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Suggested Framework for Implementation of Performance Budgeting in the Public Sector of Developing Countries

With special focus on Egypt

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1. Introduction

The last 25 years have witnessed waves of reform (reform initiatives) that swept the government sector as a whole at the mid 1980's. These initiatives in the framework of the New Public Management (NPM) are encouraging the implementation of the private sector management techniques in the public sector, as well as the development of performance audits in order to monitor the degree of efficiency and effectiveness with which the public sector services are delivered and to evaluate the financial consequences of management decisions (Lapsley, 1999). Moreover, these initiatives have had a substantial impact on public sector accounting, where accounting as an information system plays an essential role in whatever reform process any governmental entity would want to undertake. In addition, these initiatives, especially NPM, resulted in changing the accountability concept, from accountability in terms of procedural compliance to accountability in terms of efficiency and results (effectiveness and cost effectiveness). The changing of accountability concept has had a fundamental impact on the budgeting system in the public sector. As accountability for results depends on *clear objectives stated in measurable terms and on budgets showing the minimum results to be achieved*. This must also be based on expenditure limits and on accounting and auditing systems that measure and report on actual results (Htun, 2000). Of course, this raises the desirability of accrual-based accounting, **output-based budgeting (performance budgeting)**, and performance-based auditing.

Accordingly, the reforming of budgeting system is considered as an essential part of the reform initiatives that swept the government sector as a whole. These reforms are intended to transform the government sector budgeting systems from control of inputs to a focus on outputs and outcomes, in the interest of improving operational efficiency and promoting result-oriented accountability (Shah and Shen, 2007)

While many of the Organization for Economic Co-operation and Development (OECD) countries have been succeeded in reforming the budgeting system such as New Zealand (implemented output budgeting), Australia (implemented outcome budgeting), UK (implemented output budgeting), Sweden (implemented performance budgeting), the Netherlands (implemented policy budgeting), etc., most developing countries have failed to adopt the performance budgeting (example of the developing countries is Egypt). While Egypt has decided in 2005 to adopt the performance budget in 2010, the performance budget has not been implemented yet in the governmental sector.

In fact, this is not only the case of Egypt, but also the case of many developing countries. This can raise the following questions:

- Why does performance budget not work in most developing countries?
- Why have most developing countries failed to implement the performance budgeting in their public sectors, even though the performance budget as a concept is existed for more than 60 years?
- Does performance budget require a specific framework to work with?
- If yes: What are the basic components of such a specific framework, which can facilitate the implementation of performance budgeting in the developing countries (e.g., Egypt)?

The main purpose of this paper is to explore why the performance budget has not been implemented yet in most developing countries and to suggest a framework that can facilitate the implementation of performance budget in the developing countries, in that case Egypt. The performance budgeting is also known as activity-based-budgeting, outcomes-based budgeting and results-based budgeting. Bear in mind that the suggested framework will focus only on the institutional and technical components and not on the basic requirements that are required for successful implementation of the performance budgeting. Tackling of the basic requirements such as changing of legislation, qualified staff, political and bureaucratic support, information technology, etc. is beyond the scope of this paper.

The paper is structured as follows: the second section will briefly discuss the budgeting system in Egypt and its development initiatives, Section 3 will deal with the government traditional systems and explore whether the performance budget works under those systems. Section 4 makes an attempt to suggest a framework for the successful implementation of performance budgeting in the public sector of developing countries (e.g., Egypt). Section 5 is devoted to the conclusion. Hopefully, this paper offers a practical framework – that is perhaps more than 60 years late—for facilitating the implementation of performance budget in the public sector of the developing countries.

2. Budgeting System in Egypt

In Egypt, one general budget is prepared for the country as a whole. The general budget is a financial plan that comprises the estimates of expenditures for the upcoming financial year and the estimates of revenues of financing them. The general budget is related to the country's overall plan for socio-economic development. Therefore, this budget is considered as a financial program for the following financial year to achieve specific objectives in the framework of the general plan and public policy of the country. The general budget does not coincide with the calendar year but it begins in July and ends in June. The budget method, which is used by the Egyptian government, is the **line item (traditional)** budget. The general budget is an aggregation of the following budgets: 1- Budget of central government administration; 2- Budget of local governmental units; 3- Budget of public service bodies and 4- Budget of financing funds with a service character.

According to the Budget Act 53 of 1973, adjusted by Act 11 of 1979, the general budget of the country should be prepared on the basis of administrative division (Central, local and public bodies) and functional classification. These functions can further be classified into programs, activities or projects. The functional classification of the expenditures comprises: agriculture and irrigation sector, education and research sector, industrial and mineral sector, health service sector, transportation and communication sector, etc.

According to the Budget Act No.11 of 1979 and the Government Accounting Act 127 of 1981, the cash basis should be used in the preparation and execution of the budget. This basis records transactions when payments are made, independently of the time when goods and services are ordered, delivered and consumed. Because of using the cash basis, the amount of appropriation, which is not expended until the end of the financial year, is cancelled and considered to be as a surplus. In addition, the revenues that are not collected in the budgetary year should not be added to the revenues of that year but it should be added to the year in which they are collected. This, in turn, will result in that the financial statements disclose the *monetary position* of the government. On the other hand, the investment budget is prepared and executed according to the accrual basis.

- Recent developments

In 2005, the Egyptian Ministry of Finance has made some developments for budgeting system based on Government Financial Statistics Manual– 2001 (GFSM 2001). These developments have focused on the reclassification of the budget parts. The old classification was four parts and the new one is eight parts. For example, the new classification of expenses consists of eight parts as follows:

Part 1: Wages and compensations of employees;

- Part 2: Uses of goods and services;
- Part 3: Interest;
- Part 4: Subsidies, grants and Social benefits;
- Part 5: Other expenses;
- Part 6: Purchase of non-financial assets;
- Part 7: Acquisition of financial assets (Domestic and Foreign); and
- Part 8: Repayment of loans (Domestic and Foreign).

In fact, it should be noted that the GFS system (IMF 2001) was developed specifically for the government sector to accommodate the special nature and role of the government sector and for assessing its economic impact on the nation, that is, **for macro fiscal policy purposes**. *It was not intended to cover the micro departmental resource management function of government.* The system is based on IMF economic measurement standards used for the measurement of Gross Domestic Product of nations and its components, and is integrated with the UN System of National Accounts. The system enables relevant and reliable measurements of GDP to be made which are internationally comparable. It is an economic measurement system based on economic concepts throughout and uses a rigorous, analytical approach. It is based on double entry recording and on accrual basis of accounting (Barton, 2005).

While the development of the budgeting system in Egypt is based on the GFSM-2001, the GFS 2001 itself cannot be considered as budgeting or accounting system for the following reasons:

- The GFS is derived from the United Nations –System of National Accounts 1993 (UN-SNA 1993). The SNA is designed to compile aggregate financial statistics for an entire economy; government and private activities are combined together. This is in addition to private households and the outside world. Consequently, the GFS is a statistical classification system designed to provide statistics that enable policymakers and analysts to study developments in financial operations, financial positions and liquidity situation of the general government sector in a consistent and systematic manner (GFSM-2001). The primary purpose of the GFS is to provide a framework suitable for analyzing and evaluating fiscal policy, so that government financial information could be compared across economies, as it provides a mechanism to create uniformity in public sector finances across all countries public sectors.
- Although the GFS system is described in standard accounting terms, it is important to remember that **it is a statistical reporting system** that might differ in important ways from the underlying financial accounting system from which most of the GFS statistics will be derived.
- In addition, while the GFS (2001) is using the accrual basis instead of cash, the general budget is still using the cash basis.

