Volume 20 (2) October 2013 ISSN 0216-423X

JABM
JOURNAL of ACCOUNTING - BUSINESS & MANAGEMENT

Journal of Accounting – Business & Management vol. 20 no. 2 (2013) 99-112

The Transparency of Government Financial Information Systems in Arab Countries: Evidence from Palestine

Khalil Abushamsieh*
Antonio M. López Hernández†
David Ortiz Rodríguez‡

Abstract

Governments, researchers and international organizations are paying increasing attention to the issue of reforms in governmental financial reporting. Arab countries in general, and Palestine in particular, are working to develop their governmental financial information systems to make them more informative and transparent. This paper examines the extent to which Palestine has developed its governmental financial information system and analyses the most important factors underlying financial transparency. An analytical methodology is applied, using Lüder's Financial Management Reform Process Model (2001).

Keywords: financial reform, FMR model, GCC, IFAC, IPSAS, public financial information, Palestine, transparency.

I. INTRODUCTION

During the last three decades, transparency in the management of public funds has been one of the most sensitive and critical issues for governments and international organizations, as well as among academic researchers and the general public, in both developed and developing societies (Lüder, 1992; Caba & Lopez, 2007). Governments of all colours have sought to develop their financial information systems to make them more informative, efficient and transparent, and important reforms have been implemented in this respect (Nasi & Steccolini, 2008).

It is generally accepted that the financial information compiled and provided by governments must be reliable, timely, comparable and transparent. The term transparency has been widely used in the press in discussing issues such as the reliability of financial reports, corruption, inadequate disclosure and the accounting methods used (Saleh, 2007).

Organizations like the International Monetary Fund (IMF), the World Bank and the International Federation of Accountants (IFAC) have contributed to enhancing financial transparency. Since 2000, the International Public Sector

* Lecturer at Department of Financial Economics and Accounting. Email: kabusham@gmail.com.

† Full professor at Department of Financial Economics and Accounting. Email: alopezh@ugr.es.

‡ Corresponding author, Associate professor at Department of Financial Economics and Accounting. Email: dortiz@ugr.es. Address: C/ Campus Universitario de Cartuja s/n, Department of Financial Economics and Accounting, Faculty of Economic Science and Business, University of Granada, 18071 Granada, Spain.

Accounting Standards Board of the IFAC has published its International Public Sector Accounting Standards and recommended their adoption to ensure the highest quality of public sector financial information (Christiaens, Reyniers, & Rolle*,* 2010).

During the last decade, great efforts have been made by researchers worldwide in the field of financial transparency. This is especially so in Anglo-Saxon and European countries, but relatively little attention has been paid in this respect to Arab countries in general (Caba, 2001) and to Palestine in particular.

Accordingly, the present paper aims to contribute to a better understanding of financial transparency in Arab countries. We believe it is important to contextualise this study, by carrying out a review of the legislative reforms that may influence financial transparency in the countries in this geographic area. Two groups of countries were selected: the first group consisted of the only Gulf Cooperation Council countries that publish year-end accounting reports, namely Oman, Bahrain and Kuwait. These are wealthy, oil-producing countries and therefore face no pressure from donors to improve transparency. The second group of countries consists of Jordan, Egypt and Palestine, all of which receive significant quantities of international aid.

Among these aid-recipient countries, the case of Palestine warrants special attention, not only because of the financial reporting requirements imposed by funding agencies and donor countries, but also in view of its unique social, economic and political situation. Moreover, since the Oslo Accords of 1993, Palestine has been immersed in a radical redesign and configuration of its public sector.

We first provide an overview of recent reforms in accounting laws and procedures in above-mentioned Arab countries, with special attention to Palestine and focusing on the most important factors underlying the reforms made to its governmental financial information system, with a view to promoting financial transparency. We then present the results of our analysis, and in the final section, some conclusions are drawn.

II. PUBLIC SECTOR REFORMS TO ENHANCE FINANCIAL TRANSPARENCY

In recent years, many countries have made public sector reforms. The governments which are most successful in this respect benefit themselves and their countries, achieving more efficient governance, greater transparency and increased public confidence, and provide a better public service (UN, 2008).

