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A Comparative-International Theory for Portuguese Local Government Accounting

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Abstract: The main purpose of this paper is to offer an inductive theory of Local Government accounting in Portugal, in a comparative-international perspective with the United Kingdom.
From an overview of the main features of both countries' Local Government accounting systems, we have concluded that, despite similarities, some important differences still remain, namely regarding the importance of budgeting and budgetary control and their influence in accounting, and the external financing providers privileged by local governments in each country, amongst others.
A discussion of possible reasons for those differences is then offered, based on: historical reasons, local government political structure and budgetary process, users of local government financial (including budgetary) reporting information and their needs, proximity to business accounting, and the financing system predominating in each country.

Keywords: Local Government accounting; comparative-international theory.

Resumo: O principal objectivo deste artigo é oferecer uma teoria indutiva para a contabilidade autárquica em Portugal, numa perspectiva comparativa-internacional com o Reino Unido.
Partindo de uma apresentação geral das principais características dos sistemas de contabilidade dos governos locais de ambos os países, concluímos que, apesar das semelhanças, ainda permanecem algumas diferenças significativas, nomeadamente no que respeita à importância atribuída ao orçamento

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e controlo orçamental e a sua influência na contabilidade, quanto aos financiadores externos privilegiados pelos governos locais em cada país, entre outras.

Apresenta-se posteriormente uma discussão sobre as possíveis razões para as diferenças constatadas, discussão esta que é baseada em: razões históricas, estrutura política do governo local e o seu processo orçamental, utilizadores da informação do relato financeiro e orçamental e as suas necessidades, proximidade à contabilidade empresarial, e o sistema de financiamento predominante em cada país.

Palavras-chave: Contabilidade do governo local; teoria comparativa-internacional.

1.2. Introduction

As many countries all over the world, in the last decades, Portugal and the United Kingdom have been changing their Local Government accounting systems.

The extant accounting literature, either for business or governmental accounting, generally reflects a fundamental dichotomy between the Continental European and the Anglo-American accounting perspective. However, recent comparative studies, namely involving other European countries, demonstrate a trend for convergence (Lüder and Jones, in Lüder and Jones, 2003, pp.13-57).

This paper considers the current state of the Local Government accounting systems in Portugal and in the United Kingdom, representative of the aforementioned dichotomy. A comparison between both countries' Local Government systems' internal characteristics is summarised, aiming at showing whether they are different enough to justify their classification in separate international spheres of governmental accounting. The features are grouped in five broad categories of eventually distinctive criteria, in some way adapted from Montesinos Julve *et al.* (1995 and 1996), Chan *et al.* (1996), Vela Bargues and Fuertes (1999), Giroux *et al.* (2002), Brusca Alijarde and Condor (2002) and Brusca Alijarde and Benito López (2002): institutional framework, budgeting principles and rules, accounting recognition and measurement criteria, form and contents of financial (including budgetary) reporting, and financial (including budgetary) reporting information objectives.

Although it is empirically based, this is essentially a desk-study, relying on secondary sources. Nevertheless, it is an important addition, particularly considering the limitations in terms of governmental accounting international comparative research and theory. Indeed, the Financial Management Reform Process (FMR/Contingency) Model of governmental accounting innovations (Lüder, 2001) is generally accepted as the only existent comparative-international theoretical framework for governmental accounting. Yet, even its author himself recognises that it merely addresses the governmental accounting context, inasmuch as it explains why accounting innovations take place in some countries and not in others. Furthermore, even if environmental differences might be important explaining some of the diversity amongst governmental accounting systems contents, it is acknowledged the need for a theoretical framework addressing the systems themselves (accounting technique), not just the reform processes.

The remainder of this paper is organised in four sections. Section 2 presents the background for the theory building, i.e., a summarised review of some ideas from important examples of comparative international (business and governmental) accounting research, which we believe are useful in explaining international differences in Local Government accounting systems. Section 3 offers a brief overview, following a comparative-descriptive perspective, of both the Portuguese and the British Local Government accounting systems. Section 4 provides an explanation of why Portuguese Local Government accounting is the way it is, discussing possible reasons for international differences in Local Government accounting systems. The paper finishes by highlighting some concluding notes.

2. Background of the theory building

The attempts to develop a comparative international theory are not new in accounting. However, in spite of some studies, which have started earlier in business than in governmental accounting[1], it is often stated that there is little theory in accounting, either business or governmental.

In what concerns comparative international theory, while there is a considerable literature for business accounting, for governmental accounting the FMR/Contingency Model seems to be the only one existing.