In fact, it is not requested from neither the developed countries nor the developing countries to use the GFS as a budgeting system or accounting system, but what requested is to make harmonization between the GFS and

both budgeting and accounting system to facilitate the deriving of financial information.

- **Shortcomings of the Traditional/Line item budget system**

While Egypt has made some developments in the budgeting system, the budgeting method is still Line item budgeting and it is cash based .The line item/traditional budget is designed to ensure legislative control over the expenditure of public money. It is input-focused budgeting system, which is oriented toward how much resources, staff, facilities, etc. are made available for a program or ministry. Operating expenses include cost objects for day to day. Operations such as salaries, retirement, and health insurance costs, office supplies, printing, and utility costs. The capital outlays include purchase of long-lived assets such as building, machinery, office equipment, furniture and vehicles (Shah and Shen, 2007). The amount of money being spent on a program or problem is often the main performance measure when managing to input. The internal management information of an input system does not reveal what the resources actually bought or achieved were and often an input focus is accompanied by process regulation – *i.e.* standards and rules on how inputs should be aligned, how things should be done.” (Kristensen *et al*, 2002, p 8).

In addition, traditional/line item budget does not indicate the relationship between the expenditure and results, and this prohibits the formulation and execution of economically meaningful budgetary policy. Besides, it prevents proper political choice among objectives and rational allocation of resources and limits the public understanding of government activity. This budget is a short-term process that makes rational planning more difficult. It stresses inputs rather than outputs and controls only the inputs, which in turn, results in inhibiting the ability of the managers to manage resources flexibly to achieve program objectives.

Moreover, Caiden (1998) identifies several criticisms of traditional budgets. Briefly summarized, they are problematic because they:

- result in uncontrollable and unpredictable budgets;
- produce incremental budgetary growth with no link to strategy;
- involve a focus on inputs not outputs and outcomes;
- generate a short-term perspective;
- produce rigidity and waste due to little incentive for efficiency;
- involve cash based accounting resulting in weak asset management;
- use poor information about costs, outputs and outcomes; and
- produce budgets that are unresponsive to politicians and public demands.

In short, this budget system does not satisfy the information needs of the efficient and effective government. That is why the Egyptian government has decided in 2005 to adopt the Performance budget and to be implemented in 2010. However, the performance budget has not implemented yet in Egypt.

3- Performance budget and traditional government sector systems

Performance budgeting is a system of budgeting that presents the purpose and objectives for which funds are required, costs of programs and associated activities proposed for achieving those objectives, and outputs to be produced or services to be rendered under each program (Shah and Shen, 2007). Performance-based budgeting aims to improve the efficiency and effectiveness of public expenditure by linking the funding of public sector organizations to results they deliver, making systematic use of performance information (Robinson, 2009). In comparison to traditional line item budgeting, performance budgeting allows for more flexible use of fiscal resources and transforms focus from inputs to results, as it focuses on the results to be achieved. The performance budget, given its program structure, changes the focus of discussion from detailed line items to broader objectives and performance of public programs, and therefore facilitates more informed budgetary decision-making (Shah and Shen, 2007).

In addition, Schick (2008) argues that to understand the challenge facing the performance budgeting, one must decompose it into two main elements. First, performance budgeting is a system for compiling and presenting information on actual or expected results. Second, it is a system for buying results through the expenditure of public funds. The two elements are interdependent, *for government would not be able to allocate on the basis of results if it lacked result-based information. This means that governments that do not manage for results cannot budget for results*. In addition, the implementation of an effective performance budgeting system depends on reliable performance measurement and reporting system. Moreover, the performance budgeting system requires a basket of measures that assess public programs through a variety of filters, such as inputs; outputs (quantity and quality of goods and services produced), efficiency (unit cost to produce outputs); service quality (measure of service such as timelines, accessibility, accuracy and satisfaction) and outcomes (progress in achieving program objectives) (McGill (2001). The effective performance budgeting requires a comprehensive performance and reporting system, which in turn entails that one must monitor the entire results-based chain in order to understand and effectively manage government programs. In addition, budgeting for results needs a performance audit system that can assess the management and operational performance of governmental entities and consider questions of economy, efficiency, and administrative effectiveness of operations for which the Public Sector managers are accountable.

However, the **currently used traditional government systems** in the Egyptian government sector such as: public administration system (bureaucratic management), traditional performance measurement system, traditional auditing systems, cash-based government accounting system and line item/traditional budgeting system (including bottom-up approach) are no longer able to provide the required information for an efficient and effective performance budgeting system. This is because the currently used traditional government systems are suffering from severe shortcomings as follows:

- **Public Administration System (Bureaucratic Management System):** gives no (or little) incentive to manage the public resources in an efficient and effective way. In fact, this system has several shortcomings: it focuses on a blind following of instructions and compliance with written rules and regulations that aim at limiting discretion. The administrative structure is strongly hierarchical and many quite trivial decisions have to be referred to higher levels for resolution. Managers may not have been exposed to modern business techniques and they follow administrative methods based on precedent rather than personal initiatives. The Ministers are making the detailed decisions about the internal management of departments for which they did not have adequate knowledge and suitable information. Furthermore, managers act as extension of the Minister, without having any independent existence and consequently no independent responsibility. Therefore, the main feature of the public administration system (bureaucratic management system) is the focus on the input instead of output. Under this system: there is no relationship between the input and the output, managers are not completely responsible for their departments; the expenditures are more important than the costs (expenses); there is lack of a performance measurement system; the incentives to encourage efficiency and effectiveness are absent. Furthermore, under the public administration system, the role of the managers is limited to the following of the instructions and they have no effective role in improving the efficiency of their departments and their evaluation is not based on the following points: the output, results, total costs, relationship between the input and the output (efficiency) and the relationship between the output and the outcome (effectiveness). *Based on the aforementioned features of the public administration system, it can be inferred that the Egyptian government is managing the inputs and not the outputs (results). This means that governments that do not manage for results cannot budget for results, and hence, the public administration system (bureaucratic system) does not support the implementation of the performance budgeting in the government sector of Egypt.*

- **Cash-based Government Accounting System:** recognizes transactions and events only when cash has been received or paid. This takes place independently of the time when goods and services are ordered, delivered and consumed. Goods and services for which payments are made (labor, stores, transportation ...etc.) are considered to be consumed when suppliers are paid. This means that the cash basis of accounting shows only the volume of disbursements. Such disbursements do not reveal the amount of resources used and the value of actual work done. According to the cash basis, the statement of receipts and expenditures is prepared to disclose information about cash flows during a period and cash balances at the end of that period. Inherent to the cash accounting, it is not possible to prepare balance sheets because there are no assets and liabilities in the books: "sales are only recognized when cash is received (so there are no debtors); purchases are only recognized when cash is paid (so there are no creditors); there are no stock adjustments because the accounts are not concerned with recording usage, only with the fact that cash has been paid for purchases (so there is no closing stock figure); there are no fixed assets, for the same reasons. Based on cash accounting, it is not possible to measure

the financial performance of the government because there are no revenues and expenditures. Accordingly, traditional government accounting system does not assist in measuring the financial results of the government and does not support the management system, which is based on clear objectives, good performance information, incentives and freedom to manage well. In addition, it does not provide the cost of outputs. In attempting to link resources to results, it will be important to measure the full costs of the resources associated with performance goals using a consistent definition of costs between and among programs. Consequently, it can be concluded that the traditional government accounting system does not facilitate the implementation of the performance budgeting.

