

# Implementing Reforms in Public Sector Accounting

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Editor



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**THE RELEVANCY OF CONTINGENCY APPROACH  
TO PUBLIC SECTOR ACCOUNTING DEVELOPMENT:  
RECENT EVIDENCE FROM POLAND**

**Introduction**

At the end of the 20<sup>th</sup> century, the contingency approach was officially incorporated into the methodological foundations of research on public sector accounting development. In 1992, it gave rise to the development of the contingency model of public sector accounting innovation by Klaus Lüder. This model appears to have a significant explanatory, prognostic and inspirational potential, as demonstrated by its subsequent elaborations and modifications over the following decade, by researchers from the international network of the CIGAR initiative, as well as by Klaus Lüder (see Lüder, 2002). Does it still have its cognitive and prognostic value 15 years after first being formulated?

In seeking answers to this question, the main idea of Lüder's model has been confronted with sociological theories of social change, especially Talcott Parson's theory of social action system, and the contingency theory of organization. This has resulted in the formulation of the general model of change in the public finance sector<sup>1</sup> and in viewing public sector accounting innovation as a special case of such a change. Practical implementation of the change model in the public sector is illustrated by the contingency of changes in Polish public sector accounting over the years 1998-2007.

We have seen the development of the public sector and public sector accounting as a change within social action system. This general approach is possible and justified if we take into account the fact that accounting, together with accountants, constitutes a social action system in the shape of profession in sociological understanding, i.e. it

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<sup>1</sup> To be precise, public finance sector is public sector with business enterprises excluded. For the purpose of this paper, the notion "public sector" has been narrowed so as to use it interchangeably with the term "public finance sector".

comprises accountancy. Therefore, the change within accounting and accountancy is a change within the social action system.

## 1. Sources and models of social change – the sociological perspective

Since the establishment of Sociology as a science, social change is among key areas of interest of researchers and theorists engaged in the identification and exploration of its factors and models. In the following part of the paper, major sociological views on social change are presented (after Turner, 1998: 216-229) and discussed, starting from the sources of social change, and then the main models of social change are presented.

The sources of social change are the following:

1) Culture, i.e. changes (processes) in cultural symbols.

Cultural symbols have a decisive impact on interpersonal interactions and the organization of society. Changes in such symbols are mostly accompanied by changes in social structures. It is considered that the principal sources of cultural change are as follows:

- development of knowledge in manipulating the environment (technology),
- evolutionary change in value judgments ('what should be') relating to basic areas of social life,
- diffusions of symbol systems, i.e. the spreading of sets of symbols across populations<sup>2</sup>.

Changes in cultural symbols take place as a result of diffusion processes and development of new patterns of behaviour and social structures in coping with problems<sup>3</sup>.

2) Social structure, i.e. processes occurring in social relations:

- a) inequalities and the rise of class, gender and ethnic differentiation<sup>4</sup>;
- b) subcultures, whose very existence generates pressure towards change (even if there are no inequalities)<sup>5</sup>;

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<sup>2</sup> Diffusion applies to languages, values, ideas, institutional norms and technologies.

<sup>3</sup> In processes of creating new relations and structures, the change of norms comes first (because they directly guide people's behaviour), followed by change in the modes of thought (as these must adapt to new patterns of social relations). Consolidation and diffusion of new types of social relations, norms and modes of thought creates conditions for changes in the system of values, i.e. criteria of good and evil. It should be added that cultural and social structure changes are interrelated.

<sup>4</sup> Inequalities lead to political pressures for change only where they give rise to the emergence of subcultures which have cultural symbols uniting them, distinct social structures and some financial means. If, therefore, a social class, age, gender or ethnic group, or some other social category becomes a subculture as a result of inequality, it is easily capable of mobilization and effecting change.

<sup>5</sup> Contact between different subcultures inevitably leads to change because of ensuing mutual acceptance and compromise.

- c) social institutions and their endogenous transformations, and the spreading of the effects of these changes in institutional networks<sup>6</sup>.
- 3) Demographic processes relating to population size, composition and movements<sup>7</sup>.