According to (Benito, Brusca, & Montesinos, 2007), researchers have studied various aspects of financial transparency and of governmental financial reforms examining the underlying factors and the processes that facilitate accounting reform and transparency.[1]

Transparency of public accounts is an important element in establishing political democracy. Citizens want to know how and where public funds are employed, how income from tax and non-tax revenues is distributed among

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[1] See for example: (Lüder, 1992; Lüder, 1994; Chan, Jones & Lũder, 1996; Godfrey, Devlin & Merrouche, 1996; Caba, 2001)

the regions (or provinces or municipalities) and to what purpose public money is used (Nasution, 2009).

Many countries are seeking to revitalize their public administration by improving financial management and reporting to make it more productive and effective. Accordingly, governments have introduced innovations in structures, practices and capabilities, and the ways in which human capital, information technology and financial resources are mobilized to provide better services to the population (Nasution, 2009).

Governments are currently under increasing pressure to improve financial management and reporting processes in order to facilitate decision-taking on macroeconomic, monetary and fiscal issues, to ensure transparency and accountability and to demonstrate effective performance in the provision of services (Khan & Mayes, 2009). The reform of governmental accounting can be studied at different levels: theoretical, normative (laws, rules and recommendations) and practical (Nasi & Steccolini, 2008).

In this respect, the IMF recommends developing countries to follow the Government Finance Statistics manual, last updated in 2001, the aim of which is to improve the transparency of governmental accounting and financial reports and to harmonize financial reporting worldwide (IMF, 2001). However, the diversity of reforms made to governmental financial information systems meant it was necessary to harmonize international accounting standards, resulting in the development of the International Public Sector Accounting Standards (IPSAS) (Christiaens, Reyniers, & Rolle*,* 2010).

The International Public Sector Accounting Standards Board (IPSASB) is part of the International Federation of Accountants (IFAC) and is responsible for issuing the IPSAS. There are currently thirty-two IPSAS applicable to accrual accounting, and one that is applicable to cash accounting. The IPSAS recommendations are important stimuli for harmonising financial information in the public sector. Areas covered by the IPSAS include the presentation of financial statements and the effects of changes in currency exchange rates, financial instruments and liabilities. IPSAS are designed to facilitate good-quality public financial reporting and are internationally comparable (Khan and Mayes, 2009).

The main goal of introducing accrual accounting into the public sector is to achieve a more transparent, effective and informative system (Nasi & Steccolini, 2008; Christiaens, Reyniers, & Rolle, 2010). IPSAS help users improve the quality and consistency of the information provided to decision makers (US General Accounting Office, 2000). Although cash accounting has its merits, accrual accounting was introduced to improve the financial information systems of public sector entities. Because cash accounting gives little information concerning liabilities and the potential future benefits of assets, accrual accounting is better suited for planning, financial management and decision making. Accrual accounting could also improve the comparability of financial performance between government entities and favour greater accountability (Padovani, Levy, & Katsikas*,* 2009).

Several countries have adopted financial accounting reforms at one or more levels of government, replacing their traditional cash accounting systems or transforming them to support accruals in order to increase financial accountability and transparency and improve the measurement of government sector performance (STAMATIADIS, 2009).

The accrual basis of accounting offers more than the cash basis in terms of both quantity and quality (Jones & Pendlebury, 1996), and thus it is not surprising that most developed countries have now introduced forms of accrual basis accounting in their public sectors as part of an overall public sector reform (Prodjoharjono, 2009). The trend toward accrual accounting can be explained by the need for transparency, efficiency and performance in management and the IPSAS provide powerful arguments for their use (Christiaens, Reyniers, & Rolle*,* 2010).

