectors net worth and changes in net worth, clearly requiring the use of a full accruals basis. Moreover, double-entry is to be used as the bookkeeping method within each sector (Cordes, 1996).

Regarding the “general public”, traditionally in Portugal, people have not been involved in governmental budgets and accounts: first because they do not care, and second because they do not understand. Subsequently, the “general public” has not interfered in the governmental accounting reform process. Nevertheless, we still believe that a **minority amongst the general public** might have interfered, although with a much weaker influence than any other interventionist in the process.

For example, students unions interested in assessing how the money from tuition fees is about to be or has been used, might have been having some interest in governmental budgets and accounts, particularly those related to the education sector. Also some possibly higher educated citizens, some of whom paying heavy income taxes, might have been interested in governmental budgets and accounts, inasmuch as they might provide some information on the way (their) taxpayers money has been applied affecting the general well-being. This interest might increase in the future, as governmental reporting practices become clearer and understandable even for those that are not accounting experts.

1.1.3. Instrumental Variables

REFORM CONCEPT

The main innovative features in the Portuguese governmental accounting reform might be summarised as follows:

- The Budgetary Accounting – using a modified cash basis and previously a single-entry bookkeeping method – was complemented with Financial Accounting (using an accruals basis and a double-entry bookkeeping method) and Cost Accounting (to which no bookkeeping method is suggested, but cost cards are defined and compulsorily to be used);
- The three aforementioned accounting sub-systems, while independent, are integrated in one unique accounting system;
- Budgetary Accounting is now working differently than before, using a double-entry methodology and being linked to the Financial Accounting through an account designated “Debtors and creditors from the budget execution”;
- The Cost Accounting consideration is the recognition of how important the costs calculation and understanding might be for the public entities’ management and control;
- The main objectives of this new integrated accounting system are now not only related to legality accomplishment and accountability, but also to management, financial control and analysis, and disclosure, inasmuch as a budgetary, financial and management report is to be annually prepared;
- Innovations have been essentially internal oriented, focused on accounting procedures and instruments (with standards prevailing over concepts) rather than in cultural changes.

In brief, these features of the governmental accounting innovations, clearly indicating a new and more informative accounting system, have been very favourable to its acceptance and implementation. It was recognised that the previous system was no longer sufficient given the modernisation of the Portuguese Public Administration. A new governmental accounting framework was fundamental as an instrument to support public entities' management and evaluation.

IMPLEMENTATION STRATEGY

The strategy chosen to implement recent governmental accounting innovations in Portugal has been, in general, favourable to its acceptance and success.

Innovations were intended to be rapidly implemented, so the reform process would be accomplished as soon as possible.

An authoritarian strategy for the “top-down” approach could be thought as more adequate. However, Portuguese reform promoters recognised that would not be the best for implementing a reform which, given its scope and crucial importance, could not bear the risk of being unsuccessful. Instead, a **participative** and **central guided** approach was chosen to be followed.

Accordingly, attendance groups, specialised according to the sub-sectional charts of accounts, have been created at central level to provide technical support, assuring clarifications and answers to questions and problems that have arisen. From these, suggestions have been made for technical notes and possible laws alterations proposals, in accordance with the PAASC orientations. A good example of this is the SATAPOCAL (Portuguese abbreviation), a technical support group especially for Local Government accounting, which we referred to in Chapter III, section 2.3.4.

Furthermore, there has been systematic staff training in order to assure that every problem related to staff qualifications is surpassed.

Moreover, a transition period of two years on average (depending on the sub-sectional specific charts of accounts) has been allowed, during which governmental entities could still use the “old” system, while already learning about and starting to implement the “new” one.

We may also say that the innovations process has been somehow **selective** (Vela Barges, 1996, p.55), inasmuch as for some entities (e.g. parishes and small municipalities) the system has remained pretty much the same, in our opinion because

their small size made governmental accounting innovations costs to exceed the benefits, so the need for a more informative system was not a priority.

The innovations process has also been **multi-step**, as we will explain in section 1.2, reflecting, on the one hand, a certain risk-aversion towards radical changes (as referred to in section 1.1.1 concerning the Portuguese culture), and on the other hand, some prudence in implementing change – assuring enough time for good acceptance and successful results. For example, the sub-sectional charts of accounts that have been issued one at the time after the 1997 CAPA (in 1999 the CALG; in 2000 the Chart of Accounts for Health Sector and the Chart of Accounts for Education Sector; and only in 2002 the Chart of Accounts for Social Security and Solidarity Institutions) have been assuring the appropriate conditions for their implementation within the sub-sector they were aimed at.

According to this approach, we believe that the Portuguese governmental accounting reform process is not yet completed; next steps are going to follow, which we will address in section 1.3.

1.1.4. Particularities in Local Government accounting innovations

As was presented in Chapter III, Local Government accounting reform process in Portugal, at least in the last five years, derived from one that was launched at Central Government level. Subsequently, since they are an extension from those at central level, we may think about these innovations as one stage of a governmental accounting reform process that aims to embrace the entire Public Administration.

However, some Local Government particularities might have affected Local Government accounting innovations in a slightly different way than the innovations at a central level.

For example, according to the discussion in Chapter III, it seems clear that accounting changes were faster at local level. We believe that this is related to the process of Local Government autonomy that followed the 1974 revolution. In fact, local autonomy was one of the main issues in the political regime democratisation. Separated rules for local finances and accounting were needed, considering Local Government new status and organisation. The process began in 1979, as explained, with the issuance of the First Local Finances Law. Several regulations followed this one establishing a

true Local Government accounting system¹³⁷, which was consolidated in 1987 with the Second Local Finances Law.

One of the changes brought in by the 1987 law was the diversification of Local Government revenues, mainly including loans and municipal bonds. In other words, local governments were then given the possibility of issuing debt up to a certain ceiling, in order to cope with serious financial problems that most of them were¹³⁸, and still are, facing. Consequently, for these changes, financial problems seem to have been important.

Until then the Local Government accounting system was developed as independent from Central Government accounting. In fact, all this reform conducted directly by the Local Administration State Office, led to the preparation in 1995 of a rather independent chart of accounts, following the business accounting model. Yet, once by this time the CAPA for the whole Public Administration was already starting to be developed, it was decided to wait and start a more comprehensive reform process pursuing a “top-down” approach. This explains why the CALG was issued only in 1999.

Accordingly, Local Government accounting innovations process has been also multi-step, first totally separated from the reform at central level, but more recently starting a new stage within another reform process for overall governmental accounting, multi-step itself as well.

In summary, we consider that local autonomy, as a consequence of changes in the political regime, was an important stimulus for Local Government accounting innovations. These started earlier than and independently from those at central level. The reform process has been a multi-stage process, in which each stage has started with a new Local Finances Law. For the second stage, financial crisis might have been an important stimulus. For the latter stage, started with the 1998 Third Local Finance Law,

¹³⁷ In fact, before the 1979 Local Finances Law we cannot speak of a Local Government accounting system. Because there was no autonomy, local governments accounts used to follow the rules for the State General Budget Framework, as well as some procedures defined in Administrative Codes of Law.

¹³⁸ As we referred to, by the end of the 1970s, Portuguese Central Government was facing serious financial and economic problems that extended until the middle 1980s. Local Government, although autonomous, was still financially very dependent from the Central one – financial transfers from Central Government were still one of the main Local Government revenues sources. Subsequently, it is understandable that financial problems at central level had led to the same kind of problems at local level as well.

However, since the beginning of the 1990s, that dependence has been reducing: grants from Central Government have been on average around 1/3 of the Local Government total revenues. Nevertheless, there is still a considerable degree of financial dependence especially in small entities for which grants from Central Government are still the main revenue source.

the stimulus seem to have been the need to have an accounting system in harmony with the rest of governmental accounting, also allowing a more efficient, effective and economic Local Government management, i.e. mainly providing more and better information, closer to business accounting. Although this third stage of reform was essentially accountabilism-driven, we may say that managerial concerns were also important, namely via the introduction of Cost Accounting. On the other hand, the new rules for local finances aim at a fair public resources allocation between Central and Local Government, as well as correcting disparities among local governments at the same level.

In spite of what has just been explained, we do not think that this changes anything in the diagram, since the Local Government autonomy, apart from being a consequence of changes in the political regime, might also be considered as part of the requirements for a wider reform of the Public Administration. On the other hand, if this changing process could have been caused by the entrance of Portugal to the EU (then EEC), among other causes, the subscription of the European Charter for Local Autonomy in 1990 is an indication that local autonomy might indeed have been part of a more extensive reform process.

Another Local Government particularity that implies some changes in the FMR Model diagram for Portugal, relates to the **size of jurisdiction** as an element of the Portuguese INSTITUTIONAL ARRANGEMENTS.

In fact, the size of the jurisdiction is another variable that we believe has been important in the governmental accounting reform process in Portugal.

The fact that Portugal is a small country might have been considered an advantage, since accounting innovations have been probably easier and not so costly to implement as in other larger countries. Furthermore, the small size has also contributed to the homogenisation that has been sought for the governmental accounting system at the two levels of government, as well as amongst the whole Public Administration.

Nevertheless, particularly at local level, although there are not a large number of entities (around 300 municipalities and 4,000 parishes), the diversity of sizes varies within a very large range: there are very large and also very small entities.

The small size of many of them has hindered the implementation of some accounting innovations, contributing to what we previously referred to as a “selective” process of innovations. In fact, in many cases, the costs of implementing a more

complex and embraceable system seem to have surpassed the benefits of becoming more informative. Because of the entity's very simple organisational structure and staff low qualification (in many cases the president himself, or a secretary, is directly responsible for the accounting service), as well as considering the limited range of services it provides, a more informative accounting system was not believed to be a main concern.

Due to this implicit possible resistance to the reform, a simplified regime for small municipalities and parishes had to be admitted since the beginning of the CALG in 1999. As it has been implemented, it has been observed that notwithstanding, the simplification is not enough and a "new" even more simplified regime is now being considered.

Consequently, in the Portuguese Local Government, the entities' features, in particular their size determining their internal organisation, have been important in affecting the reform concept (type of innovations in order to change the accounting system to a more informative one). In many cases, due to the small size, the accounting system continues to be as before: cash-based single-entry budgetary accounting, using very simple financial statements and mainly concerned with legality accomplishment and accountability.

Therefore, for Portugal we cannot confirm Lüder's (1994b) hypothesis for the Contingency Model that one accounting system is appropriate for all situations.

1.2. Learning from the Portuguese situation

As we have mentioned, the Portuguese governmental accounting reform has been multi-step. Three main stages can be identified as:

1) Before 1990

As was explained in Chapter III, the origins of the Portuguese governmental accounting go back to the country's foundation in the XII century. However, the most important developments happened after the XV century "Discovers". In particular from the XVIII century, the "General Treasury" was created, a great reform in Public Finances started later from 1832, and the first Portuguese Administrative Code of Law was issued in 1836, setting rules for public finances and budgetary accounting. After this, other codes followed, the most important of which is the 1878 Rodrigues Sampaio's Administrative Code, once it represented some considerable innovations comparatively to the previous ones. Following the Republic implementation in 1910 several laws were issued, even

during the dictatorship period, basically recovering principles and rules from previous Administrative Codes, towards homogeneity.

Accordingly, until 1974, governmental accounting was cash-based single-entry Budgetary Accounting also called “administrative accounting”, mainly because it was based in Administrative Codes of Law. Its main purpose was to serve the government, having as central issues budgetary control and execution, and legal accountability.

The 25th of April 1974 revolution changed the political regime from a dictatorship to a democracy. Great changes were brought into the Portuguese Public Sector, mainly caused by a great number of nationalisations. However, governmental accounting seems to have remained practically the same, except for the increasing of details in financial statements and reports. Yet, important stimuli for the reform were raised during this period.

With respect to Local Government in particular, the same tendency was pursued, although one can speak of a proper Local Government accounting system only after 1974, when Portuguese Local Government’s political, administrative and economical importance started to be recognised. Despite this, its accounting characteristics remained very similar to those at central level.

2) From 1990 to 1997

The 1990s brought in great changes for the Portuguese governmental accounting, with the issuance of the Public Accounting Basis Law in 1990, launching the foundations for the State Financial Management New Regime, which started in 1992. New rules for the State General Budget Framework were meanwhile issued in 1991.

Under the new financial regime, services, bodies and institutions that somehow depend on the Central Administration (from the State Budget) were permitted to follow two different accounting regimes: a) administratively autonomous institutions should follow the general regime, preparing a budgetary and modified cash basis accounting, using a single-entry bookkeeping method; cost accounting should be organised as well; b) financial and administratively autonomous bodies should follow a special regime, preparing not only budgetary accounting, but financial accounting as well, using an accounting system close to the one used in business (accruals basis and double-entry bookkeeping method).

After these instructions several charts of accounts were issued for the main public services sub-sectors (e.g. Health, Social Security, among others) following the business model. In the same trend, within the Local Government, a chart of accounts was also

issued for the so-called “Municipalized Services” (autonomous and business oriented units within municipalities) and federations of municipalities.

Nevertheless, comparisons were difficult to make due to the lack of uniformity. Moreover, it was impossible to obtain consolidated financial information for the whole Public Sector.

3) From 1997

The basic framework that would allow the overall picture for the Public Administration to be obtained was the CAPA, finally issued in 1997. This assumes an historical importance in the recent Portuguese governmental accounting changes. It is compulsorily applicable to all public services, bodies and institutions belonging to the Central, Regional and Local Administration (except for governmental business enterprises) and its contents should be adapted, through legal instructions, to sub-sectional charts of accounts that would become necessary to create.

The CAPA represents a true innovation in Portuguese governmental accounting, including in one accounting system three sub-systems that, although independent, are integrated:

- Budgetary Accounting – modified cash-based and double-entry bookkeeping method;
- Financial Accounting – accrual-based and double-entry bookkeeping method;
- Cost Accounting – compulsory – no bookkeeping method is suggested, but cost cards are pre-set in the regulations.

Within the CAPA context, regarding Local Government, a third Local Finances Law was issued in 1998, creating conditions for the issuance of the first Portuguese CALG in 1999.

The governmental accounting changes in this period have been certainly towards a more informative accounting system, considering that, as was detailed in Chapter III, the main purposes of the CAPA relate to providing more comprehensible and reliable information on the public entities financial situation, as well as to allow obtaining useful information to support decision-making.

This stage is still occurring, mainly because the sub-sectional charts of accounts that follow the 1997 CAPA are now starting to be implemented. Thus, we believe this reform stage will only be completed after a full use of the new instruments. Nevertheless, we also think that soon enough another stage will begin, once Portuguese rulers are aware that the recent innovations, although “revolutionary” comparatively to the previous system, are not enough for a reform that is intended to bring the Portuguese

governmental accounting system close to those internationally more developed. Further discussion on this will be presented in section 1.3.

Figure IV.1 depicts what has been discussed in the previous sections for the most recent governmental accounting innovations in Portugal.

Whether a more informative accounting system is introduced depends on the specific combination of favourable and unfavourable conditions in the model's clusters. However, from what we have just presented, we may conclude in advance that the Portuguese environmental conditions not only have been favourable to change the governmental accounting system, but also tend to favour future steps of the reform.

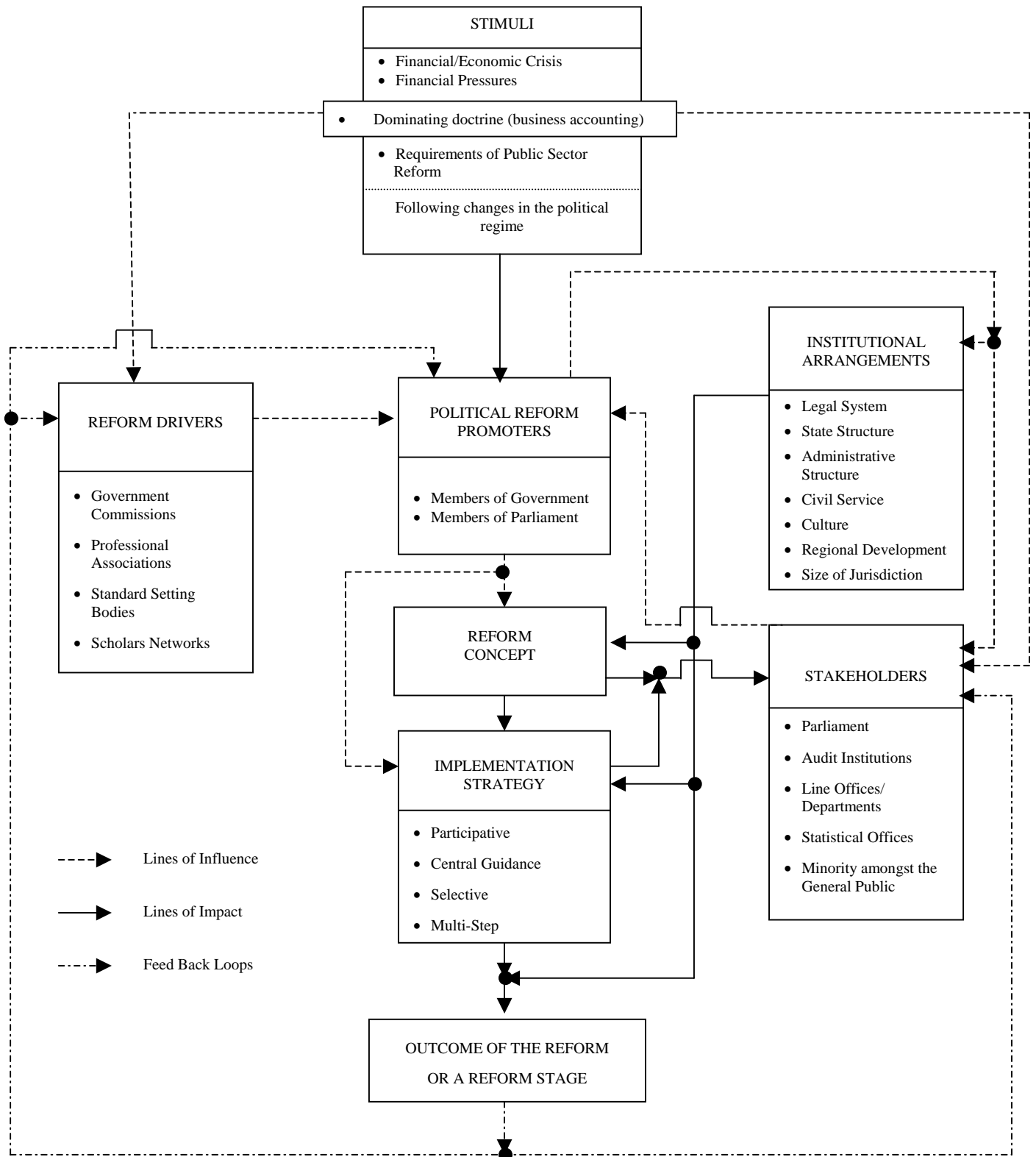


FIGURE IV.1 – FMR MODEL: GOVERNMENTAL ACCOUNTING INNOVATIONS IN PORTUGAL
 (Adapted from Lüder, 2001, p.24)

A few differences exist comparatively to the original model (Chapter II, section 4.2.6). First of all, some clusters' components are not applicable to the Portuguese governmental accounting reform, up to its present stage:

- “Financial scandal” was considered not to have stimulated the reform process – As far as we are aware, no financial scandals happened in Portugal leading to the need of a reform in governmental accounting. Yet, requirements for more transparent, comprehensive and reliable financial information to be disclosed by Public Administration entities seem to have been behind the objective of improvements in governmental external reporting.
- “Consulting firms” were not important as reform drivers – Accounting consulting to Public Administration entities does not have tradition in Portugal. Although the recent reform might come to change this trend for future stages, it seems to us that until now the participation of these firms have been null.
- “Epistemic communities”, defined as “networks of professionals with expertise and competence in governmental accounting and an authoritative claim to policy-relevant knowledge within the area” (Lüder, 2001, p.5), were assumed as non existent in Portugal – In fact, as was stated, up to this stage all the innovations have been promoted by the Government, the Ministry of Finance playing a particular key role. Moreover, there did not seem to have existed any lobbies of influence by other (public or private) institutions. In our opinion, the only reform drivers that were indeed heard in order to lead the Government to issue governmental accounting laws and regulations, were commissions particularly formed to elaborate the proposals for the CAPA and the other sub-sectional charts of accounts, as well as the PAASC as a standard setting body (merely consultative – it has powers only to recommend but not to enforce principles and practices).

“Changes in the political regime” (from dictatorship to democracy) were considered as STIMULI for the reform in first place (section 1.1.1). Additionally, “financial pressures” were considered as replacing “financial/economic crisis” as a more recent factor to continue stimulating governmental accounting changes. Also the components “regional development” and “size of jurisdiction” were added to the INSTITUTIONAL ARRANGEMENTS cluster, as they were considered important interventionists in the process for the reasons discussed in sections 1.1.1 and 1.1.4 respectively.

Moreover, new links were added between the “dominating doctrine” (superiority of business accounting) as a stimulus, the reform drivers' and the stakeholders' clusters. That stimulus was considered as possibly having moulded the ideas and behaviour of reform drivers, as well as stakeholders' expectations towards the reform stage outcome.

“Audit institutions” were better considered as STAKEHOLDERS than REFORM DRIVERS for the Portuguese governmental accounting innovations process, which was also admitted by Lüder (2001, p.13).

Finally, the “general public” as STAKEHOLDER was replaced by a “minority amongst the general public”, since we believe that only a minority of the general public has been weakly interfering in the Portuguese governmental accounting reform process so far.

Despite the modifications, we may conclude that the general ideas underlying the FMR Model can be applied to the Portuguese case.

Additionally, the reform in general seemed to have been essentially accountabilism-driven, with major emphasis on budgetary and financial accounting. The main purpose seems to have been improvements in governmental external budgetary and financial reporting, aiming at more embraceable and reliable budgetary and financial information. However, there was already some concern with developments in managerial (internal) accounting, aiming at a more efficient, effective and economic public management. The introduction of a Cost Accounting in an integrated accounting system together with Budgetary and Financial Accounting is a clear sign for this. In fact, it was the recognition of the importance of understanding the costs structure (for internal activities and investments, and also external services), aiming at better management control and analysis, and eventually calculating performance indicators. Additionally, some entities (e.g. municipalities using the CALG) are required to prepare an annual management report, which includes, among other elements, information on their economic and financial situation, namely using financial ratios and other indicators.

Table IV.1 summarises the interference of the several factors involved in the recent steps of the Portuguese governmental accounting reform process.

Criteria	Conduciveness to Innovation
Stimuli	
• Financial/Economic Crisis	+/=
• Financial Pressures	+
• Dominating Doctrine (business accounting)	+
• Requirements of Public Sector Reform	+
• Changes in the political regime	+/=
Institutional Arrangements	
• Legal System	+ -
• State Structure	+
• Administrative Structure	+
• Civil Service	-/+
• Culture	+ -
• Regional Development	+

• Size of Jurisdiction	+ -
Reform Drivers	
• Government Commissions	+ -
• Professional Associations	=/+
• Standard Setting Bodies	=/+
• Scholars Networks	=/+
Political Reform Promoters	
• Members of Government	+
• Members of Parliament	+
Stakeholders	
• Parliament	+
• Audit Institutions	+
• Line Offices/Departments	+ -
• Statistical Offices	+
• Minority amongst the General Public	=/+
Reform Concept	
• CAPA, and the sectional charts of accounts that followed, as an integrated accounting system including: <ul style="list-style-type: none"> – Budgetary Accounting – modified cash-based and double-entry bookkeeping method – Financial Accounting – accrual-based and double-entry bookkeeping method – Cost Accounting – compulsory – no bookkeeping method is suggested, but cost cards are pre-set in the regulations – Innovations essentially internal oriented and focused on procedures and instruments, with standards prevailing over concepts 	+
Implementation Strategy	
• Participative	+
• Central Guidance	+
• Selective	+ -
• Multi-Step	+ -
OVERALL ASSESSMENT	Favourable

KEY: + Favourable; + - Sometimes unfavourable; -/+ Moving towards favourable; +/- Moving towards not important; =/+ Moving towards important.

TABLE IV.1 – FMR MODEL IN PORTUGAL: INTERFERENCE OF ENVIRONMENTAL CONDITIONS TO GOVERNMENTAL ACCOUNTING INNOVATIONS
(Adapted from Godfrey *et al.*, 1995, p.28)

The information from Table IV.1 together with the discussion in the previous section, allow us to conclude that the overall climate is rather favourable for the recent governmental accounting innovations not only to have started, but also to be pursued successfully. Moreover, the environmental conditions also seem to be favourable for the reform to continue for further stages, which we will refer to next.

1.3. The FMR Model prediction for the future of the Portuguese governmental accounting

In the previous sections we have, in some way, followed Lüder’s (1994b, p.14) suggestions to substantiate or falsify the contingency framework, more specifically the

FMR Model. We have presented the case study of the recent Portuguese governmental accounting change process, basically in the form of *ex-post* analysis. Notwithstanding, from many innovations now being implemented, some conclusions might already be drawn on what might happen in the next stage(s) of the reform.

The consequences of this reform stage will be reflected on reform drivers, political reform promoters and stakeholders, shaping their expectations, ideas and future behaviour. This means that the results of the actual stage of the governmental accounting reform will determine its future tendencies.

From our point of view, we can only do these observations given the possibility presented in the model to predict how the several interventionists in the reform process will interact affecting its direction. Moreover, this ability to predict is improved when the model is made more dynamic, through the “feed back loops”, allowing multi-step reform processes. In other words, though not providing explanations for the “why” governments choose particular reform (stage) contents, we may say that the model not only identifies rather rigorously the main variables that explain how and why countries have carried out governmental accounting changes towards more informative systems, but also helps to predict if the next stage(s) of the reform will be likely to happen, following or not the same trend.

Considering the overall assessment of the conduciveness to the first stage of the Portuguese governmental accounting reform (Table IV.1), the contextual factors possibly involved in the next stage might be represented by using the FMR Model to predict as shown in Figure IV.2.

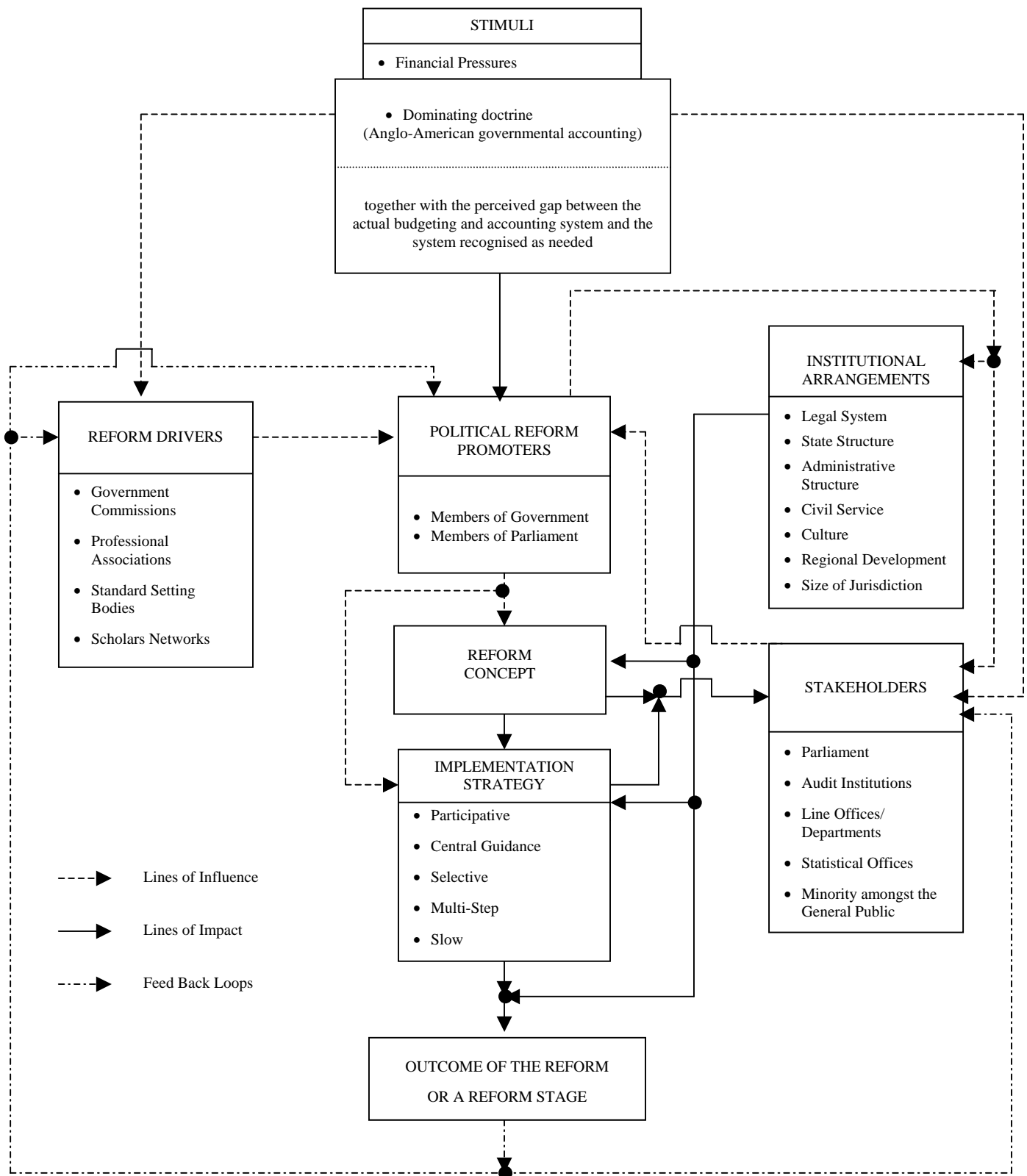


FIGURE IV.2 – FUTURE INNOVATIONS PROCESS OF THE PORTUGUESE GOVERNMENTAL ACCOUNTING
 (Adapted from Lüder, 2001, p.24)

In a general overview, apparently the environmental conditions for the next stage(s) of the reform process are expected to be similar to those affecting the innovations up to the moment (Figure IV.1). However, there are a few main differences that we believe are going to be the distinctive and more important environmental features affecting the future of the Portuguese governmental accounting.

STIMULI

Financial pressures are continuing to be important in positively stimulating future governmental accounting changes, since financial and economic discipline is needed to remain within the EMU convergence criteria. This will be likely to trigger further changes in the budgetary and accounting system, in order to allow better assessment of efficiency and effectiveness in public resources allocation.

However, a more important positive stimulus will be a **dominating doctrine**, not of superiority of business accounting as before, but of **superiority of Anglo-American governmental accounting**, with resource accounting and budgeting, as well as statements of accounting concepts (conceptual framework) underlying governmental accounting standards and practices.

In fact, we believe that this doctrine, **together with the perceived gap between the actual budgeting and accounting system and the system recognised as needed** (Lüder, 1999, p.4), will be not only the main stimuli for the next stage(s) of the reform, but also the most important environmental conditions shaping the ideas of drivers, political promoters and stakeholders of future innovations.

