Implementing Reforms in Public Sector Accounting

Susana Jorge
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IMPRENSA DA UNIVERSIDADE DE COIMBRA
COIMBRA UNIVERSITY PRESS

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Comparative
International
Governmental
Accounting
Research

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COIMBRA UNIVERSITY PRESS

COIMBRA • PORTUGAL 2008

COORDENAÇÃO EDITORIAL
Imprensa da Universidade de Coimbra
Email: imprensauc@ci.uc.pt
URL: http://www.uc.pt/imprensa_uc

CONCEPÇÃO GRÁFICA
António Barros

PAGINAÇÃO
Simões & Linhares, Lda.

EXECUÇÃO GRÁFICA
Simões & Linhares, Lda.

ISBN
978-989-8074-39-3

DEPÓSITO LEGAL
281657/08

OBRA PUBLICADA COM O APOIO DE:

1973 FEUC 2008
Faculdade de Economia
Universidade de Coimbra

Câmara dos Técnicos
Oficiais de Contas

Adhikari Pawan

Frode Mellemvik

CHANGING IDEOLOGY IN NEPALESE CENTRAL GOVERNMENT ACCOUNTING REFORM

Introduction

Cash principle has been a basis of Nepalese central government accounting since the beginning of the sixtieths. During the course of these four decades the operation of cash accounting has however drawn more critics than supports. There were perennial concerns both at the national and international arena emphasizing improvements in the quality of government accounting. In the past, accrual accounting was envisaged a panacea for all perceived deficiencies in Nepalese cash accounting. A number of studies carried out by international organizations and the government concluded with an analogue gist emphasizing the need for accrual accounting. There is evidence that some endeavors had also been made over time to install some forms of accrual accounting (see e.g. Adhikari, 2005). Despite being ceremonial, these studies and attempts contributed Nepal to be acquaintance with the tenet of accrual accounting long before the latter became a core of widespread New Public Management reforms.

Initially, the notion of accrual accounting embarked on in Nepal in the beginning of the eighties with a view to underpinning program budget (see e.g. Agrawal and Bista, 1981). In 2005, a high level committee set up for evaluating government‘s expenditures presented a five year road map for the adoption of accrual accounting in Nepalese central government (see e.g. Adhikari, 2007). Along with delineating a time frame for accrual accounting, the road map impinged on wide ranging discussions on the applicability of accrual accounting in Nepalese central government. There were quests regarding Nepal’s capabilities and available resources to install and practice accrual accounting. A prime argument was that in order to undertake a stride towards any comprehensive system of accounting, for instance, accrual accounting, Nepal should work on reinvigorating the operation of its existing cash accounting.

In recent months, a general consensus has been reached among the regulatory agencies, international organizations and donor countries on how to advance reforms in Nepalese central government accounting. Instead of accrual accounting, the adoption of the cash basis International Public Sector Accounting Standards (IPSAS), pronounced by the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC), is now acknowledged a point of departure for streamlining Nepalese central government. The myth of accrual accounting is discarded and the former is envisaged only a long term reform approach. This is seen as an ideological convergence in Nepalese central government accounting reform.

The aim of this paper is to delineate how the notion of accrual accounting evolved and was abandoned in Nepalese central government accounting. The paper is structured as follows. The first section outlines the contemporary trend towards accrual accounting in a global context. The next section provides insight into financial norms and practices in the government of Nepal. There is then a discussion of some of the drawbacks of Nepalese central government accounting. Nepal‘s past endeavors to adopt the accrual basis of accounting are then demonstrated. Ideological shift in Nepalese government accounting reform is addressed in the penultimate section before conclusion.

1. Contemporary Trends Towards Accrual Accounting

Accrual accounting has been a core of NPM inspired reforms initiating unprecedented and unabated debates since the last twenty-five years (see e.g. FEE, 2006). Researchers have even referred to this ongoing trend towards accrual accounting the most rationalized element in the promotion and institutionalization of New Public Management (see e.g. Adhikari, 2005; Meyer, 1998; Broadbent and Guthrie, 1992; Lapsley, 1999). The widespread of accrual accounting in financial reporting of public entities in different jurisdictions also envisages an era of global revolution in government accounting (see e.g. Heald, 2003). Accrual accounting has been an ultimate destiny of contemporary public sector reforms across countries and international organizations.