III. LEGISLATIVE REFORMS AND FINANCIAL TRANSPARENCY IN ARAB COUNTRIES

In order to contextualise the changes made in public financial information systems in Palestine, in this section we analyse the most important reforms carried out in this respect in neighbouring countries, talking into account the considerable diversity in the region. Two groups of Arab countries were selected, according to their level of economic development. The first group was comprised of Oman, Bahrain and Kuwait, countries with significant levels of income from oil, and the only Gulf Cooperation Council (GCC) countries that disclose and publish financial accounting reports. The second group represents a group of Arab countries – Jordan, Egypt and Palestine – that receive a high percentage of income in the form of international aid. We now examine the growth of legislative measures related to governmental accounting and financial transparency in these Arab countries.

Oman is a relatively young country, having gained its independence from the United Kingdom in July 1970. Its first financial law was issued in 1982, after 12 years of independence, under Royal Decree 56/1982. In 1998 this was replaced by a new financial law issued under Royal Decree 47/1998. One year later, some articles of this law were amended under Royal Decree 74/1999. According to Articles 6-9 of Financial Law 47/1998, the Ministry of Finance (MOF) is responsible for determining accounting procedures and practices and this Ministry has issued various manuals, the latest in 2009 under Ministerial Order 118/2008. In the preparation of its financial reports, Oman uses the modified cash basis of accounting.

The State Audit Institution of Oman was established in 2000 under Royal Decree 55/2000, which replaced Royal Decree 129/1991. The new State Audit Law authorised this institution to investigate a broad range of public agencies, including the state administrative apparatus, government entities and departments, as well as private institutions that receive government assistance. This Law was reinterpreted in the 2009 manual.

Bahrain gained its independence from the UK in 1971. Royal Decree 1/1975 sets out the rules for preparing the State budget, audit and final accounts. Royal Decree 4/1994 subsequently reorganised the MOF and all its functions. Ministerial Order 5/1998 established standards for governmental accounting and control, and in 2002, further legislation was passed (Law 16/2002) establishing the Supreme Audit Commission. The General Budget Law 39/2002 regulated budgeting and final accounts procedures, and this was subsequently amended by Law 3/2007.

In 2006, the MOF published its Standardised Financial Manual Systems, under Article 59 of Law 39/2002, which complemented the existing manual of fixed assets systems, drafted under the same Article, in the elaboration of year-end financial reports Bahrain uses the modified cash basis of accounting. Thus, it is clear that over the past two decades, governmental accounting systems in the State of Bahrain have evolved, and regulatory and administrative changes made to improve the efficiency, effectiveness, transparency and responsibility of governmental accounting systems.

After its independence, Bahrain carried out important administrative changes and major reforms were implemented with the aim of improving overall efficiency, effectiveness, transparency, performance, accountability and budget management. This goal was addressed through various reforms and the new laws as mentioned above.

The case of Kuwait is somewhat different. The first budget for the Kuwaiti government was drawn up in 1955 under a Ministerial order that included the preparation of budgets for all ministries and government entities. Royal Decree 1/1960 established rules for preparing the State budget and final accounts, and for control procedures. These developments took place before Kuwait gained its independence from the UK in June 1961. Royal Decree 1/1960 was later revoked by Royal Decree 31/1978, which remains in force today, although some articles were amended by Royal Decrees 18/2000 and 27/2000, setting the dates of the financial year, from 1 April to 31 March for all ministries, government bodies and committees.

Kuwait's accounting information system was modernised in 1981 when the MOF issued Ministerial Order 13/1981 establishing a unified manual of accounting for government entities. This was later amended by Ministerial Orders 18/1985 and 11/1989, and subsequently by Order 21/2002, which set out the financial control responsibilities of governmental accounting directors.

In 2004, the MOF consulted IMF experts on the modernisation and development of the Kuwaiti governmental accounting information system, which led to the preparation of the Reengineering Financial Transactions Project (RFTP). In 2008, implementation of this project began: it has a scheduled duration of four years and consists of three stages: the reconstruction of financial management, budget and accounting information in accordance with IPSAS; the reconstruction of stock inventory, fiscal and cost project management; and finally, the reconstruction of asset management.