The system recognised as more adequate to reach the information needs will be, in our opinion, which Lüder (1999, p.3) considers a “Performance and Resource Accounting and Budgeting (PRAB) System”, encompassing not only accrual financial accounting, but also providing information

(...) on budgeted amounts of revenues, expenses, and net worth as well as information on planned and actual performance and costs for management purposes. (Lüder, 1999, p.3)

Some problems might yet arise, considering that, although there is already some “cost and performance conscience”, a certain “budgetary cash mentality” still dominates, possibly hindering innovations towards a PRAB system.

REFORM DRIVERS

For the future stage(s) of the reform we believe government commissions will continue to be important, but they are expected to be increasingly informed by a

scholars network in governmental accounting. Consequently, scholars in governmental accounting are expected to become more influential, considering their increasing number. Additionally, their growing role might also be justified by theoretical developments (conceptual framework) expected for the future reform concept.

On the other hand, the influence of **professional associations** (certified accountants and auditors) will be more important than before, inasmuch as the number of professionals in governmental accounting is increasing, with associations given more importance to the subject and governmental entities increasing their needs for certified accounting professionals. A clear indication of this was the creation in September 2002, within the Portuguese Chamber of Certified Accountants (*Câmara dos Técnicos Oficiais de Contas*) of a Permanent Commission for the Implementation of Training and Orientation of Governmental Accounting (*Comissão Permanente para a Implementação da Formação e Orientação da Contabilidade Pública*). In this commission there is also a considerable number of academics.

The role of the auditors, through the Portuguese Order of Certified Auditors (*Ordem dos Revisores Oficiais de Contas*) is in our opinion more as a **standard setting body** than a professional association. More particularly, this entity has been recently responsible for adapting the IPSASs to Portugal, issuing in 2000 the first translation in Portuguese of IPSAS 1 to IPSAS 7. Consequently, we believe it is going to be an important interventionist in driving the reform, specially taking into account aspects concerning international harmonisation of governmental accounting.

Moreover, in view of what is already being considered regarding IPSASs in Portugal, we believe the IFAC-PSC, as a possible **international standard setting body** for governmental accounting, will also influence the future change process of the Portuguese governmental accounting.

Finally, while consolidating its position and increasing experience with the innovations now being implemented, the PAASC will also be important for future reform stages.

However, none of these standard setting bodies will ever pass from REFORM DRIVERS, since in Portugal, as in many other countries, they do not have power to enforce changes, as the Central Government itself will always have “the last word”.

STAKEHOLDERS

We believe that the influence of the **minority amongst the general public** might increase in the future, namely considering the pressures from the media/press in order to expose Government's performance to public discussion. In our understanding, "public opinion" about Government and Public Administration financial behaviour might have some importance in future changes of the Portuguese governmental accounting system, mainly considering the "poor image" the Government in power since April 2002 is offering. Therefore, we believe any possible instrument to improve that image, including governmental accounting (eventually apparent?) changes, might possibly be used, somehow as a political tactic.

IMPLEMENTATION STRATEGY

One distinctive characteristic of future governmental accounting innovations in Portugal is that they will tend to be **slowly implemented**. Two reasons support our expectation:

- The fact of the current stage of the reform is still not completed (the majority of the entities are still in a learning period). Accordingly, although further changes are perceived, most probably they will not happen so soon, since it is imperative not only to conclude implementing current innovations, but also giving time to assess its effects;
- Recent "budgetary cuts", meaning that public resources available for implementing accounting innovations are short. This is creating difficulties to the adoption of current innovations in many entities, and so is expected to hinder future changes, especially those involving large amounts of resources (e.g. resource budgeting).

REFORM CONCEPT

Although implementation results from the current stage of the reform are still difficult to obtain (all the sub-sectional charts of accounts, which embrace the most important sub-sectors of the autonomous Public Administration, are now starting to be implemented), we think it is already possible to provide some enlightenment on the Portuguese governmental accounting future tendencies. Accordingly, we believe that the next stage(s) of the reform will necessarily comprise:

- **Extending the CAPA application to the non-autonomous Public Administration**
 - In order to get information on the whole APS, the new governmental accounting

system must be extended to comprise those public bodies that are only administratively autonomous (Law 8/90), as well as non-autonomous departments and services integrated in the Central Government itself. The more recent State Budget Framework Law (Law 91/2001) seems already to have pointed in this direction.

- **A conceptual framework for the Portuguese governmental accounting** – Defining a statement of accounting concepts we believe is going to be the main concern of the reform promoters in the near future, considering as stated that the principles set in the CAPA (and copied for the CALG and the other sectional charts of accounts) are already understood as not enough. Moreover, as we will refer to in the next section, the strong Spanish inspiration for the Portuguese reform will lead the way towards this direction. On the other hand, the current and future IPSASs framework will most probably mould the Portuguese governmental accounting conceptual framework developments.
- **Further and deeper developments in management accounting** – While up to now, as mentioned, the reform process seem to have been mainly accountabilism-driven, we believe that the approach for future stages will be more managerialism-driven. In fact, the need to have internal accounting information to complete the external reporting tends to be progressively more important, as Public Administration organisations seek for more efficiency, effectiveness and economy in their activities. Different management models require different kinds of accounting information, in order to allow performance evaluation. Cost accounting improvements and performance accounting will have to be carried out.
- Although within a much longer term, we believe that **Portuguese governmental accounting might change the budgetary accounting basis** – In fact, we think that, Budgetary Accounting today using cash basis, might have to come to use accruals basis, as is already happening in some Anglo-American countries (e.g. United Kingdom), inasmuch as objectives to be reached with the assigned resources and a clear definition of responsibilities within the public services (implying responsibility/performance accounting) have been at the centre of the political debate to urgently cut out waste and improve the efficiency of the Portuguese Public Administration. Also budgeting concepts have to be linked with National Accounting already using accruals, since Portugal is compulsorily following the 1995 European System of Accounts.

- For **Local Government accounting** in particular, as it was mentioned in Chapter III, some developments seem to be urgent:
 - Consolidation rules – Allowing an overall picture of the economic-financial position of the reporting entity as a whole. This is an imperative, taking into account that the process of activities’ devolution in Local Government has been considerable, especially since 1998, after the issuance of the law regulating the creation of Municipal Business Companies.
 - Performance reporting – Considering that assessing services’ performance in Local Government is already a political issue, particularly since new competencies were decentralised from the Central Government (Law 159/99), a system of performance reporting, comprising performance (economy, efficiency and effectiveness) indicators, financial and non-financial, budgeted and actual, will most probably be developed soon.
 - “New” simplified regime – Given the characteristics of some municipalities and parishes, particularly their size determining their organisation, it has been observed that the simplified regime admitted in the CALG is not simplified enough. New rules have to be defined. In fact, this is something that is already being considered, although its implementation will not be so soon, given the early stage of the changes still being implemented.
 - CALG revision – Soon enough this will happen as an “almost natural” consequence of a first experience with a new system, which application in practice is raising the need for refinements (e.g. certain issues requiring better definitions, certain accounts revealed never used in practice, ...).

2. A CONTINGENCY/FMR MODEL FOR THE IBERIAN COUNTRIES

As was stated, the changes that have been happening in the Iberian countries governmental accounting, had followed quite similar routes, mainly due not only to the geographical and cultural closeness, but also to similar political history, especially in the last seventy years.

However, the change from a dictatorial political regime to a democratic one in Spain was a process even more pacific than in Portugal, where the power was forcibly taken through a military coup. Although this coup had not created war, it led to a period of some political, administrative and economic instability. Furthermore, while in Portugal the dictatorship period represented decades of impassiveness and economic isolation, Spain continued to develop. Accordingly, when both countries entered a democratic political system (Portugal in 1974 and Spain in 1976), the situation in Spain was much better than in Portugal, which allowed that country to get the right conditions to immediately start a reform of the Public Administration, including governmental accounting and finances.

The recent Spanish governmental accounting evolution may be summarised as follows, clearly distinguishing three periods (Montesinos Julve and Vela BARGUES, 1996, pp.220-223):

1) From the 1812 Constitution until the 1977 General Budgetary Law¹³⁹

This was the so-called “administrative accounting period”. After the separation between Crown’s and State’s accounts, public sector (State) accounting became very important. However, it was basically concerned with legal accountability, simply recording the budget execution in a cash basis, and using a single-entry bookkeeping method.

Aibar GÚZMAN and FERNANDES (1999) refer to the 1911 Public Finance Administration and Accounting Law¹⁴⁰ as one of the most important in this period, since it was the basic regulation for the public entities’ administrative and accounting functioning.

2) From 1977 until 1991

The 1977 General Budgetary Law set the basis for the Spanish governmental accounting reform. In fact, this document recognised the importance of governmental accounting, not only for budgetary purposes, but also as an instrument to support decision making, and financial and management control.

But perhaps the most important assumption of this law is the recognition of the need to develop accounting standards, recognising the “*Intervención General de la Administración del Estado*” (IGAE) as the body with the responsibility in the issuance of accounting regulations. (Montesinos Julve and Vela BARGUES, 1996, p.221)

This recognition was materialised in 1983, when the first Spanish CAPA was definitely approved, becoming in force from January 1st 1984¹⁴¹.

This CAPA defined the basic accounting standards for Central Government, though it was used by other public entities, like the National Health Service and the Social Security. Additionally it was adapted through special legal instructions, to certain public entities in particular, like to Local Government in 1990. Considering that it included a list of accounts to be used and the basic financial statements to be prepared, it was

(...) considered as an important tool for harmonisation of governmental accounting practices between the different levels of government (central, regional and local). (Montesinos Julve and Vela BARGUES, 1996, p.222)

In fact, because accrual basis and double-entry bookkeeping method were used, it became possible for the first time to show the financial and economic consequences of the accounting transactions on each entity’s patrimony.

¹³⁹ Ley General Presupuestaria – 4 de enero de 1977.

¹⁴⁰ Ley de Administración y Contabilidad de La Hacienda Pública – 1 de julio de 1911.

¹⁴¹ Resolución de la IGAE – 11 de noviembre de 1983; Boletín Oficial del Estado de 19 e 20 de enero de 1984.

This system, quite similar to that used in the private business sector, was completed by the preparation of several financial documents, apart from those related to the budget: balance sheet, operating statement, and statement of application of funds.

Consequently, the whole reporting system now allowed determining the public entities' equity and financial positions, complying with the objectives claimed by the 1977 General Budgetary Law for a modern governmental accounting.

3) From 1991

In spite of all the important alterations brought in by the 1983 CAPA, its main concern was to define standards in order to harmonise accounting practices. Still, a conceptual framework for governmental accounting was needed. This was somehow reached between 1991 and 1993, when the IGAE published a set of Statements of Accounting Principles. Since then, other documents have been issued in order to provide guidance to prepare and present public entities' economic and financial information.

Considering this new context, it became necessary to revise the CAPA. Subsequently a new CAPA was issued in 1994¹⁴², which was much more oriented to accounting principles and concepts than to standards.

According to Montesinos Julve and Vela Bargues (1996, p.223),

This chart represented a serious improvement on the accounting information systems developed by governmental entities [italics provided], specially considering the definition of a new set of compulsory external financial reports where the true and fair view concept appears as the overall reporting objective.

As it can be noticed, governmental accounting reforms in Spain have been mainly related to financial and budgetary accounting. Indeed, the efforts concerning the development of management accounting have been rather weak. Nevertheless, during the last period, a project for Central Government level (namely for State autonomous entities) was developed. This project started in 1993 is called *CANOA – Contabilidad Analítica Normalizada para Organismos Autónomos* (Normalised Management Accounting System for Autonomous Organisations) and is supposed to work in coordination with the financial and budgetary systems. CANOA represented the first step towards a deep reform in the governmental management accounting system in Spain (Montesinos Julve and Vela Bargues, 1996, p.232).

In spite of this, it seems that Spanish governmental accounting authorities are more concerned with issues related to the new CAPA application, such as revisions of

¹⁴² Nuevo Plan General de Contabilidad Pública – Orden del Ministerio de Economía Y Hacienda de 6 de mayo de 1994.

the local government instructions, adaptations to Regional Governments accounting systems, and even a new revision of the new CAPA itself.

Portugal, as it was referred in section 1.1.1, passed through a very difficult period of political instability and economic problems after the revolution, which lasted for a few years. We may say that only in the wake of the entrance to the EEC in 1986 the main problems were surpassed.

Consequently, it is understandable that Spain had started the governmental accounting reform process earlier than Portugal. Nevertheless, as Chan *et al.* (1996, p.16) state,

When certain practices are judged to be, in some sense, better, they become candidates for international transfer.

This was, in our opinion, what happened in the process of diffusion the accounting innovations from Spain to Portugal. Furthermore, the fact that many Portuguese scholars started to go to Spain in order to study (business and governmental) accounting (Spanish PhD accounting programmes are still very popular in Portugal) gave great contribution for the learning and understanding of Spanish accounting practices. Accordingly, although we believe that today this process of diffusion of accounting innovations benefits from a bilateral character, the truth is that in most governmental accounting issues Portugal has followed Spain, benefiting from learning from the Spanish mistakes, and thus becoming more advanced in some issues:

- Capital assets, namely infrastructures within public domain assets, are recognised as investments both under construction or completed, and not expensed when completed, as in the Spanish system (Montesinos Julve and Vela BARGUES, 2000, pp.138-139).
- Capital subsidies are deferred (accrual basis) while in Spain they are recognised in a modified cash basis (Montesinos Julve and Vela BARGUES, 2000, p.139).
- The criterion for a simplified regime in Local Government accounting is the annual revenue and not the number of inhabitants as in Spain, which seems to be more adequate to express each entity's economic dimension, presumably affecting the accounting system complexity/cost *versus* its benefits. This might be understandable since the Spanish Local Government accounting system – set by the 1990 *Instrucción de Contabilidad para la Administración Local* – was inspired in the 1983 Spanish CAPA and has not been revised since then. Therefore, it seems to be poorer than the Portuguese CALG.

- No consolidation standards have yet been issued and consolidation is not usually practiced in the Spanish governmental accounting (Montesinos Julve and Vela Bargues, 2000, p.146); in Portugal this still happens for Local Government, but not within the Chart of Accounts for Social Security Institutions, as well as within the Chart of Accounts for the Education Sector, where procedures for consolidated accounts are already set.

Yet, Portugal is still slightly behind Spain in other important aspects, such as a conceptual framework for governmental accounting.

In fact, the CAPA, which has revolutionised the Portuguese governmental accounting situation and created some bases for a conceptual framework, is still not enough. Further developments are needed in order to create a true complete and extensive conceptual framework. We think that Portuguese governmental accounting may benefit from what already exists for business accounting, namely Recommendation (*Directriz Contabilística*) n.18 – Objectives of the Financial Statements and General Accepted Accounting Principles – from the Business Accounting Standardisation Commission. This particularly defines a hierarchy for the use of GAAP (Carvalho *et al.*, 1999, pp.180-200). Nevertheless, some particularities of the governmental context must be considered.

Consequently, since in both countries, governmental accounting reform process has been multi-staged, we still believe that Spain is one stage ahead of Portugal, not only because the 1994 new CAPA took into account the already existent conceptual framework for Spanish governmental accounting, but because a new revision is already being considered to surpass the problems of the current one (becoming similar to the Portuguese case in the issues above listed), and also to attend to IPSASs.

Considering what we have just explained, environmental conditions were favourable to a reform in Spain earlier than in Portugal. However, the recent rapid evolutions in Portugal, as well as the cooperation with Spain in this domain are reasons for us to believe that soon enough we will catch up with our neighbours. Some ideas to support this were discussed in section 1.3.

Because we also think that environmental conditions for governmental accounting reform have been quite similar, we may generalise to both Iberian countries the model adapted and discussed in Figure IV.1 to Portugal, presenting a framework that explains how the environment of the more recent governmental financial management

innovations in these countries had influenced the reform actors' behaviour to conduct governmental accounting towards a more informative system (*ex-post* analysis). This is shown in Figure IV.3.

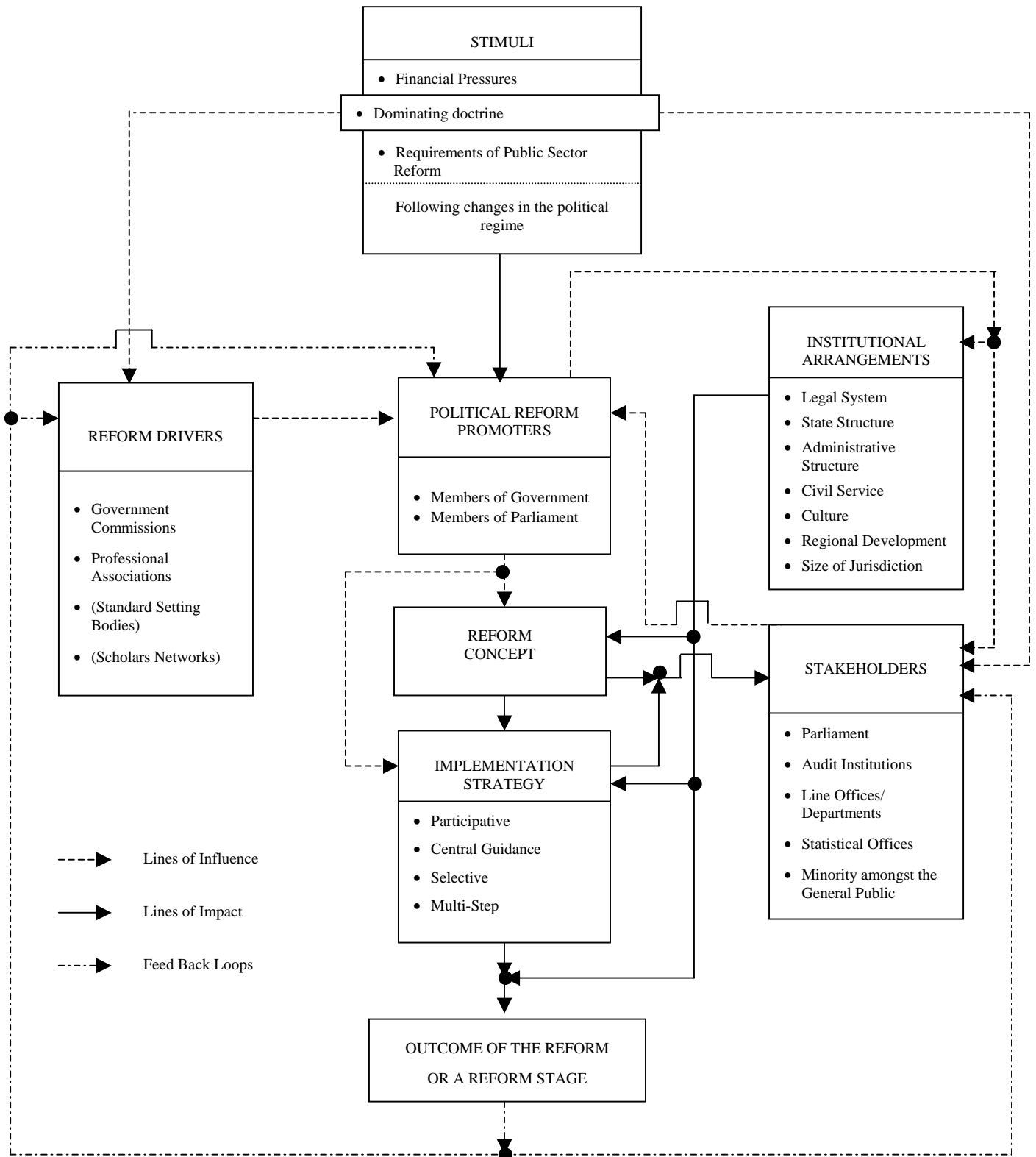


FIGURE IV.3 – A CONTINGENCY/FMR MODEL FOR THE IBERIAN COUNTRIES
(Adapted from Lüder, 2001, p.24)

Some additional explanations are important to understand Figure IV.3:

- In STIMULI, the “financial/economic crisis” disappears because, on one hand, it was not a stimulus for the 1990s more important Portuguese governmental accounting innovations. Also it does not seem to have affected the Spanish governmental accounting changes (Montesinos Julve and Vela BARGUES, 1996, p.233; Lüder, 1994b, p.13). Therefore, while in other countries (e.g. New Zealand and Italy) the financial/economic crisis underlying fiscal stress was the main stimulus for reforms in governmental accounting, this does not seem to have been very important in Portugal and even less in Spain. Yet, “financial pressures” related to the entrance first to the EEC and more recently to the EMU, have been common to both countries.
- In STIMULI the “dominating doctrine” in Portugal was, up to now, the superiority of business accounting, evidenced by the adoption of a chart of accounts (compulsory by law) for governmental accounting very similar to the business chart of accounts, following in turn a French/Continental Europe influence.

Spanish governmental accounting reform though, results from this influence but also from another dominating doctrine: the superiority of Anglo-American governmental accounting (Montesinos Julve and Vela BARGUES, 1996, p.233). This led to the development of a conceptual framework for governmental accounting, through the issuance (from 1991 to 1993) of statements of accounting principles.

But Portugal has closely followed the Spanish governmental accounting reforms, being just one stage behind Spain. On another hand, we think that the need to develop a conceptual framework for the Portuguese governmental accounting¹⁴³ has been felt by governments and supported by some reform drivers. Hence, as emphasised in section 1.3, we believe that the next stage of governmental accounting reform in Portugal will be necessarily affected by the stimulus of the dominating doctrine prevailing in Anglo-American accounting, namely defining a governmental accounting conceptual framework and addressing resource budgeting.

¹⁴³ Considering the existent recommendations for the business accounting, the accounting principles included in the CAPA are not enough for a governmental accounting conceptual framework in Portugal. Indeed, the CAPA and consequently all the sub-sectional charts of accounts that have been followed (CALG included) have the main purpose of emphasising standards, referring to only a few concepts and principles. Indeed, they do not address objectives, users, definitions and qualitative characteristics of governmental accounting information, which are crucial elements of a conceptual framework.

- We believe that the governmental accounting reform process in Spain was also embedded in a comprehensive administrative reform, as in Portugal, that was felt as needed not only in the wake of the 1978 new Spanish Constitution (after a dictatorial political regime), but also as a consequence of the country's entrance to the EEC in 1986 as well. Therefore, we do not agree with Lüder (1994b, p.10) when he states that in Spain there was an isolated reform effort.
- In REFORM DRIVERS the “professional associations” have had a rather weak influence on governmental accounting reforms in both countries.
- As to the “standard setting bodies”, although in both countries the Ministry of Finance is the main regulatory body, in Spain there is an administrative unit within that ministry, with special responsibility for the governmental accounting system and its developments: the IGAE. It is comparable to the Office of the General Controller in the Anglo-Saxon countries (Lüder, 1994b, p.6). Accordingly, the IGAE can be considered a regulatory body that has acted as the starting motor for the Spanish governmental accounting innovations, as it is the unit within the Central Government for that special purpose.

In 1989 a Commission for Accounting Standards was created within this body, whose main function is producing documents concerning government accounting principles and standards, and instructions for accounting procedures. The members of this commission belong to professional associations and most of them are also involved on academic research activities.

In Portugal, as it was explained in section 1.1.2, there is the PAASC, which is a body with authoritative status to give orientation on governmental accounting standards and procedures. Although it might seem similar to the Commission within IGAE, it is not a professional body. It is also very different from and much narrower than IGAE itself. Yet, like the one in Spain, it does not have power to enforce regulations. It is though also dependent from the Ministry of Finance, being essentially a consultative body, as is the one within the IGAE. Its members are in the majority members of Central and Regional Governments, whilst it also includes members from the Business Accounting Standardisation Commission. Its importance for the recent innovations in Portugal has been less than in the Spanish case (explaining why we use the brackets) and can be summarised as supporting the CAPA implementation. Still, we expect a more important role in conducting future reform stages.

- The “scholars networks” are shown in brackets as REFORM DRIVERS, representing an influence that in Portugal has been weak (given the still small number of governmental accounting researchers), although it seems to have had stronger importance in Spain. In our opinion, in this country, there is already a significant network of researchers that sometimes form groups to develop projects somehow linked to the Government. In fact, some of the academic researchers even may hold governmental positions.
- As has been happening in Portugal, also in Spain traditionally the “general public” has not been involved in governmental budgets and accounts. However, we believe that a “minority amongst the general public” has been interfering in the recent governmental accounting reform as STAKEHOLDER, in the same way as that in Portugal.
- Finally, as it has been mentioned in this section, while in both countries the reform process has been multi-staged, Spain is one stage ahead of Portugal, since a conceptual framework is already developed and a uniform management accounting system was already developed at central level (CANOA). In Portugal, despite Cost Accounting is within the CAPA, some flexibility is still allowed in its use.

The main current concern in Spain relates to the adaptation of the actual governmental accounting system to the three levels of government. Accordingly, political actors considered very important for the first stage of the reform in the late 1970s, are not so important in the reform stages since the 1990s (Montesinos Julve and Vela Bargues, 2000, p.137).

From our point of view, reform drivers are the most important interventionists in this stage of governmental accounting in Spain. On the contrary, in Portugal, given the fact of being one step behind, political reform promoters are still the most important.

We believe the differences still existing between the two countries are only due to the fact that Portugal is slightly delayed comparatively to Spain regarding the conceptual framework. However, it seems to us that Portugal is now well placed for moving forward in governmental accounting at a faster pace than Spain. Consequently, soon enough the countries will be level, which means that the aforementioned differences will tend to disappear.

3. FINAL POINTS

The main purpose of this chapter was to apply the FMR Model to explain the recent innovations in Portuguese governmental accounting.

Hence, we discussed which and how contextual, behavioural and instrumental variables have interfered in the recent changing process. Subsequently, a FMR Model for governmental accounting innovations was suggested for the Portuguese case.

Some variables suggested in the original model, such as “financial scandal”, “consulting firms” and “epistemic communities”, were not considered as having influenced the reform process in Portugal, at least up to now.

“Changes in the political regime” was for the first time considered in the contingencial approach as a stimulus for governmental accounting reforms. Both “size of jurisdiction” and “regional development” were added as components of the Portuguese institutional arrangements, as they have had important interference in the current stage of the reform process. Moreover, “dominating doctrine” (superiority of business accounting) was considered not only to have an impact in political reform promoters’ behaviour, but also influencing the reform drivers’ and stakeholders’ behaviour and expectations. The “general public” as stakeholder was replaced by a “minority amongst the general public”.

We concluded that the climate in Portugal is generally favourable not only for this stage of the reform to be pursued successfully, but also encouraging for future and deeper innovations.

Accordingly, since the reform was identified as a multi-staged process, some considerations were made about the likelihood of further reform stages, subsequently using the FMR Model to predict how the environmental conditions expected in Portugal will affect governmental accounting future changes. “Dominating doctrine of superiority of Anglo-American governmental accounting” is expected to be the main positive stimulus for the next reform stage(s), “together with the perceived gap between the actual budgeting and accounting system and the system recognised as needed”, also believed as becoming very important in shaping the ideas of drivers, political promoters and stakeholders of future innovations. “Government commissions” increasingly informed by “scholars networks”, “professional associations” and “standard-setting bodies” are anticipated as having central roles in driving future stage(s) of the reform. The interference of the “minority amongst the general public” might increase. Notwithstanding, it is expected that future innovations will be “slow” to happen.

Some insights were additionally presented regarding possible tendencies of the Portuguese governmental accounting, both for Central and Local Government, in future stages of its reform, the most important being the extension of the CAPA to be applied to the non-autonomous Public Administration, the definition of a conceptual framework, and further developments in management accounting. For Local Government in particular, consolidation rules, performance reporting and a CALG revision are some changes expected soon.

Given the similarities between the reform processes, we finally suggested a FMR Model adaptation to explain governmental accounting innovations recently happening in the Iberian countries, evidencing some slight differences that may exist and that were considered important to emphasise in the diagram. However, as we clarified, these differences are essentially due to the fact that a governmental accounting conceptual framework still does not exist in Portugal. We also believe that in the very near future they will disappear.

CHAPTER V

TOWARDS AN INDUCTIVE THEORY FOR PORTUGUESE LOCAL GOVERNMENT ACCOUNTING

The main purpose of this chapter is to offer an inductive theory of local government accounting in Portugal, in a comparative-international perspective. To reflect a fundamental dichotomy in the accounting literature, between the Continental European and the Anglo-American accounting perspective, we compare Portugal and the United Kingdom.

The remainder of this chapter is subsequently divided in four main sections. The first briefly presents the background for the theory building, i.e., some ideas from important examples of comparative international (business and governmental) accounting research. In the following section we provide an overview of both the Portuguese and the British local government accounting systems through a comprehensive, though summary, comparative description. The third section offers a comparative-international explanation of why Portuguese local government accounting is the way it is. The chapter finishes highlighting some concluding and open issues.

1. BACKGROUND OF THE THEORY BUILDING

The attempts to develop a comparative international theory are not new in accounting. However, in spite of some studies, which have started earlier in business than in governmental accounting¹⁴⁴, it is often stated that there is little theory in accounting, either business or governmental.

For comparative business accounting, while it is undeniable that there is an established and considerable literature, as Giroux *et al.* (2000, p.2) state,

(...) it is tentative, particularly that part which extends from description of differences into classification of them.

In comparative governmental accounting, the Contingency/FMR Model explains why governmental accounting innovations (changes from traditional cash-based budgeting and accounting towards a more informative accruals-based budgeting and

¹⁴⁴ Some good examples in business accounting are referred to in Balaguer Coll *et al.* (2001, p.3): Da Costa *et al.* (1978) and Nair and Frank (1980), both following an inductive approach, in the sense that from their empirical studies an international classification for the business accounting systems is produced. Another good example this time following a deductive approach is Nobes (1983), where an hierarchical international classification for the business accounting systems is proposed at first, being the countries later tested against that classification through scoring on several differentiation factors. A common issue of those approaches is that they had started at least ten years before the study of the Speyer School of Administrative Sciences, which led to the Contingency Model (Lüder, 1989 and 1992).

business-type accounting system) are more likely to have happened/happen in some countries than in others. The problem here is that the model (derived from an inductive approach) addresses the context of governmental accounting systems, not their contents. Moreover, the relationship between environmental factors and the accounting system contents is not elucidated, since the model clearly assumes that the information needed, not the environmental context, determines the appropriate contents for the governmental accounting system (at least for industrialised democratic countries)¹⁴⁵.

One common issue between business and governmental comparative international accounting research is that they have been developed in a context where accounting international harmonisation is sought. Additionally, all seem to accept the environmental characteristics as an important factor somehow determining the accounting technique (contents of the system) diversity. Indeed, despite the Contingency Model assumption, environmental factors are accepted as affecting the possibility and velocity of a governmental accounting reform process, thus it might be possible to explain differences between accounting systems by the different way environmental factors are combined to drive/lead to those innovations.