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[1] Some good examples in business accounting are referred to in Balaguer Coll *et al.* (2001, p.3): Da Costa *et al.* (1978) and Nair and Frank (1980), both following an inductive approach, in the sense that from their empirical studies an international classification for the business accounting systems is produced. Another good example this time following a deductive approach is Nobes (1983), where an hierarchical international classification for business accounting systems is proposed at first, being the countries later tested against that classification through scoring on several differentiation factors.

A common issue of those approaches is that they had started at least ten years before the study of the Speyer School of Administrative Sciences, which led to the Contingency Model (Lüder, 1989 and 1992).

Nevertheless, there are two common issues between business and governmental accounting comparative international research:

– It has been developed while seeking for accounting international harmonisation;

– It is generally accepted that environmental characteristics are important to somehow determine the accounting technique (contents of the system) diversity.

In recent reforms, many countries have been bringing governmental accounting closer to business accounting. Therefore, we believe it could be possible that some arguments which have been presented for international differences in the latter, might also be valid to explain governmental accounting international differences. This is our assertion for Portuguese local government accounting, where the new Plan of Accounting for Local Government (PALG) passed in 1999[2] has been adding to the previous traditional cash-based budgeting, two accounting sub-systems – financial and cost accounting – whose main rules and model for the financial reporting were adapted to the local government context from the Plan of Accounting for Business Accounting (PABA). Consequently, we believe it is equally important not only obviously referring to studies in comparative international governmental accounting, but also to some of comparative international business accounting which for us are reference points.

Seminal work in comparative international business accounting was developed by Nobes (1983 and 1998). The importance of his work is justified because he analyses a vast literature on the subject, specifically on reasons for international differences in business accounting. Moreover, he addresses a theory for international business accounting. What is also particularly interesting here is that the author radically changes his own ideas presented fifteen years ago.

Nobes (1998) developed a simplified model to explain an initially suggested split of business accounting systems (namely financial reporting practices) in two classes: Class A resembling the Anglo-American, and Class B resembling the Continental European. A major change from previous studies is that this model, at bot-

[2] This is a law-based accounting plan as others existing in France, Belgium and Spain. In Portugal it is the fundamental set of instructions for local government accounting practices and it contains: a standard decimalised chart of accounts, instructions relating to the presentation of uniform published financial and budgetary statements, and standard definitions of items and their valuation methods. It was approved through Law-decree 54A/99, February 22.

tom, classifies systems not countries, therefore allowing a country to exhibit the use of several systems in any year or over time, though having one dominant accounting system.

From a list of seventeen factors previously proposed as reasons for international differences in business accounting (Nobes, 1998, p.74), only two were kept as important – FINANCING SYSTEM and COLONIAL INHERITANCE – while arguments were discussed explaining why the others may be less useful (Nobes, 1998, pp.81-88).

Subsequently, Nobes' (1998) twofold international classification of the business accounting published financial reporting practices lays upon two variables: the strengths of equity markets and the degree of cultural dominance. He clearly assumes as initial proposition that <u>the major reason for international differences in financial reporting is different purposes for that reporting</u> (Nobes, 1998, p.77). Moreover, he relies on other studies suggesting that, at a country level, <u>the financing system is relevant in determining the purposes of financial reporting</u>. Accordingly, at first he distinguishes four categories of companies' financing systems: insiders-dominant/strong-credit, outsiders-dominant/strong-credit, insiders-dominant/strong-equity, and outsiders-dominant/strong-equity.

The outsiders v. insiders[3] split leads to <u>different amounts</u> of accounting information required in the published financial reporting, thus relates to <u>disclosure</u> issues: more information where outsiders are dominant. In turn, the equity v. credit split leads to different kinds of objectives for financial reporting, meaning <u>different types</u> of information, therefore more related to <u>measurement</u> issues (Nobes, 1998, p.80).

For companies' long-term external finance, securities are the main source in a capital market-based system; credit (usually granted by banks) is the most important source in credit-based systems, where the capital market is smaller/weaker.

Accordingly, Nobes (1998, p.78) comes out to suggest that different purposes of the financial reporting are essentially based on a dichotomy of the financing systems, where the key issue is the existence or otherwise of important equity markets with large numbers of outsider equity holders.

The hypotheses predicting a correlation between the type of corporate financing and the style of the financial reporting system were: "(…) the rule-makers for, and the preparers of, financial reports in equity-outsider (…) countries are largely

[3] "Outsiders" are not members of the board of directors and do not have a privileged relationship with the company (e.g. private individual shareholders); "insiders" are entities (such as governments, banks, families and other companies) that are likely to have close long-term relationships with their investees (Nobes, 1998, pp.77-78).

concerned with the outside users. (…) By contrast, credit-based countries (…) will be more concerned with the protection of creditors and therefore with the prudent calculation of distributable profit. Their financiers (insiders) will not need externally audited, published reports. This difference of purpose will lead to differences in accounting practices" (Nobes, 1998, p.78). Additionally, "strong equity-outsider markets (…) lead to Class A systems; otherwise Class B systems prevail" (Nobes, 1998, p.80).