As noted above, these three countries have made great efforts to develop their financial and accounting framework over the last three decades; laws have been promulgated to reform their political, economic and financial systems, and some have implemented governmental and ministerial reforms and adapted governmental systems to changing socioeconomic conditions.

Palestine, Jordan and Egypt, the three countries in this study in receipt of Official Development Assistance (ODA), share a common socio-political history with the GCC countries; Islam is the religion of all Arab countries and Arabic is their official language. However, their economies are quite different; the three recipients of ODA are considered developing countries, and different reforms to enhance financial transparency have been applied during the last decade.

In 1952, the Jordanian MOF issued State Audit Bureau Law No. 28, which was subsequently amended by Laws No. 31/1987, 3/2002 and 18/2007. Financial Law No. 3/1994 organised accounting principles and practices, and Budget Law No. 39/1962 addressed State budget procedures.

Recently the Jordanian MOF undertook an important programme of reform to develop the governmental financial and accounting system in order to increase efficiency in the planning, preparation and execution of the general budget. This programme includes a rationalisation of the budget preparation procedure aimed at achieving a result-oriented budget with clear sectoral priorities, together with greater financial transparency and a higher quality of government service to citizens and investors, through the enhanced accountability and transparency of ministries and spending units. At present, the cash basis of accounting is employed.

In Egypt, various laws have been adopted to enhance financial transparency in governmental accounting, such as Law No. 53/1973 on the organisation of the State budget; some articles of this law were amended by Laws No. 87/2005 and 109/2008. In 1981, Accounting Law No. 127 was issued, and this was later modified by Law No. 35/2009.

The central auditing organization of Egypt was established by Law No. 129/1964 which was later revoked by Law No. 144/1988, and this latter was subsequently amended by Law No. 157/1998. A new draft law is being prepared for the central auditing organization, aimed at increasing the transparency of governmental accounting. Although this organization is an independent body with legal personality, it generally follows the President's indications. Its main purpose is to supervise the State funds dedicated to Government ministries, entities and committees, as well as companies that are more than 25% State-owned.

The Palestinian National Authority (PNA) was established in 1994 following the 1993 Oslo Accords between the Palestine Liberation Organization (PLO) and the government of Israel, with responsibility for the West Bank and Gaza. Following this date, the PNA began to establish the necessary administrative frameworks for the corresponding ministries and governmental entities. At first, these bodies had inadequate controls, procedures and financial legislation, but the Palestinian financial system has gradually developed and improved.

From 1994 to 1998, the governmental accounting system was regulated by various resolutions, instructions and financial regulations issued by the MOF. There was no specific financial legislation, but the PNA has issued several financial instructions and circulars governing the financial and accounting issues of ministries and governmental entities. In 1997, the MOF began to consult experts to better establish the financial system and implement rules to control government revenue and expenditure, and financial regulations and the current and capital expenditure guide were published.

In 1998 the first financial law, No. 7/1998, was issued to regulate public budget and financial affairs. In the same year, Law No. 9/1998, regulating general supplies, was issued.

In 2004, the PNA issued Financial and Administrative Control Law No. 15, after which the Council of Ministers issued Resolution No. 43 in 2005 on the financial system applicable to ministries and public institutions. All these laws are intended to enhance transparency in governmental accounting systems.

Taking into account the wave of international public sector reforms, based on the IPSAS, in the next section we consider Lüder's financial management reform process (FMR Model) (Lüder, 2001), and use this to discuss the development of Palestinian legislation regarding financial transparency and the governmental financial information system.

IV. FINANCIAL MANAGEMENT REFORMS PROCESS

Governments introduce innovations in their structures, practices and capabilities, and in the way in which human capital, financial information, technology and financial resources are applied in order to provide better services to citizens and to achieve their objectives (UN, 2008; Nasution, 2009). An appropriate accounting system, structured to effectively manage public resources, can help governments achieve these objectives and benefit citizens (Ball, 2000).

According to the network Comparative International Government Accounting Research (CIGAR), Lüder's contingency model of governmental accounting innovations has been used as a framework for analysing the development of governmental accounting in many countries (Lüder, 1992; Lüder, 1994; Lüder, 2001).

