



NEW APPROACHES IN PUBLIC BUDGETING AND ACCOUNTING

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ANNOTATION

The choice between fair value and historical cost accounting is the subject of long-standing controversy among accounting academics and regulators. Nevertheless, the market-based evidence on this subject is very limited. We study the choice of fair value versus historical cost accounting for non-financial assets in a setting where market forces rather than regulators determine the outcome. In general, we find a very limited use of fair value accounting. However, the observed variation is consistent with market forces determining the choice. Fair value accounting is used when reliable fair value estimates are available at a low cost and when they convey information about operating performance. For example, with very few exceptions, firms' managers commit to historical cost accounting for plant and equipment. Our findings contribute to the policy debate by documenting the market solution to one of the central questions in the accounting literature. Our findings indicate that despite its conceptual merits, fair value is unlikely to become the primary valuation method for illiquid non-financial assets on a voluntary basis.

Key Words: state budgeting, modern budgeting system, externalities, public financial management, efficacy, accounting, public sector, Government budget, economic BUDGET

The public budget is a tool for quantifying the trade-off between expenditures and revenue-collection decisions made in a given fiscal year. It is a central element of public financial management. Yet, budget is not only a technical, but also a political text. After all, the budget reflects the public preferences and priorities of those members of society who will be served by and included in funding of activities. Given the competitive demands existing despite constrained resources, the budgetary process, namely the allocation of resources, may basically be expressed as a political undertaking that is shaped by the needs and preferences of the electorate, as perceived by politicians. Accordingly, budgets prepared following a similar administrative course unvaryingly in almost any country are hardly unbiased and typically represent the predominant political climate and affairs.

The process of public budgeting has undergone a rigorous transformation depending on the degree of evolution achieved by the individual, society, politics and economy.

From time immemorial, accounting for governments and government agencies has been on a cash basis. No change was contemplated until the early 1980s when it was considered appropriate that government business enterprises should move closer to commercial accounting principles practiced in the private sector either on a full accrual or a modified accrual basis. The pace of change has accelerated since then as governments around the world are being asked to do more with less and to be fully accountable to the community for resources entrusted to them. As resources become scarcer, governments and public sector managers are more conscious of different ways to deliver services to achieve government policies and desired outcomes. Examples of this are competitive tendering and other forms of contracting out of activities which have traditionally been carried out

by governments. Demands for better accountability by governments and in turn by public sector managers is being heard around the world as the public realizes that living on credit is not sustainable for individuals and that the same principle applies to governments. These forces create an environment in which the public demand reforms in the way governments manage their activities and businesses, and reforms in the way governments fulfil their responsibilities without leaving a huge burden on future generations. It can be argued that these forces are a precondition for governments adopting financial reforms. An environment of reform tends to lead to decision makers demanding more useful information to assist in deciding between competing courses of action and to discharge their accountability in a meaningful way. The move from a cash basis to an accrual basis of accounting would seem to be a progression in keeping with management and financial reforms in the public sector. This paper aims to inform readers about a range of perspectives on accrual accounting from a number of contributors who have experience in implementing this accounting reform or who have observed its progress. The PSC believes that by sharing perspectives of those who have been involved in the use of accrual accounting information for decision making purposes, others may gain insights into the value of this form of financial reporting to their own governments and other public sector entities. The PSC deliberately set out to obtain the views of a wide range of people with a range of occupational backgrounds. The PSC also set out to focus on people who have experience of changing information outputs. The contributors to this paper are politicians, economists, academics, administrators and accountants.

Budgeting, in its traditional fashion accounting practice, exists with rolling (i.e. continually updated to add a new period for the most recent period) and incremental (i.e. showing marginal change from a previous year) proposals. Budgets are typically arranged in cash terms and are based on accrual accounting. Their contents consist of line items. The traditional budgetary system makes an outlay of expenditures by inputs/resources. In such system, the budget functions as a mechanism of fiscal control over public activities. The paramount advantage that such system delivers is that it provides simplicity and facilitates for the control of public expenditures against input items in a systematic manner.