- **Traditional budgeting system uses the Bottom-up approach:** the most hazardous shortcoming of the traditional budgeting system has traditionally operated on a “bottom-up” principle. In practice, all the governmental agencies and Ministries send requests for funding to the Ministry of Finance/Treasury. It is widely known that these requests greatly exceed what they realistically believe they will receive approval for. In order to come to the real budget, the Ministry of Finance/Treasury negotiates with those concerned governmental agencies and Ministries until some common ground for agreement is reached. This “bottom-up” approach has several disadvantages as follows:
 - It is very time consuming and is essentially considered a game; all participants know that the initial requests are not realistic;
 - This approach has an inherent bias for overstating the expenditure-allocation requests. All new programs or additions/expansion of the scope of existing on-going programs are funded on the basis of new requests. Generally, using funds for a purpose other than that originally approved is not permitted under the Treasury rules. There is no system for re-allocation within and among Ministries and their respective Departments during mid-fiscal year, and there are no pre-determined internal controls and safeguards against cost over-runs; and
 - It is difficult to reflect political priorities in this approach, as it is a driven “bottom-up” with the budgetary allocations “emerging” at the end of the process. In fact, reflecting the political priorities and strategic objectives in the budgeting system is one of the main requirements for implementing the performance budgeting system. So the bottom-up approach is not consistent with performance budgeting.

- **Traditional Performance Measurement Systems:** within the aforementioned context (especially, the bureaucratic management system), the Traditional Performance Measurement Systems are no longer able to measure whether the government has efficiently and effectively used the resources entrusted to it; whether the appropriations have been used to produce the outputs that are required to achieve the outcomes. *As the old command-and-control system in the bureaucratic management regime, gave the Public Sector Managers the message that risk would not be rewarded, that inefficiency would not be penalized, that what mattered most was complying with the current procedures, rules, and regulations (Scott, 1996).* Hence, under the traditional public administration system, the Managers are most concerned about the compliance with rules and restrictions and

they are not accountable for results. Therefore, there was no real need for a sophisticated Performance Measurement System. In fact, the adoption of performance budget will require that the performance measurement should tell us how well government uses resources in production and provides decision makers with information that can be used for monitoring of results, program performance improvement, as well as the rationale for allocation resources and budget justifications. Basically, the performance measurements are required to measure whether the governmental entities have achieved their results in terms of economy, efficiency and effectiveness. It is also clear that the traditional performance measurement systems do not support the implementation of performance budgeting system.

- **Traditional Auditing System**, which is more concerned with compliance with rules and instructions, is not able to assist in assessing the management and operational performance of governmental entities and to consider questions of economy, efficiency and administrative effectiveness of the operations for which management is responsible.

Briefly, the use of the traditional government sector systems such as public administration (bureaucratic) system, line item budgeting system (including bottom-up approach), cash-based accounting, traditional performance measurement system and traditional auditing system have resulted in:

- The objectives for governmental entities are not clearly defined;
- The respective responsibility of politicians and civil servants are confused, so that the lines of accountability and responsibility are never clear.
- The relationship between the expenditure and results is not indicated;
- Appropriations are based on input in place of output/outcome;
- Goals and performance requirements of government departments are poorly specified.

This means that the currently used traditional government systems will not be able to provide the required information for preparing and executing the performance budgeting system. This can make us able to answer the first two research questions:

- Why does performance budget not work in most developing countries?
- Why have most developing countries failed to implement the performance budget in their governmental sectors, even though the performance budget as a concept is existed for more than 60 years ago?

The answer of these two questions lies in the fact that most of developing countries are still using the traditional government sector systems and based on the previous analysis, the performance budget does not work under the traditional government sector systems. This also can explain in spite of the existence of the performance budgeting from more than sixty years ago, most of the developing countries failed to implement it in their governmental sectors. This in turn means that the governments of developing countries (including Egypt) have not recognized yet the fact that the budgeting change cannot succeed alone but requires changes in the rest of government traditional systems. For example, traditional/line item budgeting system fits well with public administration system (bureaucratic system), cash-based governmental accounting system, traditional

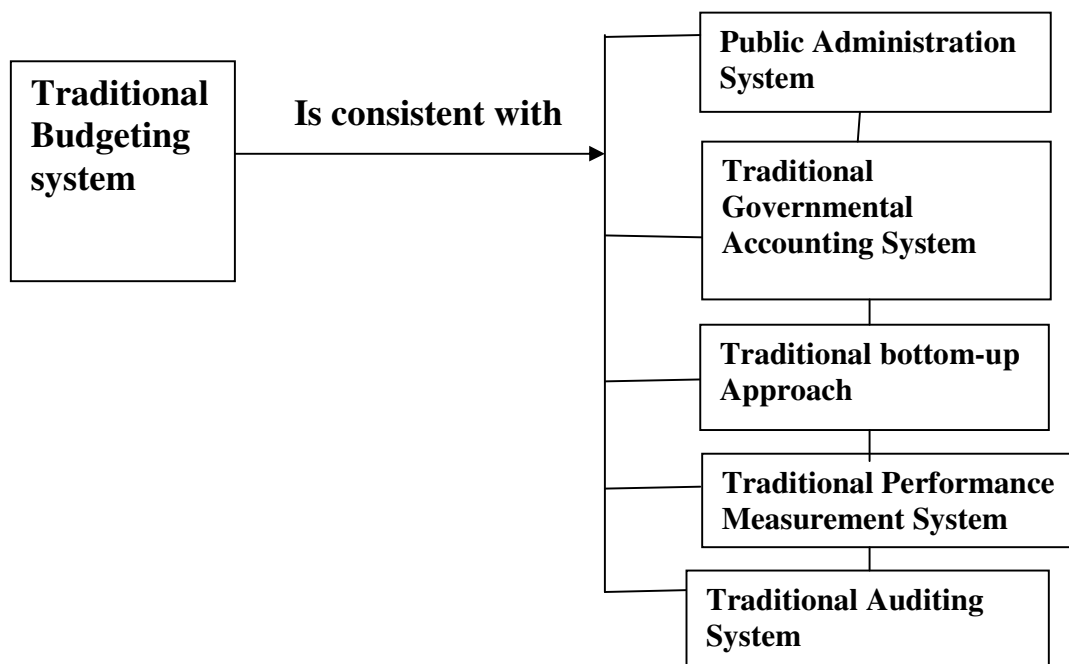
budgeting approach (Bottom-up approach), traditional performance measurement system and traditional auditing system. This is because these systems provide the information that satisfies the requirements of the line item (traditional) budget. This means that the nature and requirements of the traditional budget are consistent with the concept and the implications of these systems. But when the government wants to overcome the problems of traditional budget, namely, to emphasize the output in place of input; link costs to results; provide information relevant for performance measurement and decision-making and discharge the accountability, it should develop its budget system, for example, shift from traditional budget system to performance budget system. However, each budgeting system needs relevant management, accounting, performance measurement and auditing systems, etc. that are consistent with its nature and requirements. Generally, we can say that if one government wants to develop its budget system it should firstly adopt the governmental systems that would be able to execute this budget and be consistent with its nature. Should this not take place, the development of the budgeting system will not have major effects on the performance of the government. In addition, Scott, (1996) stated that