The use of accrual principles in accounting and budgeting is considered indispensable to upraise the notions of performance, results and outputs that have long been negated in the public spheres (see e.g. Guthrie *et al.*, 1999; Hood, 1995 and 2000; Lapsley, 1999; Broadbent and Guthrie, 1992; Klumpes, 2001; Robinson, 1998; OECD, 1993). Carlin (2005) states the superiority of accrual accounting and reporting as compared to cash on three related themes. Firstly, the adoption of accrual accounting enhances transparency and accountability both externally and internally. Next, accrual accounting leads to greater organizational performance and outputs though improved resource allocation. And, lastly accrual accounting allows public entities to identify full costs of their activities, which is pivotal to ensure greater efficiency. Athukorala and Reid (2003) further propagate accrual accounting a means in curbing fraud and corruption, particularly in the context of developing nations.

The majority of OECD countries now practice some forms of accrual accounting in their different administrative hierarchies. Chan (2003) categorizes these diversified forms of accrual accounting into four sub-groups; mild, moderate, strong and radical accrual. Accordingly, mild accruals are meant to disclose only short-term financial assets and liabilities. Moderate accruals include both short term and long term financial assets and liabilities. In addition to short and long term assets and liabilities, strong accruals put onto the balance sheet various categories of capital assets. Counties adhering to radical accruals are subjected to demonstrate legislated entitlement benefits as liabilities.

The trend towards accrual accounting is however not confined within the purview of developed nations and the OECD members. In their efforts to refurbish government accounting information many developing countries and countries in transition are either moving or contemplating a move to accrual accounting. Chan (2005) justifies the efforts of developing countries and transitional economies towards accrual accounting a basic necessity rather than a luxury. Accordingly, information on assets and liabilities is pivotal as it assuages developing countries and countries in transition to avoid liquidity and financial solvency problems (see e.g. Chan, 2005). Given the ambiguities inherited to accrual accounting, such countries are however accentuated to shift to mild accruals at the outset until they elevate their technical calibres and resources to cope with other advanced forms of accrual.

Along with countries, accrual accounting has also drawn attention of international organizations. The European Commission has been developing its general purpose financial statements on the accrual basis since 2005 (see e.g. FEE, 2006). The UN aims to practice a full fledged accrual based system by 2010 (see e.g. PWC, 2006). Other international organizations such as the OECD, IFAC, NATO and Interpol are in the process of implementing the accrual basis International Public Sector Accounting Standards (IPSASs). Additional to countries and organizations, the widespread public sector accounting systems including the 1993 SNA, the ESA 95, the IMF's GFSM and the IFAC's IPSASs are also in recent years aligned with accrual principles. And, there is no signal at present that this international trend towards accrual accounting is reversing (see e.g. Athukorala and Reid, 2003). The widespread of accrual accounting triumphs an era of '*accountanization*' in the public sector (see e.g. Laughlin and Power, 1996).

2. Norms and Financial Management Practices in the Government of Nepal

'The Interim Constitution of Nepal 2007', the 'Financial Procedures Act 1999' and the 'Financial Administration Regulations 1999' are the three primary norms providing a general framework for Nepalese financial administration. Financial regulations incorporated in section 10 of the Interim Constitution are actually copied from its predecessor, promulgated after the first people's movement for democracy in 1990. The Constitution has covered, among other things, the two main issues; the operation of government funds and the presentation of annual budget (see e.g. GON, 2007). Accordingly, each government transaction is required to be channeled through the government fund, the so-called consolidated fund. Money collected in the forms of revenues, loans, loan repayments and so on, except those of religious endowments, are directly credited to the consolidated fund accounts. Similarly, expenditures incurred from the consolidated fund are to be represented in the annual budget, which requires parliamentary approval. Albeit, budgetary compliance is the core of the constitution, the latter incorporates a provision demanding the results and performance of budgetary expenditures. Alongside the financial plans, government entities are therefore mandated to present the accounts of goals achieved from previous spending while submitting their budget proposals. Financial provisions incorporated in the Constitution are elaborated further in the 'Financial Procedures Act' and 'Financial Administration Regulation' of

1999. These two norms set basic criteria for the operation of budgeting, accounting, and reporting in the government of Nepal.