Furthermore, it is also acknowledged that the financial systems dichotomy is indirectly caused by differences in culture (including institutional structures), inasmuch as this affects the capital markets. The cultural issue (which might be seen as an overwhelming factor for some countries – Nobes, 1998, p.86) is related to the other single factor considered important in explaining business accounting international differences: the colonial inheritance. Indeed, Nobes (1998, p.81) recognises that some countries, due to their small size, underdeveloped state or former colonial status, can be affected by very strong external cultural influences. Therefore, they are culturally dominated countries likely to be using an accounting system based on that of the influential country (culturally self-sufficient).

In summary, the model admits that "cultural differences" cause "differences in the financing systems", which, in turn, cause "differences in the financial reporting practices" (Nobes, 1998, p.88-89).

One relevant fact of this study is that some factors argued here as unimportant in determining international differences in business accounting have been used to explain international differences in (local) governmental accounting, namely in two noteworthy comprehensive surveys developed by Brusca Alijarde and Condor (2002) and Brusca Alijarde and Benito López (2002). They also sustain the dichotomy Anglo-Saxon v. Continental European accounting systems addressing several reasons for differences, as displayed in Table 1, where it can be observed some correspondence with the list initially presented by Nobes (1998).

Business Accounting (Nobes, 1998, pp.81-88)	**Local Government Accounting** (Brusca Alijarde and Condor, 2002, pp.146-151; Brusca Alijarde and Benito López, 2002, pp.176-181)
1. Nature of business ownership and financing system 2. Colonial inheritance 3. Invasions 4. Taxation 5. Inflation 6. Level of education 7. Age and size of accountancy profession 8. Stage of economic development 9. Legal systems 10. Culture 11. History 12. Geography 13. Language 14. Influence of theory 15. Political systems, social climate 16. Religion 17. Accidents	1. Legal/juridical system 2. Organisation of the public sector 3. Specific objectives of governmental financial (including budgetary) reporting 4. Principal users of the financial reporting 5. (External) Financial resources suppliers 6. Impulse of governmental accounting regulatory bodies 7. Interest and formation of professionals 8. Political and administrative environment in which each system operates (Contingency/FMR Model)

Table 1 – Reasons proposed for international accounting differences:
business v. local government accounting

Since the recent international trend is for governmental accounting to become closer to business accounting, this begs the question whether these factors are relevant to explain governmental accounting international differences as well, particularising local government accounting. Accordingly, arguments in the line of Nobes' (1998) might be presented for some of them.

Figure 1 summarises our arguments regarding these factors eventually responsible for local government accounting international differences[4].

We believe that, in the last instance, the financing systems (namely the type of "external financial resources suppliers") dominate the "local government regulatory

[4] For an extended critical discussion see Jorge (2003, pp.392-419).

system" (professionals *versus* official bodies) as relevant to explain international differences amongst local government accounting systems, as it has been argued for business accounting. Also "environmental features" comprised by the FMR/Contingency Model (Lüder, 1989, 1992 and 2001) are believed as not affecting the local government system contents (only the contexts), thus not being relevant to explain international differences. To the extent that they might be important, they can be narrowed down to "specific objectives of governmental financial reporting" and "main users of the financial reporting".

Consequently, "specific purposes of local government financial – and budgetary – reporting" seems to be, as in business accounting, one key reason for international major differences between local government accounting systems. However, it is strongly conditioned by "principal users of the financial reporting". On the other hand, as argued for business accounting, the financing system (namely "external financial resources providers") is relevant in determining those objectives as well, being the relationship reinforced by the fact that financial resources providers might be users of the financial reports. Moreover, for local government, some empirical evidence[5] seems to show that, for countries of both international spheres, the main users of financial (and eventually budgetary reporting) are internal. As to external users, apart from external audit bodies, those who might be more interested in local government reporting seem to be financial resources suppliers that, as argued for business accounting, are essentially equity-outsiders in Anglo-American countries, while in Continental European countries they tend to be fundamentally credit-insiders.

Therefore, "<u>external financial resources providers</u>", in this process of some kind of consecutive elimination, <u>is one apparently prevailing over all the others</u> as a fundamental issue to consider in explaining the major international differences in local government accounting.

[5] For UK see, for example, Jones (1992) and Jones and Pendlebury (2004); for Spain see Brusca Alijarde (1997). This study is particularly interesting for ours, considering the similarities between the Spanish and the Portuguese local government accounting systems, allowing supporting arguments alike for the latter case, for which no such empirical analysis has been carried out.