Models of social change (interpretations of changes):

- 1) Cyclic models, viewing change from the political perspective – they regard social change as arising from permanent oscillation between centralization and decentralization of authority, and diffusion and concentration of capital<sup>8</sup>.
- 2) Dialectic-conflict models viewing change from the economic perspective – they regard the growth of the transformation seeds inherent to each societal form as stimulated by economic inequalities and proceeding towards a form superior to the present one.
- 3) Functional-evolutionary models, viewing change from the perspective of evolution induced by growth and development – according to them, social change has a cumulative character and corresponds to society's growth in size and complexity, which is manifest in social structures differentiation necessary for the satisfaction of the needs of a growing population, and in the emergence of new mechanisms integrating and coordinating actions<sup>9</sup>.
- 4) Evolutionary-conflict models, viewing change from the perspective of evolution induced by conflict – according to those, the force of the evolutionary differentiation of society is the drive to diminish inequalities generated by technological progress, which requires the integration and coordination functions to be developed.
- 5) Post-industrial and post-modernist models, viewing change from the perspective of technological progress in production and communications (post-industrialism) and related total decentralization (post-modernism) – these are not so much models as commentaries regarding transformation of societies as a consequence of advances in technology – mostly information technology – and media systems.

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<sup>6</sup> Social institutions, such as the economy, mode of government, education, research, medical services, law, religion and family often undergo transformations as a result of their own internal dynamics. For instance, research seeks to expand knowledge useful for the development of new technologies, which generate change.

<sup>7</sup> The main demographic factors giving rise to changes in social institutions are increase or decrease of population, movement of rural population to towns, emigration and age structure.

<sup>8</sup> The cyclic model assumes that at a certain stage of social organization – both centralization and decentralization – there are seeds moving in the opposite direction.

<sup>9</sup> For instance, Herbert Spencer in his sociological works from 1874-1896 claimed that evolutionary differentiation of societies occurs along three functional axes: (a) production-reproduction (goods and services creation, the new socialization of the new members of society), (b) regulation (political control), (c) distributional (flow of goods, services, information and other resources). Growing differentiation intensifies problems related to coordination and regulation, which causes the creation of structures that bind entities (markets, routes, means of communication and transportation) and their political control (regulations, standards, and supervision bodies).

Against the background of sociological views on the sources and models of social change, two models of change formulated in the context of public sector accounting will be presented and interpreted: the public sector accounting innovation model by Jaruga and Nowak (1996) and the model by Lüder (2002).

## 2. Innovation in accounting as social change

Broadly understood accounting together with accountants constitutes a social system of operation in the form of profession in the sociological understanding, i.e. constitutes accountancy. Accountancy relates to accounting actions and theories, including accounting practice, research and education. It also embraces the guidelines, principles and procedures to be followed by accountants in performing their tasks, i.e. measuring and communicating reality (Siegel and Shim, 2000: 4-5 (*Accountancy*))<sup>10</sup>. Thus changes in these guidelines, principles and procedures are changes in the social system. Innovation means the introduction of something new; therefore, it is a change in the found state. In the case of accounting, innovation is change in the present state of the profession, i.e. change in the social system. In the case of financial management, innovation represents change in the social system performing this type of activity. In the case of the public finance sector, innovation constitutes change in the social system performing public finance processes. Therefore, change (innovation) in these systems may be considered in terms of social change sources and models.

Similar to the case of accounting, it is possible to consider its supra-system, i.e. the financial management system, and – generalizing – also any other area of accounting, including the public finance sector as a whole. Such an approach is possible and valid in the light of the functional model of the societal operation system, formulated by Talcott Parsons and presented in Figure 1<sup>11</sup>.

According to Parsons, social action systems are characterized by functional imperativeness, which means that each such system, as well as each subsystem that it is comprised of, performs the functions set out in Figure 1. Parsons argues that in order to survive each social system (understood as any organized pattern of interactions) must successfully perform four imperative functions<sup>12</sup> (Turner, 2004: 40):

- adaptation, i.e. deriving resources from the environment and their allocation among the segments of a system;
- achievement of goals, i.e. identification of priorities and mobilization of means for their accomplishment;

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<sup>10</sup> See also Encyclopedia Britannica: Accountancy, and Godfrey *et al.* (2006: 439).