On the other hand, considering the undeniable trend that has been followed by most countries in reforming governmental accounting, of bringing this closer to business accounting, it could be possible that some arguments which have been presented for international differences in the latter, might also be valid to explain governmental accounting international differences. In fact, this is our assertion for Portuguese local government accounting, where the new Chart of Accounts for Local Government adds to the previous traditional cash-based budgeting, two accounting sub-systems – financial and cost accounting – whose main rules and model for the financial reporting were copied from the Chart of Accounts for Business Accounting (with some adaptations to the local government context).

Subsequently, we believe it is equally important not only obviously to refer to studies in comparative international governmental accounting, but also to some of comparative international business accounting which for us are reference points.

Seminal work in comparative international business accounting was developed by Nobes (1983 and 1998). The importance of his work is justified because he analyses a vast literature on the subject, specifically on reasons for international differences in

¹⁴⁵ See literature review, section 4.2.2.2.

business accounting. Additionally, he addresses a theory for international business accounting. What is also particularly interesting here is that the author radically changes his own ideas presented fifteen years ago.

Nobes (1998) develops a “preliminary parsimonious” model to explain an initially suggested split of business accounting systems in two classes: Class A resembling the Anglo-American, and Class B resembling the Continental European (Nobes, 1998, p.79). The “accounting system” means published financial reporting practices used by an enterprise (thus including not only measurement practices as in his previous study, but disclosure practices as well). A major change from previous studies is that this model, at bottom, classifies systems not countries, therefore allowing a country to exhibit the use of several systems in any year or over time, though having one dominant accounting system. The scheme proposed for classification is acknowledged by Nobes (1998, p.93), as far from being complete,

(...) for it merely seeks to illustrate the type of amendments proposed for future classifiers.

The paper starts referring to reasons previously proposed for international business accounting differences, only with the purpose of selecting those the author argues as determinant for the model suggested. Accordingly, from a list of seventeen factors, only two are kept as important: the **financing system** and the **colonial inheritance** (Table V.1). Explanations for why the other factors may be less useful are then presented in detail (Nobes, 1998, pp.81-88).

<p style="text-align: center;">INITIAL LIST (Nobes, 1998, p.74)</p>	<p style="text-align: center;">RELEVANT FACTORS FOR ACCOUNTING INTERNATIONAL CLASSIFICATION (Nobes, 1998, pp.77-81)</p>
<p>Nature of business ownership and financing system Colonial inheritance Invasions Taxation Inflation Level of education Age and size of accountancy profession Stage of economic development Legal systems Culture History Geography Language Influence of theory Political systems, social climate Religion Accidents</p>	<p style="text-align: center;">Financing system Colonial inheritance</p>

TABLE V.1 – REASONS PROPOSED FOR INTERNATIONAL ACCOUNTING DIFFERENCES IN BUSINESS ACCOUNTING

Two major causal factors in previous literature (including this author himself – Nobes, 1983) that are found non-relevant here for the international twofold-classification of the accounting systems are **taxation** and **legal systems**.

For **taxation**, it has been suggested that Anglo-American accounting systems (Class A) are not dominated by tax rules, while Continental European (Class B) are. Yet, the author now believes that taxation rules (for determining the taxable profit of business) are important in all countries, as long as the taxation of profit is significant.

Furthermore,

(...) the disconnection of tax from accounting in Class A systems may be seen as a *result* of the existence of a competing purpose for accounting rather than the major cause of international accounting differences. (Nobes, 1998, p.82)

In fact, if there is no major competing purpose for accounting for which tax rules are unsuitable – such as supplying financial reports to equity-outsider markets – tax rules made by governments will dominate accounting, and tax and accounting practices will tend to be the same.

It is therefore argued that in Class A accounting systems, the competing purpose is the accounting information requirements of strong capital markets. In contrast, within financing systems that are credit-based (weak or non-existent capital markets), where Class B accounting systems prevail, there is no such information requirements from outsiders; financial reporting aims at calculating the legally distributable profit

(protecting the creditors) as well as the taxable profit. These functions are not competing as they both benefit from precise rules for taxation purposes.

Consequently, taxation (more specifically the importance of tax rules for accounting) is not needed to explain the twofold-classification. However, Nobes (1998, p.82) acknowledges that it might be important to explain differences at a more detailed level within each class, especially in Class B where taxation and accounting tend to be closely linked.

As to the **legal systems**, Nobes (1998, p.84) starts agreeing with other authors that it is possible to split countries neatly into codified legal systems and common law systems, which is of great relevance to the regulatory system of accounting. Yet, he also refers to other studies that found a high degree of correlation between equity-outsider systems and common law countries, and between credit-insider systems and codified law.

On the whole (...), the same groupings would result from using a legal system variable rather than from using a financing system variable (...).

Hence, it seems that, as with taxation, there is a possibility of double counting for the legal systems as an explanatory factor for international accounting differences, as it also is captured by the financing systems. In the particular case of culturally dominated countries, because both the legal and the accounting systems are likely to have been imported from the same place, it is not surprising to find a strong correlation between these two variables. Notwithstanding, Nobes (1998, p.84) argues that both factors are dominated by the colonial influence factor.

Despite the aforesaid arguments, the author recognises the usefulness for his model of specifying the legal variable, addressing in particular the regulatory system for accounting rather than the more general legal system. Accordingly, the legal system is narrowed down to mean just a dichotomy of sources of the most detailed accounting regulations: (1) rules made by professional accountants, company directors, independent bodies, stock exchanges and market regulators, *versus* (2) rules made by tax authorities, government ministries (others than those concerned primarily with listed companies) and legal bureaucrats.

Once again he argues that this version of the legal variable that could be relevant for the accounting systems dual-classification is dependent on the financing variable:

In strong equity-outsider systems, commercial pressure gives the strongest power over financial reporting to group (1) because, since the financial reporting for the equity/outside uses separate rules from tax rules, there is no need for group (2) to control them. (...) Financial institutions and large companies are sufficient powerful to persuade

group (2) to allow financial reporting to respond their commercial needs (*e.g. allowing segmental reporting and interim reporting*). In common law countries, the importance of group (1) creates no problems of jurisprudence because non-governmental regulation is commonplace. [italics provided] (Nobes, 1998, p.85)

The one acknowledged problem with this line of argument is the exception of The Netherlands as a codified law country with a strong equity market, in which the accounting regulatory system gives prominence to group (1).

As to the other factors, Nobes (1998, p.88) recognises that they may be contributory causes to, or may be associated with, accounting differences. Nevertheless, they can be eliminated as a major reason for differences at the first twofold-split of the accounting systems, while they might be useful to lower levels of classification, i.e. explaining small/more detailed differences.

For example, for the level of education, Nobes (1998, p.83) highlights the difficulties for this to explain the major accounting international differences, since there are countries with totally different levels of education using similar Class A accounting systems. Instead, he argues for a connection with the colonial inheritance and relates the country's level of education with its level of economic development. Additionally, he admits that the levels of professional accounting education might be relevant, especially in developing countries. However, he finally argues that

To the extent that this is not another issue related to developed versus developing countries, differences in professional education might be covered by (...) age and size of the accountancy profession and may be a *result* of accounting differences rather than their cause (Nobes, 1998, p.83).

The level of economic development is also argued as non-important for the split, since it is suggested that not all countries create their own accounting system: developing countries are likely to be using an "imported" accounting system.

Some factors are argued as too broad to explain the classification (e.g. history and geography); others are considered as more relevant only outside the developed world (e.g. political systems, religion, stage of economic development). Language is argued as a factor that involves covariation with the dual-split rather than causation:

For example, the fact that many English-speaking countries have similar accounting practices is probably not caused by their shared language (...): the language was inherited with the accounting or with other factors which affect accounting. Language similarities may contribute to the strength of cultural dominance, and language differences may slow down the transfer of accounting technology. (Nobes, 1998, p.87)

Subsequently, Nobes' (1998) two-way international classification of the business accounting published financial reporting practices uses two variables: the strengths of equity markets and the degree of cultural dominance.

As the author himself clearly states, the initial proposition for the general model

(...) is that the major reason for international differences in financial reporting is different purposes for that reporting. (Nobes, 1998, p.77)

Moreover, he relies on other studies suggesting that, at a country level, the financing system is relevant in determining the purposes of financial reporting. Accordingly, at first he distinguishes four categories of companies financing systems: insiders-dominant/strong-credit (category I), outsiders-dominant/strong-credit (category II), insiders-dominant/strong-equity (category III), and outsiders-dominant/strong-equity (category IV).

The outsiders v. insiders split leads to different amounts of accounting information required in the published financial reporting (thus relates to disclosure issues): more information where outsiders are dominant. In turn, the equity v. credit split leads to different kinds of objectives for financial reporting, meaning different types of information (therefore more related to measurement issues) (Nobes, 1998, p.80).

“Outsiders” are not members of the board of directors and do not have a privileged relationship with the company (e.g. private individual shareholders); “insiders” are entities (such as governments, banks, families and other companies) that are likely to have close long-term relationships with their investees (Nobes, 1998, pp.77-78).

For companies’ long-term external finance, securities are the main source in a capital market-based system; credit (usually granted by banks) is the most important source in credit-based systems, where the capital market is smaller/weaker.

Accordingly, the author comes out to suggest that the different purposes of the financial reporting are essentially based on a dichotomy of the financing systems:

(...) the key issue for financial reporting is the existence or otherwise of such Category IV financing (*important equity markets with large numbers of outsider equity holders*). [italics provided] (Nobes, 1998, p.78)

The hypotheses predicting a correlation between the style of corporate financing and the type of the financial reporting system are summarised as follows:

(...) the rule-makers for, and the preparers of, financial reports in equity-outsider (...) countries are largely concerned with the outside users.

(...) By contrast, credit-based countries (...) will be more concerned with the protection of creditors and therefore with the prudent calculation of distributable profit. Their financiers (insiders) will not need externally audited, published reports. This difference of purpose will lead to differences in accounting practices. (Nobes, 1998, p.78)

Additionally,

Strong equity-outsider markets (...) lead to Class A systems; otherwise Class B systems prevail. (Nobes, 1998, p.80)

It is also acknowledged that the financial systems dichotomy is indirectly caused by differences in culture (including institutional structures), inasmuch as this affects the capital markets:

This article assumes that some cultures lead to strong-equity markets, and others do not. However, this is an issue for economists and others and is not examined in detail here. (Nobes, 1998, p.88)

The cultural issue (which might be seen as an overwhelming factor for some countries – Nobes, 1998, p.86) is related to the other single factor considered important in explaining business accounting international differences: the colonial inheritance. Indeed, Nobes (1998, p.81) recognises that some countries, due to their small size, underdeveloped state or former colonial status, can be affected by very strong external cultural influences. Therefore, they are culturally dominated countries likely to be using an accounting system based on that of the influential country (country culturally self-sufficient). About colonial inheritance, the author presents the following arguments:

- It is probably the major explanatory factor for the general system of financial reporting in many countries outside Europe;
- It extends to legal systems and to other background and cultural factors, not just to direct imports of accounting;
- It has as allied the effects of substantial investment from another country, which may lead to accountants and accounting migrating together with the capital;
- It somehow includes the factor “invasions”.

Consequently, the final model admits that “cultural differences” cause “differences in the financing systems”, which cause “differences in the financial reporting”. It is represented as follows (Nobes, 1998, p.88):

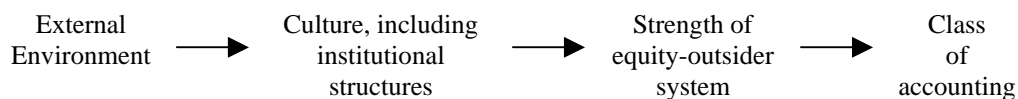


FIGURE V.1 – NOBES’ SIMPLIFIED MODEL OF REASONS FOR INTERNATIONAL ACCOUNTING DIFFERENCES

Therefore, the model relates five variables (Nobes, 1998, pp.88-89):

1. The type of country culture (e.g. individualism/collectivism; risk taking/risk aversion; masculinity/femininity; etc.)
2. The strength of the equity-outsider financing system – strong v. weak equity-outsider markets;

3. The type of company – insider companies (controlled by a small number of owners) v. outsider companies (control is widely spread amongst a large number of outsider equity-holders);
4. The country degree of cultural self-sufficiency – countries culturally self-sufficient (CS) with strong indigenous cultures v. countries culturally dominated (CD) with imported cultures;
5. The type of financial reporting system – Class A v. Class B.

The relationship between these variables is then expressed through five propositions (Nobes, 1998, p.89):

- P1: The dominant accounting system in a CS country with a strong equity-outsider system is Class A;
- P2: The dominant accounting system in a CS country with a weak (or no) equity-outsider system is Class B;
- P3: A CD country has an accounting system imported from its dominating country, regardless the strength of the CD country's equity-outsider system (e.g. New Zealand and Malawi, both former British colonies. Both have now Class A accounting systems. Nevertheless, the former developed a strong capital market, thus implementing a strong equity-outsider accounting system. The latter did not develop any capital market, being Class A accounting adopted by the profession a mere colonial inheritance from the United Kingdom);
- P4: As a country establishes a strong equity-outsider market, its accounting system moves from Class B to Class A (e.g. China);
- P5: Outsider companies in countries with weak equity-outsider markets will move to Class A accounting (e.g. some multinational listed companies in Germany).

One relevant fact of this study is that, as shown below, some factors that Nobes (1998, pp.81-88) argues as unimportant in determining international differences in business accounting have been used to explain international differences in (local) governmental accounting, namely sustaining the dichotomy Anglo-Saxon v. Continental European accounting systems. Table V.2 provides an overview of both lists. Although an item-to-item comparison is not deliberately made, the factors suggested for governmental accounting can find some correspondence with those for business accounting.

BUSINESS ACCOUNTING	LOCAL GOVERNMENT ACCOUNTING (Brusca Alijarde and Condor, 2002, pp.146-151; Brusca Alijarde and Benito López, 2002, pp.176-181)
<ol style="list-style-type: none"> 1. Nature of business ownership and financing system 2. Colonial inheritance 3. Invasions 4. Taxation 5. Inflation 6. Level of education 7. Age and size of accountancy profession 8. Stage of economic development 9. Legal systems 10. Culture 11. History 12. Geography 13. Language 14. Influence of theory 15. Political systems, social climate 16. Religion 17. Accidents 	<ol style="list-style-type: none"> 1. Legal/juridical system 2. Organisation of the public sector 3. Specific objectives of governmental financial (including budgetary) reporting 4. Principal users of the financial reporting 5. (External) Financial resources suppliers 6. Impulse of governmental accounting regulatory bodies 7. Interest and formation of professionals 8. Political and administrative environment in which each system operates (Contingency/FMR Model)

TABLE V.2 – REASONS PROPOSED FOR INTERNATIONAL ACCOUNTING DIFFERENCES: BUSINESS V. LOCAL GOVERNMENT ACCOUNTING

If the recent international trend is for governmental accounting to become closer to business accounting, this begs the question of the relevance of these factors for governmental accounting international differences as well, particularising local government accounting. Accordingly, arguments in the line of Nobes’ (1998) could be presented for some of them.

The authors mentioned in Table V.2 for local government accounting acknowledge an international difference between countries that **LEGAL SYSTEMS** (Factor 1) are based on Common Law and those based on codified Roman Law.

Moreover, they identify common law countries basically as Anglo-Saxon countries,

(...) where legal dictates are fewer and of a general character. In the accounting field there is an emphasis on the informative aspects of the annual accounts, with priority being given to the content more than the form. (...) although public sector accounting is subject to the corresponding legislation, it is easy to feel the strong influence of the accounting profession. (Brusca Alijarde and Condor, 2002, p.146)

On the other hand, codified Roman law systems are identified fundamentally with Continental European countries, where legal pronouncements are widespread and detailed. Regarding accounting,

(...) the norm has a legal character and is contained in charts of accounts, there is a more detailed description of the content of the accounting information, with the object of ensuring compliance with the principles established by the legal framework. The public accounting system has a more macroeconomic orientation, in the sense that the standards

are produced by official organisms with legislative capacity. (Brusca Alijarde and Condor, 2002, p.146)

Furthermore, governmental accounting reforms in these countries are recognised as having been imposed by law, generally affecting all entities. Also in the Continental European context, governmental accounting is influenced by legislation that regulates the budget execution, as well as the management of public funds, since traditionally it has been linked to legal compliance. Indeed, they add:

In Continental European countries the legal system has traditionally favoured the importance of the budget and the legal control in local government accounting. (Brusca Alijarde and Condor, 2002, p.147)

Subsequently, Brusca Alijarde and Condor (2002, p.147) conclude for the differences between legal systems as a possible explanation for the two-way split Anglo-Saxon v. Continental European also in local government accounting.

Although the authors initially mention the legal system in general, they address in particular the regulatory system of local government accounting, ultimately referring to the influence of the profession in the local government accounting policy-making. Therefore, as Nobes (1998) did, they too narrow down the legal system to a dichotomy between local government accounting systems predominant in Anglo-Saxon countries where professional bodies have an important role as policy-makers, and those dominant in Continental European countries where accounting policies are promulgated by official (governmental) bodies, the profession being much more passive.

In fact, it is important to bear in mind that rules from professionals might be just recommendations (as they are, for example, in the United Kingdom) which might not be accomplished, while those from official bodies are in fact legally compulsory requirements.

Consequently, it might be argued that the legal system as a major cause of international differences in local government accounting can in fact be reduced to the local government accounting regulatory system.

As to the relationship between the legal system and the importance of the budget and legal control, the authors seem to believe that Continental European/Roman Law countries tend to favour that importance. Indeed, they argue that within this context the influence of budgeting concepts and laws on the accounting and reporting system is very important, while in Anglo-Saxon/Common Law countries there is a tendency to separate the budgetary and financial information (Brusca Alijarde and Condor, 2002, p.140).

Furthermore, they state:

(...) we can indicate that one of the fundamental differences between local government accounting systems is in the treatment of budgetary reporting. Although compliance with the budgetary regimen is a coincident aspect of all public administrations, it has not always conditioned the development of the accounting system in the same manner. (Brusca Alijarde and Condor, 2002, p.139)

Nevertheless, they also acknowledge:

The key is whether to consider budgetary control as one of the objectives of public accounting information, including the budgetary statements within the reporting model, or whether, on the other hand, that public accounting information should deal mainly with financial information, leaving the budgetary information for budgetary regulation, without them being necessarily connected. (Brusca Alijarde and Condor, 2002, p.139)

Therefore, it might be argued that the importance of the budget and legal control (that seems to be a major distinctive feature between local government accounting systems) is more related to different objectives/purposes of the financial and budgetary reporting than with different legal systems.

Two other factors also pointed out by Brusca Alijarde and Condor (2002, pp.149-150) as possible causes for major international differences in local government accounting systems could be argued as embraced by the local government accounting regulatory system: **THE IMPULSE OF GOVERNMENTAL ACCOUNTING REGULATORY BODIES** (Factor 6) and **THE INTEREST AND FORMATION OF PROFESSIONALS** (Factor 7).

As to the former, the authors explain that the different strength of policy-making bodies in the local government accounting reform process has led to different levels of development, the systems being more developed in the Anglo-Saxon context given the strong impulse of regulatory (professional) bodies to introduce innovations, namely taking the business accounting model as a benchmark. By contrast, in most Continental European countries, the regulatory bodies have not been very important in the accounting reform, thus seeming to have led the local government accounting system to a lower level of development.

Some counter-arguments might be presented here:

- Notwithstanding some exceptions (e.g. Germany national government) it seems clear that there is a context amongst industrialised countries generally favourable to governmental accounting reforms, which has led countries to recently engage in reform processes;
- The general trend, regardless of whether the countries belong to the Anglo-Saxon or Continental European environment, is for governmental accounting to take the business accounting model as a reference;

- Regardless of whether the regulatory bodies are professional (as in the Anglo-Saxon countries) or governmental official bodies (as in the majority of Continental European countries), considering the endeavours for reforms in the great majority of the developed countries, the impulse of governmental accounting regulatory bodies for the development of accounting would probably be the same, as providers of rules and policies to guide the budgeting and accounting system functioning; thus of no importance to explain major international differences;
- A different issue concerns the role of professionals v. official bodies for local government accounting policy-making process as possible cause for international differences, but this is comprised in the regulatory system of local government accounting discussed above.

Concerning the interest and formation of the professionals, Brusca Alijarde and Condor (2002, pp.149-150) take as reference other studies developed for business accounting where the level of development of the accounting profession was argued as a possible factor responsible for the international accounting diversity:

The nature and extent of the accounting profession would have an effect in the case of the public sector, along with the experience of professional associations or the audit function. The business formation of professionals and auditors in the public sector could be a factor in approximating the public accounting system to business accounting, both in Anglo-Saxon and Continental European countries. (Brusca Alijarde and Condor, 2002, p.150)

They argue that in Anglo-Saxon countries, accountants have been taking great interest in local government accounting, most of them having studied business accounting, and professional associations combine accountants working both in governmental and business accounting; in Continental European countries the situation has been considerable different. In the latter, professionals have been traditionally trained in the public sector, with a legal rather than accounting background, given predominance to budgeting and with little interest in accounting. Only recently have business accounting professionals been incorporated in local government accounting positions. Moreover, there are no professional associations that combine accountants from public and private sectors.

According to the authors, these differences had favoured that innovations in local government accounting systems, namely those resulting from the influence of business accounting, although can be found in countries belonging to both spheres, had been carried out earlier in Anglo-Saxon than in Continental European countries.

Subsequently they conclude for a considerable influence of the accounting profession in Anglo-Saxon countries, in face of a more passive role in most Continental European countries.

Some points must be highlighted concerning their arguments:

- Nobes (1998, p.83) argued that the level of development of the accounting profession seems to be more a result than a cause for international accounting differences;
- Even if this factor could be accepted as cause, it seems that the arguments presented converge to those offered for the impulse of public accounting regulatory bodies. In fact, Brusca Alijarde and Benito López (2002, p.180) acknowledge that this might include the interest and the development of the professionals. Therefore, according to our previous arguments, the development of the accounting profession would be relevant in explaining the international dual-classification to the extent that professionals are important as accounting policy-makers, thus once again being embraced by the local government accounting regulatory system;
- Brusca Alijarde and Condor (2002, p.150) use the case of the United Kingdom as the outstanding example amongst the Anglo-Saxon countries where there is a strong influence of the accounting profession with business accounting formation at local level, favouring the introduction of innovations. As Jones (p.11, in Lüder and Jones, forthcoming in 2003) argues, the active role of professionals in the UK local government accounting policy-making in the last decades is due to the fact that national government has eschewed deeper intervention, the law providing a definitive but just skeletal framework. This has to be supplemented by professional recommendations (not requirements). On the other hand, since the birth of the accounting profession in the United Kingdom during the late nineteenth century, a specific accounting body for local government was created, given the legal requirement for the major local governments to appoint a treasurer/chief financial officer. According to Jones (p.12, in Lüder and Jones, forthcoming in 2003), the local chief financial officers, as apolitical and implementers of the law, though learning their techniques from officials of the national government and from auditors, also learned from each other, having the need to formalise a professional association (accounting body), which from the middle 1970s became the Chartered Institute of Public Finance and Accountancy. Therefore, it seems that recently the predominant role of the professionals here, at least as policy-makers, was almost

driven by other circumstances, notwithstanding the power that local chief financial officers might always have had. And even this power seems to have been indirectly provided by legal requirements.

As presented above, Nobes (1998, p.85) argues that the regulatory system for business accounting is in turn dependent on the financing system. The same argument might be presented for local government accounting, in spite of the obvious irrelevance in here of income tax rules. Although we will come back to this later, it may be acknowledged now that local governments both from Anglo-Saxon and Continental European countries are able to borrow when needing external financial resources, the capital markets being more important in the first group, while in the second credit provided generally by banks prevails. On the other hand, for the Anglo-Saxon context generally characterised as having strong equity-outsider financial systems, it might be argued that credit rating agencies as well as accounting professional bodies have power to persuade official accounting policy-makers to allow the use of their accounting rules and procedures (recommendations), because these can affect the rating and the interest. This power might be even stronger, considering that there is no relevance of taxation rules for local government accounting; notwithstanding legal requirements, accounting rules will prevail. In turn, for Continental European countries where the predominant financing system is credit-based, the purpose of accounting rules in local governments will tend to protect the creditors, benefiting from rules detailed by legal pronouncements.

Another factor presented as possible cause for local government accounting international major differences is **THE ORGANISATION OF THE PUBLIC SECTOR** (Factor 2).

Brusca Alijarde and Condor (2002, p.147) argue that the way in which the public sector is organised can also influence the local government accounting system, thus explaining international differences. They refer in particular to the extent to which the public sector is involved in the economic activity of the country, the different levels of public administration (national, regional and local) and respective importance, the decentralisation process, and the privatisation of the management of public services, as examples of possible aspects that have oriented the development of each country local government accounting system towards a certain direction.

They continue saying that, regarding these matters, there are more commonalities amongst Continental European countries than between these and Anglo-Saxon countries, inasmuch as only recently local governments within the former have been affected by pressures to reduce public debt, especially within the convergence process of the Economic and Monetary Union. Some Anglo-Saxon countries (e.g. New Zealand) however had experienced financial difficulties earlier, which led to local government accounting reform processes to have happened earlier as well. Additionally, the authors state that in recent years local governments in Continental European countries have been characterised by strong financial autonomy (presumably admitting that this has not been happening in the other sphere).

Also the decentralisation process of the public sector towards local government in some countries is acknowledged as favouring the introduction of accounting reforms in local government in a more urgent way than in others where the decentralisation process has not been so notable.

The control of central government over local government is highlighted as a prevailing feature of Continental European countries, which has even led to central government itself controlling the governmental accounting standardisation (policy-making) process. In some cases, the central government accounting system has been implemented in local government, the reform following a top-down approach.

Another issue raised by the authors relates to the recent trend within local government to decentralise/devolve the management and provision of public services through the creation of different dependent entities, aiming at better management of resources.

This has shown the necessity of unifying accounting systems adopting solutions from the business sector. So, the increase in the diversity of the local sector is one of the factors that can affect the accounting system, which first was noted in Anglo-Saxon countries and later in Continental European countries. (Brusca Alijarde and Condor, 2002, pp.147-148)

Brusca Alijarde and Benito López (2002, pp.177-178) additionally recognise that the organisation of the public sector is not only *per se* a factor creating accounting international diversity, but also can cause governmental accounting diversity at a national level, amongst different types of public entities. Hence, they argue for a need for standardising the information to be presented by the different entities comprised within the public sector, once the environmental circumstances tend to be similar, except for entities of business character. Yet, they admit that each type of entity might

require, as for different activities in companies, certain adaptations without compromising uniformity.

These authors also address other issue related to the public sector structure that they consider as possible of affecting the (local) governmental accounting system: the size of the country. In the line with some arguments presented by other authors, Brusca Alijarde and Benito López (2002, p.178) agree that the country size determines the quantity and quality of the information provided by the Central Administration: larger countries seem to be logically more concerned with publishing accounting information to control public funds than providing information relevant for decision-making; also they have a slower adaptation to a new orientation for governmental accounting.

It might be argued that most of the issues raised here can be somehow included in the environmental variables comprised within the Contingency/FMR Model (Factor 8). For example:

- The financial problems happening in some countries and triggering governmental accounting changes earlier than in others are stimuli, as can be the decentralisation process, which might also be included in the requirements of a more embraceable public sector reform;
- The control of central government, more specifically its control over local government accounting policy-making and reform might be, on one hand comprised in the State structure (thus being an institutional arrangement); on the other hand, it might relate with the local government accounting reform promoters, as well as with the reform approach (implementation strategy);
- As to the arguments presented for the size of the country conditioning the quantity and quality of the information conveyed by governmental accounts, first of all, the country's dimension might be an institutional arrangement also embraced by the Contingency/FMR Model; on the other hand, the quantity and quality of the information published in governmental financial (and budgeting) reports, is more related to the purposes sought for these documents, as well as their users, thus included in the other factors eventually causing international differences in governmental accounting, which are about to be discussed;
- Therefore, the organisation of the public sector does not seem to be relevant to explain local government accounting systems international differences.

Moreover, it might also be argued that **THE ENVIRONMENTAL FEATURES COMPRISED WITHIN THE CONTINGENCY/FMR MODEL** (Factor 8) do not seem to be relevant in explaining major international differences in local government accounting systems.

Once the model accepts environmental factors as affecting the likelihood and velocity of a governmental accounting reform process, it might be possible to explain differences between the accounting systems by different combinations of those factors in leading to accounting innovations. Yet, as Brusca Alijarde and Condor (2002, p.151) conclude,

This allows us to establish a classification between favourable and unfavourable politico-administrative environments, be it through the influence of social, political or administrative variables (...).

Indeed, this is in fact all that the model seems to offer regarding the relationship between contextual factors and the governmental accounting system. Therefore, environmental features comprised within the Contingency Model do not affect the local government system contents, which according to the model's assumptions, are in fact affected by the information needs. Environmental differences are believed here as simply explaining differences in the conduciveness to local government accounting innovations. It might be though admitted that the international differences are due to the fact that not all countries are at the same stage on the way to a more informative local government accrual-based budgeting and accounting system. But these differences will tend to be surpassed, inasmuch as they might be related to cost/benefit issues or simply different priorities regarding the same information needs. Thus, within the users/users' needs paradigm, it can be argued that the importance of Factor 8 in explaining international differences in local government accounting can be narrowed down to specific purposes of governmental financial reporting (Factor 3) and to principal users of the financial reporting (Factor 4).

Brusca Alijarde and Condor (2002, p.148) also highlight the **SPECIFIC OBJECTIVES/PURPOSES OF GOVERNMENTAL FINANCIAL REPORTING** (Factor 3) as a possible cause for international diversity amongst local government accounting systems. They relate it with the information needs from those who use the reporting documents.

Accordingly, they start from the Contingency Model basic assumption, arguing that

Although the information needs can be similar in different countries, specially those related to financial position, resource allocation and efficient management (...), the interpretation

and the order of priority of the objectives in which these needs are manifested varies from one country to another, resulting in different specific objectives, which further act as factors causing diversity. (Brusca Alijarde and Condor, 2002, p.148)

The authors then carry on referring to a double orientation that can be seen in the latest reforms that happened internationally in local government accounting systems. On one hand, there have been reforms aiming at improving accountability and thus centred on the enhancement of external information tools; major endeavours towards the development of financial accounting and reporting, relegating management accounting to second place. On the other hand, some reform processes have been directed towards the improvement of efficiency and effectiveness of public management hence focused on internal management tools; the emphasis here has fallen mainly on management accounting, primarily concerning the calculation of cost as well as economy, efficiency and effectiveness of service delivery.

Furthermore, they include in the first trend basically Continental European countries (namely Portugal, Spain and France), where the systems that have been implemented aim at legal control and accountability. The majority of Anglo-Saxon countries, plus Germany, are following the second orientation.