The budget of the government of Nepal consists of an annual budget and the medium term expenditure framework (MTEF). The Ministry of Finance and the National Planning Commission are the responsible agencies for the annual budget and the MTEF respectively. The annual budget proposals adhere to a vertical path through departments to line ministries and are consolidated at each level before presenting them to the Ministry of Finance. The National Planning Commission (NPC) prepares the MTEF by assorting the projects and programs deemed essential for national development. The MTEF assures funding to prioritized programs and projects over a period of three to five years (see e.g. NPC, 2002 and 2003). Following the parliamentary approval in June, the Ministry of Finance through district treasuries releases money to all spending units. The government of Nepal consists of approximately 3279 spending units scattered over 75 districts (see e.g. World Bank, 2002). One-sixth of the total budget is disbursed initially and the reimbursement is made every month on the basis of financial statements submitted by the spending units.

The Financial Comptroller General Office (FCGO), an autonomous unit operating under the jurisdiction of the Ministry of Finance, is a central accounting unit in the government of Nepal. At the district level, the FCGO is represented by district treasuries, the so-called 'District Treasury Control Office (DTCOs)'. The FCGO regulates government accounting, custodies the consolidated fund, and presents an integrated accounting statement for the country as a whole. Apparently, accounting in the government of Nepal operates at three different levels; central level, district level and operating level. Central level accounting, carried out by line ministries, is meant to examine the accounts of their subordinate units and consolidate such accounts in the ministerial level statements. District level accounting, conducted by the DTCOs, aims at scrutinizing the accounts prepared and presented by district offices and integrating them in the consolidated district statements. Each spending unit covered by the appropriation act is required to furnish operating level accounting, which commences by preparing journal vouchers and ledgers, primarily the cash book and the budget sheet.

Presently, two levels of reporting are ostensible in Nepalese government accounting. First level reporting begins after the spending units forward their monthly statements to the respective line ministries and the concerned DTCOs. Such statements are evaluated and amalgamated in the ministerial level statements, which are relayed both to the FCGO and the Auditor General Office (AGO). The DTCOs also collect statements on a monthly basis from each district office, operating under their jurisdictions, facilitate internal audits, and prepare the monthly and annual consolidated statements for the district as a whole. The ministerial and district level reports are further verified and consolidated in the FCGO. The FCGO's consolidation of these district and central level accounting statements is a point of departure for second level reporting. The FCGO prepares the integrated reports for the country as a whole and relays to the AGO for final auditing within six months following the year-end.

Additional to compliance-oriented reporting, the projects and programs are mandated to submit their progress reports on a trimester basis and the certification of satisfactory performance by appropriate authorities in their concerned line ministries and aid agencies (see e.g. NDF, 2004). The perpetuation of the projects and programs largely relies upon the results presented in these reports. The projects/programs must meet approximately 80% of their targets in order to receive money without any interruption or investigation. The budget release will be subjected to further interrogation if their achievements are in between 50 to 80%. The budget release may even halt to those projects and programs in which the progress incurred is less than 50 percent of the intended targets.

3. Some Drawback of Nepalese Central Government Accounting

Adhering to the fundamental cash principle, accounting of fixed assets, obligations and commitments, and debtors and creditors etc. are beyond the scope of Nepalese government accounting. The accounting system is therefore incapable to tie expenditures with the results, outputs or outcomes to be attained through those expenditures as demanded by the constitution and financial regulations (see e.g. World Bank, 2002). Additionally, it is evident that despite being claimed as cash oriented, the operation of accounting has to a large extent been inconsistent and incompatible with the requirements of cash principles (see e.g. World Bank, 2007). Some of the defaults inherited to Nepalese government accounting include the treatment of advance payments as expenditures, the omission of 'off budget' transactions, and the absence of accounting policies (see e.g. Chitrakar and Macmillan, 2002).

There is no such provision in Nepalese government accounting that allows the recording of direct payments and commodity grants offered by donors. Inventories are being treated as expenditures of the fiscal year in which they are procured (see e.g. Sharma, 2006). Similarly, the accounting statements and reports are generated on an annual basis and these reports eventually do not present cumulative expenditures incurred or incomes generated for more than a year. Along with this, the absence of standardized forms and formats has led to considerable ambiguities in the consolidation of government expenditures, revenues, debts, other reimbursements and investments in the annual statements. It is apparent that the audited reports, issued by the Auditor General Office, exclude basis accounting policies, assumptions and explanatory notes. Given these drawbacks, comprehending government accounting reports is actually a challenging endeavor. This complication in reading financial statements has elevated further due to the absence of subjective analysis and interpretation of accounting numbers. The use of accounting data for planning and decision making is consequently rare (see e.g. Sharma, 2006).

