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# New Public Management and Accounting Reform in Europe and wider: Can Croatia learn from New Zealand experience?

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# Presentation outline

- The aim and the hypothesis
- New Public Management and accounting reforms worldwide
- Background to public sector reform processes and public finances in Croatia and New Zealand
- The development of public sector accounting (PSA) in Croatia and NZ through a 25 - year period (1990 -2015)
- The basic characteristics of today's PSA in Croatia and NZ
- Similarities / differences between the accounting systems in Croatia and NZ
- Conclusions

# The Aim and the Hypothesis

**The aim** is to:

- ✓ compare the path of development and identify key national and external influences on solutions in Croatia and New Zealand (NZ)
- ✓ explore whether and to what extent it is possible and useful to apply financial management and PSA reform experiences of other countries (NZ) or international authorities in the development of national PSA systems in Europe (Croatia)

**The research hypothesis:**

The development of PSA should be viewed in close connection with the *degree of development of the country* (state and political structure, territorial organization, the structure of the public sector, economic development and development of the society) *and the influence of international sources* (harmonization and unification of methodological and legislative frameworks and national accounting practices and wider concepts of New Public Management (NPM) and New Public Financial Management (NPFM) directed at improving efficiency, effectiveness and accountability in the public sector).

# The Aim and the Hypothesis – cont.

In order to confirm the hypothesis, authors:

- analyse public sector management and governmental accounting reforms: Continental European vs. Anglo- Saxon countries (in this paper with the reference to New Zealand)
- analyse the fundamental characteristics of public sector accounting in Croatia and NZ - emphasis on legal framework, public finance, and choice of accounting basis
- explore key influences on solutions to public sector reporting
- make comparisons between the accounting systems of Croatia and NZ

# Public sector management reforms

New Public Management concept

processes of modernizing governmental management and achieving efficiency in the public sector



Public Sector Financial Management



Public sector Asset Management System reforms

Public sector Accounting and financial reporting system reforms

Public spending/Debt management

Statistics reports

# New Public Management and accounting reform

- *Historically, management and control processes in governmental organizations differed from business organizations.*
- *Consequently, financial accounts and performance accounts have been prepared in government and business sectors differently.*
- *Performance evaluation - to evaluate performances of managers within business sector only.*
- *Government sector - the main objectives of accounting have been money management, budgetary control and payment control.*
- *In the 1980s, the process of public sector reform (modernization) started worldwide.*

# New Public Management and accounting reform – cont.

- **Public sector reform changes:**

- Reform mainstreams firstly developed and implemented in the private sector and then “transferred” and implemented into the public sector.
- The main reasons for public sector reforms: public sector inefficiency and ineffectiveness (ECA, 2003); governments constantly under pressure to improve public services quality, contain costs and enhance public accountability at the same time (Barret, 2004).
- Consequently, since 1990es management and control in governmental organizations more similar to management and control in business organizations.
- *Major processes of change - New Public Management (NPM) and New Public Financial Management (NPFM).*



## New Public Management and accounting reform – cont.

- *Hood, 1995* - changes in public sector (governmental) accounting central to the international public sector financial management developments,
- *Christensen, 2002*- accrual based financial reporting significant amongst the accounting technologies that have dominated public sector management reforms.
- *Lüder and Jones, 2003* - governmental accounting reforms in European countries and the European Commission; accounting reforms = introduction of accrual accounting in governmental organizations,
- *Brusca and Candor, 2000* - in Anglo-Saxon countries the accrual accounting predominates in public sector accounting whilst Continental European countries still in the process of converting to accrual accounting, by adopting modified cash or modified accrual systems instead of complete or full accrual systems.

# New Public Management and accounting reform: Continental European countries vs. Anglo - Saxon countries

- *Monsen and Oulasvirta, 2007:*

## *Continental European countries*

- ✓ cameral accounting influence,
- ✓ high degree of normativism (law regulations and concepts - a stronger influence on public sector accounting systems and concepts),
- ✓ very strong link between budgeting and accounting (the budget had its focus on the financial development; strong money focus in the budget; strong legal traditions),
- ✓ reluctance to replace financial accounts (focusing on revenues as cash receipts and expenses as cash payments) with performance accounts (full accrual accounts - focusing on revenues earned /realized and expenditures incurred).