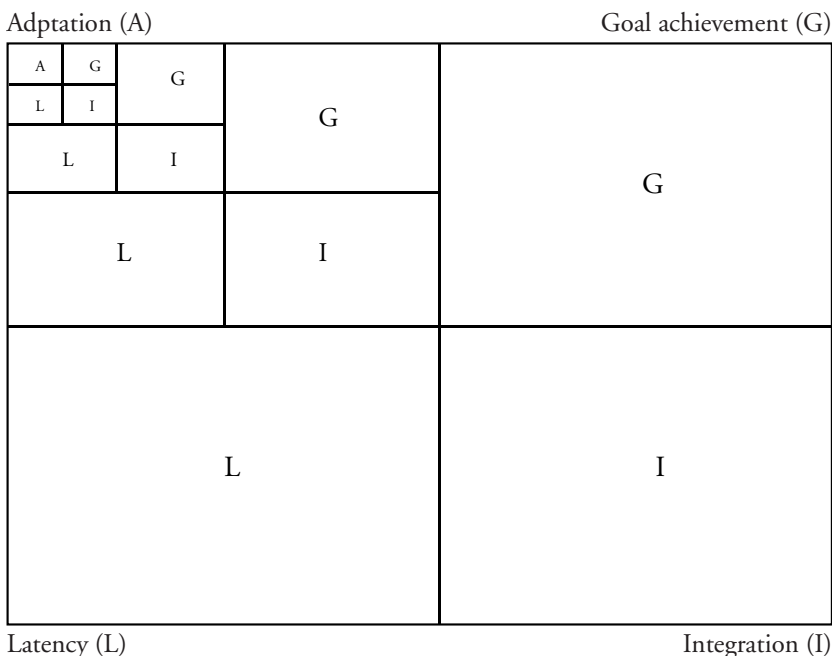
<sup>11</sup> Functions are realized within specific structures, so we are dealing with functional consequences of the structures. The structures should be such as to allow the functions to be realized. At the level of society, as a whole, the structures providing the functions are: economy (A), politics (G), system of norms (I) and system of values (L).

<sup>12</sup> The importance and relevance of Talcott Parsons' theory has been summed up by Jurgen Habermas as follows: "...so far, no social theory can be taken seriously which at least does not make a reference to Parsons" (Habermas, 2002: 352).



- internal integration, i.e. coordination and maintaining proper relations among the elements of a system;
- latency (cultivation of patterns), i.e. maintaining the proper characteristics of a system, mainly through learning (education) and control of inner tensions (pressures).

Figure 1 – Functional model of social action system



Source: Turner (2004: 41)

Each of the above segments must cope with the same problems as the whole system ('functional sectorization'), i.e. problems of adaptation, integration, goals achievement and patterns cultivation. The same goes for all sub-segments. In this way a specific functional structure emerges, in which self-resemblance occurs, which means – to use the language of non-linear system dynamics – fractals appear<sup>13</sup>. Looking at it from a different angle, it can be said that a system in which each element of the structure of the whole system repeats itself as a holographic system. Thus, the functional approach to the social action reveals its holographic nature. Morgan (1986: 107) claims that organization may have the nature of a holographic system. He also argues that the

<sup>13</sup> Fractals in the structure of the functional model of a social system imply usefulness of the non-linear dynamics approach to social systems analysis. Functional imperatives may be viewed as social system attractors, i.e. centers of gravity around which all activity concentrates.

coding of the properties of a whole in each of its parts “enables the system to learn and organize itself as well as maintain proper functioning of the whole system even though some of its subsystems are not functioning properly or are eliminated” [*ibidem*].

Therefore, in view of the above, it can be said that change in a social system subsystem involves change in at least one of the subsystem’s imperative functions, with models of social change taking into account its sources and patterns. Change (innovation) in accounting will thus mean change in its adaptation function, goals function, integration function or patterns cultivation function. The consequences of change, though, will also affect its environment.

With regard to the areas of accounting in question, one of the models of change is the general model of public sector accounting innovation, formulated in the mid-1990s by Jaruga and Nowak (1996: 30)<sup>14</sup> (see Annex 1). Annex 2 presents a model of financial management reform process (in the public finance sector) developed by Lüder in 2002 (Lüder, 2002: 18). Annex 3 presents a model of public management reform developed by Pollit and Bouckaret in 2000 (Lüder, 2002: 19). Analysis and comparison of those models show that their structural elements are of the same nature, although the model by Jaruga and Nowak (1996) tends to be rather conceptual in character, while the model by Pollit and Bouckaert and Lüder’s model have a more operational character. All models specify sources of change (STIMULI) and provide its pattern. In Jaruga and Nowak’s model, the pattern of change seems to allow each of the social change models presented in Section 1. In models by Lüder, and Pollit and Bouckaert, though, the emphasis seems to be on the evolution-conflict aspect (albeit not to the same extent).