Nevertheless, the authors finally recognise:

In any case, the fact is that in most countries the reforms have been carried out in both directions, giving at least as much importance to the financial accounting as to the management accounting, because achieving an efficient and effective resource management requires the development of both external and internal information systems, in such a way that they complement each other. (Brusca Alijarde and Condor, 2002, p.148)

Subsequently, it might be argued that the distinction between objectives of accountability v. internal management (decision-making) has not been relevant to explain major local government accounting international differences, since the two have been present both in Anglo-Saxon and Continental European countries. Additionally, if these purposes result from different interpretation and priorities of users needs, the latter are very important in determining the former. Hence Factor 4 (principal users of the financial reporting) tend to dominate Factor 3 (specific objectives of governmental financial reporting).

On the other hand, as mentioned before, it might be argued that different purposes of local government financial and budgeting reporting determine the importance of budgetary over accounting information. Nevertheless, at the last instance, within the users/users' needs paradigm, this is determined by what users consider as more important for their needs.

In respect, referring in particular to central governments, Chan (2001, pp.1-2) acknowledges the budget as a primary instrument for creating and enforcing financial accountability in the public sector within the domestic context of democratic countries, thus not distinguishing its importance between Anglo-Saxon and Continental European countries. Indeed, he states:

Even after recognizing the many budgets reforms in the past decades, the basic government budget remains the traditional type. This type of budgeting focuses on the period and is concerned mostly with cash receipts and disbursements, even though appropriations may be expressed in terms of obligations authorized to be incurred. Besides allocating resources, the budget may also serve as an accountability tool in the exercise of administrative control, legislative control and popular control. In this regard, it needs the support of the accounting system, which measures and communicates *actual* financial performance. (Chan, 2001, p.2)

However, he seems to recognise that there are some differences within the purpose of accountability itself, which might be relevant in distinguishing different government accounting systems: hierarchical accountability from the executive to the parliament v. accountability to the electorate and general public (Chan, 2001, p.2). Furthermore, he argues that in terms of importance, in systems adopted primarily by Continental European countries, accounting tends to be subordinated to budget, hierarchical accountability prevailing. On the other hand, accounting exerts influences on budgeting amongst most Anglo-Saxon countries, where accountability to electorate seems to be within the government concerns. In the first case it is believed that parliamentary control (requiring legal basis) provides legitimacy to interfere in designing the accounting system; the second situation reflects a public concern – the government needs popular control in a democracy (Chan, 2001, pp.2-3).

If the aforementioned users (parliament/politicians and public) are in reality interested in governmental financial (including budgetary) reporting, once again these arguments seem to point to the users' needs as determinant for the budgeting and accounting systems purposes and therefore for its features.

Balaguer Coll *et al.* (2001, p.5), addressing local government, also refer to the objectives of local government accounting information as a possible cause of accounting international diversity. Moreover, they consider that the local government degree of financial autonomy affects the purposes of accountability and decision-making:

The local authority's degree of financial autonomy conditions the amount of control that central government exercises on the local governments and, therefore, its influence on the objectives of public accounting information. As the autonomy of the local government increases, their direct accountability to the society increases, as well as their concern for having an adequate information system to empower their decision-making. (Balaguer Coll *et al.*, 2001, p.5)

Though in the end they also point to the users information needs, the results of their study reveal large divergence amongst European local governments regarding the funding model – represented by the degree of financial autonomy (Balaguer Coll *et al.*, 2001, p.18). Yet, when analysing what they called the “conditioned convergence”, meaning convergence within a certain region, they conclude that the degree of autonomy tends to converge among countries of the same region (Balaguer Coll *et al.*, 2001, p.28). The regions considered according to geographical, cultural and economic proximity criteria, though only comprising European countries, separate clearly Anglo-Saxon from others: Region 1 – Ireland, Netherlands and United Kingdom; Region 2 – Denmark, Sweden and Finland; Region 3 – Germany, Austria and Luxemburg; and Region 4 – Belgium, Spain, France, Italy and Portugal (Balaguer Coll *et al.*, 2001, pp.23-24).

Consequently, one visibly important factor possible for causing local government accounting international diversity is therefore **THE PRINCIPAL USERS OF THE FINANCIAL (including budgetary) REPORTING** (Factor 4) also emphasised in Brusca Alijarde and Condor (2002, pp.148-149).

First of all, Brusca Alijarde and Benito López (2002, p.179) clearly state that this factor is related to the purposes of the accounting information, since this aims at satisfying users’ needs. They argue that local government accounting information objectives, and subsequently the basic features of the accounting system, are identified as a function of its users’ needs. Therefore, some diversity may arise amongst different countries accounting practices.

Brusca Alijarde and Condor (2002, p.148) also believe that,

Although in principle it is to be expected that the potential users of the financial reporting will be the same in all countries, the importance given to them it not always the same.

In fact, it is argued that different users groups might exert different pressures over the accounting system. Examples are given of potential external users of the local government accounting: control and auditing bodies, financial resources providers and citizens.

The general public as well as financial resources suppliers are accepted as having greater importance in Anglo-Saxon countries, demanding not only for financial but also for economy, efficiency and effectiveness accountability (Brusca Alijarde and Condor, 2002, p.148). The importance of citizens is acknowledged in particular within the North-American context, where studies have been developed to access the relationship

between the accounting information published by public administration entities and the electoral results (Brusca Alijarde and Benito López, 2002, p.179).

Within Continental European countries, legislative and oversight bodies are the most important users groups demanding accountability from local government financial reporting. Bodies such as the Parliament, the Central Government and Supreme Audit Institutions require local government to demonstrate legal compliance with the budget, thus fiscal accountability is more important than operational accountability (Brusca Alijarde and Condor, 2002, p.149). The importance of organised pressure groups in Germany is highlighted as an exception within Continental European countries, as important users affecting local government accounting contents.

These arguments meet those above mentioned presented by Chan (2001).

Regarding this factor there are already some empirical studies, both for Anglo-Saxon and Continental European countries, evidencing the importance (or not) of certain type of users, namely their interest in local government financial (and budgetary) reporting.

Jones and Pendlebury (2002, p.3) refer to one developed for the United Kingdom examining the use made of local authorities annual reports and accounts. Though several groups of potential external users had been identified (general public, media, pressure groups, central government and external auditors), the study concludes that except for external auditors (and to a lesser extent, central government), there was little evidence of substantial use of local authorities annual reports and accounts.

On the other hand, notwithstanding they recognise that, in modern democratic countries, audited financial statements are considered as part of explicit accountability from governments to the electorate, they explain that in the United Kingdom case, local authorities financial reports have not played such a role in the past and still do not do it at present:

The available theory suggests that the economic incentives that might explain an interest in business accounts cannot be applied to the audited financial statements of local authorities (...). This theory, we suggest, would conform to the widespread experience that the latter are not widely read by people outside each local authority. (Jones and Pendlebury, 2002, p.3)

Furthermore, Jones and Pendlebury (2002, p.3) state:

The lack of interest in the *local authorities annual reports and accounts* policy-making, by groups other than accountants and auditors responsible for their preparation, adds to the doubts about the usefulness of the accounts to external users [italics provided].

Consequently, they offer a theory that the published audited accounts of local authorities are the means by which the preparers provide implicit assurance of the underlying accounting. In other words, the published audited annual financial reports and accounts legitimate the internal accounting (Jones and Pendlebury, 2002, p.2).

Indeed, acknowledging that the purpose of being the basis of performance measurement is clearly less relevant in financial statements of local authorities than in those of companies, Jones and Pendlebury (2002, p.21) suggest

(...) that the publication of audited financial statements by a local authority merely legitimates what is inherent in them, regardless of their outward form; (...)

Therefore, in their opinion this seems to be the main purpose of local governments accountability in the United Kingdom.

Among the several studies used to support their theory, the authors highlight Jones (1992) to argue for the absence of external users. He states that in the United Kingdom public sector,

The publication of financial statements is not in the public interest, because the public has no interest; (...) (Jones, 1992, p.262)

Addressing in particular the influences on local government accounting, the author argues:

'Users' do not appear to have an important role. (...) local government accounting is essentially determined by statute for the financial control of elected councillors (...).(Jones, 1992, p.261)

As Jones and Pendlebury (2002, p.19) clarify, the argument in this study was that, in the absence of users, accountants account to auditors; moreover, published financial statements are public records of the bargains struck.

For Continental European countries, one study interesting to be mentioned here was developed for assessing the usefulness of the financial (including budgetary) reporting in the Spanish local governments (Brusca Alijarde, 1997)¹⁴⁶.

Questionnaires were sent to those recognised as more familiar with the accounting system: finance directors (chief financial officers responsible for each local government accounting) and public auditors.

Among other things, the study highlights for the current Spanish local government accounting system: 1) the users of financial reporting; 2) the usefulness of particular

¹⁴⁶ The interest of this survey for our study is enhanced considering the similarities between the Spanish and the Portuguese local government accounting systems, allowing supporting arguments alike for the latter situation, for which no such empirical analysis has been carried out.

financial statements comprised within the reporting; and 3) the utilisation (purposes) of financial reporting.

The results concerning issue 1) revealed that the main users identified as benefited from the (then new) system were in first place audit offices, followed by financial directors and management (internal users). In third place were the financial entities and other providers of resources. The citizens were clearly stated as not considered important users of local governments financial reporting (Brusca Alijarde, 1997, p.23).

Concerning topic 2), the budget execution statement (particularly the part concerning the execution of revenues) was found as the most useful for financial directors, followed by the cash statement and the statement of debt. For public auditors, the cash statement and the statement of debt seem to be above (or at least at the same level as) the budget execution statement, since the first two provide very important information for the process of control, as well as for analysing the entity's future perspectives. Finance directors also find the balance sheet as having a high-medium usefulness. This is also the opinion of public auditors, though these evaluate fundamentally the information conveyed relative to liabilities (both current and long term) followed by current assets. The operating statement is generally considered of medium interest, being the statement of sources and applications of funds the least useful piece (Brusca Alijarde, 1997, pp.25-26).

Financial directors also pointed out reasons for not considering financial statements as useful:

One of the principal reasons why the information was not considered useful is the insufficient accounting training of the potential users, since the financial statements can only be analysed if the users have at least some minimal accounting knowledge. In consequence the lack of accounting training of potential users of the information reduces its usefulness enormously. (Brusca Alijarde, 1997, p.27)

Regarding topic 3), on what local governments use the financial information for, the results showed that financial reporting is used most importantly in the accountability to Audit Offices. A second most important purpose, is the use of financial reporting information to prepare the budget of the next period, resulting in a feedback process. The third purpose is when loans are requested from a financial entity (Brusca Alijarde, 1997, p.29).

In relation to the latter purpose, the author emphasises that it allows refuting the general opinion that in practice financial entities do not pay attention to possible financial problems that local governments could have because they believe the debt is low-risk. Therefore, she argues that financial entities are one of the main users of

Spanish local government financial reporting. Brusca Alijarde (1997, p.30) goes further in admitting that, although there are few Spanish local governments issuing bonds, financial reporting information is also used in the issuing processes.

The financial reporting information is also acknowledged as used importantly for local government management itself, both in making decisions on debt operations and on analysing the entity's financial situation – current and long term (Brusca Alijarde, 1997, p.30).

Relating the users of governmental accounting information with their interest on the local government accounting harmonisation process, Balaguer Coll *et al.* (2001, p.2) consider that, contrary to what happens in the business sector, external users of governmental accounting do not pressure for the harmonisation process:

After all, the operations of the local governments lack international scope and, therefore, neither the supranational organisms (*which usually prefer to use national accounts*), nor the potential lenders, nor even public opinion need to compare the accounts of local governments that operate in different countries [*italics provided*]. (Balaguer Coll *et al.*, 2001. p.1)

Although this argument concerns specifically the harmonisation process, it seems somehow to point also to a general lack of interest by external users.

Finally, Brusca Alijarde and Condor (2002, p.149) address **THE FINANCIAL RESOURCES SUPPLIERS** (Factor 5) as an important reason to explain international diversity between local government accounting systems.

They acknowledge that amongst the users of accounting information, the (external) financial resources suppliers deserve special attention. In fact, although the most common source of financing in local governments is taxes without direct counter-provision, on many occasions they need external financing, namely borrowing, generally to support investment (capital) spending. Depending on the type of borrowing, its suppliers will exert different (more or less) influence on the accounting system to get information suitable for their needs.

In this sense, it is not the same to use formalised loans from financial institutions as to issue bonds, where accounting information demands will be higher. (Brusca Alijarde and Condor, 2002, p.149)

Therefore, they also acknowledge the importance of capital markets as one factor that can determine local government accounting system reforms and contents.

In countries with strong capital markets, especially in North America, local governments issue bonds and ratings of local debt are regularly prepared. Subsequently,

rating agencies are an important user of local government accounting information.

Hence,

(...) in those countries where ratings exist there is a bigger incentive to adopt practices close to generally accepted accounting principles, because accounting practices can affect rating and financial interest. (Brusca Alijarde and Condor, 2002, p.149)

Brusca Alijarde and Benito López (2002, p.180) add that in the USA, the economic crisis of New York City at the late 1970s stressed the interest of local governments to present accounting information revealing its capacity to reimburse its debts.

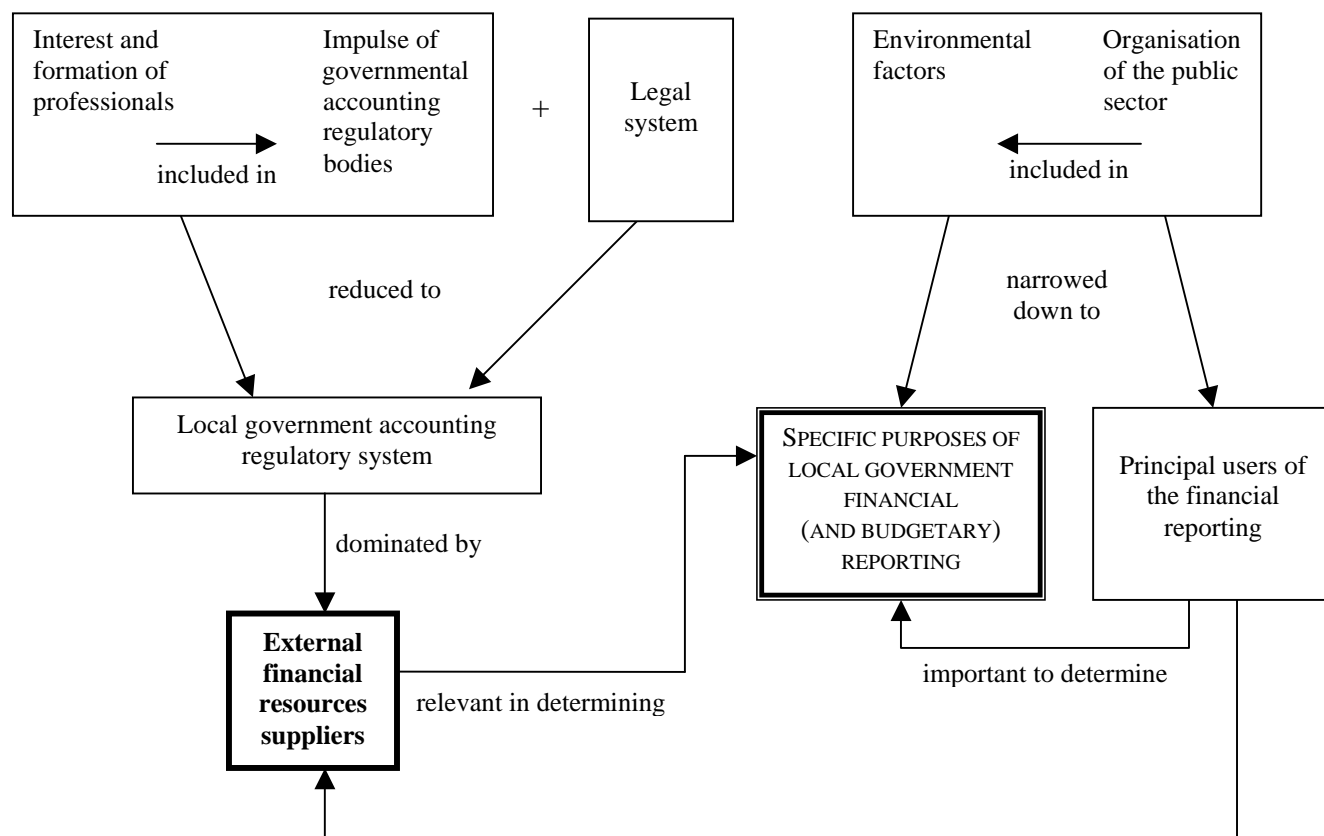
On the other hand, in Continental European countries where capital markets are weaker, they have not been affecting the development of local government accounting systems. Yet, the authors admit that rating agencies are beginning to issue ratings of regional debt of European countries. Although this is not yet commonplace in local government, rating agencies might be recognised as potential users of governmental accounting information in Continental European countries.

In summary, regarding the factors eventually responsible for local government accounting international differences, we argue the following, as portrayed in Figure V.2:

- Factor 1 (legal system) as well as Factor 6 (impulse of governmental accounting regulatory bodies) may be reduced to the local government accounting regulatory system, considering Factor 7 (interest and formation of professionals) included within Factor 6;
- In the last instance, the financing systems (namely the type of external financial resources suppliers – Factor 5) dominate the local government accounting regulatory system as relevant factor for international differences amongst local government accounting systems, as it has been argued for business accounting;
- Factor 8 (environmental features comprised by the Contingency Model), somehow including Factor 2 (organisation of the public sector), is believed as not affecting the local government system contents, thus not being directly relevant to explain international differences. To the extent that it might be important, it can be narrowed down to Factor 3 (specific objectives of governmental financial reporting) and Factor 4 (principal users of the financial reporting);
- Consequently, **Factor 3** (specific purposes of local government financial – and budgetary – reporting) seems to be, as in business accounting, one key reason for international major differences between local government accounting systems.

However, it is strongly conditioned by Factor 4 (principal users of the financial reporting). On the other hand, as argued for business accounting, the financing system (namely Factor 5 – external financial resources providers) is relevant in determining those objectives as well, being the relationship reinforced by the fact that financial resources providers might be users of the financial reports;

- For local government, some empirical evidence seems to show that, both for Anglo-Saxon and Continental European countries, the main users of financial (and eventually budgetary reporting) are internal. As to external users, apart from external audit bodies, those who might be more interested in local government reporting seem to be financial resources suppliers that, as argued for business accounting, are essentially equity outsiders in Anglo-Saxon countries, while in Continental European countries they tend to be fundamentally credit insiders;
- Therefore, Factor 5 (external financial resources providers), in this process of some kind of consecutive elimination, is one apparently prevailing over all the others as a fundamental issue to consider in explaining the major international differences in local government accounting.



from the external users, external financial resources suppliers might be one of the most relevant

FIGURE V.2 – REASONS PROPOSED FOR INTERNATIONAL ACCOUNTING DIFFERENCES IN LOCAL GOVERNMENT ACCOUNTING: PROCESS OF CONSECUTIVE ELIMINATION

2. MAIN FEATURES OF THE LOCAL GOVERNMENT ACCOUNTING SYSTEM: PORTUGAL IN COMPARATIVE PERSPECTIVE WITH UNITED KINGDOM

The major purpose of this section is to compare the main characteristics of the Portuguese local government accounting framework with the one from the United Kingdom (what the systems are doing), aiming at showing if the two systems are really as different justifying an international classification in separate spheres of accounting: Continental European v. Anglo-American.

The information regarding Portugal comes from Chapter III, while that on the United Kingdom is gathered from a country study developed in 2002 included in Lüder and Jones (forthcoming in 2003).

In order to provide an overview of both local government accounting systems, several tables are going to be presented, aggregating the detailed features in broad categories of eventually distinctive criteria: institutional framework, budgeting principles and rules, accounting recognition and measurement criteria, form and

contents of financial (including budgetary) reporting, and financial (including budgetary) reporting information objectives. These categories were in some way adapted from Montesinos Julve *et al.* (1995 and 1996), Chan *et al.* (1996), Vela Bargues and Fuertes (1999), Giroux *et al.* (2000), Brusca Alijarde and Condor (2002), Brusca Alijarde and Benito López (2002).

For each table, further explanations are subsequently provided, specifying some items when found necessary.

INSTITUTIONAL FRAMEWORK		
Features	PORTUGAL	UNITED KINGDOM
Type of Local Governments	Parishes, municipalities, metropolitan areas of Lisbon and Porto, district assemblies, and parishes and municipalities' associations.	Parish councils, county councils, district councils, unitary councils, London boroughs, metropolitan boroughs.
Superior Government Control	Although parishes and municipalities' competencies are broadly defined in the law set by the Parliament, Local Administration is constitutionally autonomous from the Central Government (independent from its decision and control). There is an inspective tutelage (control), but this is summarised to the formal control of legality in the budget execution, with no interference in any political and economical matters – it is normally performed by two independent oversight public bodies: the Finance General Inspection and the Territory Administration General Inspection.	Local districts can do only what is allowed by the Parliament.
Centralisation	The competencies are broadly prescribed, meaning that they can do more than that; however, they cannot do what the law states as a restriction.	<i>Ultra vires</i> : can do only what is prescribed.
Budgets	Annual global (current plus capital) balanced budgets (cash surpluses are carried forward for future spending), requiring the current (operational) budget to be at least balanced as well.	Annual balanced budgets (but equity surpluses can be spent).
Audits	Annual external audits legally required as a form of <i>ex-post</i> control to the entity's accounts. Local governments executive committees are required to send the entity's accounts to The Court of Accounts (General Audit Office) until May 15 of the following year they concern,	Annual audits required.

INSTITUTIONAL FRAMEWORK		
Features	PORTUGAL	UNITED KINGDOM
	regardless of their approval by the deliberative committee.	
Auditors	The Court of Accounts as the oversight General Audit Office. Other type of auditors is generally not required ¹⁴⁷ .	Picked by the Audit Commission: 70% district auditors; 30% are private firms.
Annual Report	Required; December 31 year-end.	Required; March 31 year-end.
Audit Report	Required. Subsequently to all local governments sending the annual accounts for inspection until May 15 every year, The Court of Accounts is legally required (Local Finances Law) to issue a report on the appreciation, which is later sent to the entity's committees as well as to the Minister of Finance and the Minister responsible for the Local Government. Thus, this report is not included within the entity's annual report; it is in fact posterior. Under the new regime set in the CALG and Local Finances Law, local governments budgetary and financial reporting statements are analysed not only on the compliance with the law, but also on the true and fair view, though considering that legality overrides.	Required; it must be completed by December 31. The auditor's report is statutorily required as an opinion on local governments financial statements, expressed in terms of the phrase "presents fairly" (which does not explicitly mean that all authoritative professional pronouncements have been followed). It is an opinion on compliance with the law and on the fair presentation. This report is to be included within the entity's annual report.
Professional influence on local government accounting policy-making	Very scarce. The policies are legal requirements set centrally by the government, notwithstanding the consultative role of the Public Administration Accounting Standardisation Commission. However, this is not a professional body.	Considerable, since the law only provides a definitive but skeletal framework for local authority accounting.
Fund Accounting	Not required, notwithstanding Municipalized Services.	Required.
		Required – each local government as a whole is required to produce consolidated financial statements, including any funds for which the law additionally requires separate sets of financial statements.

¹⁴⁷ Notwithstanding, this might change soon. We are aware that the legally required intervention of auditors in local governments accounts, with subsequent production of regular audit reports/certificates, is already being considered; developments on the process have been carried out between the Portuguese Order of Certified Auditors (*Ordem dos Revisores Oficiais de Contas*) and the competent legal authorities.

INSTITUTIONAL FRAMEWORK		
Features	PORTUGAL	UNITED KINGDOM
Consolidation	Not required – pending development.	sets of financial statements, except pension funds and other trust funds. Additionally, when a local authority has material interests in subsidiary or associated companies, it is required to publish summarised group accounts in the notes.
GAAP statute	Compulsory <i>requirements</i> stated in the law – Chart of Accounts for Local Government. Possible additional <i>recommendations</i> from the Public Administration Accounting Standardisation Commission (PAASC).	Statements of <i>recommended</i> practice from the Chartered Institute of Public Finance and Accountancy (CIPFA).
Conceptual framework	Though it might be admitted that the budgeting and accounting principles set within the CALG are a good basis for a conceptual framework, there is not such type of document (official or non-official).	There is no conceptual framework of local government budgeting and accounting, in the sense of a fully articulated set of principles, though the Statement of Recommended Practice does draw on a few principles of the one for business accounting.
Uniformity of accounting policies, rules and records	Great uniformity with the same legally compulsory rules being applied to all local government entities.	Low degree of uniformity: nor the law neither the government prescribe practices in detail. The professionals prescribe detailed recommendations that might not be followed, since there are no particular sanctions for accountants and auditors non-compliance. It is difficult – and can be misleading – to generalise about UK local government budgeting and accounting practices.
Simplified regime for small entities	Essentially cash-based budgetary accounting for small municipalities and parishes with annual revenues lower than around (in 1999) 1,425,000 EURO. They still have to produce and publish some statements mainly related to the budget execution, which also have to be sent to The Court of Accounts.	Parishes with budgeted income lower than £500,000 have to keep accounting records but they do not have to publish annual audited accounts. The accounting records to be kept are no other than basic records of cash transactions (cash accounting).
(Full) Accrual Accounting	Yes, for financial and cost accounting – based on the <i>historical cost convention</i> modified to include revaluation of certain fixed assets and other exceptions.	Yes, both for budgeting and accounting, based on <i>current values</i> .

INSTITUTIONAL FRAMEWORK		
Features	PORTUGAL	UNITED KINGDOM
	No, for budgetary accounting – still (modified) cash-based.	
Double-entry	Compulsory both for budgetary and financial accounting; the use in cost accounting is optional.	Yes, only for accounting – not for budgeting.
Local Revenues	Local (mainly property) taxes, rates and prices have been responsible for 40% to 50% of the total local revenues. In the other half, the major part has been transfers from central government, program-contracts and cooperation agreements, and EU grants. Debt, though increasing, on average has not surpassing 10%.	Mainly property tax but on average only 25% of total spending financed from local revenues.
Intergovernmental Revenues	Non-earmarked financial transfers from the State Budget have been on average 35% of the total local revenues.	On average, 75% of local spending met from central government.
Long-term borrowing	Can borrow from banks and other financial institutions, issue bonds and use financial leasing, but there are limits and other constraints on borrowing – local government borrowing regime is set in the Local Finances Law. Debt is <i>not default-free</i> , though it might be considered as of low-risk.	Can borrow from Government Agency or money markets but limits on borrowing. Debt has been considered as <i>default-free</i> .
Financial Information Available	Annual budget and accounts due by law (Law-decree 54A/99 – article 6) to be sent annually to the Regional Commissions of Coordination, which in turn send those to the Local Government General Department.	Annual financial data available from CIPFA.
Performance Measures	Not yet required.	Legal requirement to publish performance measures.

TABLE V.3 – LOCAL GOVERNMENT ACCOUNTING SYSTEMS INSTITUTIONAL FRAMEWORK: PORTUGAL V. UNITED KINGDOM

Some additional explanations seem to be important for clarifying the information included in Table V.3:

- Local government in both countries seems to have suffered an important change, which coincidentally happened at around the same time. In fact, both the Portuguese and the British local government passed through a large reorganisation in the middle 1970s: in the former case as a consequence of a democratisation process after forty

years of dictatorial political regime; in the latter as a consequence of a study sponsored by the Ministry of Housing and Local Government in 1967 covering every aspect of local government (Jones and Pendlebury, 2002, p.18).

- Both UK and Portugal are unitary states, though some arguments have been recently presented that the former might be now a “quasi-federal” state (Jones, 2002, p.2, in Lüder and Jones, forthcoming in 2003). However, in the former the Parliament has sovereignty, while in the latter the Constitution is sovereign.
- In the UK, local government is clearly subordinated to the national government: local authorities can only do what the law specifically empowers them to do. In Portugal local government is autonomous, though working in coordination with the central government; central government interference is very limited and clearly set within the law. Regarding its competencies, the process seems to be somehow opposite to the case of the UK: local authorities can do more than is set in the law, and they cannot do only what the law clearly restricts them to do.
- Although in both countries the legal provisions require annual balanced budgets, both the meanings of annuality and balance seem to be different, as it will be presented in the following table. For the purpose of the present comparison, the relevant issue concerns the possibility of eventual annual surpluses not to be returned to the central government.

Concerning this issue Jones (2002, p.37, in Lüder and Jones, forthcoming in 2003) states for the UK:

Annuity is as fundamental to local government as it is to the national government, with additional emphasis because of the reliance of the former on the latter for financial support. Major parts of national government grants do not have to be surrendered to the national government if they are unspent at the end of the financial year; however, there are some specific grants that do. Within each local government, different interpretations of annuity are possible (...).

In Portugal, because local governments are autonomous and do not necessarily rely on central government for financing, cash surpluses do not have to be surrendered at the end of the year in any case. The annuity principle simply requires expenditures and revenues to be estimated annually, being the financial year coincident with the civil year. Once it is clearly stated as a budgetary principle within the CALG, it must be applied uniformly by every entity under the CALG regime.

Notwithstanding the differences, it might be argued that the principle in practice works in the same way in both countries, in the sense that local authorities in both countries are allowed to carry forward unspent surpluses.

- In the UK, the practice of *fund accounting* is referred to in some laws relating to specific kinds of local government activities, which have to be separated out from the rest. As Jones (2002, p.44, in Lüder and Jones, forthcoming in 2003) exemplifies, this is the case of housing services (comprising building, maintenance and operation of public-funded housing) that are required to be accounted for separately, namely because its form of funding (rents charged to the tenants, and grants) is different than the rest of the local government activities (funded by grants and local taxation).

On *fund accounting*, Jones and Pendlebury (2000, pp.157-158) explain:

It refers to the practice of accounting, not in terms of an organisation taken as a whole, but in terms of its separate, independent, constituent parts (which are called ‘funds’) [italics provided]. (...)

(...) therefore, an organisation which adopts fund accounting and accruals accounting and had, say six funds, would keep six complete and separate sets of accounts. Six cash books, six sets of personal accounts, six nominal ledgers, six operating statements, six balance sheets. In practice, however, there are modified versions of fund accounting which achieve the same overall purpose, namely keeping the accounts of the funds separate.

Consequently, we believe that some kind of fund accounting has existed in fact in Portuguese municipalities specifically for the so-called Municipalized Services, while the accounting regulations do not explicitly refer to it as a requirement. Indeed, Municipalized Services are operationally autonomous units within the municipality (though not juridical independent), performing activities in an industrial business way. Therefore, their functioning logic moves away from the other regular activities performed by local governments, normally financed by local taxes and grants. Municipalized Services (e.g. services for water and sewage, services of urban public transports, etc.) are financed also by grants, but essentially by prices and rates charged for the services and goods provided. Their functioning is regulated by the Portuguese Administrative Code of Law that, due to their independent character within each local government, requires each unit to prepare a set of financial statements totally separated from those regarding the rest of the municipality¹⁴⁸.