These aforementioned limitations justify the inadequate control or reporting of cash in the government of Nepal. The cash flow statements prepared and presented by the budgetary entities ignore disclosures on cash prepayments, accrued cash expenses of prior years, and accrued expenses and trade creditors of the current year. Similarly, the accounting system is incapable to disclose accounts receivable from donors for reimbursable expenditures, the revenue assessed and recorded but not yet collected, and contingent liabilities and guarantees (see e.g. Chitracar and Macmillan, 2002). Financial reporting is a means through which to discharge accountability of public funds. The absence of important accounting information in financial reporting means that there is a weak basis for discharging accountability, ensuring transparency, and maintaining uniformity in Nepalese public sector finance. Government accounting in Nepal is circumscribed to ensuring that transactions are recorded and reported in compliance with budgetary regulations.

4. Nepal's Endeavours to Move to an Accrual Basis of Accounting

Both the government and international organizations in the past emphasized the need for accrual accounting to ratify the aforementioned limitations and to improve the quality of government accounting (see e.g. Adhikari, 2005). Initially, the notion of accrual accounting was linked to the successful implementation of program budgeting. In 1985 a new financial norm was enacted, which emphasized the imperative of program budgeting and some forms of actual accounting with a view to evaluating the costs and benefits of each project and program. In 1987/88, to transform this norm into practice, the Financial Comptroller General Office (FCGO) together with the Canadian experts emanated an accounting and auditing reform project. The project was aimed at facilitating accounting changes and fostering the implication of newly introduced program budget (see e.g. AGO, 1989).

The project recommended the government to supersede the existing cash basis of accounting by modified accrual (see e.g. Adhikari and Sharma, 2006). According to Niroula (1991), the new accounting codes, techniques and classifications designed during the project period were formally endorsed for use on May 31, 1989. In 1990/91 the new accounting forms and patterns couched on the ideas of accrual accounting were literally experimented in approximately ten development programs. The dissemination of these new accounting measures did not, however, take the pace after the foreign experts left and the allocated resources for the project were consumed. The project succumbed as a result of inadequate resources, technical skills and commitments to cope with accrual principles. In the late ninetieths, a feasibility study of accrual accounting was facilitated in collaboration with the Asian Development Bank. The study also emphasized the need for accrual accounting and accounting standards. There is however no evidence that the results of this study had been materialized (see e.g. Chitrakar and Macmillan, 2002).

With the advent of a new century, Nepal witnessed incessant critics both at the national and international spectrum due to its deteriorating public services and growing resource dependency. Deficiencies in the planning, budgeting, and expenditure management process were purported a major weakness of Nepalese financial management (see e.g. ADB, 2005). In 2002/2003, Nepal heralded massive public sector reforms to overcome these escalating criticisms in its financial management. A number of nascent financial management approaches, embedded in the NPM reform package, for instance, the 'midterm expenditure framework (MTEF)', 'the immediate action plan (IAP)' and 'the public expenditure tracking survey (PETS)' were introduced.

Despite the adolescence of new measures in financial management, the prevailing accounting norms and techniques emphasizing budgetary compliance however remained intact. A question then raised was how to ensure the results and effectiveness of those nascent financial measures in the absence of a modern government accounting system. Government accounting was pinpointed an important discipline demanding a rigorous reform (see e.g. GON, 2005a). In 2005, the government responded to these nagging international concerns on accounting by formulating a high level expenditure committee (HLEC). The committee that consisted of representatives both from the regulatory agencies and professional bodies was assigned with a task of preparing a time-bound action plan for the phase wise introduction of accrual accounting (see e.g. GON, 2005b).

In late 2005, the committee submitted its report proposing a five year plan for the adoption of accrual accounting in Nepalese central government. Additionally, the committee report explicitly demonstrated the need for additional political commitments and internal supports, and adequate resources including the enhanced IT capacities, rigorous training to government officers, a system of rewards and punishments, to name a few, prior to experimenting accrual accounting in government entities. By addressing the basic requisites for accrual accounting, the report literally posited a question on the feasibility and applicability of accrual accounting in the government of Nepal in the near future.