### 3. Accounting change and contingency

Contingency is commonly understood as possibility or uncertainty. Possibility means something that might happen, and uncertainty is something in the future that no one is certain about. It possibly means a future event very difficult to foresee, uncertainty means condition dependent on chance. According to the contingency theory of organizations, contingencies comprise: the environment, organizational size, and organizational strategy.

What determines organizational effectiveness is adaptation of its characteristics to contingencies, which usually leads to high performance. Therefore to maintain effectiveness, organizations need to adapt to changing contingencies. This type of adaptation is called a fit. Under the contingency theory of organizations, adaptation affects performance, which in turn forces adaptive organizational change (Donaldson, 2001: 1-2).

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<sup>14</sup> On the basis of Lüder’s contingency model of public sector accounting innovations (Lüder, 1994 and 2002).

If we regard the public finance sector as organization<sup>15</sup> (as is commonly the case today<sup>16</sup>) and accounting as its component, then accounting will be subject to adaptive organizational change, forced by the need to adapt its characteristics to contingencies, i.e. the broadly understood environment, to the size of the public finance sector and its strategy. Events connected with the public finance sector will therefore affect accounting not so much directly as through their actual or potential effect on the environment, organizational size and organizational strategy. Accounting, being a service activity, will adapt to the needs arising in these areas. It should be noted that both the operational model from Annex 2 and conceptual models from Annex 1 and Figure 2 take into account thus understood contingency.

#### 4. The general model of public finance sector change

Taking into account both models, i.e., Jaruga and Nowak's (1996) model and Lüder's (2002) model, and the contingency theory of organizations, the fractal nature on the imperative functions of the social action system, the extensiveness of change consequences and highlighting the interactions with the environment as a source of change, it is possible to extend the model by Jaruga and Nowak to embrace the whole of the public finance sector (see Figure 2). It thus includes the change both in the public finance sector and in all its subsystems, i.e. also the financial management subsystem and accounting subsystem.

It should be stressed at this point that accounting, being a subsystem of the social action system, supports the fulfillment of the imperative functions of this system. This means that information generated by accounting supports adaptation, goals achievement, integration and the cultivation of the cultural patterns of structures through its aims for a lasting and developing social supra-system.