¹⁴⁸ Under the current system, the CALG applies also to Municipalized Services. However, in the previous local government accounting regime, the separation between Municipalized Services and the rest of the municipality was even more clear, inasmuch as while the accounting system for the latter was cash-based budgetary accounting, the former were already under an exceptional regime, with a specific chart of accounts following rules very close to business accounting, including accrual basis, cost accounting and double-entry (see Chapter III – section 2.2.2). Even the forecasted statements were accruals-based. For example, the so-called financial budget was no more than a forecasted statement of origins and applications of funds as that used in companies; there was also a forecasted Results Statement. Evidently, the set of accounts for Municipalized Services was totally separated from the rest of the municipality.

More evidence of this separation is given in the explanation of the transactions to be recorded in CALG account 264 – *Local government administration*. This is included within a class of third parties accounts in the financial accounting sub-system and, according to CALG section 11, it can only be used in municipalities' (and municipalities' associations) accounting. It comprises transactions (e.g. grants and loans – excluding transactions related to providing current services, fixed assets and financial investments) between the municipalities and their “partners”, such as municipalities' associations, other municipalities, Municipalized Services, parishes, parishes' associations, and municipal and inter-municipal business companies. Moreover, at a more detailed level, for the sub-account regarding Municipalized Services, another sub-account must be created to record loans contracted by the municipality (as an intermediary) to finance activities performed by Municipalized Services. This means that in relation to the municipality's accounts, Municipalized Services are separate entities, becoming municipality's debtors.

- Local governments in the UK are required to prepare consolidated financial reporting for each local government as a whole. All funds are included in the consolidation, excluding some such as pension and other trust funds administered for third parties (Jones, 2002, p.44, in Lüder and Jones, forthcoming in 2003). Moreover, both revenue and capital budgets are also prepared at an aggregate level for each local government as a whole.

Concerning group accounts, the definition of “group” as the reporting entity is the same as it would be if the local government were subject to company law. Therefore, the criteria to include an entity within the local authority consolidated reporting are very close to those for business accounting. Jones (2002, p.53, in Lüder and Jones, forthcoming in 2003) states these criteria, both for local government subsidiary and associated companies:

(...) a company is a subsidiary of a local government if any of the following applies:

- The local government holds a majority of voting rights in the company;
- The local government is a member of the company and has the right to appoint or remove directors holding a majority of the voting rights at meetings of the board on all, or substantially all, matters;
- The local government has the right to exercise a dominant influence over the company, either,
 - by issue of provisions contained in the company's memorandum or articles, or
 - by virtue of a control contract. The control contract must be in writing and be of a kind authorised by the memorandum or articles of the controlled company. It must also be permitted by the law under which that company is established;

- The local government is a member of the company and alone controls (pursuant to an agreement with other shareholders or members) a majority of the voting rights in the company;
- The local government has a participating interest in the company and either:
 - it actually exercises a dominant influence over the company, or
 - it and the company are managed on a unified basis.

A company is an associated company of the local government if it is not a subsidiary of the local government but in which the local government's interest is for the long-term and, having regard to the disposition of other shareholdings, the local government is in a position to exercise a significant influence over the company.

The local authority group consolidated accounts also do not include pension and other trust funds.

In Portuguese local governments, consolidated financial reporting for each entity as a whole is still pending development. Indeed, the CALG does not set any rules for its preparation, so it is not required. However, other charts of accounts for other sectors of the Public Administration (e.g. Health Sector and Education Sector) already require entities to prepare annual consolidated financial reports. Moreover, underlying the CALG main purposes, and considering it is based on the CAPA, there is the objective of creating conditions for consolidated financial reporting. In fact, the system set in the CALG is now not only the same as that used in the Municipalized Services, but also very close to that used by municipal business enterprises (using the Chart of Accounts for Business Accounting), the types of entities most likely to be grouped within the reporting entity for each local government. Additionally, the CALG already states a definition for reporting entity (considered an accounting principle – CALG section 3a):

Reporting entity is every entity of public or private law to which the preparation and presentation of the accounts according to the present Chart is compulsory. When the organisational structures and the management and information needs require, accounting sub-entities might be created, since the coordination with the central system is assured.

Therefore, these issues plus the need that has arisen in practice for some municipalities to report accounting information concerning its associates¹⁴⁹, might

¹⁴⁹ As was highlighted in Carvalho and Jorge (2003), for Porto municipality for example, although consolidated annual reporting is not required within the CALG, there was a perceived need to disclose some consolidated financial information, namely concerning investments.

From 2000 the local executive decided to transfer to municipal business enterprises the responsibility of new buildings construction and repairs. Yet, after completion, many of these works revert to be property or managed by the municipality, in practice being just managed by municipal business enterprises while being under construction. Accordingly, in order to assess a more truthful evolution of the municipality investment expenditures, in 2001 annual report, concerning Porto municipality total investment expenditures, it was decided to disclose (out of the balance sheet) information adding together not only those investments carried out directly by the municipality, but also those carried out indirectly via municipal business enterprises.

lead to the conclusion that soon enough rules and requirements for consolidated financial reporting for each local government as a whole are going to be published.

On the other hand, since each local government summary budget has to include the Municipalized Services (see Chapter III – Appendix III.3), it might be argued that some consolidation is already practiced in budgeting.

- One major difference in the accounting practices of the two countries is on the GAAP statute. The Portuguese policy-makers (government ministries) issue **requirements** for budgeting and financial and cost accounting – the CALG is a set of legally compulsory applied pronouncements, that goes far beyond bookkeeping, namely embracing budgetary and accounting principles, as well as requirements for financial (including budgetary) reporting, and rules for calculating the costs by functions and goods or services provided.

The UK policy-maker (CIPFA) issues **recommendations**, which sometimes are not followed. Additionally, as Jones (2002, p.39, in Lüder and Jones, forthcoming in 2003) clearly states,

The accounting profession has addressed the perceived need for accountants to provide consistent information between local governments by making recommendations for financial reporting, not for budgeting.

Regarding this matter, Giroux *et al.* (2000, pp.30-31) elucidate:

The UK has (...) a tradition in accounting (properly referred to as the Anglo-American tradition) – for the most part established in the context of business – in which non-profit accounting bodies promulgate practices to be used by preparers and auditors of financial statements who make accounting judgements that are ostensibly non-governmental and non-political [italics provided]. These accounting practices, by their nature, are – in terms of measurement and disclosure policies – different between sectors of an economy and between economies.

In Portugal, business accounting rules are promulgated by central government as law, following studies carried out by specific working groups, and/or directives both from the Business Accounting Standardisation Commission (BASC) and the EU. Additionally, the BASC issues recommendations of practice, complementing the legal requirements (*Directrizes Contabilísticas*).

For governmental accounting, the policy-making process is similar, except that orientations/instructions (recommendations with no legal force) up to the moment have come only from the PAASC. However, this body is not related to the profession, as it is the policy-maker body in the UK. In this sense, the financial statements of Portuguese and British local governments do not adopt the same accounting.

Nevertheless, concerning financial accounting and reporting, both closely follow the framework adopted for companies: the Portuguese CALG copies the financial accounting sub-system from the Chart of Accounts for Business Accounting, while the British Code of Practice on Local Authority Accounting admits that the Statement of Recommended Practice is a mean of indirectly applying to local authorities the Statements of Standard Accounting Practice and the Financial Reporting Standards developed to be applied to financial statements intended to give a true and fair view of companies (Jones and Pendlebury, 2002, p.11). Indeed, since 1980, CIPFA has chosen to base its policies on those of business accounting.

On the other hand, the legal requirements on the Portuguese framework are just minimum demands, meaning that entities might in fact prepare additional statements and disclose supplementary information, as long as they keep within the CALG rules and principles. Yet, as explained, due to the legal requirements, there is clearly much more uniformity amongst Portuguese than amongst British local governments budgeting, accounting and financial reporting practices.

- Another major difference concerns the bases of accounting. In both countries full accrual basis is used for financial accounting. However, while in Portugal budgeting remains essentially cash-based (with commitments for expenditures), in the UK it uses some accruals, though diverging from the full accrual basis in accounting (Jones, 2002, p.36, in Lüder and Jones, forthcoming in 2003).

In the British case, the legal requirement of a balanced revenue budget seems to have some implications responsible for those divergences. First, this requirement focuses on the general fund, which does not include capital items. Yet, operating items within the (revenue) budget are defined not only in terms of receipts and payments, but including adjustments for changes in working capital (e.g. provisions for doubtful credits). Moreover, when capital items are financed by borrowing,

(...) the annual tax calculation *in order to balance the revenue budget* does not include provisions for depreciation but does include a provision for, at least, the prescribed minimum amount of total debt outstanding [*italics provided*] (Jones, 2002, p.36, in Lüder and Jones, forthcoming in 2003).

This has been considered by the profession as not suitable to provide economically important measures of the cost of the services provided. Accordingly, the profession has responded with some recommendations to be carried out concurrently with the statutory requirements for a balance budget. Therefore, while for capital budgeting the accounting basis is clear – cash-basis adjusted for changes in working capital,

i.e. some accruals¹⁵⁰ – for revenue budgeting (and accounting) there are two accounting bases: one reflecting the statutory requirements, and another recommended by the profession's definition of the cost of the services provided.

As Jones (2002, p.42, in Lüder and Jones, forthcoming in 2003) explains, the statutory basis above stated requires the provision for repayment of debt statutorily defined as an amount for each local government as a whole. The one recommended by the profession, which is particularly used in the individual budgets for each service, includes a common element to the statutory basis: operating items are receipts and payments adjusted for changes in working capital. Nevertheless, the cost of services neither includes provisions for repayment of debt (as it does not in business accounting) nor a charge for the interest payable, including instead charges for the use of all capital assets – the “capital charge”. In the context of capital accounting, this aims at charging services for the use of the net capital invested, regardless of whether it is financed by debt or equity. Within the balance sheet, it corresponds to creating a “capital financing reserve” (Jones, 2002, pp.48-49, in Lüder and Jones, forthcoming in 2003).

Although the basis for the capital charge is for each authority to determine, it is recommended that it must be at least equal to the sum of any depreciation on the asset and the “capital financing charge”. The latter basically corresponds to the opportunity cost of capital and is calculated by applying a centrally determined national rate of interest to the net book value of the asset (Jones, 2002, p.52, in Lüder and Jones, forthcoming in 2003).

The author also highlights that, in the context of capital accounting, the “capital charge” was a way of accommodating the legal definition and requirement of the balanced budget (precluding charging depreciation) within the local government accounting, creating an accounting that is different from contemporary business accounting (Jones, 2002, pp.54-55, in Lüder and Jones, forthcoming in 2003). In fact, the net cost of services comprising the opportunity cost of capital has no parallel in companies, which might put accrual accounting in British local governments ahead of business accounting.

On the other hand, while the Portuguese accounting system follows the historical cost convention, modified to include revaluation of certain fixed assets and other

¹⁵⁰ Brusca Alijarde and Condor (2002, p.139) call this a “current financial resources flows” accounting basis.

exceptions, in the UK current cost accounting is clearly used. This will be made clear when addressing the accounting recognition and measurement criteria.

- With regard to the use of double-entry bookkeeping method, there are also some important differences between the two countries. However, they seem to be related to the link between budgeting and accounting systems in both countries, which is going to be addressed later. What might be important to highlight here is that in the UK, as Jones (2002, p.36, in Lüder and Jones, forthcoming in 2003) stresses, budgeted numbers are just informal items:

(...) they are not otherwise part of the formal accounting and reporting system, and are certainly not part of the double-entry.

In turn, in Portugal, the CALG framework is an integrated system comprising budgetary, financial and cost accounting. Hence, though having different bases and principles, and working separately, budgetary and financial accounting sub-systems are linked, in particular through the account 25 – *Debtors and creditors from the budget execution*, as explained in Chapter III. Consequently, because double-entry is compulsorily used in financial accounting, it has to be used in budgetary accounting as well in order to facilitate the accounting records in the link account.

- The differences between the two countries regarding local revenues and intergovernmental revenues seem clearly related to the process of decentralisation/centralisation of services and spending.

In this respect, Giroux *et al.* (2000, p.30) explain:

(...) although UK local government grew out of local initiatives, the tendency over the past two centuries has been to impose more and more homogeneity from the centre. Thus, while local governments have lost major services since the nineteenth century, they became bigger (by area), fewer and, in terms of their rights and duties, more uniform – and central government control has become greater. Since the 1980s, this latter has been exacerbated by a significant reduction in the percentage of local spending financed by local revenues.

Therefore, it seems that local government in the UK has lost autonomy and financial independence, somehow within a process of centralisation/uniformity. While uniformity has always been present amongst Portuguese local governments (mainly because their functioning is also ruled by laws uniformly applied), in comparison with the UK, the opposite has been happening (particularly in the last twenty five years) in terms of autonomy, decentralisation and, though to a lesser extent, financial independence.

- Concerning long-term borrowing, there are some important differences to be stressed.

In Portugal, although local governments are allowed to issue bonds, i.e. borrowing from the financial markets, this is not a common practice. Indeed, because the capital market is weakly developed, the cases of local governments issuing bonds have been rare, and involving only the largest municipalities (e.g. Lisbon). The most likely reasons why these might have been preferred to “common” bank loans, relate to better terms such as lower interest rate or longer repayment period. Therefore, the most preferable external financing source has been credit provided by banks or other financial institutions. For Porto municipality for example, the second largest one in Portugal, bonds have not been issued and for the last two years, bank loans have been on average 90% of the long term liabilities; the remaining 10% have been financial leasing, i.e. credit by other financial institutions to finance fixed tangible assets. The local governments credit regime is set within the Local Finances Law, which defines among other things credits ceilings (some types of credits, such as those for financing social housing or public calamity damages, are not considered for these ceilings). As in the UK, long-term borrowing is allowed essentially to finance long-term investments, although it might be exceptionally allowed to help municipalities in reaching financial equilibrium (solving long-term financial difficulties). The only possible guarantee for local debts is local revenue (except grants and other earmarked revenues); loans for social housing might be warranted via the houses’ mortgage. Therefore, local governments **debt is not considered as default-free**.

In the UK, the main debt provider seems to be the central government. As Jones (2002, p.8, in Lüder and Jones, forthcoming in 2003) clarifies,

Almost all of local government borrowing is now provided by a national government agency (the Public Works Loan Board), which influences local borrowing by using rates of interest and quotas. On the other, local governments have also been able to borrow from the markets, including internationally. The national government does not guarantee local authority debt.

The author additionally mentions that, although until the 1980s local government **debt was considered as default-free**, this might have changed recently. The return of local governments to money markets has led to suggestions to introduce credits ratings for them (including from credit rating agencies). Consequently, capital markets are here much more important as a possible source of local government debt financing than in Portugal.

- A fourth considerable difference between the two countries is that, in the UK, along with audited financial statements, local governments are now required to produce

and publish measures of performance. As Jones (2002, p.43, in Lüder and Jones, forthcoming in 2003) explains,

(...) performance measurement was originally imposed through the audit. The auditors were given the legal duty to make a judgement about whether each local government made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. This was interpreted to mean that those ‘proper arrangements’ included measures of performance.

However, nowadays, each local government is required to prepare and publish an annual performance plan (Jones, 2002, p.43, in Lüder and Jones, forthcoming in 2003), which is

(...) seen as a mechanism of accountability to local government staff and politicians, groups and associations with an interest in local government, and the national government, as well as a management tool; it is not primarily directed at local people. The plan is about what services the local government will deliver, how it will deliver them, what standards of service are currently provided and can be expected, and what action will be taken to deliver those services over what timescale.

This plan includes information such as performance indicators, standards and targets, comparing with previous years and other local governments. It is also inspected by auditors, who report on whether the plan was produced according to the law and guidance.

The reporting of performance measurements and the performance plan are still not requirements within the Portuguese local government reporting system, but the issue is already in the centre of the debate of the current changes of the Portuguese Public Administration, thus being most likely a next step within this reform process.

BUDGETING PRINCIPLES AND RULES		
Features	PORTUGAL	UNITED KINGDOM
PRINCIPLES:	Set within the CALG, as legal requirements.	The law on local authorities accounting does not mention the budget. However, there is a statutory requirement for each local government to produce a budget on which to base its tax levy. Additionally, the law (Local Government Finance Act) also provides the framework within which local governments operate, including budgeting and accounting functions.
	Although not written within the CALG list, this is always present as an underlying budgeting principle – the budgeted revenues and	Local budgets are authorisations to spend in any form. Yet, at local level, there is no separation of legislature and executive, and there is no use of law through

BUDGETING PRINCIPLES AND RULES		
Features	PORTUGAL	UNITED KINGDOM
Legality and regularity	<p>expenditures are legal requirements, approved by the local deliberative committee, so demanding for legality to be constantly verified in all internal and external (budgetary) control procedures, namely by The Court of Accounts.</p> <p>Legality is also a latent accounting principle within the Public Administration, considering that legal provisions as general rule override the true and fair view.</p>	<p>which the budget approval of the legislature is expressed – budget numbers are informal items within the formal accounting and reporting system.</p> <p>The CIPFA recommendation for local authorities is for statutory provisions to override, although there is neither requirement to disclose details, nor formal monitoring of the financial statements of local governments.</p>
Independence	<p>The local governments' budget preparation, approval and execution is independent from the State Budget.</p>	<p>The Treasury does not explicitly have the power over, or ultimate responsibility for, the assets, liabilities, revenues, expenses and cash flows of each local government (nor of the budgeting and accounting), notwithstanding the fact that it does have such power and responsibility over that significant part of local finance that is provided by the national government.</p> <p>Since 1984 the national government can limit the amount of taxes that a specific local government can raise in a year, but does not otherwise have a role in approving local budgets.</p>
Annuality	<p>The amounts forecasted within the budget are annual, being the financial year coincident with the civil year.</p>	<p>There is an annual budgeting and accounting cycle, with year-end at March 31. Annuality means that grants from the central government have to be surrendered at the end of the financial year if unspent. However, a strict interpretation of this principle does not apply to local governments, since the major part of the unspent grants can be carried forward.</p>
Unity	<p>Local governments budget is single, comprising current (revenue) and capital operations.</p>	<p>Each local government produces, broadly, two budgets: a capital budget and a revenue budget (this increasingly includes performance indicators).</p>

BUDGETING PRINCIPLES AND RULES		
Features	PORTUGAL	UNITED KINGDOM
Universality	The budget comprises all expenditures and revenues, including those from Municipalized Services (which budget must be presented as an appendix to that for the municipality), in global terms.	The capital budget tends to cover more than one year and is given by programmes, which may reflect either the political (committees) or the departmental structure of the local government. Each programme is often divided according to each material capital project and budgeted capital expenditure. Additionally there is a summary of how the capital budget as a whole is to be financed – the capital financing statement. The revenue budget focuses on the coming year and has three levels of partition: 1) summary of the local government as a whole; 2) departments/committees (“services”) within the local government; and 3) inputs and miscellaneous income within each department/committee (“service”). Both the capital and revenue budgets comprise all activities for the local government as a whole.
Balance	The budget forecasts the resources needed to cover all expenditures, and the current revenues must at least be equal to the current expenditures.	The law requires the revenue budget to be balanced by taxation after taking account of any use of reserves: the local government cannot plan to finance budgeted deficits by borrowing. Furthermore, the law also requires the balanced budget to include provision for the repayment of debt: budgeted net current spending must also include budgeted principal and interest repayments, and taxes must be levied to finance the total.
Specification	The budget distinguishes in sufficient detail all expenditures and revenues it comprises.	Items of income and expenditure are accounted for and detailed separately.
Non-allocation (of revenues)	The income coming from any revenues cannot be allocated to cover certain expenditures, except if the law allows such	There is non-assignment of the revenues from the local tax.

BUDGETING PRINCIPLES AND RULES		
Features	PORTUGAL	UNITED KINGDOM
	allocation (e.g. earmarked capital revenues).	
Non-compensation (gross amounts)	All expenditures and revenues are written within the budget considering its gross amounts, without deductions of any nature.	Strict gross accounting.
RULES:	Set within the CALG, as legal requirements.	National government has never regulated local government budgeting (and accounting) in detail. It is for each local government to apply and to interpret the law in its own case.
Publicity	After the approval by the deliberative committee, local governments must publish within 30 days (CALG Law-decree 54A/99 – article 4): the provisional statements (namely the Big Options of the Plan and the Budget, normally approved in the local council meeting happening in November/December); the financial statements (accounts including the budget execution) as well as the annual Management Report, normally approved in a local council meeting happening in the following April.	As far as the law is concerned, the published <i>ex-post</i> financial statements do not include budgeted numbers. Yet, publication of budgets is a rule in local governments. Additionally, since 1974, the law has required each local government to produce and publish an annual statement of accounts, covering all its activities. Though focused on actuals, this includes a brief but important comparison to the budget, which has been ensured by policies of the accounting profession. There is also a more recent legal requirement for local authorities to obtain “best value” in providing public services – this legal regime requires the preparation and publication of an annual performance plan.
Rules for budget items forecasting	The CALG also states rules to be taken into consideration when the budget (still in terms of inputs) is being prepared. Although local governments have some discretion on some rules (e.g. the level of detail within the budget, and whether the budget is based on programmes), those related to methods of forecasting revenues and some expenditures are legally prescribed. The emphasis on	Although the accounting profession might issue recommendations for budgets, many important budgeting principles are a matter of each local government to determine: whether there should be multi-year budgets; how detailed the budgets should be; whether budgets should be based on responsibility centres or whether on programmes; whether budgets should be only in terms of inputs or whether they should be in

BUDGETING PRINCIPLES AND RULES		
Features	PORTUGAL	UNITED KINGDOM
	rules concerning revenues provisions (using methods of direct evaluation – e.g. for current and capital transfers, and for loans – or the average of the last 24 months, namely for taxes, rates and prices) shows prudence and good sense as crucial rules to be considered on the budget preparation, in order not to inflate revenues that might not become effective.	terms of inputs and outputs. Specific issues related to accruals are also not addressed in the law: each local authority can decide by itself, sometimes with the direction of the profession.
RELATIONSHIP BETWEEN BUDGETING AND ACCOUNTING	The budgeting and financial accounting systems are linked, but budgetary rules are different from accounting rules. Budgeting and accounting are comprised within an integrated single system that allows articulating both processes even if they have different rules and accounting bases. Budgetary operations lead all the records in the budgetary sub-system, and the major part in the financial accounting sub-system (except treasury non-budgetary operations, and others only possible to be recorded in an accrual basis).	In particular from 1974, budgeting and financial accounting are two different and independent systems: on one hand, financial accounting statements follow essentially professional recommendations, despite the legal broad directions (especially regarding its form); on another hand, in budgetary statements preparation, legal provisions must be taken into account, especially regarding annual balanced revenue budgets. Budget numbers are not formally part of the annual financial reporting, though overall there is a comparison budget to actual. Nevertheless, budgets are still central to local government accounting.

TABLE V.4 – LOCAL GOVERNMENT BUDGETING RULES AND PRINCIPLES: PORTUGAL V. UNITED KINGDOM

Regarding Table V.4 some issues must also be highlighted:

- In general terms the legal provisions for local government budgeting (and accounting) are much more detailed in Portugal than in the UK. Additionally there is in Portugal a legally defined mechanism for the local budget approval and publication, involving a budget proposal from the local executive to be publicly discussed and approved by the local council (deliberative committee).

In the UK the primary legislation comprised within the Local Government Finance Act, provides only a bare framework for understanding local government

accounting, although also giving the power to the relevant minister to make additional regulations (Accounts and Audit Regulations), namely addressing the form, preparation, certification and publication of statements of accounts. Notwithstanding, most matters of content are left to be determined by each local government (Jones, 2002, pp.8-9, in Lüder and Jones, forthcoming in 2003).

In terms of legal provisions for local government budgeting, the most important (if not the only one) seems to be the requirement for the budget to be balanced – focusing on the general fund broadly corresponding to the revenue (current) budget. Jones (2002, p.36, in Lüder and Jones, forthcoming in 2003) refers to two associated legal requirements. Both of these relate to the broad categories of expenditure and revenue to be included within the general fund: 1) the law defines what are and what are not capital items (the latter cannot be included within the general fund and are the only items that can be financed by borrowing); and 2) when capital items are financed by borrowing, a prescribed minimum amount of total debt outstanding must be charged to the general fund in any year.

- As stated before, the meaning of annuality seems to be particularly different, in the sense that in Portugal, for every part of the autonomous Public Administration with budgetary independence, there is no requirement to surrender unspent grants from the national government. Yet, because in the UK local government there is an exception to the strict interpretation of annuality, it might be argued that, in applying the principle there is no real differences.
- With regard to unity and universality, the differences are not significant as well. In fact, also in Portugal the single budget is in practice divided into capital and current budgets, both comparing respective expenditures with revenues of the same nature. Additionally, there is a legal economical classification to be followed uniformly by all local governments, defining what are current and what are capital items. The law additionally allows a departmental classification for expenditures. Within the context of cost accounting, expenses are required to be classified by legally defined broad functions – general functions, social functions, economical functions, and others – which are the same for every local government.

In the UK, some kind of classification for revenues and expenditure might be used as well, particularly for the revenue budget. As Jones (2002, p.39, in Lüder and Jones, forthcoming in 2003) explains, since accountants recognise the need to provide consistent information between local governments, a “standard

classification” was proposed by the professionals, in particular to be used in more detailed (second and third) levels of partition of the revenue account. This classification is to be used by local governments when publishing financial reports or providing statistics; its main purpose is to facilitate comparison of actual results between local governments. However,

In any of *the legally-required* financial statements, when reporting the costs of individual services within the local government, it is recommended that the profession’s code of practice on the classification of income and expenditure be used [italics provided]. This classification firstly defines each ‘service’ (the so-called ‘objective’ classification, e.g. highways, museums and art galleries) and then, within each service, the inputs (the ‘subjective’ classification, e.g. employees, running expenses). A recurring problem within this is that in some local governments the standard classification will not reflect the management structure. (Jones, 2002, p.47, in Lüder and Jones, forthcoming in 2003)

Concerning the use of that classification in budgeting, as the author also acknowledges,

(...) although there is an obvious advantage in using this standard classification in budgets (to facilitate comparison of budget and actual results between local governments), other purposes of budgeting (particularly control of budget-holders) sometimes conflict. (Jones, 2002, p.39, in Lüder and Jones, forthcoming in 2003)

In fact, particularly in the second level of partition, the revenue budget tends to be prepared reflecting each local government departmental/committee structure, being part of responsibility accounting. The problem here is, since there is no requirement for every local government to have the same organisational structure, this is different among local governments. Subsequently, at this level of classification, budgets are not comparable between local governments. Yet, at the third level, once there is more uniformity, budgets tend to be based on standard groupings of inputs (e.g. employees, premises, supplies and services, etc.) and miscellaneous income (sales, government grants, rents, etc.) provided by the professionals. The standard classification suggests a further level of detail, which might be used by some local governments in their budgets (e.g. supplies and services might be divided into: equipment, furniture and materials; catering; clothing, uniforms and laundry; printing, stationary and general office expenses; among many).

On the other hand, in Portugal, the Big Options of the Plan – comprising the investments multi-annual plan and a statement of other relevant non-investment activities – seems to be quite similar to the UK capital budget. Indeed, it is normally divided into objectives (strategic lines)¹⁵¹, which are divided into programmes, in

¹⁵¹ For example, the Big Options of the Plan for Porto municipality was in 2001 comprised of eighteen major objectives: increasing the standards of environment quality; increasing the standards of urban and architectonic quality; recovering of the historical centre; revitalisation of the traditional centre; improving

turn divided into projects, which might additionally comprise actions; furthermore, it also embraces a long-term period, legally established as a rolling period of four years.

- As was pointed out before, the meaning of balanced budgets is also different between the two countries. In the previous table, the legal requirement for a balanced revenue budget in the UK was explained as having clear consequences on the accounting basis – accruals as in business accounting, but with some changes to accommodate the legal requirements. This does not happen in the Portuguese system, because though budgeting and accounting are integrated, they follow clearly different accounting bases and rules, eventually related to different purposes. Accordingly, the different meaning of balance budgets seems to be associated with the relationship between budgeting and accounting in both countries. Further details on this matter are going to be offered below.

For the purpose of the present discussion, it is important to add first that in Portugal the legal requirement of balanced budgets addresses budgets in terms of inputs and cash-based. In the UK, as explained in the previous table, local budgets are accruals-based. Moreover, concerning debt repayment, in Portugal the principal is considered a capital expenditure, thus not included in the current (revenue) budget. Notwithstanding these differences, it is interesting to note what appears to be a common issue to the balanced budget definition in both countries: in Portugal it is allowed to use the current saving (surplus from the revenue budget) to finance capital expenditures; in the UK, something similar seems to exist, since there is the legal requirement for taxes (current revenues) to be levied in order to finance also the debt repayments principal.

- As to the publicity rule, there are some differences between the two countries related to the statements legally required to be annually published.

One concerns the legal requirements to publish the budgetary documents: in Portugal this is comprised within a formal and legally established process of budget approval within the local government budgeting and accounting annual cycle; in the

the conditions of security and protection of citizens; improving the provision of educational, cultural and sports equipments and facilities; revitalising “dead” areas; reinforcing social cohesion; improving mobility conditions; improving the conditions of communication and information to the citizens; modernisation of the municipality’s internal organisation; general functioning of the Municipalized Services; municipality’s external cooperation; animating cultural life and entertainment activities; delegation of competencies; promoting the economic activity; tourism promotion; and increasing the level of qualification of the municipality’s human resources.

UK, though budgets are still central in local government accounting, budgeting is a public but not so formal process.

Another difference relates to the annual performance plan, which is demanded in the UK and not in Portugal. This relates to the different development of local government performance measurement, already addressed in the previous table.

Nevertheless, there seems to be some similarities between the two countries on the main purpose that seems to lie beneath this publicity rule: all documents to be published appear to be used as mechanisms of accountability to those with an interest in local governments (regardless of the arguments and empirical support that might be presented for the citizens' lack of interest). Moreover, the published documents are also used in both countries as management tools, inasmuch as they seem to provide basic information to support many day-to-day decisions in the local government. This matter is addressed later on this section.

Some differences also seem to exist on the contents of the annual report, which are going to be highlighted in Table V.6.

- Concerning the additional rules for the forecast of budget items, two important issues must be highlighted. First, as already emphasised, the stringency of the legal pronouncements is evident in the Portuguese case, the UK being much more flexible regarding this matter. Second, associated to that discipline, there is a degree of prudence or conservatism within the budgeting and accounting process that appears to be greater in Portugal than it is in the UK. More on the prudence principle is going to be discussed in the following table.
- On the subject of the relationship between budgeting and accounting, there are also some important differences to be emphasised.