## New Public Management and accounting reform: Continental European countries vs. Anglosaxon countries - cont.

*Anglo- Saxon countries:*

- ✓ The legal and budgetary systems not as prescriptive as in Continental European countries - easier to change the accounting system and introduce full accrual accounting.
- ✓ The accounting system has precisely influenced the budgetary system, and not vice versa as in Continental European countries (Common Law influence)
- ✓ Governmental accounting information system structure and contents less viewed as function of State's budget achievements and more as function of achieving greater management efficiencies and better fiscal outcomes (Vašiček, 1998; Brusca and Condor, 2002; Roje, 2007).
- ✓ Governmental accounting reform has been placed in the wider context of the development of new public management.

# Background to public sector reform processes and public finances

## CROATIA

- Three levels: central, regional and local government
- The executive branch includes 34 central state administration bodies - CSAB (state offices and Ministries)
- Parliament (law-making authority); the Government (decrees, provisions); CSAB (recommendations, ED, resolutions).
- Population 4.3M and area 88 073 km<sup>2</sup>
- Net debt (2016) – 84,6% GDP

## NEW ZEALAND

- The Government of New Zealand has three branches: the legislative, executive and judicial branches.
- The executive branch includes around 40 departments and Ministries.
- In New Zealand governmental system, Parliament is the supreme law-making authority and provides authority for all governmental activity.
- Population 4.5M and area 268,021 km<sup>2</sup>
- Net debt (2016) – 24,6% GDP

# Background to public sector reform processes and public finances – cont.

## CROATIA

- The scope of the general government: The Budget Act + many additional set of regulations – decrees, provisions and guidance documents
- The budget system consists of the central budget and budget of local and regional governments and extra – budgetary users.
- The establishment of the Registry of the budget users and the extra-budgetary users – to define the scope of the public sector for national statistics purposes
- Activities in accordance with criteria and requirements of the EU: budgetary control system (state audit + internal audit + internal controls)

## NEW ZEALAND

- The authority to scrutinise and control the financial authority is given to the Government by section 22 of the Constitution Act 1986
- The Public Finance Act (2004) is the core legislative framework authority for, and scrutiny of, government activity.
- Public Finance Act (2004) represents the foundation of accountability systems for the resources provided by taxpayers to the New Zealand Government.
- Other acts: The State Sector Act 1988 , The Public Audit Act 2001, The Crown Entities Act 2004, The State-Owned Enterprises Act 1986 (SOE Act)

# Background to public sector reform processes and public finances – cont.

## State's budget achievements vs. greater management efficiencies

### CROATIA

- Public sector - new managerial tools and wider reform concepts (i.e. new public management concept) have a limited effect, as processes are perceived more in a political context.
- Croatian system of public financing is highly centralized.
- The process of fiscal decentralization started in 2001. However, data from 2014 show that the central state incurred about 85, 5% of total budget expenditures while regional and local units amount to 15, 5% of total budget expenditures.

### NEW ZEALAND

- New Zealand's public sector management system is focussed on promoting public sector performance.
- The emphasis on clear objectives and clear lines of responsibility, greater freedom to manage, and an expectation of accountability.

# Key public sector accounting (PSA) development phases

## CROATIA

### •**First Phase (1991-1993)**

- the continuity in the application of legislation and accounting models inherited from the former state;

### •**Second Phase (1994-1994)**

- the introduction and application of a completely new system which in addition included all non-profit organizations- state and private.
- conceptually based on fund accounting and modified accrual accounting, but its legislative operationalization was non-systematic and inconsistent

### •**Third phase (1995-2001)**

- the modernization of the budget system and accounting system
- mandatory cash basis supplemented with the information on: obligations and receivables, non-monetary resources and debts

### •**Fourth phase (2002- today) – next slide**

## NEW ZEALAND

### •**Four phases of change:**

- cash basis until late 1980,
- accrual-based accounting coupled with sector neutral standards from early 1990s to 2005-2007,
- modified IFRS from 2007 to 2015,
- IPSAS based standards with multi-tiers from 2015.

## Key public sector accounting (PSA) development phases – cont.

### CROATIA (4th phase, as of 2002 to today)

- The State Treasury established
- The introduction of classifications' system, consisting of six mandatory classifications
- Accounting is standardised and unified for all budget users and closely connected to other budget processes.
- A double-book keeping principle and accepted analytical framework which determines the content of accounts and rules of recording.
- Modified accrual basis.
- IPSASs are not applied directly, but some provisions are applied indirectly through national legislation.
- Revenue, expenditure, inflows and outflows, are presented according to budget classifications, mandatory in all stages of the budget process.