#### 5. Contingencies of recent changes in public finance sector in Poland

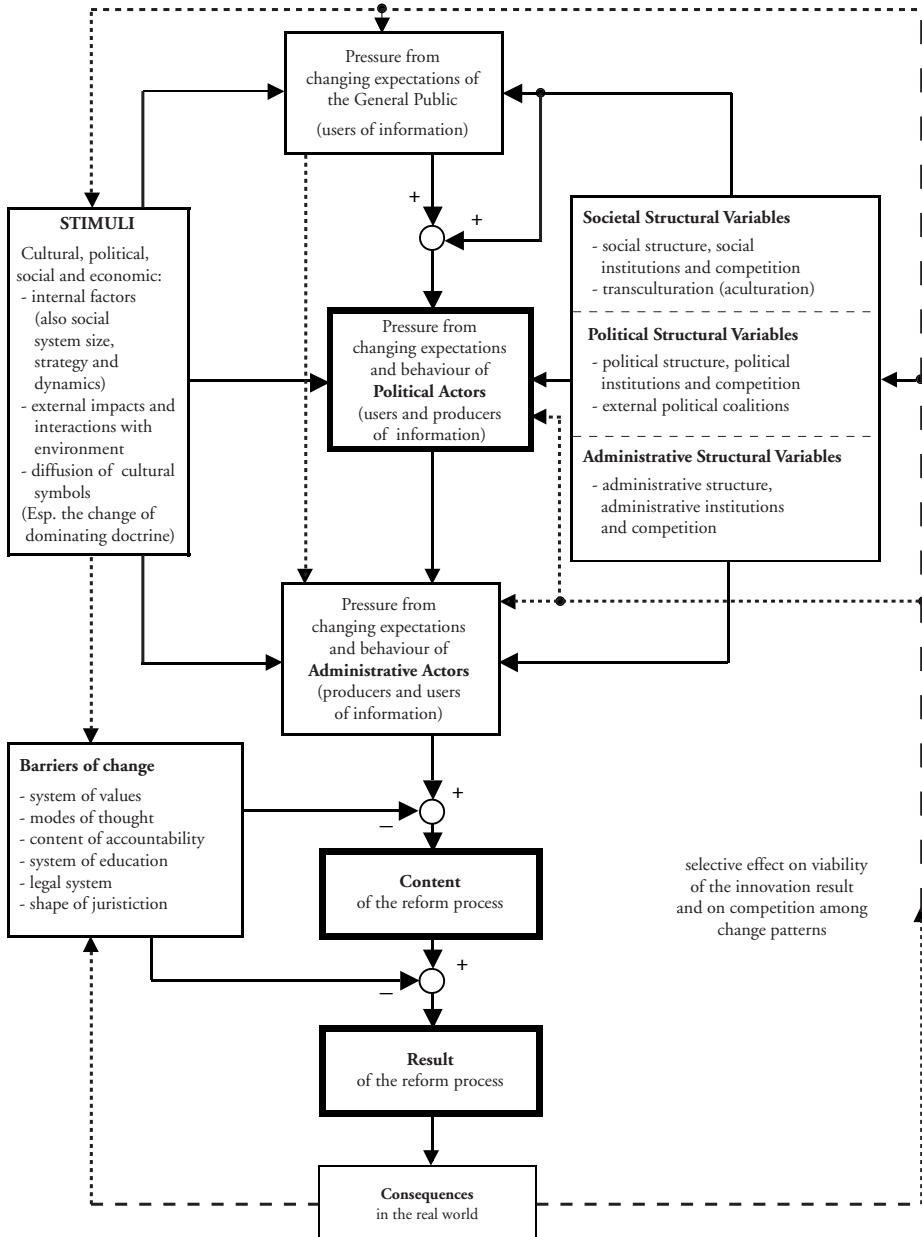
Recent changes in the Polish public finance sector accounting were caused by the 1998 *Act on Public Finance*. Its content and context were extensively reproduced at the 7<sup>th</sup> CIGAR Conference in 1999, and discussed in a publication by Nowak and Bakalarska (2001). Conceptual aspects of accounting change initiated by this Act were described at the 9<sup>th</sup> CIGAR conference in 2003 and in a subsequent publication by Nowak and Bakalarska (2005). The Act was frequently amended, which, however, did not concern accounting. Finally, it was superseded by *the Act on Public Finance of 30 June 2005*, with effect from 1 January 2006. The new act provided a stimulus for further change in accounting, which resulted in the addition of the statement of changes in equity to the set of financial statement presented by Local Government

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<sup>15</sup> Understood as the collection of human and non-human resources which objective is meeting its founder needs due to meeting its client needs, i.e. as the entity being social action system.

<sup>16</sup> See, for e.g., Nowak (2002).

Figure 2 – The General Model of Public Finance Sector Change



and The State Treasury component entities<sup>17</sup>. Moreover, to enhance the transparency of public finance, organizational units belonging to the public finance sector were required to make their annual statements on finance and operations available to those interested in them.

But the 2005 *Act on Public Finance* has seemingly turned out to be an interim Act. In April 2007, the Finance Ministry published on the Internet a draft of a new act on public finance, which is intended to lead to the fundamental reform of public finance, including a significant reduction of the size of the public finance sector. This was to accommodate to the Maastricht Treaty requirements for joining the sphere of Euro. The perfected draft of the 2007 *Act on Public Finance* was going to be enforced from 1 January 2008 onwards. However, the political crisis which happened in the summer of 2007 resulted in subsequent elections. Previous ruling coalition had lost power and the winning parties have formed a new coalition. This coalition has decided to abandon the public finance reform in the shape projected by former ruling coalition. The new project of public sector finance reform has not been known till now (late January 2008).