In Portugal, the purposes of budgeting and accounting are very distinct: while accrual-based financial and cost accounting have brought considerable addition to the traditional budgeting system, notwithstanding some changes in the way this is now operated (namely using double-entry), it continues aiming essentially at showing legal accountability (particularly to the deliberative committee and the external General Audit Office), controlling the budget execution, and calculating the budget deficit/surplus on a cash basis. In turn, financial and cost accounting, apart from calculating the cost of functions and goods/services provided, aim at determining each local government's patrimonial and financial position, according to a true and fair view, as well as determining the annual economic result on an

accruals basis. On the other hand, within the legal mechanism of the local budget approval, there is no requirement for endorsing forecasted financial/patrimonial accrual-based accounting information (e.g. forecasted Balance Sheet or Results Statement). Consequently, financial and cost accounting functioning essentially follows budgetary transactions, meaning that budgeting still strongly determines the development of the accounting and reporting system.

In the UK, traditionally, budgeting and accounting have been integral parts of the same system: the form and content of the budget were inseparable from those from the accounts and financial reporting; accounting for local government (whether *ex-ante* or *ex-post*) meant comparisons between budgets and actuals (including within published budgets or accounts). As Jones (2002, p.35, in Lüder and Jones, forthcoming in 2003) states,

The prevailing assumption was that the accounting basis of the budget had to be the same as that for the actuals.

Therefore, because local governments budgeting and accounting were (and still are) done by accountants, for accountants and auditors (Jones, 2002, p.35, in Lüder and Jones, forthcoming in 2003), and for the direct purposes of each local government, they have much in common with business budgeting and accounting: they address a specific time and place. Furthermore, they are not, either in form or content, the same as those required of each local government by the national government for macroeconomic purposes, in spite of significant overlap in data (Jones (2002, p.34, in Lüder and Jones, forthcoming in 2003).

Subsequently, the integrated system seems traditionally to be aimed at supporting local government internal management (notwithstanding the arguments presented in Jones and Pendlebury, 2002, regarding the assurance of legitimacy to internal accounting). However, over the past thirty years (and especially after the 1974 legal requirement for local governments to publish audited annual accounts) local government accounting and budgeting have become increasingly divorced (Jones, 2002, p.36, in Lüder and Jones, forthcoming in 2003): when the law has been used to prescribe certain accounting practices, it has focused on financial reporting, only peripherally referring to budgets; financial reports now tend not to give detailed budget numbers; budget documents tend to emphasise budget numbers often excluding details of actual spending; and the bases of accounting, as explained above, have diverged.

Some important consequences of this divorce in the UK have been clear:

- Local government budgeting, although a public process, is now hardly part of the formal accounting system (Jones, 2002, p.54, in Lüder and Jones, forthcoming in 2003);
- The overall statutory regulation on local government budgeting and accounting, executed by the national government, has in recent decades produced a tension between legal and professional requirements (Jones, 2002, p.35, in Lüder and Jones, forthcoming in 2003).

Brusca Alijarde and Condor (2002, p.139) also observe for the UK that there has been a separation of the accounting system from the corresponding budgetary system, so that the monitoring of the budget is not expressly recognised as an objective of the accounting information. They add that (Brusca Alijarde and Condor, 2002, p.139)

(...) local entities elaborate the financial information with the same criteria as other business entities, presenting the same statements, **without taking into account the budgetary obligations**. Sometimes a certain flexibility is maintained that permits the local entities to include budgetary information [our highlighting].

Jones (2002, p.54, in Lüder and Jones, forthcoming in 2003) seems to oppose that argument, stating:

The lingering influence of the budget on local government accounting, which produces an accounting that is different from contemporary business accounting, is of the legal requirement to charge operating accounts with a provision for the repayment of loans. **This is an influence of budgeting because the legal requirement related to the definition of the balanced budget**, which is also required by law [our highlighting].

As a result of the influence of the balanced budget legal requirements on one hand, and the legal imperative for local government to publish annual audited financial statements on the other hand, since the middle 1970s, local government budgeting have been increasingly dissociated from accounting. Yet, local government accounting including some comparisons with budgeted numbers has been converging to business accounting. As Jones (2002, p.54, in Lüder and Jones, forthcoming in 2003) emphasises, they now share fundamental features:

(...) cash management is a treasury management function carried out at the centre of each local government. Budgets, therefore, are authorities to spend in any form, whether the 'spending' is defined as the signing of a contract, the issue of an order, the receipt of goods, the receipt of an invoice, or the payment of cash. Scoring against the budget, in the formal, published annual accounting, is accrual-based, and the formal accounting of a local government is of its revenues, expenses, assets, liabilities and cash flows.

ACCOUNTING RECOGNITION AND MEASUREMENT CRITERIA		
Features	PORTUGAL	UNITED KINGDOM
GAAP:	Clearly set in the CALG as legal	The law does not address

ACCOUNTING RECOGNITION AND MEASUREMENT CRITERIA		
Features	PORTUGAL	UNITED KINGDOM
	requirements.	accounting principles in detail, although some laws sometimes refer to a basic accounting practice (e.g. fund accounting). Financial reporting on accruals basis takes UK business accounting practices as reference.
Reporting entity	Reporting entity is every entity of public or private law to which the preparation and presentation of the accounts according to the present Chart is compulsory. When the organisational structures and the management and information needs require, accounting sub-entities might be created, since the coordination with the central system is assured.	Financial reporting requires the production of a set of consolidated financial statements, including all funds, except those administered for third parties (e.g. pension and trust funds).
Going concern	It is considered that the entity operates in continuity, with unlimited duration.	
Uniformity/consistency	It is considered that the entity does not alter its accounting policies from one financial year to another. If it does and the changes would produce material effects, they must be disclosed in the notes to the financial statements.	
Accruals (specialisation)	The revenues and costs are recognised when obtained or incurred, regardless its receipt or payment, and must therefore be included within the financial statements of the year they refer to.	In spite of business accounting practices being followed, local authorities financial reporting is not totally accrual-based. There is a specific reporting on whether there was a surplus or deficit in the consolidated revenue account, which is partially determined by accrual-based numbers and partially not.
	The accounting records must be based on acquisition or production costs. The historical cost convention is generally followed, modified to include revaluation of certain	The definition for the principle is the same. However, the general rule for fixed assets is using current values (current cost), with revaluations every five

ACCOUNTING RECOGNITION AND MEASUREMENT CRITERIA		
Features	PORTUGAL	UNITED KINGDOM
Historical cost	fixed assets and other exceptions, namely in valuing some public domain goods in the initial balance sheet.	years at the latest, as well as annual test for impairment of the assets values at the end of each year. The historical cost (net of depreciation, when appropriate) is exceptionally used for infrastructure assets (e.g. roads, footpaths...) and community assets (e.g. parks, historical buildings...). For current assets, the face value is used, meaning historical cost (net of provisions when appropriate).
Conservatism/prudence	It means that it is possible to include within the accounts a certain degree of precaution when estimating values in uncertainty conditions without, however, allowing creating hidden reserves or excessive provisions or deliberately quantifying assets and revenues by shortage or liabilities and costs by excess.	
Materiality	Financial statements must disclose all elements considered relevant and that might affect evaluations or decisions by local governments committees and by all those with an interest in local government.	
Non-compensation	All elements within assets and liabilities (balance sheet), costs/expenses and losses and revenues and gains (results statement) are disclosed separately, and cannot be offset.	
Recording	All transactions must be recorded in the accounting following a chronological order, preventing the existence of gaps in the accounting information. Moreover, those records must follow technical procedures more suitable to the entity's organisation, in order to assure	The accounting records have to be sufficient to produce the required statements of accounts. Consequently, there are detailed requirements for the accounting records, namely that they must contain: 1) entries day to day of all sums of money received and

ACCOUNTING RECOGNITION AND MEASUREMENT CRITERIA		
Features	PORTUGAL	UNITED KINGDOM
	<p>information internal coherence.</p> <p>While not stated in the CALG, this principle is followed in the Portuguese local government accounting practices (e.g. there is a diary recording all day to day transactions).</p>	<p>expended, and the matters to which the income and expenditure or receipts and payments account relate; 2) a record of assets and liabilities; 3) a record of income and expenditure related to claims for contributions, grants or subsidies from the national government, a body appointed by the national government, or an EU institution.</p>
Substance over juridical form	<p>The accounting operations must be recorded considering its substance and financial reality and not only its legal form.</p> <p>This principle is not stated in the CALG, considering the legality override. Yet, the regulation allows some exceptions, where economic reality might be considered as prevailing over the legal form (e.g. financial leasing contracts).</p>	
Matching concept	<p>The revenues and gains must be balanced with the costs and losses in order to determine the economical net result in each financial year.</p> <p>Because its application within the governmental context is very controversial, it was decided not to be explicitly stated within the CALG. Yet, it seems to be underlying the application of the accruals principle, specially with respect to the computation of the entity annual economical net result (as an aim of accruals-based financial accounting), defined as a difference between costs and revenues in economical terms, and not expenditures and revenues in cash terms. Additionally, Local Finances Law states that Local Government accounting regime aims at allowing, among other things, analysing and evaluating each entity activities annual</p>	<p>It does not seem to apply to local governments revenue account, where the purpose appears to be calculating the amount of net cost of services to be met from central government grants and local taxes. This is made applying the legal requirement that taxes must cover repayment of loans to the so-called “net operating expenditure” measured for the entity as a whole. In turn, this starts from the “net cost of services”, which because it includes the “capital charge”, has to be corrected to reach the net operating expenditure (equivalent in companies to the net operating profit before taxation).</p>

ACCOUNTING RECOGNITION AND MEASUREMENT CRITERIA		
Features	PORTUGAL	UNITED KINGDOM
	result.	
TRUE AND FAIR VIEW	Yes. In spite of legality overriding, local governments accounts are required to present true and fair view. Moreover, any situation where the entity moves away from the pronouncements set in the CALG must be disclosed and justified in the notes to the financial statements, together with the consequences on the balance sheet and results statement.	Strictly, no. But local governments accounts should follow professional recommendations for fair presentation, notwithstanding the statutory provisions override. While there is no requirement to disclose that the statement of accounts conforms with the recommendations, there is a recommendation from CIPFA to fully disclose and, where relevant, quantification of the departure in the statement of accounts.
Recognition criteria and valuation rules:		
FIXED ASSETS DISCLOSURE	All fixed assets disclosed in the balance sheet (patrimonial perspective with accrual basis), even those that are not legally owned by the entity, such as those under financial leasing contracts and some public domain goods under the entity's control and management.	All fixed assets are to be capitalised (on an accrual basis).
Public domain goods (infrastructure and heritage assets)	The general rule is to disclose these assets using the production/acquisition cost (including direct and indirect costs), under the historical cost convention. However, it is generally acknowledged that for some of them, that value is sometimes difficult to reach, because it is unknown (especially for the initial balance sheet), or because they were gratuitously obtained. In these cases, if there are no similar assets which acquisition/production cost might be taken as reference, exceptions to the historical cost convention are allowed, namely using current costs, as result of evaluations applying criteria legally defined on the	Infrastructure assets (such as roads and footpaths) and community assets (such as parks and historical buildings) are valued at the historical cost. If a fixed asset is acquired without a cash consideration, it is included in the balance sheet at a "fair value" (defined as its price in an arm-length transaction less any grants receivable).

ACCOUNTING RECOGNITION AND MEASUREMENT CRITERIA		
Features	PORTUGAL	UNITED KINGDOM
	<p>Assessment and Inventory of Public Property (e.g. for insured assets, the current insurance value; for assets yielding a constant income, the income net present value; for buildings not to be sold, the replacement cost; for assets possible to be sold, the net realisable value).</p> <p>If neither of the above criteria can be applied (not adequate or too subjective), the assets are given temporarily a “zero value” (not capitalised in the balance sheet but referred to in the notes) until they are repaired.</p>	
Operational fixed tangible and intangible ¹⁵² assets	<p>Valued at the acquisition/production cost (including direct and indirect costs).</p> <p>If the value is unknown or there is no cash involved in the transaction, the criteria stated for public domain assets must be used.</p>	<p>Valuated at the lower of net replacement cost and net realisable value in existing use. The criterion of the “fair value” is also applied for these assets, if no cash is involved in the transaction.</p>
Long term financial investments	<p>Financial investments comprise investment in properties (non-operational fixed assets) and also capital bonds and shares, such as parts of capital in the equity of associated companies. All are capitalised using the historical cost.</p> <p>If the value for some properties is unknown, they must be valued using the criteria used for such cases in public domain goods, namely the net realisable value (market value), or the net present value of future rents.</p>	<p>Non-operational fixed assets (such as land and investment properties) are capitalised at the lower of net current replacement cost and net realisable value. For investment properties this will normally be an open market value.</p> <p>Long-term financial investments are valued at the market value¹⁵³.</p>
Leasing	<p>Assets under financial leasing contracts are treated as any others (different categories) that the entity legally owns, being an exception to the principle of</p>	<p>For finance leases, assets must be disclosed as being entity’s property, being valued according to the criterion appropriate to its</p>

¹⁵² CALG section 11 states that intangible fixed assets comprise namely certain rights (e.g. special licences to explore certain services exclusively, concession contracts...) and expenses related to the entity settlement and expansion (e.g. planned R&D in order to improve scientific and technical knowledge).

Carvalho *et al.* (2002, p.185) explain that some elements here were copied from the Chart of Accounts for Business Accounting, and its application to local governments is very short.

¹⁵³ Brusca Alijarde and Benito López (2002, p.163).

ACCOUNTING RECOGNITION AND MEASUREMENT CRITERIA		
Features	PORTUGAL	UNITED KINGDOM
	legal form prevailing over economical substance.	category.
REVALUATION (FIXED OPERATIONAL AND NON-OPERATIONAL ASSETS, INCLUDING PUBLIC DOMAIN GOODS)	As general rule, the CALG states that fixed assets cannot be revalued, except by legal authorisation. This does not mean compulsory revaluations, but just recommended. Any revaluations are credited as a Revaluation Reserve (equity).	For all assets included at a current value, there is a recommendation that there are formal revaluations every five years at the latest, but valuations should also be adjusted annually when the value of particular assets is adjudged to have changed materially. Any revaluations are credited to the “Fixed asset restatement reserve”.
DEPRECIATION (FIXED DEPRECIABLE OPERATIONAL AND NON-OPERATIONAL ASSETS, INCLUDING PUBLIC DOMAIN GOODS)	<p>All fixed assets with limited useful life must be systematically depreciated during that period (based on cost or revalued amount, if any revaluation had been authorised).</p> <p>There is a possibility of an extraordinary depreciation, recorded as an extraordinary cost, if at the end of the year, the asset market value is lower than its book value. This depreciation has to be suppressed when the motives that led to it no longer exist. It is allowed for fixed assets (tangible and intangible) either with finite useful life or not. In the first case, the assessment is done comparing the market value with the net book value (after the normal annual depreciation).</p> <p>Settlement and R&D expenses (intangible fixed assets) must be depreciated within a maximum period of five years.</p>	<p>Of all fixed assets, those with a finite useful life must be depreciated, being disclosed in the balance sheet net of depreciation (based on cost or revalued amount, as appropriate).</p> <p>In addition, the values of all categories of fixed assets in the balance sheet should be reviewed at the end of each year to test for impairment of the assets values. If the impairment loss results from a consumption in the economic benefit, it must be charged to the operating statement. If it comes from any other losses (e.g. reflecting the fall in the general level of prices), it should be charged to the “Fixed asset restatement reserve”.</p>
PROVISIONS FOR FINANCIAL INVESTMENTS	In accordance with the prudence principle, provisions must be created or reinforced at the end of the year, if the financial investment market value is lower than the book value (there is a potential loss). When the potential loss no longer exists, provisions have to be	Long-term financial investments face value in the balance sheet must reflect the market value, so provisions might be considered at the end of the year, to express changes in the market value.

ACCOUNTING RECOGNITION AND MEASUREMENT CRITERIA		
Features	PORTUGAL	UNITED KINGDOM
	suppressed.	
STOCKS	<p>The general valuation criterion is the purchase or production cost, under the historical cost convention (including direct and indirect costs, as for fixed assets). Some exceptions are allowed: for by-products, residuals and wasting, the net realisable value might be used.</p> <p>Sold stocks must be recorded in the stocks ledger at the specific cost or the weighted average cost.</p> <p>Work-in-progress – multi-annual activities (e.g. houses, but also roads, bridges and dams, still under construction) – must be valued considering the completion degree at the end of the year, computed by dividing the total cost incurred up to the moment over the sum of this with the estimated amount to complete the asset.</p> <p>Provisions are admitted (created or reinforced) at the end of each year: if the market value is lower than the book value, and if the goods are physically damaged, obsolete or for some similar reason they can only be sold at a price lower than its book value. The market value for reference here might be the replacement cost or the net realisable value.</p>	
RECEIVABLES (LONG AND SHORT TERM DEBTS)	Both long-term and short-term debts are disclosed at the face value, with provisions for bad debts, created or reinforced considering criteria essentially related to the time beyond the receivables turnover.	
LIABILITIES – ACCOUNTS PAYABLE	<p>Long-term debts and short-term liabilities are clearly distinguished. For both the face value is used.</p> <p>Provisions for contingencies and expenses are admitted at the end of the year, to assure</p>	Disclosure of provisions to meet future pension liabilities.

ACCOUNTING RECOGNITION AND MEASUREMENT CRITERIA		
Features	PORTUGAL	UNITED KINGDOM
(LONG AND SHORT TERM CREDITORS) – AND PROVISIONS	potential liabilities of specific nature (e.g. for expenses with legal processes in court, for personnel non insured working accidents and professional illnesses, for warranties to be provided to customers if the entity is obliged to provide post-sale assistance to the goods/services sold...).	
FOREIGN CURRENCY EXCHANGE RATE DIFFERENCES	<p>Credits and debts in foreign currency are valued using the exchange rate of the operation date, except if a different one had been agreed before. However, at the end of the year they must be up to date according to the actual exchange rate. The eventual exchange rate differences (costs or revenues) affect the economic result of the year, as general rule. The exception is for favourable differences: if expected to be reversible they must be deferred.</p> <p>Exchange rate differences are also considered for cash (foreign currency) on hand and short-term financial applications/investments, which value has to be up dated considering the actual exchange rate; eventual differences here are taken to the annual results statement.</p>	
CASH AND EQUIVALENTS, INCLUDING SHORT TERM FINANCIAL APPLICATIONS	<p>Disclosed at the face value.</p> <p>Foreign currency situations have to be up dated, considering the above-mentioned differences.</p> <p>For short-term financial investments, the face value is the purchasing cost. At the end of the year, provisions are allowed to be created or reinforced if the market value is lower than the book value.</p>	
ACCRUALS AND DEFERMENTS	In the accomplishment of full-accruals accounting principle, accrued revenues and deferred costs are disclosed as assets; accrued costs and deferred	

ACCOUNTING RECOGNITION AND MEASUREMENT CRITERIA		
Features	PORTUGAL	UNITED KINGDOM
	accrued costs and deferred revenues (of which the most common are investment grants) are disclosed as liabilities.	
EQUITY	<p>It is defined as the residual interest in net assets that remains after deducting liabilities.</p> <p>The CALG requires local governments' equity to comprise, where applicable:</p> <ul style="list-style-type: none"> • Patrimony • Adjustment of parts of capital in companies • Revaluation reserves • Legal, statutory, contractual and free reserves • Reserves from grants (non-investment and non-operational) and donations • Reserves from gratuitously transferred assets • Previous years accumulated results • Net Result of the Year 	<p>Although it is defined as the difference between assets (disclosed at net amounts) and liabilities, "total net equity" is disclosed in the balance sheet in a perspective emphasising not only that difference, but also the sources for financing total net assets.</p> <p>It is recommended to comprise:</p> <ul style="list-style-type: none"> • Fixed asset restatement reserve • Capital financing reserve • Earmarked reserves • Other balances

ACCOUNTING RECOGNITION AND MEASUREMENT CRITERIA		
Features	PORTUGAL	UNITED KINGDOM
COST OF SERVICES PROVIDED	<p>The CALG requires cost of functions to be compulsorily calculated, considering the functional classification.</p> <p>“Functions” are in fact activities performed by each entity, regardless the department. Each function (e.g. housing, sewage treatment...) normally embraces provision of several goods and services, for which costs underlying rates and prices must be computed. There are some functions (e.g. related to the entity management) that might not comprise any service/good to be provided.</p> <p>Accordingly, functions are divided in constituent services or goods (when appropriate) and total costs for functions have to be computed in first place, after which total costs for the services or goods they embrace are then calculated.</p> <p>All costs by nature must be reclassified by function, being divided in direct and indirect costs, and aggregated in cost cards of direct materials, direct labour, direct machinery and vehicles, and overhead (full absorption costing is used). Cost cards are also used to compute costs per function, service or good.</p> <p>Indirect costs (overhead) are conventionally allocated according to direct costs.</p> <p>Each function indirect costs are obtained applying to the total overhead, the coefficient direct costs of the function over the total direct costs of all functions. Each good/service indirect costs are obtained applying to the indirect costs of the function it is comprised within, the coefficient direct costs of the good/service over the total direct costs of the function it is comprised within.</p> <p>Only gross cost is compulsory to be computed (although revenues and results – net cost – by function, good or service</p>	<p>“Services” are generally considered as departments or political committees within each local government. Therefore, the cost of “service” is, in fact, the cost of the department or committee. On the other hand, for each “service” what is computed is the net cost, meaning gross expenditure less income, considering the “capital charges” instead of annual fixed assets depreciation and interest. Furthermore, the net cost of “services” is disclosed both in the revenue budget and in the revenue account.</p>

ACCOUNTING RECOGNITION AND MEASUREMENT CRITERIA		
Features	PORTUGAL	UNITED KINGDOM
	might also be computed as an option at each entity's will). Costs must be computed monthly using accumulated values up to the moment, and are not required to be disclosed (internal management accounting), though local authorities might include some information regarding costs in the financial reporting.	

TABLE V.5 – LOCAL GOVERNMENT ACCOUNTING RECOGNITION AND MEASUREMENT CRITERIA: PORTUGAL V. UNITED KINGDOM

Some comments must be added to Table V.5:

- Regarding GAAP, we basically listed what is stated in the CALG for Portugal, highlighting for the UK only the situations that seem to be different. Therefore, the majority of the principles applied are similar in both countries, mainly because both take business accounting as a reference for financial accounting practices. Yet, also in both countries, as it will be shown in the next table, local governments' financial reporting model is different from the one in companies: in Portugal it adds to the accrual-based financial statements, cash-based budgetary statements and additional information; in the UK, some financial statements might comprise information that is not strictly accrual-based (namely the consolidated revenue account), and there is a performance report.
- The matching concept seems to underlie the calculation of the Annual Net Result and the Results Statement by Nature itself in Portugal, since, as occurs in business accounting, within this statement, several types of results are computed – operational, financial, current, extraordinary, and net results – all requiring each category of annual costs to be balanced with respective revenues, in a strictly accrual (economical) perspective.

In the UK, the Annual Revenue Account aims at disclosing the net cost of services (in an accrual basis, though different from that used in business accounting, due to the “capital charge”) that has to be financed by local taxes and grants (spending/cash perspective). Therefore, notwithstanding the Net Operating Expenditure (parallel to the Portuguese Annual Net Result) is computed for the entity as a whole (in an

accrual basis similar to companies), the matching concept does not seem to be applied.

- With respect to the “true and fair view”, we acknowledge it is more a relevant feature/purpose of financial reporting information than an accounting principle. However, it might be seen as an embraceable accounting principle that is accomplished if all GAAP are complied with.

For Portugal, CALG section 8.2.1 (notes to the balance sheet and results statement) clearly requires:

Statement and justification of the CALG pronouncements that, as exceptional cases and duly substantiated despite what is established in the law, have been departed from, as well as its effects on the balance sheet and results statement, so that these can provide a true and fair view of the local government assets, liabilities and results.

- Some differences are noticeable with respect to fixed assets recognition and valuation criteria. As general rule in both countries, all fixed assets (including infrastructure and heritage) are to be disclosed in the balance sheet. However, within capital accounting technique (as in other accounting practices) more flexibility is allowed amongst British local authorities than amongst Portuguese ones, meaning that in the former case there are some exceptions at the discretion of each local authority. Therefore, as Jones (2002, pp.52-53, in Lüder and Jones, forthcoming in 2003) explains,

(...) there have been a number of ways in which different authorities could produce materially different measures of assets and expenses. The requirement to include all fixed assets in the balance sheet has been subject to the varying of *minus* levels. Some authorities have only capitalised those with values of £5,000 or over, others with values of £25,000 or over. For those categories of assets that are shown at current value, the rolling programme of valuation (...) can produce different schedules across authorities for the same categories of assets. The capital charges are left to each authority to determine. The minimum levels of these depend on the depreciation charge. Some authorities did not depreciate most of their assets, on the ground that they were extending their useful life to the point where depreciation would not be material, by making regular repairs and maintenance.

- Also the valuation criteria for fixed (capital) assets seem to indicate that, in general, there is a higher degree of prudence in Portuguese than in British local governments’ accounts. Even though both countries follow the prudence principle, and the UK uses historical cost for infrastructure and heritage assets, the general rule here is to use current cost for fixed assets, while in Portugal the general rule is to use historical cost, surely more prudent since it shows lower assets’ values. Additionally, while in Portugal any fixed assets’ revaluations have to be authorised by law, in the UK there is a recommendation for formal revaluations to be done every five years at least, apart from annual revisions of fixed assets values in the

balance sheet. Therefore, it might be said that prudence principle is not applied in both countries at the same level.

- Concerning the use of historical cost *versus* current cost, the question arises only in the context of fixed (long term) assets. In fact, current assets valuation criteria are similar in both countries, using the face value (historical cost) net of provisions where there is a potential loss at the end of the year in comparison with the market value.

Yet, for fixed assets, there are differences between the two countries. As stated, the general rule for Portugal is the historical cost convention, while in the UK it is the current cost. However, it seems that the exceptions in both countries relate to the same type of assets – infrastructures and heritage: in Portugal these are the (main) exception to the use of historical cost; in the UK these are the exception to the use of current cost.

- Regarding revaluation of fixed assets, the differences do not seem significant.

In Portugal, fixed assets revaluations cannot be done, except if there is a legal authorisation to do it. Only when this happens, all fixed assets – public domain goods, operational, and non-operational (investment) fixed assets – might be revalued. Nevertheless, this revaluation is not a requirement, but just a recommendation to be followed at the discretion of each entity management committee. For business accounting, the legal authorisation/recommendation has been approximately every five years¹⁵⁴. Given its closeness to business accounting practices, this periodicity will tend to be adopted also in governmental accounting.

In the UK, formal revaluations are recommended every five years at the latest, but only for fixed assets included in the balance sheet at the current value, meaning excluding infrastructure and community assets (public domain goods). Additionally, also for fixed assets at current value, annual revaluations should be made if the assets value change materially.

On the other hand, there is a recommendation for an annual test for impairment of all assets' values at the end of each year. Although this test is not considered in the Portuguese local government accounting system, and it is not carried out by Portuguese local authorities, the CALG allows an extraordinary depreciation for all fixed assets, either with finite useful life or not. The character of this depreciation,

¹⁵⁴ The latest was by Law-decree 31/98, February 11th, to reevaluate fixed assets as at December 31st 1997.

not related with the annual normal depreciation, seems to bring it close to an annual impairment test, since the assets' book value is compared with the market value at the end of each year, leading to this depreciation in the case of loss. Moreover, regardless of the causes of the value loss, it is always considered a cost that has to be annulled when the loss is reverted.

- Each entity balance sheet in Portugal discloses for each item in the assets, gross amounts (including any revaluation if legally authorised), accumulated depreciation or provisions as appropriate, and net amounts. In the UK local authorities' balance sheets, assets are disclosed using the net amounts, i.e., including revaluations but with accumulated depreciation or provisions deducted.

It might be argued that, in the Portuguese case, more information is disclosed in that statement, since in the UK, information on gross amounts and accumulated depreciation or provisions cannot be gathered directly from the balance sheet.

- As stated, the valuation criteria for current assets and liabilities are broadly similar for both countries, explaining why we basically listed what is clearly stated in the Portuguese CALG. One difference worth stressing concerns the disclosure of contingent provisions. In the UK, local authorities are recommended to disclose provisions to meet future pension liabilities. This is not a requirement in Portugal, where the provisions for contingencies relate to other potential expenses. Here, local government employees are, in general, public civil servants, whose career is regulated at central level, where there is an autonomous pensions fund which every public civil servant is obliged to contribute to with a certain percentage of his/her monthly salary.
- There are also important differences in the equity structure. First of all, in the Portuguese case, the equity structure set in the CALG is essentially copied from that used in the Chart of Accounts for Business Accounting, with slight adaptations.

The *Patrimony* corresponds to “capital” in companies: it represents the funds related to the entity constitution, as a result from the initially attributed assets and liabilities; if the entity is already created and is applying the CALG for the first year, this is just the difference between assets and liabilities (CALG section 11.3). This item does not seem to exist in the UK recommended statement.

The *Adjustment of Parts of Capital in Companies*, which also does not seem to have a parallel in the UK statement, is to be used in recognising financial investments (parts of capital) using the “equity method”.

As to the *Reserves*, there are some similarities, but also some considerable differences, once again due to the fact that, in the Portuguese case, the companies' model is closely followed. The *Revaluation reserves*, corresponds in the UK to the *Fixed asset restatement reserve*, and comprises differences in the assets values resulting from revaluations. In the UK case, it might also comprise losses in the assets values as a result of annual impairment tests.

The *Capital financing reserve* in the UK has no parallel in Portugal; in fact, as was explained, this results from applying the “capital charge” to the cost of services, for the use of capital invested, which is not done in Portugal.

As to the *Legal, statutory, contractual and free reserves* in Portugal, all of them must be created from the positive Net Annual Result. CALG section 2.7.3.5 requires local authorities to compulsorily constitute a *legal reserve* of 5% of the (surplus) Net Annual Result. Concerning the *Statutory and free reserves*, CALG section 11.3 states that they are to be created (according to deliberation of the respective committees) only by local authorities that have legal authorisation for these (e.g. municipalities' associations and metropolitan areas). They do not seem to have equivalent reserves in the UK.

Reserves from grants and donations might be somehow comparable to the *Earmarked reserves* in the UK.

Reserves from gratuitously transferred assets comprise the book value to be given to assets gratuitously transferred from other entities also using the CALG (CALG section 11.3). Therefore, they might be considered a specific type of donations.

Previous years accumulated results, again as happens in companies, this is the balance brought forward of the Net Annual Result of previous years. The balance here accumulated must be used either for constitution or reinforcement of reserves, or for reinforcement of *Patrimony*, which in turn has to be at least 20% of the entity's net assets (CALG sections 2.7.3.2.to 2.7.3.4). All these requirements were brought from business accounting to local government accounting in Portugal, where the Net Annual Result computed in the Results Statement is clearly evidenced as part of the entity's equity.

In the UK, this does not happen. Equity in local authorities is different from companies, comprising essentially reserves (whose importance within the equity is emphasised considering the recommendation to prepare a statement of total movement in reserves). The Annual Net Result (Net Operating Expenditure) in the

UK local authorities accounting system is not emphasised in the balance sheet (notwithstanding the revenue account), which reveals how unimportant this seems to be for the entities management, where the central information appears to be the net cost of services provided.