5. Ideological Shift in Nepalese Central Government Accounting Reform

The implication of accrual accounting is challenging and incurs substantial costs and time. This has been realized from the governments that have moved or are contemplating a migration to the accrual basis of accounting in recent years. To install the accrual basis of accounting there is a need for effective communication, quality assurance, and the rigorous use of commercial accounting software (see e.g. Athukorala and Reid, 2003). The participation of accounting professionals, comprehensive training to public accountants, and enhanced IT capacity are some of the basis prerequisites to practice accrual accounting smoothly. The use of accounting standards, support and involvement of auditors, a system of incentives and penalties, and the reduction of fraud and corruption are further demanded to perpetuate the functioning of accrual accounting (see e.g. Ellwood and Wynne, 2005). International experience shows that a transition period of 8-10 years is essential to ensure all fundamental infrastructures for accrual accounting and to overcome its technical ambiguities. Although a journey towards accrual is rewarding it is actually a costly, time consuming, and assiduous venture (see e.g. Vonck, 2004).

There is no argument in the government of Nepal regarding the wide ranges of benefits both for public entities and users that arise from using the accrual basis of accounting. At the same time, there is also a consensus that Nepal needs a substantial time period to ensure all fundamental infrastructures and resources pivotal for accrual accounting. Both the government and international organizations have therefore ruled out the possibility of introducing accrual accounting in the government of Nepal in the near future. The financial accountability assessment report, published jointly by the government of Nepal and its major development partners such as the World Bank, the Asian Development Bank, and the DFID in 2005, for instance, exhorts accrual accounting a desirable but distant prospect. According to the Asian Development Bank (2005), Nepal is not yet ready to switch over to an accrual accounting system.

Given the present capacity level, a possible move towards accrual accounting would be an ambitious endeavour. The scenario of accounting sector reform is therefore altering in the government of Nepal. Instead of accrual accounting, the focus is now on improving the existing cash basis and elevating its quality to the accepted level set internationally.

The World Bank's assessment report on Nepalese public sector accounting and auditing standards, issued in 2007, presents crucial recommendations to improve the existing cash basis system. The report further suggests the government to consider the cash basis International Public Sector Accounting Standards (IPSASs) as part of a longer-term program to adopt accrual accounting. Nepal's major development partners and international organizations are also in favour of imposing the cash basis IPSASs with additional voluntary disclosures of un-drawn borrowings, liabilities, and outstanding advances, to name a few, as an immediate reform approach (see e.g. Adhikari and Sharma, 2006). The implication of accounting standards is expected to improve both the quality and comparability of financial information reported by public entities. Moreover, it is assumed that the standardization of financial reporting will aid the government to accommodate the donor agencies and international organizations within an umbrella of a unified financial framework while reporting the accounts of their projects and programs.

The Accounting Standards Board (ASB), an autonomous body formed by the government to develop accounting standards for profit oriented enterprises, has recently been empowered to pronouns Nepal public sector accounting standards in line with IPSASs applicable to budgetary entities (see e.g. Adhikari, 2007). In order to advance the project a steering committee has been set up in the ASB by including representatives from the regulatory agencies including the Auditor General Office, the Financial Comptroller General Office, the Ministry of Finance and the professional bodies such as the Institute of Chartered Accountants of Nepal and the Auditing Standards Board. The committee aims at accomplishing the task of developing the cash basis Nepal public sector accounting standards within a period of one year by the end of the financial year 2008 (see e.g. Adhikari and Sharma, 2006). It is however suggested that the implementation of cash IPSASs would also be assiduous in the government without some fundamental preparations including the amendment of laws and regulations to make the use of IPSASs compulsory, a massive training to public accountants, support from donor countries, and the participation of professional accountants. Altering focus on the cash basis IPSASs by leaving the notion of accrual accounting to the foreseeable future is however an ideological shift in Nepalese public accounting reforms.

Conclusion

The innovations in accounting are perhaps the most remarkable features of the new public management era. Accrual accounting has been the life blood of public sector reforms and there are no discussions regarding a step back to a cash basis accounting. Accrual accounting at the same time inherits a number of ambiguities that may demand for substantial time and resources both technical and human resources. This has led many developing countries to prolong its application in order to ensure necessary resources and technical skills. The tenet of accrual accounting is actually not innovation in Nepalese financial administration. There is evidence demonstrating a number of failed strives towards the accrual basis of accounting over time. Such failures have enlightened that accrual accounting could not be an immediate approach to reforming Nepalese central government accounting. The immediate focus is now on improving the quality of prevailing cash accounting. The adoption of the cash basis IPSASs is at the top of the agenda. International partners and accounting professionals are confident that the use of public sector accounting standards would contribute not only to eliminating the deficiencies in Nepal's existing cash accounting but also to improving decision making and financial accountability.

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