If the New Zealand experience were to be summed up in a sentence, it would be that “good managers cannot succeed in a bad system and bad managers cannot succeed in a good system—both required to be good”

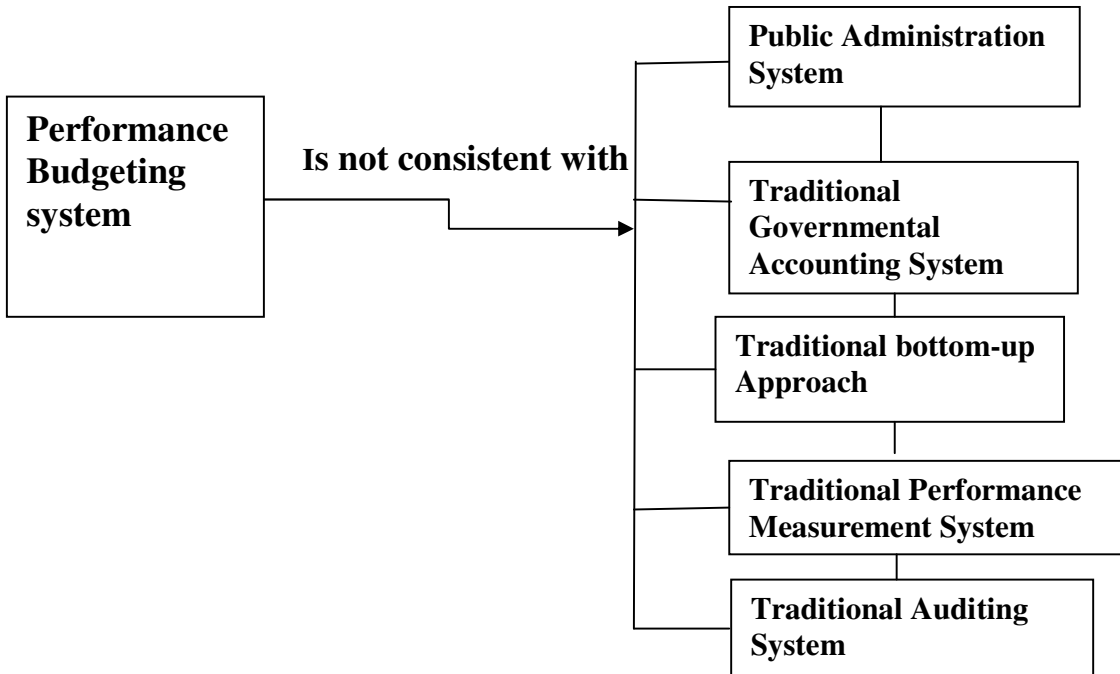
Similarly, it could be inferred that: *Modern budgeting system cannot work with or succeed in a traditional system and a traditional system cannot work with or succeed in a modern system --- both required to be modern (or to be traditional).*

Consequently, it could be concluded that:

1- ***Traditional/Line item budgeting is consistent with the traditional systems:***



2- Performance budgeting is not consistent with the traditional systems



4- Suggested framework for successful implementation of performance budgeting system

4.1 Overview and assumptions

The previous section has made clear that the performance budget does not work under the government sector traditional systems due to the fact that these systems are not consistent with characteristics of the performance budget and they do not provide even the basic requirements that the performance budget needs to work with such as information about the objectives and results of government expenditures. Different writers have supported this conclusion, for example, Folsher (2005) stated that to a large degree, modern budgeting techniques do not operate on their own. Where they are successful, they are linked to an overall approach to managing the public sector, with the budget and its associated methods as a central process to make the approach operational. In addition, Robinson (2009) argues that Performance budgeting should not be seen as an isolated initiative. It should be viewed, rather, as part of a set of broader reforms—often referred to as managing-for-results—designed to focus public management more on results delivered and less on internal process. Also, Schick (2008) has argued that without exception,

performance-oriented approaches are effectively only in well-managed governments which have low corruption, elevated of public trust, reasonably efficient and fair public services, and media and interest groups that pay attention to results. *When these conditions are lacking, no Performance budgeting system is capable of fulfilling its ambitions.* This can pose the following questions:

- Does performance budget require a specific framework to work with?
- If it is yes: What are the basic components of such a specific framework, which can facilitate the implementation of performance budgeting in the public sector of the developing countries (e.g., Egypt)?

Answering these two questions can result in suggestion of a framework, which can facilitate the implementation of the performance budget in the government sector of the developing countries and make the performance budget capable of fulfilling its ambitions. The suggested framework is based on an intensive study of experiences of the OECD countries with respect to the implementation of performance budget in their governmental sectors (especially, New Zealand, UK, Australia, the Netherlands, Sweden and Finland). Based on the experiences of the OECD countries, I can derive the following **assumptions** that represent the cornerstone of the suggested framework:

- 1- Performance budgeting should not be seen as an isolated initiative. It should be viewed, rather, as part of a set of broader reforms—often referred to as managing-for-results—designed to focus public management more on results delivered and less on internal process (Robinson, 2009).
- 2- Governments budget the way they manage, which means that governments cannot budget for results unless they manage for results (Schick, 2008). Consequently, Managing-for-results (performance management) is a prerequisite for the success of performance budgeting.
- 3- Introduction and using of performance information into budgeting process will facilitate the implementation of performance budgeting. As the provision of objective performance information can facilitate better decision making for the efficient use of resources, management of programs, central resources allocation and expenditure prioritization decisions.
- 4- Performance budgeting fits naturally with the medium-term budget framework, as the best way to improve the expenditure policy formulation is both to make maximum use of performance information and to consider the medium-term cost implications of expenditure choices (Robinson, 2009).

- 5- The shift from Bottom-up approach to the Top-down approach can facilitate the implementation of performance budgeting. The Top-down approach can make a binding of political decision as to the total level of expenditures and divide them among individual spending ministries.
- 6- Modernizing the governmental accounting system (change from cash to accrual accounting) can largely facilitate the implementation of performance budgeting because it provides measures of costs of services/outputs in the budgetary documentation. In other words, the absence of an appropriate accounting system may undermine performance budgeting reforms.
- 7- Developing an appropriate performance measurement system that is consistent with the introduced/included performance information facilitate the successful implementation of the performance budgeting in the government sectors of developing countries.
- 8- Changing the structure and format of the budget that should be consistent with the nature and characteristics of performance budget will facilitate the implementation of the performance budgeting.

4.2 Discussion of the suggested framework:

This section discusses in details the components of the suggested framework that will contribute in creating appropriate condition for the successful implementation of performance budgeting in the government sector:

4.2.1 Shifting to Managing-for-results

This section discusses why it has been so difficult to implement performance budget in the public sector of developing countries in the last sixty years. Performance budgeting can fail for many reasons, but they never succeed when governing and managerial conditions are inhospitable to improvement. Specifically, governments cannot budget for results unless they manage for results (Schick, 2008). Budgeting is embedded in the norms, traditions, culture, practices and relationships of public management. *Governments budget the way they manage*, which is why it typically is necessary to modernize management practices in order to reform the budget process (Schick, 2008). This can explain why the line item/traditional budget has been lasted for centuries. In fact, public administration system/bureaucratic system manages the inputs, therefore, the line item budget allocate the resources for inputs. Accordingly, as long as the bureaucratic system exists, the line item budget will be the most suitable budgeting method. Therefore, the change from the line item budget to the performance budget will inevitably require parallel change in the public management system. As the budget for results will be

based on managing-for-results. Managing-for-results can be tackled from two perspectives: 1- focus on results and 2- relaxing central input control.