– Regarding the costs of services provided, the differences worthy of being highlighted are:

- In Portugal they concern cost of functions, services and goods provided (activities), and not departments or political committees, as is the case in the UK. Subsequently, it might be said that the cost of services provided is computed at a more detailed level in Portugal than in the UK. Yet, because in Portugal the CALG admits entities to classify expenditures per departments, this suggests that costs per department might be computed as well.
- In the Portuguese local government sub-system of Cost Accounting, goods and services are always included within some function, although some functions might not be divided into any particular services or goods (e.g. general administration, concerning the entity administrative and financial management).
- According to the Portuguese costing rules, all costs from financial accounting have to be reclassified and considered (divided into direct and indirect) for the computation of the total cost of functions, goods or services, in cost cards. Therefore, a full accrual basis similar to companies is used here. In the UK, as explained, the accrual basis is different, since services (departments/committees) are charged with a “capital charge” for the use of all assets, which is different than the normal annual depreciation plus interest charged for debt, considered in businesses.
- In Portugal they are gross costs, i.e., what the CALG requires entities to do is to compute gross amounts of costs of functions, as well as those underlying the establishment of rates and prices for goods and services provided within each function (when appropriate). Although entities might (as an option) additionally compute revenues and results by function and service, this is in fact different than in the UK, where the cost of services (departments/committees) provided are computed and disclosed net of income.

The major reason we believe this is not done in Portugal is that most services (activities) do not generate direct income to be deducted from the gross expenses. The main exceptions are the Municipalized Services (independent units within each local authority, providing functions/services in a business way, for which there are rates and prices – sometimes here the service is coincident with the function): for these it could be said that the net cost of the “service” (meaning the net cost of the unit, similar to the British notion) is the Net Annual Result for the unit, disclosed in the respective Results Statement.

- The Portuguese CALG does not require entities to disclose cost of functions, goods or services provided, though they might decide to do it. In the UK system, the net cost of services is disclosed both in the revenue budget and in the revenue account.

The accounting system in both countries involves several tasks allowing to process operations in the accounts in order to keep financial information up to date, as

well as to prepare the annual financial reporting. Yet, the application of all the above-listed accounting recognition and measurement criteria has to be controlled by a set of procedures that in Portugal are designated as the Internal Control System.

For Portugal, in the CALG section 2.9.1 this is required to comprise the plan of control arrangement, policies, methods and procedures, as well as other methods and procedures defined by the entity’s responsible committees. These aim particularly at assuring activities order and efficiency, including: assets safeguard, prevention and detection of illegal, fraud and error situations, accuracy and integrity of the accounting records, and reliable information to be prepared on time. The Internal Control System (which must be officially approved by the entity’s committees, published, and sent to The Court of Accounts – General Audit Office) must encompass: the Internal Control Norm (specific methods and procedures to control records in all accounts), the Organisational Plan (departmental structure, highlighting responsibilities), Specific (internal) Regulations, Accounts Lists, the Accounting Procedures Manual, and the Internal Auditing (control) Procedures Manual.

Such system also exists in the UK, as Jones (2002. p.45, in Lüder and Jones, forthcoming in 2003) stresses, and it must include:

- Measures to ensure that the financial transactions of the body are recorded as soon as reasonably practicable and as accurately as reasonably possible;
- Measures to enable the prevention and detection of inaccuracies and fraud;
- Procedures to reconstitute any lost records;
- Identification of the duties of officers dealing with financial transactions and division of responsibilities of those officers in relation to significant transactions;
- Procedures for uncollectable amounts, including bad credits, not to be written off except with the approval of the responsible financial officer (or his staff) and for the approval to be shown on the accounting records.

The author also emphasises the requirement for each local authority to have an adequate effective internal audit system of its accounting records and control systems, which seems to be similar to the internal auditing procedures manual within the Portuguese Internal Control System.

FINANCIAL (INCLUDING BUDGETARY) REPORTING FORM AND CONTENTS		
Features	PORTUGAL	UNITED KINGDOM
Form:	Non-consolidated (individual) accounts (though there is some consolidation in budgeting – Municipalized Services are already considered within the summary	Audited accounts are statutorily required to be annually prepared and published for each local

FINANCIAL (INCLUDING BUDGETARY) REPORTING FORM AND CONTENTS		
Features	PORTUGAL	UNITED KINGDOM
	budget of each municipality as a whole).	authority as a whole – legal entity – excepting some funds (budgets are also prepared for the entity as a whole).
Contents:	Each local government annual report comprises both budgetary and financial statements and complementary notes, presented in a particular order suggested in the CALG; these are minimum requirements, meaning that each entity might disclose additional information according to its needs, as long as keeping within the CALG rules and principles. It is expected an introduction to be included with a general overview of the report, highlighting the most important points.	The annual report is distinguished from the annual accounts (financial reporting), sometimes even as a separate document. Hence, it comprises information beyond the financial statements, namely on the budget execution and an annual performance report.
ENTITY CHARACTERISATION	<p>Elements such as:</p> <ul style="list-style-type: none"> – Identification (name, address, revenue services identification number, etc.); – Regulation applied, including internal statute; – Organisational structure (departments, committees, etc.); – Summary description of the main activities; – Human resources, namely identifying the president and other members of the local committees, inasmuch as they are individually responsible by the positions they hold; – Accounting organisation: computing and information system main features, interim reports if existent, general overview of the accounting system, among others. 	<p>Supposedly, this information would be included in the report introduction (and in the explanatory foreword to the annual accounts).</p> <p>Additionally, information concerning the entity itself might be included within a statement recommended by the accounting profession related to the local government responsibilities.</p>
	<p>Within the budgetary accounting sub-system, budgetary statements are required to be prepared, namely for the purpose of controlling the budget execution. These disclose essentially cash-based information. Its form and content are set within the CALG.</p> <p>They are:</p> <ul style="list-style-type: none"> – Note to the Investments Multi-Annual Plan – Note to the Budget – Notes to the Budgetary Execution Statements – Expenditures and Revenues – Statement of Annual Execution of the 	Budget numbers are not part of financial reporting, notwithstanding some broad comparisons of budgets and actuals.

FINANCIAL (INCLUDING BUDGETARY) REPORTING FORM AND CONTENTS		
Features	PORTUGAL	UNITED KINGDOM
STATEMENTS OF BUDGETARY EXECUTION (cash-based)	<p>Investments Multi-Annual Plan</p> <ul style="list-style-type: none"> – Note to the Cash Flow Statement – Note to the Treasury Operations Statement – Notes to the budgeting process and budgetary execution – complementary statements: <ul style="list-style-type: none"> • Budget modifications • Modifications in the Investments Multi-Annual Plan • Contracting out situation • Transfers and grants • Financial investments and applications (fixed and variable income) • Debt 	
FINANCIAL STATEMENTS (accruals-based)	<p>Balance Sheet (horizontal)</p> <p>Results Statement (economic results by nature; by function is optional)</p> <p>Notes to the Balance Sheet and Results Statement:</p> <ul style="list-style-type: none"> – Valuation criteria – Changes in Gross Fixed Assets – Changes in Depreciation and Provisions for Fixed Assets – Loans to finance fixed assets – Revaluations – Fixed assets managed or controlled by third parties – Fixed assets built in third parties property – Reversible fixed assets – Assets in financial leasing regime – Fixed assets not possible to be valued – Not depreciable public domain goods – Participated entities – Information on the treasury (short term financial) applications – Materially relevant differences in stocks valuation – Extraordinary provisions – Bad (doubtful) credits – Debts to and from the personnel – Bonds and other (borrowing) securities – Debts to the State in delay – Warranties and bails provided by third parties – Accumulated provisions – Changes in the accounts of Class 5-Patrimonial Fund 	<p>Explanatory foreword</p> <p>Statement of accounting policies</p> <p>Consolidated revenue account (by departments/services)</p> <p>Some fund revenue accounts</p> <p>Consolidated balance sheet (vertical and highlighting the difference between assets and liabilities)</p> <p>Statement of total movements in reserves</p> <p>Consolidated cash flow statement (model close to that from companies – by type of activities)</p> <p>Pension fund accounts</p> <p>Notes (comprising group accounts if the local authority has subsidiary and/or associated companies)</p>

FINANCIAL (INCLUDING BUDGETARY) REPORTING FORM AND CONTENTS		
Features	PORTUGAL	UNITED KINGDOM
	<ul style="list-style-type: none"> – Statement of the cost of sold commodities and used materials (periodical inventory system) – Statement of production variation – Statement of financial results – Statement of extraordinary results 	
MANAGEMENT REPORT	<p>It comprises general information on:</p> <ul style="list-style-type: none"> – The entity’s economical situation in that year, especially analysing the management evolution of different activity segments (namely in what concerns to investment, operating conditions, and costs and revenues when appropriate) – The entity financial situation, including financial ratios supporting the balance sheet and results statement analysis – The (long and short term) debt evolution, as well as receivables – Justified proposal for application of the annual net result – Relevant facts after the year-end <p>Some information here might be cash-based.</p>	Additional information on the entity economical and financial situation is provided on the notes to the accounts.

TABLE V.6 – FORM AND CONTENTS OF LOCAL GOVERNMENT FINANCIAL (INCLUDING BUDGETARY) REPORTING: PORTUGAL V. UNITED KINGDOM

Some additions are important to be made clarifying the information in Table V.6:

- In Portugal the so-called “Annual Management Report” for local governments comprises, as listed, cash-based statements of budgetary execution complemented with notes, accrual-based financial statements with supplementary notes, and the management report. The presentation order suggested in the CALG indicates a model of an annual report divided in four major parts from the introduction onwards¹⁵⁵: 1) Financial Statements (in particular Balance Sheet and Results

¹⁵⁵ As Carvalho and Jorge (2003) highlight, exemplifying with the case of Porto Municipality, this order tends not to be followed in practice by Portuguese local governments in its reports, inasmuch as budgetary information not only has been presented in first place in the report, but also has comprised the most part of the information disclosed (in Porto case, around 75% of the whole 2001 report was disclosing cash-based budgetary information). This is justified by the importance that in practice cash-based budgetary information still has for the Portuguese local governments executive and deliberative committees, because this is the one that is approved in budgeted terms and therefore against which is important to make comparisons to actuals for control purposes. Additionally, accrual-based numbers are acknowledged as still very difficult to understand by local politicians, considered important users in practice of the financial reporting information.

Statement); 2) Statements of Budgetary Execution; 3) Appendix, organised in three sections – entity characterisation, notes to the Balance Sheet and Results Statement, and notes to the budgeting process and budgetary execution; and 4) Management Report (which contents are clearly stated in CALG section 13).

Therefore, contrary to what might happen in the UK, the annual report is not a document separate from the annual accounts; in fact, these constitute the major part of that. Furthermore, the annual statement of accounts (financial reporting) in Portugal manifestly includes budgetary information, because one of the main purposes of the information it comprises is controlling the budget execution. In the UK, as emphasised before, notwithstanding some comparisons of budgets to actuals might be made, financial reporting does not encompass budgetary statements.

As Brusca Alijarde and Condor (2002, p.139) explain, contrasting with the tradition in the UK, budgetary information is nowadays not necessarily included in the statement of accounts (financial reporting), though it might be in the annual report, sometimes published as a distinct document from the annual accounts. This might then include comparisons of actuals to budgeted numbers, as well as a performance measurement report that, as explained in Table V.3, does not exist yet in Portugal.

- The financial statements listed on the table for the UK are according to the CIPFA *Code of Practice on Local Authority in the UK: a Statement of Recommended Practice* (in Brusca Alijarde and Condor, 2002, p.136). Nevertheless, Jones (2002, p.45, in Lüder and Jones, forthcoming in 2003) refers to the 1996 Accounts and Audit Regulations to give more details on local government financial reporting contents. Accordingly, the statement of accounts must include the following list of statements, where no reference is made to budgeted numbers:

- An explanatory introduction;
- Summarised statements of income and expenditure of each fund in relation to which the local government is required by any statutory provision to keep a separate account;
- A summarised statement of capital expenditure, showing the sources of finance of the total capital expenditure in the period;
- A statement of the accounting policies adopted, drawing attention to any changes of policy which have significant effect on the results shown by the statement of accounts;
- A consolidated operating account;
- A consolidated balance sheet;
- A consolidated cash flow statement;
- Notes to the accounts.

Compared with Portugal, apart from the already stated differences concerning consolidated accounts, there are two important differences.

One relates to the operating (revenue) account. As explained in Table V.5, the Revenue Account in the UK is different from the Results Statement in Portugal: it clearly does not consider the matching concept and, though the Net Operating Expenditure is computed (which is similar to the Portuguese Annual Net Result in the Results Statement by Nature), its main purpose seems to be reaching the amount of net cost of services to be met by government grants and local taxes, considering the legal requirement of balanced revenue budgets. Therefore, some numbers here are not accrual-based.

In Portugal, the Results Statement by Nature balances costs with revenues of the year (model copied from the business accounting with slight adaptations), and it is undoubtedly a financial statement prepared only on a full accrual basis. It also does not aim at calculating and disclosing the cost of services, which is done separately in the Cost Accounting sub-system, being part of the internal management accounting; however, within this sub-system, each local government might disclose a statement of costs by function¹⁵⁶, considering the functional classification that the CALG requires to be compulsorily used in Cost Accounting.

The other difference regards the cash flow statement. Although in both countries it is prepared on a cash basis, in the UK it is considered a financial statement, while in Portugal it is a budgetary statement, presenting dissimilar form and contents, and having apparently a different utility and reason underlying its preparation. In fact, according to the Portuguese CALG (section 2.3.4.4),

The cash flow statement discloses the receipts and payments associated to the budget execution and others (*non-budgetary*) affecting treasury, evidencing the initial and final cash balances [italics provided].

Therefore, it is included in the budgetary accounting sub-system and not in financial accounting. It must also comprise changes in the receipts pending collection, and warranties and bails provided by third parties and represented by contracts – order accounts (see Table III.8). The most important information it discloses relates to the balance for the next administration: it shows if the budget now closing was managed more or less successfully, presenting respectively a cash surplus or deficit. Since it

¹⁵⁶ For example, Porto Municipality in 2001 financial reporting disclosed a statement of expenditures (instead of costs) by function (functional classification), because the cost accounting sub-system was not yet in operation.

is a budgetary statement, instead of providing information on the local authority capacity to generate cash inflows or equivalents (from operational, capital or financing activities – on a vertical model) allowing evaluating the need for external financing – as it is the case of the UK – the cash flow statement in the Portuguese system compares receipts with payments following an horizontal model, only distinguishing those related to the budget execution from treasury (non-budgetary) operations. Therefore, it does not allow evaluating the contribution of each type of activities within the entity for creating cash flows. On the other hand, the information on Order Accounts is not addressed in the British framework.

- In both countries financial statements include corresponding amounts for the previous year for the purpose of comparative analysis.
- The law in Portugal, namely that regulating the competencies of local governments committees, as well as the Local Finances Law, set a period between four to five months beyond the financial year-end (December 31) for the annual report to be published (after the final approval by the deliberative committee – local council), i.e. by the end of May at the latest. In the UK, this time length is nine months, meaning until December 31 at the latest, considering the financial year-end March 31.
- In the UK, the accounting profession recommends a statement of the respective responsibilities of the local governments itself and of the responsible financial officer. Jones (2002, p.46, in Lüder and Jones, forthcoming in 2003) presents a combined statement, where local government responsibilities are broadly stated as requirements (e.g. make arrangements for the proper administration of its financial affairs, manage its affairs so as to secure economic, efficient and effective use of resources and safeguard its assets, and approve the accounts). Additionally, the Chief Financial Officer's responsibilities are also generally stated as being responsible for the preparation of the entity's accounts in accordance with the professional Code of Practice. In the remainder of the statement, his responsibilities statement is narrowed to that year's financial reporting (e.g. selecting suitable accounting policies and applying them consistently, making reasonable and prudent judgements and estimates, keeping proper accounting up to date records, taking reasonable steps for the prevention of fraud and other irregularities).

The final part of the statement is a certification by the Chief Financial Officer that the statement of accounts “presents fairly” the entity's financial position and income

and expenditure for the year now ending. This is a legal requirement, since the law recognises the responsible financial officer as also responsible to its employers, i.e., the local government as a whole, including politicians (Jones, 2002, p.44, in Lüder and Jones, forthcoming in 2003).

Although this statement is not required in Portugal, local government responsibilities are set in the law that broadly characterises the competencies for all local governments in Portugal (Law 159/99). The law also states the responsibilities and functioning rules for the local committees – executive and council (Law 169/99). Additionally, there are some internal statutory provisions, namely included in the above-referred Internal Control System (which is defined for each local government, approved by the local council and published), where responsibilities are clearly defined for those holding internal control positions. Nevertheless, up to the moment, no certification of the accounts is legally required to be stated by the responsible financial officer.

FINANCIAL (INCLUDING BUDGETARY) REPORTING INFORMATION OBJECTIVES		
Features	PORTUGAL	UNITED KINGDOM
INFORMATION QUALITATIVE CHARACTERISTICS: – Objectivity/understandability – Consistency – Comparability – Timeliness – Relevance/Materiality – Reliability (faithful representation, neutrality, prudence and completeness)	Yes, though not explicitly stated in the CALG.	Yes, though not clearly stated in the recommendations.
PURPOSES:		
Legality control (legal compliance in the management of public funds)	Yes	Yes, though not explicitly.
Monitoring the budget execution (budgetary control)	Yes	No
Disclosing the entity patrimonial and financial position (assets and the way they are being financed – liabilities)	Yes	Yes
Disclosing the entity economic annual surplus or deficit – net result (services financed with resources from the year; potential future financial needs)	Yes	No

FINANCIAL (INCLUDING BUDGETARY) REPORTING INFORMATION OBJECTIVES		
Features	PORTUGAL	UNITED KINGDOM
Disclosing the cost of services provided	No	Yes
Controlling economy, efficiency and effectiveness	Yes, though not explicitly.	Yes
Accountability (to facilitate monitoring by): – Legislative committees – External auditing bodies – Creditors and other (external) resources providers (e.g. bondholders, grantors and donors) – General public	Yes Yes Yes No	No Yes Possibly No
Protecting creditors	Yes	No
Supporting internal decision-making (management and control) process	Yes	Yes
Supporting outside government debt providers decision-making	Yes	Possibly

TABLE V.7 – OBJECTIVES OF LOCAL GOVERNMENT FINANCIAL (INCLUDING BUDGETARY) REPORTING INFORMATION: PORTUGAL V. UNITED KINGDOM

A few additional notes to Table V.7:

- We believe it important to make some references to the information’s qualitative characteristics, since compliance with these might be seen as an objective of the financial reporting information. In fact, regardless of the financial reporting purposes, if information does not fulfil these features, its significance is in jeopardy. Accordingly, in both countries, financial reporting information usefulness rests upon the listed characteristics, of which the most important are relevance and reliability, often having an inverse relationship. Notwithstanding financial reporting searching for maximum relevance for users’ needs, the fact is that sometimes this is prevented from being attained in order to get reliable information, thus being restricted by all the other characteristics. Moreover, balancing benefits with costs of preparing the information to be included in the financial reporting is another important constraint to be considered when carrying out the necessary trade-off between these characteristics.

Although not explicitly stated in the regulations or recommendations, they are implicitly followed in the financial reporting preparation both in Portugal and in the UK.

- Conformity with a certain budgetary regime is a common feature of both the Portuguese and the British local governments. In fact, in governmental entities, the traditional and enduring role of accounting in controlling financial assets and liabilities, lead to the use of budgets as comprehensive and complex control systems, with different dimension and importance than in businesses. In this sense, budgets have an equally important role in both countries local government management, inasmuch as they are instruments for financial control.

However, as highlighted in Table V.4, in the UK, especially since 1974, the accounting system does not embrace budgetary information. Furthermore, as stated in Table V.6, budgeting is not part of the formal accounting and financial reporting system. Therefore, monitoring the budget execution (budgetary control) is clearly not recognised amongst the main purposes of local government financial reporting in the UK, which subsequently does not include budgetary statements.

Brusca Alijarde and Benito López (2002, pp.168-169) explain that the UK is among the countries that have been orienting the main purpose of financial reporting to disclose information about the economy, efficiency and effectiveness of the services provided, inclusively adapting budgetary information for this purpose, since output budgets are now prepared. Moreover, they argue that accounting information here aims actually at improving public administration management and not merely rendering accounts (showing accountability).

On the other hand, in Portugal, as emphasised in Table V.6, financial reporting includes cash-based budgetary information, because monitoring the budgeting execution is one of its main purposes. Within the integrated local government accounting system, the budgetary sub-system linked to the financial accounting sub-system, has a considerable importance, as shown in particular in Table V.4, in fact leading all the process of recording the transactions on the accounts. Nevertheless, it was also stated that each sub-system within the CALG produces different kind of information with clearly dissimilar purposes: the budgetary sub-system produces budgetary cash-based statements, essentially aiming at demonstrating legal accountability and controlling the execution of the (still) cash-based budget, as well as computing the annual cash deficit/surplus; the financial accounting sub-system prepares financial statements, aiming at disclosing accrual-based information on the entity's financial and patrimonial (all assets and liabilities) situation, as well as determining the annual economic net result; the cost accounting sub-system aims at

calculating the (gross) costs of functions (activities), as well as those underlying the rates and prices for the goods and services provided. Therefore, since the financial reporting in Portuguese local governments compulsorily comprises budgetary and financial information (disclosing information on costs of functions is not a specific requirement, though entities might include it in the report), the above-sated objectives are clearly its main purposes.

In **summary**, local governments financial (including budgetary) reporting in Portugal aims at: 1) showing if the resources were obtained according to what is set in the law and in the budget, 2) informing on the origins of the financial resources used and their destinations, 3) showing the entity's capacity to finance its activities, and 4) showing a true and fair view of the entity's financial and patrimonial situation, as well as of the annual economical net result. Computing gross costs of functions and costs underlying the rates and prices of the services provided is one of the purposes of the Portuguese local government cost accounting sub-system, but disclosing information on those is not necessarily a purpose of the financial reporting. Controlling economy, efficiency and effectiveness is not a purpose clearly stated for the local authorities financial reporting in Portugal, especially considering that performance measures, plans and reports are not yet legally required. However, one of the main reasons acknowledged for the local governments accounting reform that is ongoing is was a perceived need for the system to provide information in order to control financial equilibrium and efficiency, along with legality – the system must allow legal, financial and economical control. The introduction of cost accounting (despite all the deficiencies that the sub-system still might present) as one major addition to the previous regime, is already a clear indication of a considerable importance attached to the understanding of costs structure in order to better manage and control each entity's activities and services provided (mainly in terms of economy and efficiency). Additionally, the use of performance indicators is by now being considered, inasmuch as it has also been acknowledged that there is a need to complement the annual net result, which is a very weak performance measure in the Public Administration.

On another hand, in the UK: 1) showing legal and budgetary compliance is not an explicit purpose for the local authorities financial reporting; 2) calculating and disclosing the entity annual net result is not a purpose as well; 3) computing and disclosing the net cost of services to be financed by central government grants and

local taxes is a clear objective of the annual revenue account, which also discloses the annual cash deficit/surplus; 4) getting “best value” on providing the services (either directly or using other organisations) is a current legal requirement for local authorities in the UK, now obliged to prepare and publish an annual performance plan that is a mechanism of accountability for those with an interest in the local government to control economy, efficiency and effectiveness. Though this plan is not part of the annual accounts (financial reporting), it is compulsorily comprised in the annual report, as explained in Table V.6; furthermore, it includes financial information. Consequently, it might be said that providing information for controlling economy, efficiency and effectiveness is another clear purpose of the local governments financial reporting in the UK.

- Accountability is in general a common purpose of the local government financial reporting in both countries, considering that in every country, government financial reports always aim at providing information for the proper authorities controlling public money.

Nevertheless, there are some important differences in regard to the entities local governments might (are requested to) be accountable to in each country. In other words, the external users actually using local governments financial (eventually including budgetary) reporting information for monitoring (control) purposes are distinct between Portugal and the UK.

In Portugal there is a separation between executive and legislature (local parliament – deliberative committee) at local level (legal mechanism of budget proposal, public discussion and approval). Hence, legislative committees are here important users of financial (and budgetary) reporting information, requiring executives to demonstrate both operational and fiscal (legal compliance with the budget) accountability. Regarding external auditing bodies, The Court of Accounts is the General Audit Office; subsequently, it is the major oversight body that local governments have to be accountable to, especially on fiscal (legal and budgetary) accountability.

On the other hand, in the UK local government there is no separation of legislature and executive – no use of law through which the budget approval by the legislature is expressed. Therefore, there is no accountability to local legislative committees. As to external auditors, local governments auditing has always been independent from the Comptroller and Auditor General. In this sense, it is different than in Portugal. Yet, local governments’ accountants are accountable to auditors via the

annual financial reporting information: as highlighted in Table V.3, local authorities accounts are audited on compliance with the law and fair presentation, by either district or private auditors nominated by the Audit Commission.

Regarding the use of local governments financial reporting to show accountability to creditors and other external resources providers, first of all it is important to consider Central Government.

Notwithstanding Portuguese local government autonomy, grants (non-earmarked transfers) from Central Government have been on average one third of local government total revenues. Furthermore, some earmarked financial transfers from contract-programs and cooperation agreements are also provided by Central Government. Accordingly, local governments must also be accountable to Central Government through the financial reporting (though yet again, at present, particularly showing fiscal accountability). In fact, the regulation passing the CALG (Law-decree 54A/99, article 6) requires, for the purpose of monitoring local finances, that both forecasted (budgetary) statements and financial reporting to be sent (30 days after presented by the executive committee, regardless the approval by the deliberative committee) to the respective Regional Coordination Commissions (regional representatives of the Central Government), which later must send a report to the Local Government General Department for the purpose of global assessment of local government financial situation and prospective analysis of the local finances.

In the UK, on average 75% of local spending is met from Central Government. This, more specifically the Treasury, though not explicitly having the power over, or responsibility for, local government finances and patrimony, has power and responsibility over the financing provided centrally. Additionally, the major part of local government borrowing has been provided by a National Government Agency. Consequently, Central Government as a resource provider requires accountability from local government. Moreover, the Treasury seems to have some interest in controlling the use of grants which strict annuality is applied to. On another hand, within the “Best Value Regime”, demands are not only for fiscal, but also for economy, efficiency and effectiveness accountability.

Another important category of financial resources providers is debt providers (outside the government), namely creditors or bondholders, who might also use local government financial reporting for the purpose of monitoring the entities’

economic-financial situation, especially concerning its ability to repay the debt outstanding (probability of default). In addition, debt providers might also use local government financing reporting information to support decisions of providing loans or investing in local government bonds. The central issue relates to the assessment of the risk taken in lending operations.

There are important differences between Portugal and the UK regarding the type of lenders and subsequently the kind of information they might require (information needs) from local governments financial reporting.

Whereas in Portugal, as was explained in Table V.3, creditors (namely banks and other financial institutions providing loans) are more important than bondholders, in the UK capital markets are stronger and thus tend to be much more important as a possible source of debt financing. In line with Nobes' (1998) arguments presented in section 1, the requirements made to the accounting system in terms of form and contents of the financial reporting are different if the financing system regarding external resources is credit-based or securities-based (capital markets). On another hand, there is also a considerable difference regarding the risk involved in lending to local governments in both countries: while in the UK it has been considered as default-free, in Portugal it is not. Accordingly, whereas in Portugal, creditors have an interest in the local governments financial reporting information, in the UK, security-holders do not care. Nevertheless, recent changes in the financing of UK local governments seem to have affected the debt default-free character. Therefore, lenders might become possibly interested in local governments financial reporting.

Furthermore, as it will be addressed in the following section, because local governments financial accounting and financial statements closely follow business accounting practices, the information they disclose in Portugal aims at protecting the creditors (for example, favouring the historical cost convention, requiring the creation of legal reserves, disclosing a true and fair view of the entity's assets and liabilities, and calculating an accurate and reliable annual economical net result on the basis of legally established detailed rules). In the UK, creditors do not need protection (debt has been taken as default free). Instead, given the proximity to business accounting, the main concern might be providing more relevant and diverse information (sometimes at the expense of some reliability and prudence – e.g. favouring the use of current cost) to persuade anonymous outsiders as possible bondholders.

Citizens (general public) are believed as non-important users in practice in both countries. For the UK there is some empirical evidence stated in section 1 supporting the view that the general public do not have an interest in local authorities' accounts. For Portugal there is no such evidence (there is still no empirical study on the use of the local government accounting information resulting from the CALG application); however, as also explained in section 1, a study on the usefulness of financial reporting resulting from the new local government accounting system was developed for Spain, in an environment very similar to the Portuguese one; in this, citizens were clearly stated as non-important users of local governments financial reporting. Nevertheless, in Portugal the system promoters seem to claim that improved accountability to citizens and taxpayers is one of the main results of the current local government accounting reform. Yet, this seems to be what is supposed to happen in modern democracies, where local authorities (in theory) should use financial reporting to express accountability to the electorate.

- Regarding the purpose of providing information for decision-making, it is important make a distinction between internal and external users. In the first case, the information comprised within the financial reporting (regardless if including only financial or budgetary information as well) appears to be generally acknowledged as used for the internal management and control processes (eventually including the budget preparation) both in Portugal and in the UK, i.e., financial reporting is used as a management tool in both countries.

On the other hand, the usefulness of financial reporting information for external users decision-making is rather debatable, especially considering some empirical evidence referred to in the previous section, when discussing the purposes and the main users of financial reporting as causes for international differences in local governments accounting systems. However, as discussed above, outside government debt providers, namely creditors and bondholders, might have an interest in local government financial reporting information in both countries. For Portugal, given the similarities between local government contexts and accounting systems, we can follow the results shown in the above-referred Spanish study on the usefulness of local governments financial reporting for creditors – they are one of the main external users, namely when deciding about providing credit. This is reinforced by the fact that, as stated, local governments debt in Portugal is not considered as default-free.

For the UK, as far as it is our knowledge, there is no empirical study specifically on the usefulness of local government financial reporting for outside government debt providers’ decision-making (perhaps because the main debt provider has been the Central Government). If existent it most likely would show that outside government lenders have not been interested in local governments accounts, because debt has been default-free. Nevertheless, we believe that the recent return of local governments to money markets for borrowing (with suggestions for introducing credit ratings, inasmuch as the default-free conditions seem to be changing), might increase the importance of those as users of local government financial reporting information to make decisions regarding possible investments.

Finalising this section, we present a table summarising the major differences between the Portuguese and the British local government accounting systems.