Political change is a major factor in the innovation process (Caba, Lopez, & Ortiz, 2009). In analysing this process, we must address not only the context in which it begins and ends, but also the variables that affect the internal process of the development of innovation in accounting, as indicated in the comments made on the Contingency Model (Christensen, 2001; Lüder, 2001; Ouda, 2001).

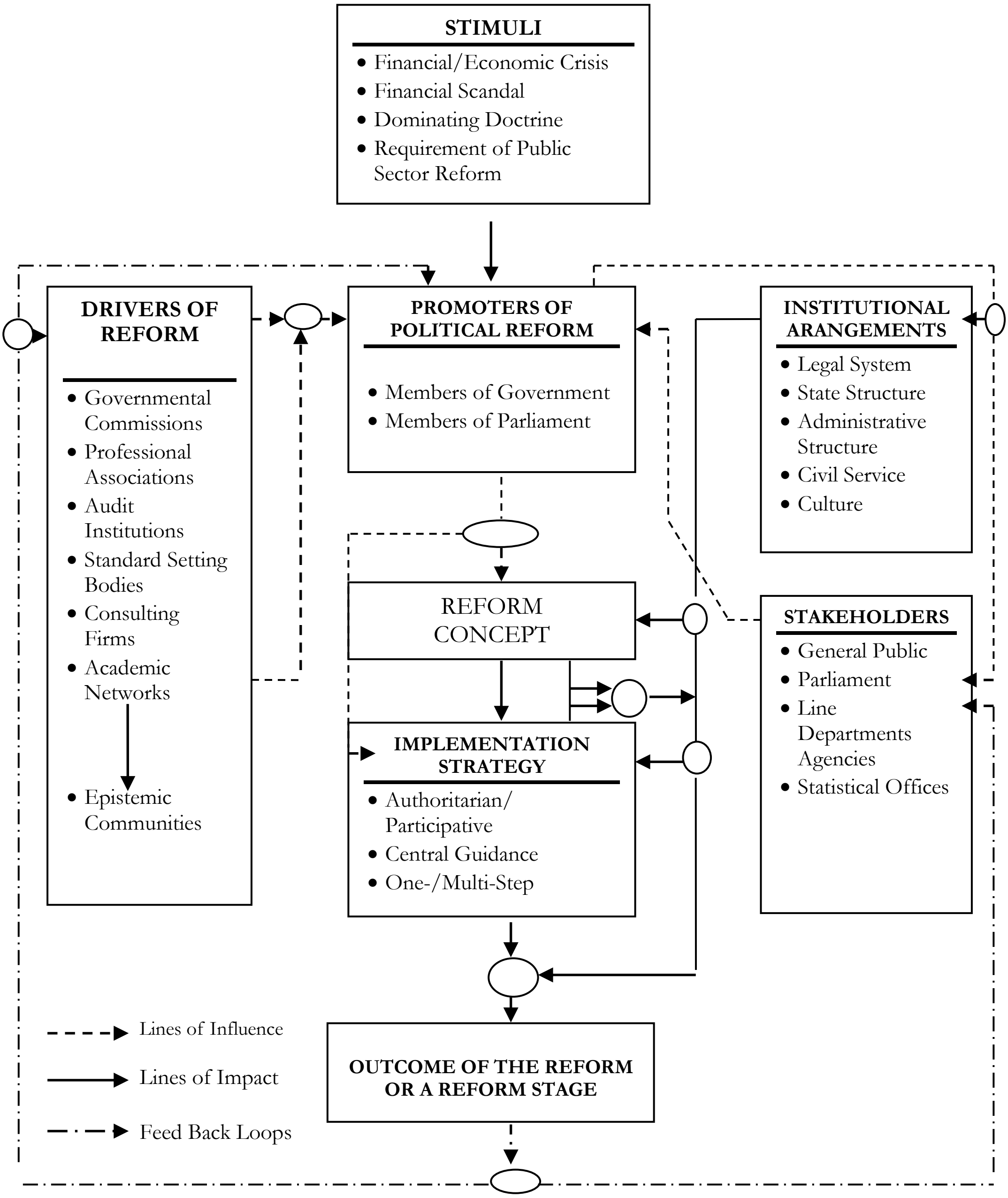
Lüder's contingency methods (Lüder, 1992; Lüder, 1994), have been used (and modified) in many studies, including (Budaüs & Buchholtz, 1996; Chan, Jones, & Luder*,* 1996; El-Batanoni & Jones, 1996; Godfrey, Devlin, & Merrouche*,* 1996; Jaruga & Nowak, 1996; Montesinos & Vela, 1996; Pallot, 1996; Yamamoto, 2000). Furthermore, in 2001 Lüder adapted his own contingency model in the form of the FMR Process Model (Lüder, 2001). These modifications were aimed at enabling the method to be applied in other countries with different environments, or were required due to the absence of certain factors.