Managing-for-results (Focus on results) means, in short, the focus on performance in terms of efficiency and effectiveness rather than compliance with rules and regulations and linking resources with results. The managing-for-results designed to focus public management more on results delivered and less on internal process (Robinson, 2009). Moreover, the managing-for-results entail the change of accountability system in the public sector to hold managers accountable for *what* they do, not *how* they do it. However, the effectively implementing the managing-for-results system needs to define the results either in terms of outputs or outcomes. In other words, what kind of results the public managers will be accountable for. Outputs and outcomes are defined as follows: outputs are goods and services produced by departments or third party suppliers. Outcomes are the consequences for the public resulting from the outputs and activities of government. In fact, the distinction between the outputs and outcomes is critical to the concepts of the financial appropriation and accountability. The main reason underlying this distinction is that outputs are easier to measure than outcomes, so that it is easier to hold managers accountable for delivering agreed services and goods (output). To illustrate the significance of the distinction between them, consider, for example, road safety. Assume that a reduction in road accidents is an outcome sought by ministers; they might seek from appropriate department's output such as road petrol, vehicle safety checks, road maintenance and driver testing. So the reduction in road accidents as an outcome is the result of many departments. Consequently, if the accountability were based on the outcomes, this would provide the chief executives with ready-made excuses for poor performance. Moreover, it will result in diluting the responsibility and punishing some departments although they had provided the outputs agreed. It can also result in rewarding some departments while they did not deliver the outputs agreed. However, using of outcomes directly to measure performance is problematic for several reasons: (Ball and Dale 2001)

- *Causality* is difficult to determine with certainty. It is very difficult to show a causal relationship between an outcome and the activities of a particular department. For example, assume that reduction in road accidents, as an outcome has not been achieved. Thus, it will be very difficult to determine which department is responsible for the failure of achievement of the outcomes. It is also possible that increasing in road accidents is due to the bad weather, while all respective departments have provided the outputs agreed.
- *Measurement* can be very difficult. In case of increasing in road accidents, how can we measure the success of one department against the failure of other departments?
- *Time-frames* for outcome achievement can often be very long. It can take many years, possibly decades, before the impact of education or health can be assessed.

- *Allocating* input costs to outputs is possible. Taking the next step and allocating output costs to outcomes would in most cases be impossible.

These problems mean that the use of the outcome, as the basis for assessment of the performance and for effective accountability relationships, is of limited value. On the contrary, the use of the output, as the basis for effective accountability relationship, assessment of the performance and for organizing a budgeting system, is a more appropriate and practical measurement tool than outcome.

In addition to the focus on results, the managing-for results system requires ***relaxation of the central control of input***. As the managing-for-results system is grounded on a simple principle: managers cannot be held responsible for results unless they have freedom to act, that is, to spend and hire within agreed budgets as they see fit, to make their own choices respecting office accommodation and other purchases to run their organizations free of ex-ante control by outsiders (Schick :<http://www.ssc.govt.nz/Spirit/Transforming.asp>). Moreover, relaxing central input control have as the goal to empower public managers to operate their governmental entities in the most efficient manner possible. No longer can they claim that their poor performance is due to the fact that they are not free to choose the most efficient mix of inputs to achieve the required results (OECD, 2002).

So it can be inferred that when the governments manage for results, they can budget for results. In other words, managing-for-results will entail and facilitate the implementation of the performance budgeting.

4.2.2 Introduction and using the performance information into budgeting process

It is clear from the previous section that the performance budgeting initiatives tend to go hand in hand with managing-for-results (performance management). In addition, in order to improve the expenditure control and public sector efficiency and performance, and to be able to translating the strategic objectives and priorities into outcomes and/or outputs in the performance budgeting, the introduction of performance information into budget process is a fundamental. The OECD countries experiences have proved that if government lacked result-based information, it would not be able to allocate on the basis of results. Performance information refers to performance measures (outputs and outcomes) and evaluation, and it is used to link the allocation of resources with performance units (generally output). In addition, it is used as background information for the purpose of accountability and dialogue with legislators and citizens on public issues and government direction (OECD, 2007). In fact, the introduction of performance information facilitates better decision making for efficient use of resources, the management of programs, central resource allocation and expenditure prioritization decisions (OECD, 2007). Briefly, the use of performance information in budgetary decision-making can contribute to budgetary goals of improving productive efficiency, allocative efficiency and

even aggregate fiscal discipline. In addition, OECD countries (2007) have reported a number of benefits from the use of performance information (PI):

- It generates a sharper focus on results within the government.
- It provides more and better information on government goals and priorities, and on how different programs contribute to achieve these goals.
- It encourages a greater emphasis on planning and acts as a signaling device that provides key actors with details on what is working and what is not.
- It improves transparency by providing more and better information to parliaments and to the public.
- It has the potential to improve the management of programs and efficiency.

For the aforementioned benefits, it is important to integrate the Performance Information (PI) into the budget process. The next section provide an overview of one of the OECD countries experiences of developing and using performance information in the budget process which is the United Kingdom experience.

- **United Kingdom Experience:**

In the UK , the performance information is presented in the Public Service Agreements (PSA) and the Service Delivery Agreements (SDA) of each department. The PSA is an agreement between the government and the public and it is the responsibility of the lead minister of the department to deliver the targets set in the agreement. The PSAs include the government priorities and strategic objectives with measurable targets, and the vast majorities of these measures outcomes. The PSAs should feed into the more detailed business planning within a government department and into the individual performance targets of staff within a central department or a service delivery agency.(Ellis and Mitchell, 2002).

The structure of the PSAs sets out the aim and objectives of each department as well as performance targets, including measures of operations and outcomes as follows:

PSAs bring together in a single document the aim, objectives and performance targets for each of the main Government departments. They include:

- **Aim:** a high level statement of the role of the department.
- **Objectives:** in broad terms, what the department is looking to achieve.
- **Performance targets:** under most objectives, outcome focused performance targets.
- **Value for money:** each department is required to have a target for improving the efficiency or value for money of a key element of its work.
- **A statement of who is responsible for the delivery of these targets.** Where targets are jointly held this is identified and accountability arrangements clearly specified

The following example (Box 1) clarifies how to implement the structure of the PSAs into practice:

**(Box 1). PSA for cross-departmental policy area:
Action against illegal**

Aim

To create a healthy and confident society, increasingly free from the harm caused by the misuse of drugs.

Objectives and performance targets

Objective 1: To help young people resist drug misuse in order to achieve their full potential in society.

Target: Reduce the proportion of people under the age of 25 reporting the use of Class A drugs by 25% by 2005 (and by 50% by 2008). (Also in Home Office PSA.)

Objective 2: To protect our communities from drug-related anti-social and criminal behaviour.

Target: Reduce the levels of repeat offending amongst drug-abusing offenders by 25% by 2005 (and by 50% by 2008). (Also in Home Office PSA.)

Objective 3: To enable people with drug problems to overcome them and live healthy and crime-free lives.

Target: Increase the participation of problem drug abusers in drug treatment programmes by 55% by 2004 (by 66% by 2005 and by 100% by 2008). (Also in Department of Health PSA.)