The contemporary budgetary system is not primarily cost-oriented, but instead, more focus on cost-effectiveness and cost-efficiency. This stance requires investigation of what a casual citizen obtains as benefit from the program, rather than probing into detail with the actual cost of a program. However, investigation of cost under a limitation of resources is rather associated with how to obtain the greatest benefit versus the cost undertaken.

While the traditional budgetary system is not suitable for establishing the cost-outcome relation from the viewpoint of results delivered by the public, the contemporary budgetary systems allow for evaluating the result-oriented nature and quality of budget applications, by integrating performance parameters into the budgeting process. On the other hand, within the array of modern budgetary system applications so far implemented, the task of establishing the relation between costs and targeted outcomes for describing performance has gained wide acceptance and more importance, rendering economic, efficiency and effectiveness the major components of performance. In public perception of performance, the hegemony of 3E (economic, efficiency and effectiveness) is a phenomenon that is mostly criticised.

While 'economic' concentrates on the cost of inputs as an aspect of performance that assists the selection of most optimal input components, 'efficiency' is derived from the relation between the product (output) of a production process and the resources (input) consumed to realise the output. Effectiveness demands a comparison to be made between the realised and predicted outcome. However, the level of attainment of the

predicted outcome with effectiveness concept does not take account of the externalising effects of the outcomes delivered by public. It is therefore essential that the said effects as caused by public activities should, as well, be considered. The efficacy concept has been proposed to denote the effects inflicted by a program upon a society.

A similar relation has been conceptualised by as 'net effects'. According to this concept, a service program may have entailed to additional costs in other programs and within the community, in a broader perspective. For instance, expenditures allocated to development of roads and motorways may have principally aimed at pruning the time of travel, and hence achieved this objective of theirs. However, such objective may have been accomplished at the expense of extra environmental pollution. Consequently, in order for the net effects of a particular program to be measured in perfect accuracy, the need is eminent for correctly identifying and assessing the effects caused by the practical implementation of that program on private sector and other public programs in progress.

As a matter of fact, in most cases, the potential occurs for realisation of a program at cost of compromises in assurance of productivity and effectiveness, sustainability and gender mainstreaming. For this reason, there is the need for expanding the meaning and conceptual coverage of performance so as to cover, in addition to thrift, productivity and effectiveness, such budget-driven externalities as gender mainstreaming, sustainability and participation, as accommodated by the concept of efficacy, in order to induce a comprehensive and homogeneous definition of the term. Therefore, performance as an umbrella term, should better be denoted with cost-effectiveness rather than cost of effectiveness.

New approaches in budgeting

The approaches to budgeting, which facilitates due consideration of the budget at planning, preparation, approval, application and supervisory stages also with consideration of economic and social externalities caused by public activities consist of

- (i) environmentally sensitive budgeting approach,
- (ii) citizen-centred budgeting approach,
- (iii) citizen's budget approach,
- (iv) participatory budget approach
- (v) gender-responsive budgeting approach. The following section will describe the characteristic traits and integration into the basic budgeting processes of these approaches.

Environmentally sensitive budgeting approaches

In this part of the study, green budgeting and ecoBUDGET approaches are discussed under environmentally sensitive budgeting.

Green budgeting

The green budget, or efforts for integrating environmental concerns in fiscal processes of the public, is relatively new in the historical timeline. For decades, countries have been working for attaining their political goals on environment, utilising financial instruments. The mindset lying behind the green budget assumes that economic welfare of the future would depend on green technologies. These efforts bring along the ecological modernisation as a concept, thus envisaging approaches for economic growth bundled with environmental sustainability, based on a win-win strategy.