Analysis of changes taking place since the late 1990s in the Polish public finance sector<sup>18</sup>, coupled with insights gained from the social change approach, general model of change in the public finance sector (Figure 2) and contingency theory, makes it possible to identify their character and determinants. First of all, these are functional-evolutionary changes in sociological sense. Their drivers are both within and outside the country. Internal causes include endogenous changes in social institutions, initiated by the change of the dominating doctrine (change of political regime in 1989), growing social inequalities caused by economic factors (high unemployment, limited social benefits), and unfavourable demographic changes, such as the ageing of population and mass emigration of young people (especially after Poland's entry in the EU in 2005). External stimuli are mainly the diffusion of cultural symbols from developed country areas – including formal and informal organizations and transnational networks – and impacts from the European Union<sup>19</sup>.

In recent years, changes in Polish public finance sector accounting were introduced as a result of revisions of public finance law. Thus, they are contingent adaptive changes, initiated by mandatory representations of changes in the size and strategy of the public finance sector. The main factor that spurred changes in accounting was the introduction in this strategy of the principle of public finance transparency and openness, which allowed the financial reporting model to be developed.

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<sup>17</sup> After this revision, the set of financial statements of central and local government entities consists of: balance-sheet, profit and loss account and statement of changes in equity. It should be noted that the 1998 Act introduced, for the first time, in Poland the consolidated balance-sheet for local government.

<sup>18</sup> Which are reflected and embodied in successive acts on public finance and relating regulations.

<sup>19</sup> Pre-accession financing requirements, transformation-related financing requirements, and requirements connected with joining the euro zone.

First the consolidated cash-based statement of financial position for central and local government was introduced (balance of the execution of, respectively, the state budget and local government budget<sup>20</sup>) and accruals-based consolidated balance-sheet of local government. Then, the accrual statement of changes in equity was introduced to be presented individually by central and local government component entities (in addition to the accrual balance sheet and accrual profit and loss account).

To increase the relevancy and reliability of financial statements, the general principle of consistency of plans of accounts with national accounting regulations and international standards<sup>21</sup> was adopted, and plans of accounts for budgets were laid down. The recording of the components of assets, liabilities, equity, revenue, expenses, gains and losses according to additional classifications has been allowed if it is a requirement of public sector finance reporting regulations, especially budgetary reporting regulations. The factors conditioning the extent and shape of these changes included first of all: impacts from international organizations (such as World Bank, OECD, International Monetary Fund, IFAC), regulators from the European Union, diffusion of concepts and models developed within the CIGAR network, the revisions of national Accounting Act and the revisions of public finance sector regulations.

## Conclusion

Consideration of the changes in public finance sector accounting from the perspective of social change theory and contingency theory of organization confirms the contingency-based nature of these changes, as demonstrated in Lüder's 1992 model. This is also confirmed by the nature of changes that have occurred in Polish public finance sector over the last decade.

Therefore, ignoring contingency in comparative research and case studies relating to public finance sector accounting should be regarded as considerable limitation of the cognitive value of the method applied as well as the reliability of the results thus achieved.