Objective 4: To stifle the availability of drugs on our streets.

Target: Reduce the availability of Class A drugs by 25% by 2005 (and by 50% by 2008). (Also in Customs and Excise PSA.)

Who is responsible for delivery?

This PSA covers government activity against illegal drugs, co-ordinated by the Minister for the Cabinet Office and led by the Secretary of State for Health, the Secretary of State for Education and Employment, the Home Secretary and the Paymaster General. On behalf of ministerial colleagues, the Home Secretary, supported by the Secretary of State for Health and the Secretary of State for Education and Employment, takes the lead on Target 1. The Home Office's prime contribution is through effective management of the Drug Prevention Advisory Service and support for Drug Action Teams. The Home Secretary also has lead responsibility for delivery of Target 2. The Secretary of State for Health has lead responsibility for delivery of Target 3. The Paymaster General has lead responsibility for delivery of Target 4, supported by the Home Secretary. Anti-drugs operations in Scotland, Wales and Northern Ireland are the responsibility of these devolved administrations.

Source: Ellis and Mitchell, OECD (2002).

The Service Delivery Agreements (SDA) sets out how the department will deliver its PSA targets and how it will modernize and reform to get better value for money. The SDAs include measures of outputs, processes and inputs necessary to deliver the outcomes that government is aiming for (Marti, 2010).

Delivering a PSA implies that a certain level of budget will be required; hence *the PSA agreement should be an integral part of the budget setting process*. This requires exploring ways to measure the costs of specific delivery outputs that will give an indication of the cost of a given PSA outcome. The results achieved could (and should) then be incorporated into subsequent rounds of budget planning. The PSA system introduces incentives to direct activities of the different entities towards the priorities defined by government. Better costing methods will also enable better alignment between public priorities and public resources (Marti, 2010).

4.2.3 Changing the budgeting format and structure towards a more performance-oriented approach.

The provision of the performance information alone is not sufficient to improve performance, as it has to be used in decision-making. In order to use the performance information into budgetary decision-making, it has to be integrated into the budget process. One method of integrating it into budget process is the changing the format and the structure of the budget towards more performance-oriented approach.

In fact, the line-item budget format, which includes separate lines for travel, office supplies and salaries, tends to facilitate the micro control and to make it difficult to include any type of information on performance. Therefore, the implementation of performance budgeting requires the change of traditional budget classifications/line-item format to new classification (structure and format) that tend to focus on administrative organizational units and to consider budgets in terms of outcome and goals (OECD, 2007). The outcome and/or output classifications are more open to incorporate performance information than the line-item budgets. Some of the OECD countries changed their budget structure to focus on outputs and /or outcomes. For example, the New Zealand, the Netherlands, Australia and the UK changed their structures as part of their initiatives to introduce the accrual-based budgeting as follows (OECD, 2007): In 2000, Australia changed its budget structure to focus on outcomes (Sheers, Sterck and Boukaert, 2005). Since the 1980s, New Zealand has changed its budget structure to focus on the output. In 2001, the Netherlands changed its budget format so that it is organized along the policy lines or the desired outcomes of the Dutch government. For example, the new structure of the Dutch government budget has the following elements:

- 1- Legislative proposal:** This integrates the expenditure and the revenue under each department.

- 2- **Policy paragraph**, this is the key focus of the new budget structure and divided into Policy Agenda and a number of Policy Articles as follows:
- **Policy agenda**: herein, the government’s policies have to be stated as well as the means that will be applied to achieve them and the financial resources allocated to them.
 - **Policy articles**: each policy agenda will be followed by a number of policy articles. The first section of each policy article includes the General Policy Objectives. Here, outcomes targets, including timing of expected achievements i.e. outcomes, are stated and targets groups for policies are identified. The next section in the policy articles will be the Budgetary Consequences of Policies, which includes an overview of financial information for the last two years and the forthcoming four years, including the budget year. The last section of the policy article will outline the budgetary assumption as for example macroeconomic performance, demographic changes and structure of consumption.
- 3- **Management paragraph**, which will give an overview of major expected organizational changes in the ministry, such as creation of an agency or change of accounting standards.
- 4- **Agency paragraph**, This contains basic financial information on agencies connected to the ministry in question. Besides financial information, inputs, outputs and outcomes of agencies will be integrated in the budget and accounting documents as if it was any other expenditures, i.e. they will be included in the policy paragraphs.
- 5- **In-depth appendix**, which includes necessary technical information.(Blondal and Kristensen, 2002)

The new budget has been centred on three *ex ante* questions and three *ex post* questions (three “W questions” for the budget and three “H questions” for accountability), as follows:

Ex ante-questions:

1. What do we want to achieve??
2. What steps will we take to achieve it?
3. What should it cost?

Ex post-questions:

1. Have we achieved what we intended?
2. Have we done what we should have done to achieve it?
3. Did that cost what we had expected?

4.2.4 Shifting to a Multi-year budget framework (a Medium-term expenditure framework)

The traditional one-year horizon of budgeting does not suit decisional performance budgeting systems, as results often take years to be realized, especially when they involve social interventions by government (Schick,

2008). Therefore, OECD countries, which have implemented the performance budgeting, have adopted the multi-year budget framework. In fact, the Multi-year budget frameworks/formats (medium-term budget framework) are the basis for achieving fiscal consolidation. Within these frameworks, the Sovereign State's medium-term objectives are stated in terms of high-level targets such as the magnitude of

- aggregate revenues;
- aggregate expenditures;
- deficit/surplus; and
- debts.

The high-level fiscal targets are fixed in the context of a medium-term. They aim to achieve a certain fiscal outcome over a number of years. The short-term [one-year] traditional budget format does not assist in monitoring the achievement of the high-level fiscal targets. In addition, the multi-year budget framework enables the Public Sector managers to be in a better position to plan their operations logically and strategically as they have some indicative level of funding beyond the next ensuing fiscal year. The application of the multi-year budget framework could vary from one country to another on taking into account the particular local needs.

For example, Sweden employs a multi-year budget framework as the basis for the annual budget process. It has a three-year time horizon, i.e. the upcoming budget year and the next two consecutive years. The multi-year budget framework provides the linkage between the Swedish Government's fiscal policy objectives in a macro-economic setting and their application in an operational context. It operates on the specified three cascading levels:

The **first level** constitutes the articulation of the Swedish Government's fiscal policy objectives in macro-economic terms, i.e. level of surplus or deficit as a percentage of GDP.

At the **second level**, these objectives are translated into a maximum level of the total expenditure based on certain economic assumptions.

At the **third level**, the limit for total expenditure is further analyzed operation-wise by giving indicative funding levels for each of the expenditure areas (Bolandal, 2001)

As the multi-year budget framework is in place, the starting point in the annual budget exercise is to update the information for year 2 in the framework. The Ministry of Finance [Sweden] starts by re-examining the macro-economic outlook for the coming year to see if the economic assumptions applied in the multi-year framework remain valid. The updated macro-economic outlook plays a key role in determining the stance of budget policy. For example, a

higher level than the assumed economic growth would permit making available additional resources for the next ensuing year (Bolandal, 2001).