Green budgets are grounded on a careful consideration of environmental sensitivities in time of determination of the composition and magnitudes of expenditure and revenue items of the state budget and preparation of informed forecasts thereof. Budgets affect activities concerning the environment in various

different ways, through their expenditure, revenue and neutral items, namely, those instructions that facilitate transition between funds. Public expenditures may yield positive externalities and positive impacts on the environment, when they support positive economic behaviour in general. Public revenues, on the other hand, are rather allocated to actions deterring activities that are generally detrimental to the environment. Such purposes are predominantly associated with application of environmental taxes.

The budgeting process typically starts with planning of areas of expenditure by prioritisation. The second stage oftentimes involves approval of the budget by the parliament, on submission by the finance ministers. The legislative body may superimpose additional environmental or non-environmental conditions to groupings of expenditure by type, subject to constitutional arrangements made at national level. The third stage is the implementation phase of the budget. In the course of budget implementation, expenditures are made by means of the central government, local or regional administrations, EU bodies and NGOs. The fourth stage comprises monitoring, final assessment and reporting, handled either by the spending department or by external auditing functions. This is the phase where environmental expenditures are assessed for efficiency and efficacy, together with all other expenditures. The first four stages usually result in an increase in revenues, which is then taken into account during the planning efforts for the next budget period.

ecoBUDGET

The ecoBUDGET is an environmental management tool designed for and in joint action with local authorities, by the International Council for Local Environmental Initiatives (ICLEI), upon disclosure of its name for the first time in 1997 in the context of the Aarhus Charter, which will be used by all levels of government. The ecoBUDGET has been originally put forth as a protection inspired by the idea that air, potable water, biodiversity and other similar natural resources can and must be managed with due care and diligence at the same level with financial resources.

The basic idea follows the assumption that natural resources can be managed in the same way financial resources, such as money, are managed in a developed and stable society, by rendering smart allocation of resources easier. The basic idea is to facilitate the management of resources on a local scale, based on a prioritisation of natural resources for use. Besides, it contributes to accountability in the political decision-making process, by way of budgeting and evaluation of natural resources. In this sense, ecoBUDGET is a tool that enables the budgeting of environmental assets, in the same way followed for creating a financial budget for environmental assets. With this tool, the local governments may monitor their already scarce natural resources prospectively, and set objectives for these resources

Implementation of the budget consists of:

- (i) measurement management referring to the responsibilities and programs for individual indicators that must be agreed upon within the administration,
- (ii) accounting in full support of mechanisms for monitoring and reporting of individual indicators enables early detection of whether environmental budget figures are complied,
- (iii) feedback given to the senior management on all major expenditures to enable timely realisation of necessary corrections or gain political legitimacy through parliamentary bills.

Evaluation stage consists of:

- (i) the budget balance for the period which is reached with compilation of annual accounts from individual accounts,

- (ii) the internal audit that verifies and validates how close the administration is to attaining the predefined objectives, by comparing annual balance with long-term objectives,
- (iii) the approval of budgetary outcomes which follows a similar stance to the approval of the main budget.

In this context, the implementations of contemporary budgeting systems seem to employ frequent repetitions of the 'value for money' when describing performance and support successful attempts on raising awareness among those who are actively involved in financing of public activities, on cost-efficiency. The new budget approaches help expanding the concept and context of performance from the point it covers cost-efficiency towards cost-efficacy, to be thenceforth defined as the level of progress achieved by public activities in 'intended effects' instead of 'actual outcomes' obtained. Doing so would make it possible to base budgetary decision-making process upon social and economic externalities of public expenditure and revenue items. This is meaningful especially for unveiling the idea that public performance is not just a matter of tax payers only, but in fact a concern of all other citizens who may not have registered their names as tax-payers for this or that reason, as well. Apart from this, new approaches inferred also possess significance for supporting the notion of developing accountability of the contemporary budgetary systems, because of their profound ability to allow for a better understanding among those who partake in the financing of public activities, of the positive externalities brought forward by financial activities.

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