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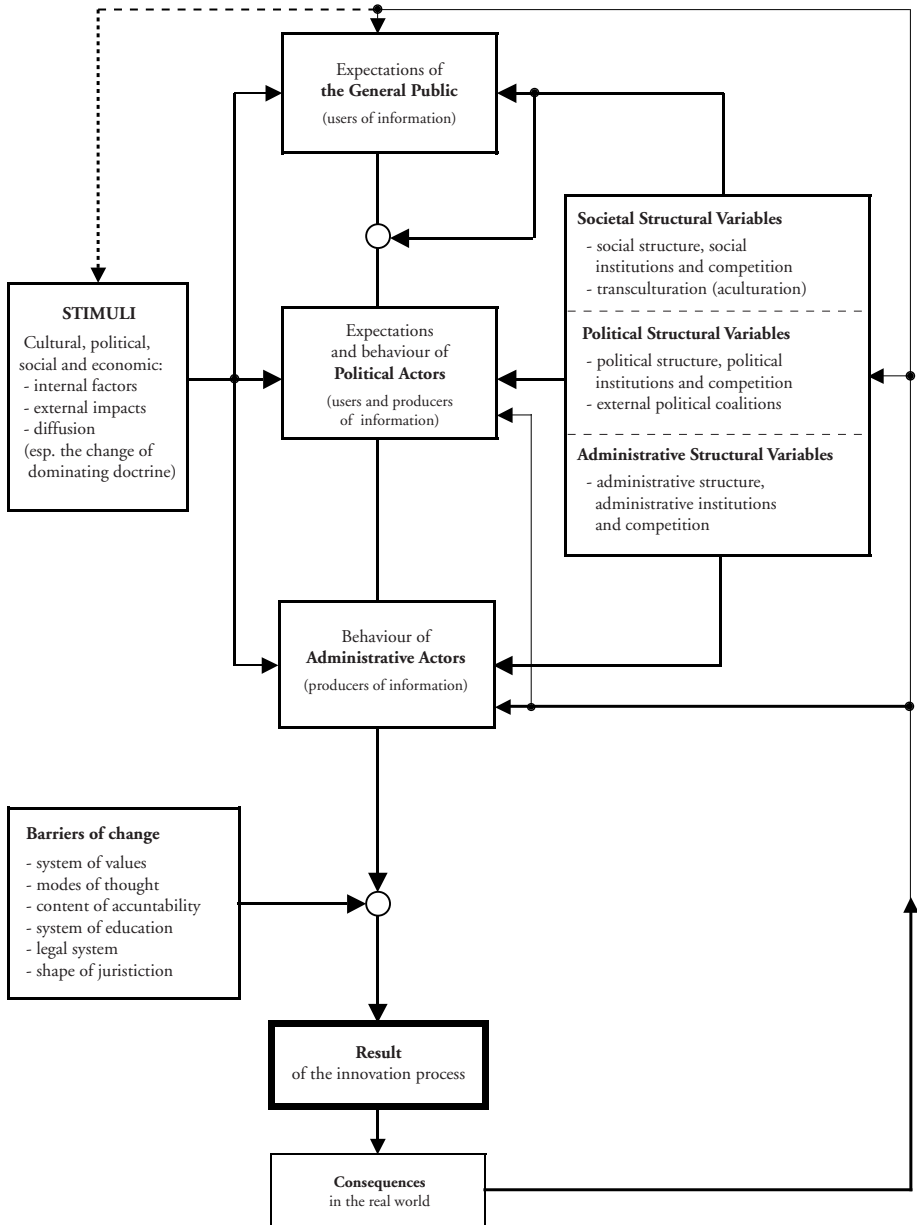
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<sup>20</sup> Generally such budgets are cash-based.

<sup>21</sup> Basically IFRS, IPSAS, SNA 93, ESA 95, IMS – according to the requirements of national budgetary classification, national statistical regulations and European Union regulations.

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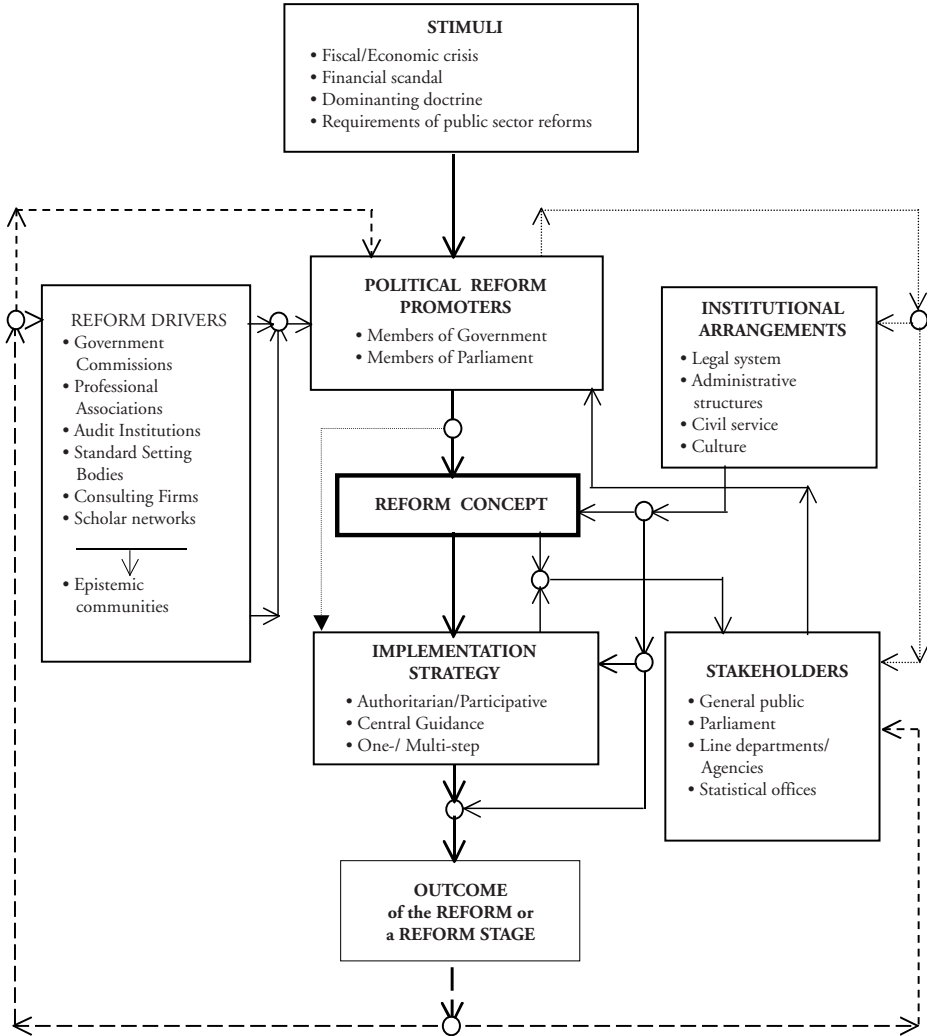
**Annex 1**  
**The General Model of Public Sector Accounting Innovations**