Lüder's FMR Process Model includes various contextual variables to characterize the institutional organization of a country. It corrects the contingency model's emphasis on context and provides a feedback mechanism to relate the attitudes and behaviour of the key actors in the process with the final results. Thus, it addresses the possibility that the reform process might be carried out in several stages. This model aims to shed light on the process by which innovations are generated in governmental accounting.

The FMR Process Model (Figure 1) consists of two contextual variables (stimuli and institutional arrangements), three behavioural variables (drivers of reform, promoters of political reform and stakeholders) and two instrumental variables (the concept of reform and implementation strategy).

Stimuli are defined as events that occur prior to the innovation stage of accounting and which generate the need for more informative accounting information. Examples of stimuli include economic crisis, corruption or dominant doctrine within the government. On the other hand, drivers of reform are institutions and professionals in the field, such as government commissions, professional associations, academic and standard-setting bodies, at the national or international level.

Figure 1
Financial Management Reform Process Model (FRM Model)



Source: Lüder (2001)

Promoters of political reform may include the Minister of Finance, parliamentarians and other political actors with the ability to initiate reform and the power to enforce it. Institutional arrangements are the social structural variables (political and administrative) and barriers to implementation that may influence the legal or regulatory system, such as the state structure, the administrative structure, the qualifications of the personnel involved and the national culture (political, social and administrative). Stakeholders are those institutions or individuals who are affected by the reforms and whose condition is not that of drivers of reform or promoters of political reform; this category includes citizens, parliament, departments or administrative agencies and statistical offices.

Finally, in terms of instrumental variables, it is important to note that the mode in which reform is implemented will affect its degree of success or failure, as well as the presence or absence of deviations between the concept and results of the reform. This process could be affected, for example, by the particular implementation strategies used, i.e. whether it is more or less participatory, whether one or more phases are involved, and whether the training policy is followed. Innovations in governmental accounting are more likely to succeed if conditions are favourable, namely the existence of at least one stimulus, of strong political competition and of users who demand a more informative accounting system, the influence of private sector accounting on staff training, an administrative culture prepared to accept change and an absence of barriers to implementation (Chan, 2003).

V. ANALYSING THE DEVELOPMENT OF THE GOVERNMENTAL FINANCIAL INFORMATION SYSTEM IN PALESTINE

Figure 2 illustrates the factors affecting the development of the governmental financial information system in Palestine.

1. Stimuli

The main influences on the development of governmental accounting system and transparency in Palestine are, on the one hand, the financial/economic crisis, and on the other, its dependence on international aid (from the IMF and agencies such as USAID) to support the Palestinian budget. Furthermore, financial scandals and corruption are also considered important factors in this respect. One of the major requirements for public sector reform is the harmonization of accounting procedures among government ministries and public institutions in order to facilitate a better understanding of financial reports.