In addition, the most important task of the performance budgeting is linking goals with resources. As the primary purpose of the performance budgeting process is to link what the government wants to achieve for the community with resources necessary to achieve it. In other words, the performance budgeting is intended to focus on the key questions of what governments do and why, not just how much does it cost and how will it be funded. In this context, Multi-year budget framework makes a great deal of sense. As such, multi-year budget framework enables the government to better-set meaningful objectives with realistic timeframes for completing them. Accordingly, it reinforces the government commitment to long-term fiscal health by looking beyond a one-year time horizon to fund operating programs and capital improvements. In addition, it retains the fiscal control provided by annual budgets and saves time and effort in preparing annual budgets. Therefore, it can be inferred that the multi-year approach is fundamental for performance budgetary process as it assists in: (Statler, 2007)

- 1- identifying the most important things that governments want to achieve for their communities;
- 2- establishing reasonable timeframes and organizational responsibility for achieving them; and
- 3- allocating the resources necessary for programs and projects to implement them.

Moreover, the performance-based budgeting fits naturally with a medium-term budget framework, as the medium-term budget framework aims to improve expenditure prioritization (Robinson, 2009).

4.2.5 Top-down budgeting Approach

As noted earlier in section 3, the “bottom-up” approach has many shortcomings. The most important shortcoming of the “bottom up” approach is that it is difficult to reflect political priorities in this approach, as it is a driven “bottom-up” with the budgetary allocations “emerging” at the end of the process. Basically, reflecting the political priorities and strategic objectives in the budgeting system is one of the main requirements for implementing the performance budgeting system. Therefore, that approach is now being replaced with a modern “top-down” approach to budget formulation. The “top-down” approach, in practice, has been found to be of great assistance in achieving fiscal consolidation.

The starting point of the “Top-down” approach is for the government to make a decision as to the total level of expenditures and to divide that “pool” among individual spending Ministries. The key point is that each Ministry has a pre-set limit on how much it can spend. Once this decision is taken by government,

the Ministry of Finance/Treasury largely withdraws (stops taking part in) from the details of budgetary allocations of each ministry (OECD, 2002). The Ministry of Finance/Treasury concerns itself only with the level of aggregate budgetary expenditure allocation for each Ministry, not the internal allocations within the each respective Ministry. The internal allocation is attended to by Minister for each respective Ministry. Each Minister is deemed to be his own finance minister. Each Ministry has a total amount and each Minister can re-allocate the budgetary provision among that Ministry's various agencies and programs. This approach gives each Minister greater control over his Ministry's Budget proposals. In this manner, each Minister is in a position to identify and select the priority level of each budget program for appropriate funding accordingly (OECD, 2002).

4.2.6 Modernizing governmental accounting system

In addition to the aforementioned components, the absence of an appropriate accounting system may undermine the implementation of performance budget. As the budgeting system should be integrated with the accounting system, which is used to carry out the budget, therefore, the basis on which the budget is prepared should be consistent with the basis of accounting utilized (Ouda, 2003a). Thus, the budgeting reform makes the accounting reform inevitable. As the shift from input-based budget to output-based budget requires the determination of the output that will be used as a basis for allocating the appropriations. One key dimension of performance budgeting is the cost of output provided. In an attempting to link resources to output (results), it is important to measure the full cost of the resources associated with the output provided. Due to the fact that cash accounting basis cannot measure the cost of the output, the modernizing of the government accounting system entails the adoption of accrual accounting system. The main objective of adoption of accrual accounting is to make the true cost of government more transparent. In addition, adoption of accrual accounting on both revenues and expenses in government entities leads to getting the right information that is required for planning, control, decision making, and performance evaluation. Accordingly, the adoption of accrual accounting in the public sector gives the government the opportunity to develop the budget system and provides meaningful information that can satisfy the needs of budget functions (Ouda, 2003b)

A key aim in the managing-for-results is to hold managers responsible for outcomes/or outputs while reducing controls on inputs. In this context, it is expected that managers should be responsible for all costs associated with outcomes/outputs produced, not just the immediate cash outlays. Only accrual accounting allows for the capture of these full costs, thereby supporting effective and efficient decision-making by the managers. This in turn will assist the managers in managing their budget in an efficient and effective manner.

Furthermore, many of the writers who are concerned with public sector reform agree on the integration and consistency of budgeting and accounting system. For instance,

Schick (2001) states that the accounting system would need to be on the same basis as the budgeting system to avoid the possibility of conflicting objectives. Hepworth (2002) states that budgeting system and accrual accounting should go together. Unless the budgeting system is on the same basis as the accounting system, the scope for mismanagement and a loss of financial control are considerably enhanced. United Nations (1984) argued, “When reforming accounting system, considerations have to be given the status of other components within the public financial management system such as budgeting. Changes in the basis of recording transactions for accounting purposes affect the budgeting process. The integration of budget and accounting systems based on common classification and measurement techniques constitutes a prerequisite for good management. Therefore, the implementation of accrual accounting should not be undertaken without regard to the requisite changes in budgetary system”. Therefore, the governments should be aware of the particular relationship between the budgeting system and the accounting system that will be used to execute it. Simply it is said that budgeting and accounting go hand in hand. Accordingly, we can conclude that the implementation of performance budget needs to be enhanced by a consistent accounting system that would provide the cost of the outputs that will be used for linking the resources with the results.

4.2.7 Developing an appropriate performance measurement system

After the introduction of performance information into the budget process and using it in decision-making and allocation of resources, there should be a well-designed performance measurement system. The development of the performance measurement system is considered essential for regular systematic collection, analysis, and reporting of data that tracks resources used, work produced, and whether specific outcomes were achieved by a government. Basically, performance measurements are required to assess whether the governmental entities have achieved the projected results, quantified with respect to economy, efficiency, and effectiveness.

Economy: provision of inputs of a specified level of quality at the lowest cost.

Efficiency: how well a Public Sector entity uses its resources to produce outputs [goods and services] relative to the best practice at a given point in time. In other words, the relationship between inputs and outputs, or the productivity rate at which inputs are converted into output.

Effectiveness: how well the outputs of a Public Sector entity fulfill the objective criteria and reach the levels expected by the Government; for example, are the activities of hospitals having an effect on the general health of the community? So it is usually conceived to be the extent to which objectives have been fulfilled.