Source: Jaruga and Nowak (1996: 30).

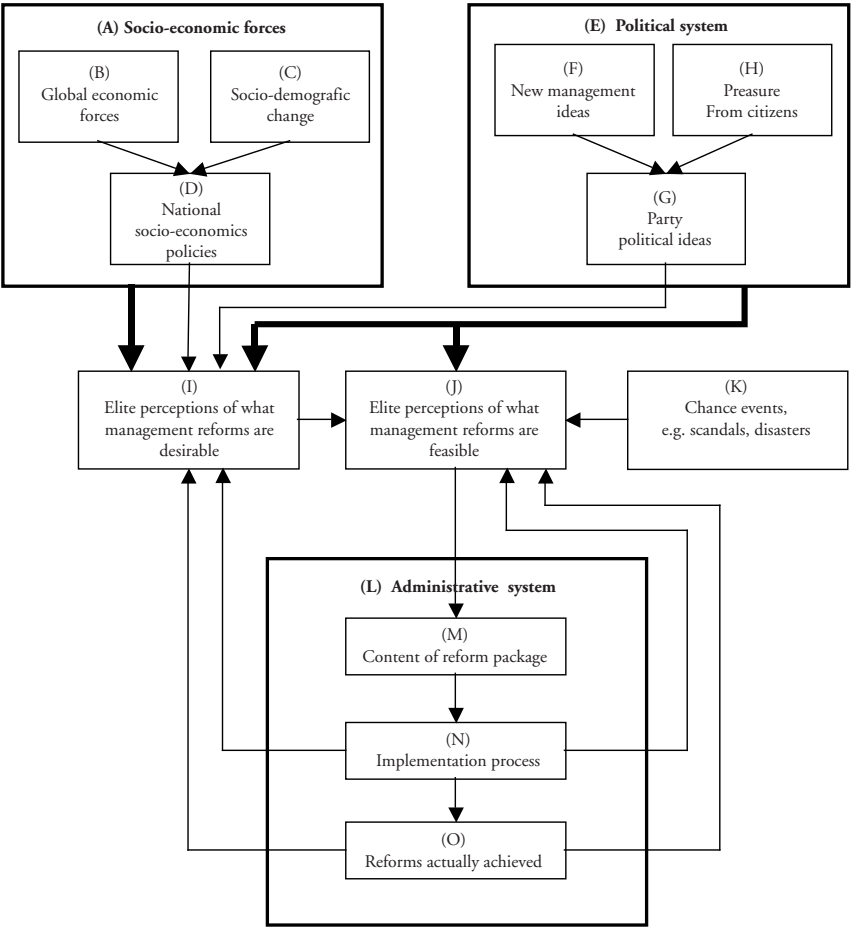


## Annex 2 Financial Management Reform Process Model



Source: Lüder (2002: 18)

**Annex 3**  
**A model of Public Management Reform by Pollit & Bouckaert**



Source: Lüder (2002: 19)

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