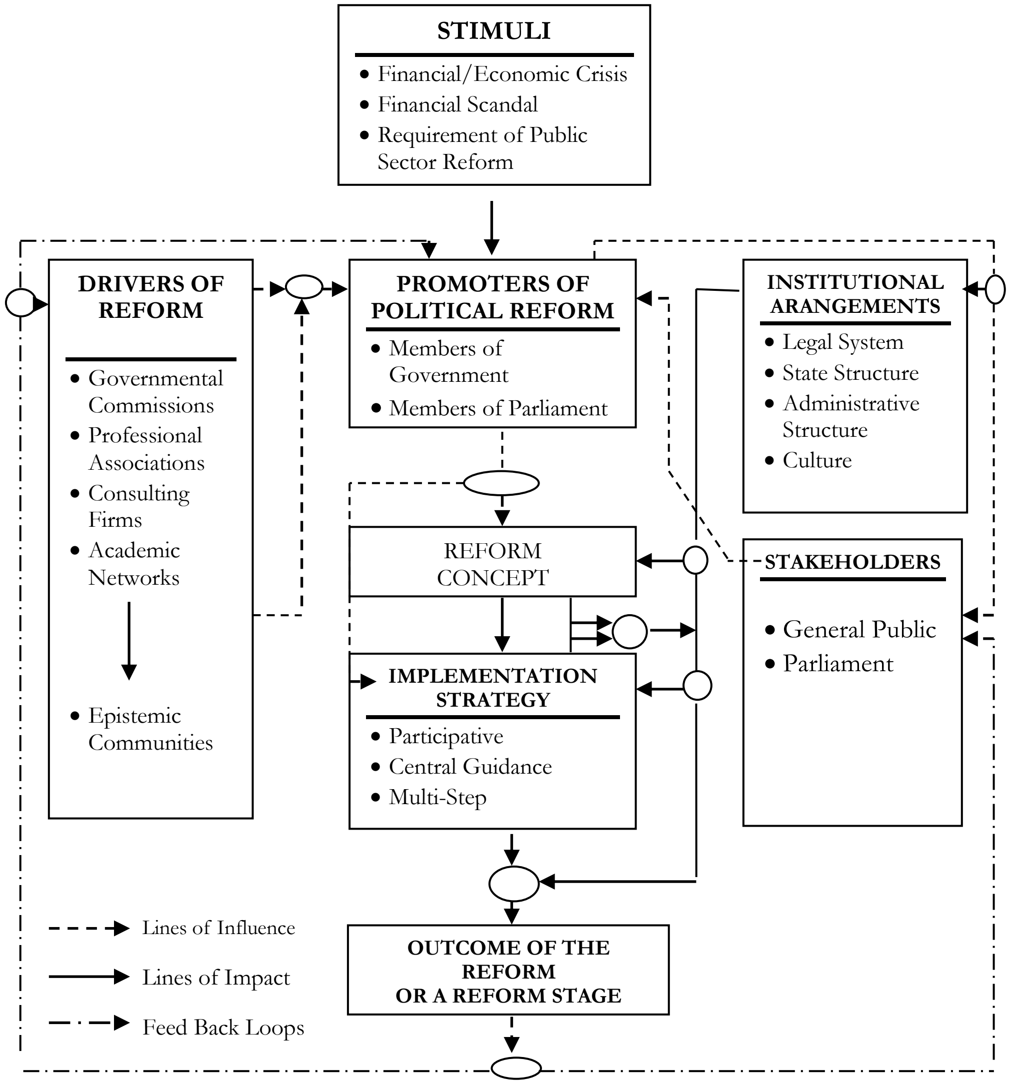
2. Drivers of Reform

The following are the main drivers of reform:

- Governmental commissions; the budget and financial affairs committee has contributed to the development of financial laws, especially Law 7 of 1998, to regulate the public budget and financial affairs.
- Professional associations; the State Audit and Administrative Control Bureau is considered the supreme audit institution of Palestine. It has contributed to the development of governmental accounting and transparency in Palestine.

- Academic networks; some scholars have recommended the development of the governmental accounting system in Palestine.[2]
- Consulting firms; some international agencies have been consulted with respect to developing the financial system. No clear contribution has been made by Standard Setting Bodies to the development of governmental accounting systems.