LOCAL GOVERNMENT ACCOUNTING SYSTEM MAIN FEATURES	
Broad Categories	Major Differences
INSTITUTIONAL FRAMEWORK	<ul style="list-style-type: none"> • Consolidated financial reporting • Requirements v. recommendations of accounting principles and practices – uniformity (Chart of Accounts) v. flexibility • Budgeting accounting basis: cash v. accruals (revenue budgeting and accounting in the UK with two different accrual bases) • Long-term borrowing: banks and other financial institutions v. central government and capital markets; non-default-free v. default-free • Performance measurement
BUDGETING RULES AND PRINCIPLES	<ul style="list-style-type: none"> • Great detail v. broad statutory framework – uniformity v. flexibility • Legal requirement for balanced revenue annual budgets in the UK: must consider repayment of debt principal and interest – consequences on the bases of accounting • Degree of prudence • Relationship between budgeting and accounting: integrated v. totally separated systems

LOCAL GOVERNMENT ACCOUNTING SYSTEM MAIN FEATURES	
Broad Categories	Major Differences
ACCOUNTING RECOGNITION AND MEASUREMENT CRITERIA	<ul style="list-style-type: none"> • Historical cost convention v. current cost as general rule for fixed assets • Degree of prudence • Matching concept • Provisions for future pension liabilities • Equity structure • Cost of services provided: <ul style="list-style-type: none"> – Activities, goods/services v. departments/committees – Gross cost v. net cost – In the UK must include a “capital charge”, corresponding to an opportunity cost for the use of capital
FORM AND CONTENTS OF FINANCIAL (INCLUDING BUDGETARY) REPORTING	<ul style="list-style-type: none"> • Individual v. consolidated statements • Budgetary together with financial statements v. financial statements eventually with some budget to actual comparisons • Performance reporting • Results statement v. revenue account • Cash flow statement: budgetary v. financial statement • In the UK – statement of responsibilities
FINANCIAL (INCLUDING BUDGETARY) REPORTING INFORMATION OBJECTIVES	<ul style="list-style-type: none"> • In Portugal: <ul style="list-style-type: none"> – Disclosing the cost of services provided is not a purpose – Controlling economy, efficiency and effectiveness is a purpose not explicit • In the UK: <ul style="list-style-type: none"> – Budgetary control is not a purpose – Local legislative committees do not require accountability – Protecting the creditors is not a purpose • Information requirements by debt providers: credit-based v. capital market-based financing system

TABLE V.8 – SUMMARY OF THE LOCAL GOVERNMENT ACCOUNTING SYSTEMS: PORTUGAL V. UNITED KINGDOM

In our point of view, not all these differences are equally important. We believe that the most significant regard:

- **The cost of services**, due to the concept of “service” itself, and particularly given the consideration of the “capital charges” in the UK. Therefore, here the revenue account uses an accrual basis different from that used in business accounting, also including cash numbers, taking into account the legal requirement for annual balanced revenue budgets. Yet, these features seem to be very particular to the British system, not necessarily extended to other Anglo-Saxon countries.
- **The accounting basis for budgetary accounting**, with budgets still essentially cash-based in Portugal. This we believe relates to the tradition of local government

accounting in both countries. While in Portugal it has been only cash-based budgeting, in the UK budgeting was integrated in the accounting system, with the same form, contents and accrual basis. The recent tendency has been opposed in both countries: integration in Portugal and separation in the UK. Accordingly, while in the UK the separation has led to divergence in the accounting basis though still accruals, in Portugal the integration has led to introducing full accrual-based financial and cost accounting within a system for which this was totally unfamiliar. This “revolution” however, did not reach budgetary accounting basis yet. In our understanding, this is because the accruals concept is very difficult to understand by the main (external) users of the Portuguese local government financial and budgetary reporting – deliberative committees and The Court of Accounts – for which cash-based information for controlling the budget execution is still the most important.

– **The importance of budgeting and budgetary control**

The integration in Portugal did not diminish the role of budgeting in determining the development of the accounting and reporting systems; financial and cost accounting functioning is still basically guided by budgetary transactions.

The separation in the UK has led to budgeted numbers to be reduced (if not banned from) within the financial reports.

Referring to the previous item, this is therefore related to the main purposes of the local government financial reporting, which in turn are determined by the requirements made to the system by its users (information needs). As presented in Table V.7, there are some relevant differences on this matter between Portugal and the UK, which are going to be picked up for the discussion in the next section.

- **Outside government debt providers**, as one of the most relevant external users of the local government financial reporting. The differences here relate to the features of the financing systems dominating in each country: credit-based in Portugal and capital markets-based in the UK. Different prevailing financing systems determine the type of financiers (creditors v. bondholders), who might have different information needs subsequently making different requirements of the local government accounting and reporting system.

In summary, we observe similarities between the local government accounting systems prevailing in both countries, namely in the form and contents of the reports produced. Nevertheless, differences still remain as to their aims and purposes.

On the other hand, we also consider that at broad level more commonalities than differences seem to exist between the two systems. While acknowledging that those are hard to balance, we believe that this raises the question whether the international dichotomy of Continental European v. Anglo-American governmental accounting is valid. However, at a more detailed level, we still recognise the existence of considerable differences that justify the classification of the two systems in eventually different groups. Brusca Alijarde and Benito López (2002, pp.166-176) made an attempt in this direction, as mentioned in the literature review, classifying the local government accounting systems of Portugal and the UK in separate groups, using cluster analysis: the former is included within the group of accounting systems with a medium-high degree of development; the latter within the group of accounting systems with a high level of development.

From a comparison US/UK, Giroux *et al.* (2000, p.30) came to a conclusion that we believe also valid for our comparative study:

In significant ways, differences in accounting and auditing for local governments in the two countries are, as it is to be expected, intrinsic parts of the different structures of their sovereign governments (albeit both of which are characterised of being within liberal democracies).

We also think that this conclusion can possibly to be extended to any comparative-international research within industrialised developed countries, where differences will always be found at several levels. The central issue is analysing if those differences will be relevant enough to conclude for (local) governmental accounting systems being fundamentally different.

3. AN EXPLANATION IN COMPARATIVE PERSPECTIVE FOR THE PORTUGUESE LOCAL GOVERNMENT ACCOUNTING

Perhaps a good way of starting addressing this discussion on the “why” of Portuguese local government accounting in comparative-international perspective with the United Kingdom is putting three questions:

- Why the budgetary accounting is as it is?
- Why the financial (and cost) accounting is as it is?
- Why they relate (or not) as they do?

Although we are not going to address each question individually, our answers to all of them lay basically upon the following arguments:

- “Historical” reasons – tradition and evolution process of local government accounting in each country;
- The local government political structure and budgetary process (legal mechanism for the local budget approval and execution);
- The users of local government financial (including budgetary) reporting information and their needs (purposes of the local government financial reporting information);
- The proximity to business accounting;
- The financing system predominating in each country.

As mentioned, local government accounting (as governmental accounting in general) in Portugal was traditionally single-entry Budgetary Accounting, i.e. cash-based budgeting, aiming at showing legal and budgetary compliance and recording cash movements. Governmental accounting was not an autonomous discipline, being integrated in Law (due to its legal matters) and in Public Finance (for its strictly cash perspective). Therefore, the main purpose was controlling the budget and it was subsequently very different from business (financial) accounting.

In the UK local government, traditionally budgeting and accounting were integrated in the same accrual-based system. Accounting and budgeting tasks have been carried out by professionally-qualified accountants (since its birth in the UK in the middle nineteenth century, the accounting profession has included a specific accounting body for local government). Moreover, addressing a specific time and entity, local government accounting and budgeting in the UK had (and still have) much in common with business budgeting and accounting (though the publication of budgets is the rule in local governments, while is the exception in businesses).

In both countries, there has been a changing process in the local government accounting and budgeting system since the middle 1970s. The proximity to business accounting has been increasing.

In the UK there have been significant improvements in accounting practices consistency: local government and business accounting and budgeting have now the same essential characteristics. On another hand, as stated, within local government, budgeting and accounting have been divorcing.

In Portugal, the major changes have happened since 1990 as a consequence of a governmental accounting reform process at a national level. The new local government accounting system set in the 1999 CALG has been implemented, bringing financial and cost accrual-based accounting to be integrated with budgetary cash-based accounting.

There was, of course, great addition with the two new sub-systems; the budgetary accounting sub-system itself suffered some changes as well (e.g. now uses double-entry), especially because the need of integration. Although each sub-system has clearly different functions, the leading role is for budgetary transactions to be recognised in the three sub-systems according to different stages and perspectives.

Therefore, the first reason we believe explains the “why” of both countries local government accounting systems, also elucidating on the importance of budgeting and its link (or not) to accounting, is **the local government accounting tradition and evolution process**.

Within the process of approximation to business accounting, in Portugal it was chosen to add to the single existent cash-based budgetary accounting, financial and cost accrual-based accounting, closely following the model for businesses (namely the Chart of Accounts for Business Accounting), without reducing the central role of the former. Additionally, the reform did not imply abandoning or replacing the fundamental rules and purpose of budgetary accounting: expenditures and revenues are still recognised on a modified cash basis (with encumbrances for future commitments); the main purpose continues to be controlling the budget execution.

In the UK, there has always been a significant proximity between business and local government budgeting and accounting. Yet, more recently, within local government, there has been an increasing separation between budgeting and accounting, with budgets becoming essentially an instrument for central government financially controlling local elected councillors (politicians) – authorisation for spending – totally apart from the accounting system, which therefore does not include controlling the budget execution within its purposes. This seems in fact a political issue, within the relationship between central and local government.

Furthermore, in Portuguese local governments, contrary to those in the UK, authorisation for spending is not given by central government. There is a political process at local level, totally independent from the central government (although similar to that happening there), through which the local budget is legally prepared and presented by the executive committee to the local legislature (local council – deliberative committee), to be discussed, approved and published at a certain time. Therefore, there is a political commitment from local politicians with the cash-based budgeted numbers approved (budgetary statements). This legal requirement is not extended to the approval and publication of any forecasted financial/patrimonial

accrual-based statements (e.g. forecasted Balance Sheet or Results Statement). On the other hand, local budgets are also authorisations for spending given by the council to the executive. These are still understood and recognised in terms of cash, in our point of view given the difficulties in comprehending the accruals concept by those non familiar with accounting, namely politicians. This does not mean that Portuguese local politicians are not concerned about costs (of activities or services) and efficiency, which is proved by the importance already given to cost accounting in the new local government accounting system (CALG). However, costs are still not considered in both local governments budgets and budgetary accounting.

Even so, local councils in Portugal have also to approve local governments annual accounts, which given the traditional central role of budgeting, include cash-based budgetary information (budgetary statements reporting on the execution of both the budget and the investments multi-annual plan) together with the new added accrual-based financial information (financial statements reporting on the entity's financial and patrimonial situation, as well as on the annual economical result). The central role of budgetary information, which in practice, as explained in Table V.6, still embraces the majority of each local government financial reporting, in our opinion, is due, on one hand, to the aforementioned difficulties in understanding the accruals concept. But, on another hand, it might also be justified by the legal mechanism underlying the budgetary process (from approval to execution). Because the law requires local councils to publicly approve and commit to only the annual budgeted cash-based numbers, these are those fundamental to be controlled through an equally reliable instrument: the accounting and financial reporting system, in particular the annual accounts, which are also required to be approved and published by a legal mechanism similar to the budget approval. Notwithstanding the inclusion of accrual-based financial statements in the accounts, these are still relegated in practice to second place (Carvalho and Jorge, 2003).

In the UK there is no use of law through which the local budget approval by the legislature is expressed. In fact, there is no separation between local legislature and executive. Additionally, local governments budgets were traditionally inseparable from the accounts: budgets and accounting integrated within the same system. Hence, it might be stated that budgets have been important tools supporting local governments internal control and management, especially considering that local governments accounting used to mean always comparing budgets with actuals. On another hand,

local budgets are also authorisations for spending given by central government to local councillors. These have a political commitment to their main external financial resources provider – the Treasury –, which therefore has the power and responsibility for controlling the way they are applied (i.e. budgetary execution). Over the past thirty years however, it seems that the role of budgets as tools for internal management has been reduced, considering the increasing divorce between budgeting and accounting. Moreover, once the budgetary control, though financial, tends to be of political nature, there is no need for accounts to report on the budget execution. Thus, budgeting is totally separated from the formal accounting and financial reporting system.

Consequently, another important factor in our explanatory theory concerns **the local government political structure and budgetary process**, in particular **the legal mechanism for the local budget approval and execution**.

Based on Nobes' (1998) arguments presented in section 1, we also argue that another important factor explaining why local government accounting systems are as they are in Portugal and in the UK, concerns **the main purposes (uses) of the accounting information produced and reported**. As argued, these are strongly determined by **the information needs of the main users of the local government financial (eventually including budgetary) reporting**.

Subsequently, we argue that different purposes of local government financial (and budgetary) reporting also determine the importance of budgeting and budgetary control within the accounting system. Yet, in the users/users' needs approach, this is in the last instance conditioned by what users find as important to satisfy their information needs.

Referring to Table V.7, if internal users are the same in both countries, then accounting information might be used for similar internal purposes. However, this is not the case with external users and their needs (purposes they require for the information included in the local governments financial and budgetary reporting). As explained, the relevant external users are legislative/deliberative committees (only for Portugal), oversight bodies, namely auditors (in Portugal specifically The Court of Accounts) and external financial resources providers (Central Government and outside government debt providers).

Accordingly, in the Portuguese local government accounting system, considering the arguments we have just provided for other factors important in our theory, budgetary information remains the most important because the external users of local governments' financial reporting still find controlling the budget as the main role of the

accounting and reporting system. These users, as explained in Table V.7, are in particular deliberative committees, The Court of Accounts and, to a lesser extent, Central Government.

In the UK, empirical evidence referred to in section 1 showed that auditors and Central Government are the main external users of local government's financial reporting. Regarding the first, their main function is to provide an opinion about local governments financial statements, in particular on compliance with the law and on the fair presentation. Therefore, they are not concerned with budgetary statements – budgetary information is not important for them. A different situation appears to happen with the Central Government, namely the Treasury: as main financier, it seems to have a special interest in controlling the budget execution. However, this rather statutory process of a political nature, aims essentially at financially controlling the local politicians, thus being totally separated from the accounting system. This is also related to the aforementioned mechanism of budget approval and execution.

Nevertheless, we may say that in both countries, budgeting somehow affects the way local government accounting systems work: even though this influence is clearly larger in Portugal, it also exists in the UK, in particular concerning the revenue budget and account.

As to financial (and cost) accounting in particular, it has been acknowledged the **proximity of the local government accounting system to that used in business accounting**. In our point of view, this might also answer why these (sub)systems are as they are in both countries: they have been following/adapting the business financial accounting system prevailing in each country. Because the business accounting systems used in both countries have some differences, these have been transported to local government accounting.

Accordingly, we believe some arguments presented in the literature for eventual differences in business accounting, might also be considered here. Once again picking up Nobes' (1998) perspective, one important factor explaining international differences in businesses financial reporting, which can be adopted to local governments, might be **the financing system prevailing in each country**, represented by the type of **outside government debt (external financial resources) providers**.

As highlighted before, the prevailing financing system in Portugal is credit-based, while in the UK is capital markets-based. Despite the fact that the main (long-term) debt

provider in the UK has been a central government agency, local governments are now returning to capital markets. Consequently, while banks are the main creditors in Portugal, in the UK, capital markets predominate as important financiers after Central Government. These financiers, as explained in Table V.7, might be another category of external users of the local government reporting, making different information requirements, specifically to financial accounting.

Indeed, as explained, because local governments debt in Portugal is not default-free (though it might be seen as of low risk) lenders have an interest in their accounts. Also in UK local governments, because default-free conditions seem to be changing, lenders might become possibly interested in their financial reporting information.

On another hand, the proximity of local government accounting to business accounting in both countries (where lenders, both within capital markets and as creditors, have a especial interest in companies' financial statements to assess the risk) might lead us to consider that lenders would also be interested in local governments financial reporting: they would have a particular interest in information regarding the entity's economical-financial situation and its capacity to repay the debt outstanding, thus not interested in budgetary information.

Moreover, the proximity to business accounting has also brought to local government accounting some particularities of the former, sometimes not so important within the latter context.

In the Portuguese case there are several examples of rules and procedures required in the CALG that were copied from the Chart of Accounts for Business Accounting that are not very relevant for local governments: R&D expenses, legal reserves, valuation criteria for stocks, among others. An outstanding feature is the patrimonial perspective: all patrimony, namely assets, belonging to the entity must be disclosed in the balance sheet. This explains the public domain goods (infrastructure and heritage assets); yet, unlike business companies, these cannot legally be used for the entity's debts/responsibilities, so the relevance of this disclosure is rather debatable.

Similarly, protecting the creditors is amongst the purposes of local government financial reporting information in Portugal. In fact, as in businesses, local government financial reporting aims at showing a true and fair view of each entity's patrimony, financial situation and annual economical-financial result, in order to protect those with some special interest in it. In business accounting, those whose interests are to be protected are essentially creditors and tax authorities. In some cases, taxation rules still

have a considerable influence over accounting rules. Although accountability for taxation purposes is irrelevant in the local government context¹⁵⁷, protecting the creditors was an objective carried from business to local government accounting (notwithstanding local governments creditors' need to be protected as well), which therefore also demands rules detailed by legal pronouncements, so as to benefit that purpose.

In the UK, the information prepared by the business accounting system does not address the creditors in particular, i.e. financial reporting embraces information more concerned with the prevailing equity-holders' needs, in that greater quantity and diversity of information is emphasised, many times at the expense of reliability and accuracy. These features were also somehow brought into the local governments accounting context.

Finally, we believe we can conclude as we did in the previous section: that sovereign independent democratic governments in each country have the ultimate power to decide on local governments budgeting and accounting rules, according to their will.

4. FINAL NOTES AND OPEN ISSUES

In this chapter we basically offered an explanatory theory for the “why” of local government accounting in a comparative-international perspective with the United Kingdom.

We started presenting and analysing some ideas from the literature on comparative-international governmental and business accounting, which we believed as useful to support our theory building, namely because they were addressing possible factors for explaining eventual international differences in local government accounting systems features. From the discussion, in the line with Nobes' (1998) arguments, we came to the conclusion that “specific purposes of local government financial (and budgetary) reporting” seems to be one key reason for international major differences between local government accounting systems, as it is in business accounting. Nevertheless, that factor is strongly determined by “the main users of the financial reporting”. On another hand, the financing system predominating in each country, associated with the “external financial resources providers”, is also very important in determining those purposes/objectives, the relationship being reinforced by the fact that

¹⁵⁷ Except in Municipal Business Enterprises, but these are not the issue here.

external financial resources providers are actually users of the financial reports. Furthermore, some empirical evidence seems to show that for local government both in Anglo-Saxon and Continental European countries, the main users of financial (and eventually budgetary reporting) are internal. As to external users, apart from external audit bodies, those who might be more interested in local government reporting seem to be financial resources suppliers that, as Nobes' (1998) also explains, are essentially equity outsiders in Anglo-Saxon countries, while in Continental European countries tend to be fundamentally credit insiders, considering the degree of development of capital markets. Therefore, from a process of elimination, from eight factors we argued that "external financial resources providers" is one factor apparently prevailing over all the other factors as a fundamental issue to consider in explaining the major international differences in local government accounting.

We continued the chapter carrying out a thorough comparison between the Portuguese and the British local government accounting systems internal characteristics, which we grouped in five broad categories of eventually distinctive criteria: 1) institutional framework; 2) budgeting principles and rules; 3) accounting recognition and measurement criteria; 4) form and contents of financial (including budgetary) reporting; and 5) financial (including budgetary) reporting information objectives. From the comparison we highlighted several differences. However, in our understanding, not all of them are equally important, the most significant being: the cost of services provided, the accounting basis for budgetary accounting, the importance of budgeting and budgetary control, and outside government debt providers. Furthermore, we argued that, notwithstanding these and other differences at a more detailed level – which will naturally be expected as intrinsic parts of different structures of both countries sovereign governments – at a broad level more commonalities than divergences seem to exist between the local government accounting systems prevailing in both countries, raising the question whether the international dichotomy of Continental European v. Anglo-American governmental accounting is valid.

Finally, in the last section we provided an explanation – an inductive theory – in comparative-international perspective with the United Kingdom, for the Portuguese local government accounting. Our answer to the central question "why local government accounting system in Portugal is as it is, comparatively to the UK?" rests basically upon several arguments, which we believe explain some of the most significant differences emphasised at the end of section 2, namely: the accounting basis

for budgetary accounting, the importance of budgeting and budgetary control and their influence in accounting, and the type of outside government debt providers associated to the financing systems prevailing in each country. Accordingly, these arguments are:

- “Historical” reasons – tradition and evolution process of local government accounting in each country;
- The local government political structure and budgetary process (legal mechanism for the local budget approval and execution);
- The users of local government financial (including budgetary) reporting information and their needs (purposes of the local government financial reporting information);
- The proximity to business accounting;
- The financing system predominating in each country.

While all of them apply to both the budgeting and accounting (sub)systems, the last two are specifically related to financial accounting.

We evidently acknowledge that the arguments raised here, though empirically based, are very debatable, meaning that they are unfinished questions needing further research, namely embracing other countries. Summing up, the main open issue in our explanatory theory is that it needs empirical testing in order to be validated, following what has been suggested for CIGAR further developments: more quantitative or “hard” research.

CHAPTER VI

CONCLUSION

This thesis addressed local government accounting in Portugal in what could be said to be a complete approach.

The main purpose was to offer an inductive theory explaining why Portuguese local government accounting system is as it is and has evolved as it has, in a comparative-international perspective, by comparing with the one from the United Kingdom. One underlying intention was to bring the Portuguese local government accounting situation to the international literature.

The study started with a literature review showing what is known of the “why” of governmental accounting systems, concentrating on local government accounting when possible. From this we came to conclude that:

- The international literature on Portuguese (local) governmental accounting is poor, concentrates on the “how” of accounting technique, and most of it is outdated;
- Other material that might be seen as attempts at theory concerns governmental accounting conceptual frameworks, IPSASs and the Contingency/FMR Model. Yet, none of these provide explanations for the “why” of governmental accounting systems in comparative-international perspective: the first relate specifically to the Anglo-American context and essentially explain the “what ought to be” of governmental accounting systems; the second are simply international standards for recommended practice of governmental accrual-based financial reporting, not addressing budgeting and once again focusing on the Anglo-American accounting context; the third, while addressing Continental European countries within the CIGAR context, is an explanation for the “why” of governmental accounting reform process towards a more informative accrual accounting and budgeting system – it explains why governmental accounting reform processes happen and does not address the systems contents.

Subsequently, the thesis continued with three main chapters, each one representing a key contribution.

Firstly we comprehensively explained how the Portuguese local government accounting system currently works, specifically addressing the “how” of budgetary, financial and cost accounting technique, and focusing on the 1999 CALG. Some problems on its functioning were additionally highlighted. This chapter also embraced

brief descriptions on the Public Sector, on the evolution of governmental accounting (specifying the local government), and on the governmental accounting standard-setting process in Portugal.

Then we used the FMR Model to explain the recent innovations in the Portuguese governmental accounting, describing the context within the reforms have been occurring. The model was also used to predict the conduciveness to future developments, offering some glimpses at the probability of further reforms. The focus here was on the central government situation, once the reform has been a top-down process. Yet, some particularities of the local government accounting innovations were also referred to.

Although we had suggested some changes in the original model to be applied to the Portuguese case, we concluded that in general the contingency approach could be used to explain the governmental accounting recent reforms in Portugal. Moreover, the model allowed us to show that the context has been favourable not only to the current reform stage, but also seems to be encouraging further stages. Accordingly, we suggested factors that might possibly affect future innovations. For example: dominating doctrine of superiority of Anglo-American governmental accounting, together with the perceived gap between the actual budgeting and accounting system and the system recognised as needed, as major positive stimulus; and scholars networks, professional associations and standard-setting bodies as main reform drivers. Notwithstanding that they are expected to be slow to happen, future governmental accounting developments were anticipated, such as the extension of the CAPA to be applied to the non-autonomous Public Administration, the definition of a conceptual framework, and further improvements in management accounting. Specifically for Local Government we predicted consolidation rules, performance reporting and a CALG revision.

The same model was also used to explain the governmental accounting innovations process that recently occurred in the Iberian countries.

The final and most important contribution was an explanatory inductive theory for the “why” of local government accounting, comparing Portugal with the United Kingdom. It is a technical theory, since it does not rely upon contextual factors.

The process involved comparisons between the Portuguese and the British local government accounting systems internal features, grouped in five wide categories: institutional framework, budgeting principles and rules, accounting recognition and

measurement criteria, form and contents of financial (including budgetary) reporting, and financial (including budgetary) reporting information objectives. We showed that at a broad level more similarities than differences seem to exist between the local government accounting systems prevailing in both countries, which questions the validity of the international dichotomy of Continental European v. Anglo-American governmental accounting.

We finally provided an answer for the question “why local government accounting system in Portugal is as it is, comparatively to the UK?”, which rested essentially upon the following arguments:

- “Historical” reasons – tradition and evolution process of local government accounting in each country;
- The local government political structure and budgetary process (legal mechanism for the local budget approval and execution);
- The users of local government financial (including budgetary) reporting information and their needs (purposes of the local government financial reporting information);
- The proximity to business accounting;
- The financing system predominating in each country.

The main limitation we recognise in our study relates to its theoretical character. In fact, although our explanations are empirically based, the theory needs to be empirically tested to be validated. Therefore, empirical work should be carried out, eventually embracing other countries, both European and Anglo-American, and also central government.

APPENDICES

Appendix III.1 – BALANCE SHEET

Appendix III.2 – RESULTS STATEMENT BY NATURE

Year

(Entity designation)

(Unit: 10³ EURO)

CALG Accounts Codes	Expenses and losses	Years			
		N		N-1	
61	Cost of sold commodities and used materials:				
	Commodities.....				
	Materials.....				
62	Supplies and outside services.....				
	Personnel expenses:				
641+642	Wages.....				
643 to 648	Social charges.....				
63	Transfers and current subsidies conceded and social grants.....				
66	Fixed assets depreciation of the year.....				
67	Provisions of the year.....				
65	Other operating expenses and losses.....				
	(A).....				
68	Financial expenses and losses.....				
	(C).....				
69	Extraordinary expenses and losses				
	(E).....				
88	Net result of the year.....				
	Revenues and gains				
	Sales and Provision of Services:				
7111	Commodities sales.....				
7112+7113	Products sales.....				
712	Services provision.....				
72	Taxes and fees.....				
(a)	Production variation.....				
75	Work for the entity itself.....				
73	Supplementary revenues.....				
74	Transfers and grants obtained.....				
76	Other operating revenues and gains.....				
	(B).....				
78	Financial revenues and gains.....				
	(D).....				
79	Extraordinary revenues and gains.....				
	(F).....				

(a) This value is obtained calculating the algebraic difference between initial and final stocks of “finished and intermediate products”, “by-products, residuals and wasting”, and “products-in-process”, also considering the movements in “stocks regularisation”.

Summary:

Operational result: (B)-(A)

Financial result: (D)-(C-A)

Current result: (D)-(C)

Net result of the year: (F)-(E)

Executive Committee
Date _____

Deliberative Committee
Date _____

Appendix III.3 – BUDGET AND SUMMARY

BUDGET

Year

(Entity designation) (Unit: 10³ EURO)

REVENUES (a)			EXPENDITURES (b)		
Code	Designation	Value	Code	Designation	Value
	Current Revenues (...) <i>Current Revenues Total</i>			Current Expenditures (...) <i>Current Expenditures Total</i> ...	
	Capital Revenues (...) <i>Capital Revenues Total</i>			Capital Expenditures (...) <i>Capital Expenditures Total</i> ...	
	<i>General Total</i>			<i>General Total</i>	

- (a) To be developed according to revenues economic classification.
 (b) To be developed according to expenditures economic classification and considering the departmental classification adopted by the entity.

SUMMARY

Year

(Entity designation) (Unit: 10³ EURO)

REVENUES		EXPENDITURES	
Current.....		Current.....	
Capital.....		Capital.....	
<i>Total</i>		<i>Total</i>	
Municipalized Services.....		Municipalized Services.....	
<i>General Total</i>		<i>General Total</i>	

Executive Committee
Date _____

Deliberative Committee
Date _____

Appendix III.4 – BUDGETARY CONTROL STATEMENTS

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Legislation:

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- Decreto-Lei nº243/79, de 25 de Julho – Elaboração dos Orçamentos e das Contas das Autarquias Locais
- Decreto-Lei nº341/83, de 21 de Julho – Reforma da Contabilidade das Autarquias Locais
- Decreto Regulamentar nº92C/84, de 28 de Dezembro – Normas de execução das Contabilidade das Autarquias Locais
- Decreto-Lei nº155/92, de 28 de Julho – Novo Regime da Administração Financeira do Estado
- Decreto-Lei nº226/93, de 22 de Junho – Plano de Contas para os Serviços Municipais e Federações de Municípios
- Decreto-Lei nº232/97, de 3 de Setembro – Plano Oficial de Contabilidade Pública
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- Decreto-Lei nº59/99, de 2 de Março – Novo Regime Jurídico das Empreitadas de Obras Públicas
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- Decreto-Lei nº562/99, de 21 de Dezembro – Aprova o classificador económico das receitas e despesas públicas

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- Decreto-Lei nº321/2000, de 16 de Dezembro – Altera o decreto-lei nº562/99, que aprova o classificador económico das receitas e despesas públicas
- Decreto-Lei nº12/2002, de 25 de Janeiro – Plano Oficial de Contabilidade das Instituições do Sistema de Solidariedade e de Segurança Social
- Decreto-Lei nº26/2002, de 14 de Fevereiro – Estabelece o regime jurídico dos códigos de classificação económica das receitas e das despesas públicas, bem como a estrutura das classificações orgânicas aplicáveis aos organismos que integram a Administração Central
- Lei nº64/77, de 26 de Agosto – Lei do Enquadramento Orçamental
- Lei nº1/79, de 2 de Janeiro – 1ª Lei das Finanças Locais
- Lei nº1/87, de 6 de Janeiro – 2ª Lei das Finanças Locais
- Lei nº8/90, de 20 de Fevereiro – Bases da Contabilidade Pública
- Lei nº6/91, de 20 de Fevereiro – Enquadramento do Orçamento do Estado
- Lei nº27/96, de 1 de Agosto – Regime Jurídico da Tutela Administrativa
- Lei nº42/98, de 6 de Agosto – 3ª Lei das Finanças Locais
- Lei nº58/98, de 18 de Agosto – Lei das Empresas Municipais, Intermunicipais e Regionais
- Lei nº159/99, de 14 de Setembro – Estabelece o quadro de transferência de atribuições e competências para as autarquias locais
- Lei nº162/99, de 14 de Setembro – Primeira alteração ao decreto-lei nº54A/99, que aprova o POCAL
- Lei nº169/99, de 18 de Setembro – Estabelece o quadro de competências, assim como o regime jurídico, dos órgãos dos municípios e das freguesias
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- Resolução nº04/2001, de 12 de Setembro – 2ª Secção do Tribunal de Contas – Instruções para a organização e documentação das contas das Autarquias Locais e entidades equiparadas, abrangidas pelo Plano Oficial de Contabilidade das Autarquias Locais (POCAL)

Sites:

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