# The basic characteristics of the contemporary PSA: financial reporting

## CROATIA (4th phase, as of 2002 to today)

- Financial reports are drafted on the following forms:
  - Balance sheet - Form BIL,
  - Report on revenue, expenditure, receipts and expenses - Form: PR-RAS,
  - Report on expenditure according to functional classification - Form: RAS-funkcijski
  - Report on changes in the value and volume of assets and liabilities - Form: P-VRIO
  - Report on liabilities – Form: OBVEZE
- Semi –annual and annual budget execution reports
- All reports are subject to auditing by State Audit Office and public disclosure.
- Consolidated financial statement of general government is achieved by a three level consolidation basis.

# The basic characteristics of the contemporary PSA: financial reporting - cont.

## NEW ZEALAND

- Treasury responsible for preparing Budget documents, monitoring the use of funds, preparing the monthly monitoring report on appropriations for the Auditor-General.
- Monitoring - the departments must ensure that all expenses and capital expenditure are in accordance with the statutory authority provided.
- Regular exception reporting required to highlight potential breaches of appropriations.
- Departments report monthly to Treasury on the use of appropriations.
- **At least once every four years, a statement on the long-term fiscal position, covering a period of at least 40 years. This requirement was introduced in 2004.**
- **At the end of the financial year, departments' annual reports contain a Statement of Appropriations reporting actual expenses and capital expenditure incurred against each appropriation and actual expenses incurred against each class of outputs.**
- **Compared to other countries, the New Zealand system provides a large number of detailed individual appropriations.**
- Public Finance Act (2004) provides reasonable flexibility for the New Zealand Government.

# The basic characteristics of the contemporary PSA: financial reporting - cont.

## NEW ZEALAND

- **Whole-of- Government Financial Statements**

- Financial Statements of the Government of New Zealand as part of the Government reporting entity under the Public Finance Act (2004). This includes the State Services, tertiary education institutions, State-Owned Enterprises and Mixed Ownership Model companies, a small number of agencies that operate as instruments of the Legislative Branch of Government.
- Concept of the Government Reporting Entity is applied -the Government reporting entity concept is similar to the parent entity in a private sector context.
- The financial statements of the Government report on the whole-of-government - group accounts.
- The Public Finance Act, 2004 (section 27(3)) requires that the annual consolidated financial statements for the Government reporting entity must include the Government reporting entity's interests in all Crown entities named or described in the Crown Entities Act (2004)
- **Local authorities are not included in the financial statements of the Government because they are not controlled by the Government.**

# Conclusions

## Similarities / differences: public management and accounting system reforms

### NEW ZEALAND

- long - term reform processes
- strategic goals and development paths that would define the role of the individual segments in the overall general reforms are more constant
- the public sector accounting reform was triggered and had the support of the political structure at the time
- reform has been placed in the wider context of the development of new public management as a governance reform in the NZ public sector
- New Zealand - “advanced reformer” offering conceptual and valuable practical experience in the sphere of public sector management and accountability
- accounting system is developed based on accounting standards and rules of accounting and finance profession
- full accrual accounting adoption
- public sector has experienced somewhat of a turnaround. Using full accrual accounting and IFRS showed that the specifics of public sector were not sufficiently catered for - the adoption of IPSAS

### CROATIA

- long- term reform processes
- the existence of many regulations and frequent amendments to the normative regulation of the matter (planned economy changed to the market-driven one; public finances centralization. . . .)
- excessively complicated administrative procedures and the unnecessary system of bureaucracy
- lack of political will and resistance to change from within the administration structure; political incentives only on ad hoc basis - political option/structure changes
- no long-term sustainability of public administration; Croatian government has only recently embarked on the long term financial management reforms
- a need for other reform processes to enhance the development of the accounting system – fostered by EU membership processes
- accounting system is based on a law fostering standardization and unification
- no tradition of developing accounting standards
- modified accrual accounting application

# Conclusions

- simple comparison of the two countries is not yet possible; differences rather than similarities in developmental stages
- the decisive influence on the shaping of governmental accounting at the country level comes from two sources: a national source and the international source (in New Zealand case there has been active participation of NZ experts in international standard setting)
- it is important to observe the effects of the structure of the state, tradition and historical heritage, the effects of public policy and wider reform processes (budgetary processes, wider public sector management processes, political incentives etc.)
- whether it is possible to apply any of the developed countries experiences (NZ) and wider international trends as an example of good practice in transitioning countries (Croatia), depends greatly on variety of factors that have influenced the developments made so far:
  - ✓ national specifics and limitations affecting the dynamics of the national accounting development
  - ✓ external forces: EU integration processes; the IMF and other international institutions requirements; New Public Management (NPM) which has emerged over the past two decades as the dominant public administration model
- harmonization and unification of methodological and legislative frameworks and national accounting practices and IPSAS adoption shall further lead to reducing national specifics (i.e. deregulating of the system) in Croatia