Figure 2
Financial Management Reform Process Model of Palestine



Source: The authors

[2] See for example: (Wishah & Shahin, 2010; Albhaysy, 2013)

3. Promoters of Political Reform

In analysing the situation of Palestine, we noted the existence of the following promoters of political reform:

- Members of government; the Council of Ministers supported the creation of the Anti Corruption Committee in 2005.
- Members of Parliament; the members of the Palestinian parliament have also contributed to the development of the governmental accounting information system. Their role is to participate in the drafting of laws and regulations for discussion and approval. Laws adopted include those establishing the Anti-Corruption Committee and the State Audit and Administrative Control Bureau, and accounting and budget laws.

4. Institutional Arrangements

The following contextual variables of institutional arrangements are relevant to the development of transparency in Palestine:

- The legal system, which is active in promoting the development of the governmental accounting system.
- The State structure; the executive authority drafts laws and regulations to be presented to the legislative authority. The separation of authorities contributes to this development.
- The political parties.
- The Administrative structure; although the administrative system is centralized; it can promote the development of transparency.
- Culture; the population is free to criticize the government. Civil society exerts pressure, calling for the development of the accounting system. An example of the role played by civil society is the pressure exerted by the Coalition for Accountability and Integrity (AMAN) which was established in 2000 at the initiative of a number of Palestinian civil society organizations working in the fields of democracy, human rights and good governance.

5. Stakeholders

The following stakeholders influence the development of governmental accounting and transparency:

- The general public; as stated above, citizens can criticize government activities and the financial situation, and thus may influence the development of the governmental accounting system. Public interest is also expressed through demonstrations against corruption, unemployment and the financial situation.
- Parliament; the influence of the Palestinian parliament is expressed via the different political parties.

6. Implementation Strategy

A better understanding of the legal system, the State structure, the political system and public pressure can help us to determine how a new implementation strategy to develop the accounting system in Palestine has been elaborated. As noted above, this development process was carried out in conjunction between the

Government, local and international organizations and consultants, as a multi-step procedure with central guidance from the Ministry of Finance.

VI. CONCLUSIONS

In the absence of prior research studies on the development of government financial information systems to promote transparency in the Arab countries, this paper analyses the legal reforms carried out in this respect, differentiating two groups of countries in terms of their level of economic development, and focuses particularly on the case of Palestine, which presents certain special characteristics.

In the selected GCC countries, Oman and Bahrain still use the modified cash basis, and appear to have no clear plans to adopt accrual basis accounting, despite some amendments made to their accounting laws in response to economic development. It seems that these countries need to take further steps to develop their financial reporting systems. The case of Kuwait is somewhat different. This is the only GCC country in this group that has a plan to adopt IPSAS. In 2008, Kuwait initiated a plan aimed at adopting the full accrual basis of accounting, with the incorporation of IPSAS into the governmental accounting system; this plan is expected to be accomplished by the end of 2012.

The second group of countries - Jordan Palestine and Egypt – are seeking to develop their financial reporting systems. They are still using the modified cash basis of accounting, but Jordan plans to adopt the accrual basis. In the case of Palestine, there does not appear to be any plan to adopt the accrual basis of accounting, although the governmental accounting system and the level of financial transparency have improved considerably since the Oslo Accords. Furthermore, the financial reports are prepared using the modified cash basis the accrual basis at the same time.

With respect to the contingency model, the following factors facilitate the development of the Palestinian governmental accounting system.

- Contextual variables: the dependence on international aid, together with the need for public sector reforms, and the presence of corruption. These are all factors requiring the development of the accounting system and the adoption of cash IPSAS. The legal system and the State structure are additional factors favouring the development of the governmental accounting system.
- Behavioural variables: audit institutions, governmental commissions and academic networks are considered to be drivers of reform and elements favouring the development of the governmental accounting system. Promoters of political reform and stakeholders are also considered favourable to development and reform.
- Instrumental variables: the implementation strategy in Palestine is a multi-step participative reform effected with central guidance.

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