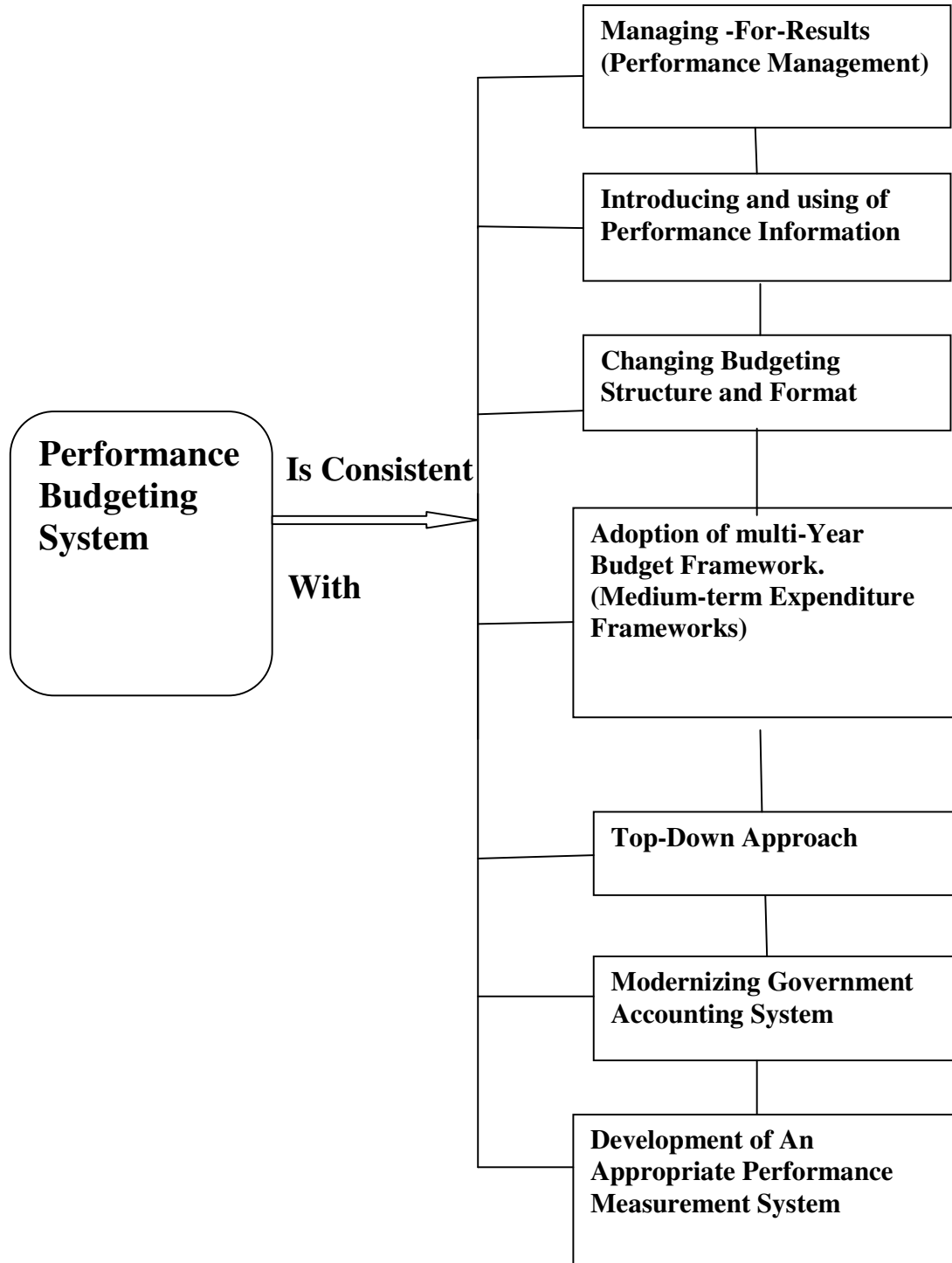
However, measuring the performance of governmental (public sector) entities is considered to be a complex issue. The government performs different activities such as education, defense, health care, etc. and the accomplishment of those actions results in different outputs. Hence, the assessment of the value created would involve specialized

technical know-how. The outputs of each governmental entity require a suitable performance measurement system with appropriate metrics. Essentially, effective performance measurement in the Public Sector should be guided by the following axioms: must be “Value - Based”; reflect achievement of long-term objectives; must not be sold as a “self-contained” solution; Rewards / Incentives must be linked to performance:

- **Performance Measurement must be “Value –Based”:**
The focus is on the value-added concept relative to a Public Sector entity being organized and managed according to a well-formulated strategic plan with defined measurable results. These accomplishments must justify the fundamental purpose of that Public Sector entity.
- **Performance Measurement to reflect achievement of Long-term Objectives:**
The performance measurement should be designed to help the Public Sector entities “learn to do the right things right”. To achieve this, performance measurement requires a long-term, multi-dimensional multi-disciplinary perspective, not just a short-term outlook.
- **Performance Measurement must not be sold as a “Self-contained” Solution:**
Performance measures will not produce *per se* higher levels of efficiency, quality, and effectiveness. These are achieved through decisions to re-allocate or re-assign resources, improved work methods, adoption of best practices, and adjusting as necessary the task priorities. Nevertheless, the Performance Measurement System can provide some of the data to facilitate the re-direction/deployment of resources.
- **Rewards must be linked to Performance:**
To be successful a Public Sector entity needs to have carefully defined measures of success. This involves a structured process for the linking of government’s objectives to critical success factors and to the associated performance measures. Experience shows that the behavior of Executive Managers is directly linked to the performance criteria on which their contribution is appraised. This contention is valid and affirms the motivation value of their compensation being pegged to the performance appraisal.
- **Performance Measures should provide:**
 - Information to facilitate accountability;
 - A means of identifying areas for review;
 - A means of monitoring policy implementation and success;
 - Information on the potential productivity improvements of a Public Sector entity;
 - Assistance for the resource allocation/budgeting process by providing the means of allocating funding between competing needs, based on priorities and performance cost/benefit, rather than historic precedent;
 - A powerful internal management tool for the Public Sector entities - they provide Managers with an idea of how efficient they are, as may be explain areas of poor performance as well as identify appropriate leading performers.

Based on the discussion of the aforementioned components, it can be inferred that the performance budgeting is consistent with the following suggested framework:

The suggested framework for successful implementation of performance budgeting system in the public sector can be reflected as follows:



5. Conclusion

Performance budget indicates the relationship between the inputs and the outputs and whether the resources have been effectively used and the target objectives have been achieved. In short, it focuses on the purpose[s] of the expenditure[s] and the end-results/outcomes of the expenditures and provides data, which can be used to evaluate those outcomes. However, the absence of an appropriate conditions and environment for better performance and transparency, and results-based accountability, the implementation of performance budgeting may not be succeeded. This is the case of most developing countries. These countries are still using the traditional government systems (such as public administration (bureaucratic) system, line item budgeting system (including bottom-up approach), cash-based accounting, traditional performance measurement system and traditional auditing system) that are more concerned with compliance with rules and instructions. These systems are not able to assist in assessing the management and operational performance of governmental entities and to consider questions of economy, efficiency and administrative effectiveness of the operations for which management is responsible. The use of the traditional government sector systems have resulted in: The objectives for governmental entities are not clearly defined; the respective responsibility of politicians and civil servants are confused, so that the lines of accountability and responsibility are never clear; the relationship between the expenditure and results is not indicated; appropriations are based on input in place of output/outcome; and goals and performance requirements of government departments are poorly specified.

The prevalence of a such environment will not assist in the implementation of the performance budgeting and can explain why most of the developing countries have been failed to implement the performance budgeting in their governmental sector, in spite of the existence of the performance budgeting for more than 60 years ago. Consequently, it has been inferred that modern budgeting system cannot work with or succeed in a traditional system. In fact, performance budgeting should not be seen as an isolated initiative. It should be viewed, rather, as part of a set of broader reforms—often referred to as managing-for-results—designed to focus public management more on results delivered and less on internal process. Therefore, the successful implementation of performance budgeting in the public sector requires appropriate conditions (a specific framework) that can facilitate its adoption and putting it into practice. This framework should include the following components:

- Shifting from public administration/bureaucratic system to performance management (managing-for-results). Government cannot budget for results unless it manages for results.
- Introducing and using of performance information into budget process will facilitate the implementation of performance budgeting.

- Changing the budgeting format and structure towards a more performance-oriented approach.
- Shifting to a multi-year budget framework.
- Shifting from Bottom-up approach to Top-down approach.
- Modernizing the governmental accounting system.
- Developing an appropriate performance measurement system.

It is important to note that when these conditions/components (framework) are lacking, the implementation of performance budgeting is doubtful and it will not lead to improving the performance of the public sector.

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