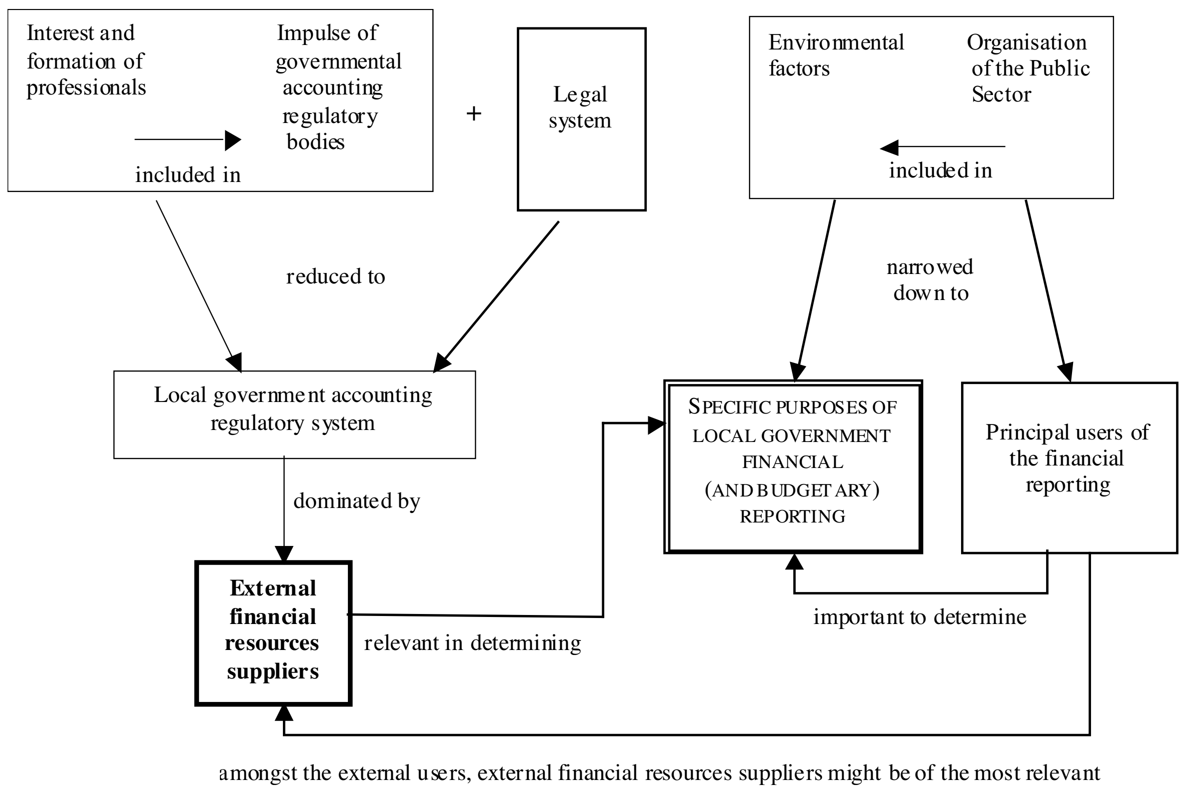

Figure 1 – Reasons proposed for international accounting differences in local government accounting

3. Overview of the Portuguese and the British Local Government accounting systems

This section summarises an analysis of the main features of the local government accounting systems comparing Portugal with the United Kingdom[6]. Information on the former was gathered from Jorge (2003, pp.206-347), while for the latter the source was Jones (in Lüder and Jones, 2003, pp.941-1017). Table 2 displays the major differences.

[6] For the comprehensive analysis, see Jorge (2003, pp.419-478).

LOCAL GOVERNMENT ACCOUNTING SYSTEM MAIN FEATURES	
Broad Categories	**Major Differences**
Institutional framework	• Consolidated financial reporting in the UK • Requirements v. recommendations of accounting principles and practices – uniformity in Portugal (Plan of Accounts) v. flexibility in the UK • Budgetary accounting basis: cash v. accruals (revenue budgeting and accounting in the UK with two different accrual bases) • Long-term borrowing: banks and other financial institutions in Portugal (non-default-free) v. central government and capital markets in the UK (default-free) • Performance measurement in the UK
Budgeting rules and principles	• Great detail in Portugal v. broad statutory framework in the UK – uniformity v. flexibility • Legal requirement for balanced revenue annual budgets in the UK: must consider repayment of debt principal and interest – consequences on the bases of accounting • More prudence in Portugal than in the UK • Relationship between budgeting and accounting: integrated in Portugal v. totally separated systems in the UK
Accounting recognition and measurement criteria	• Historical cost convention in Portugal v. current cost in the UK, as general rule for fixed assets • Matching concept assumed in Portugal • Provisions for future pension liabilities reported in the UK • Equity structure • Cost of services provided: Activities, goods/services in Portugal v. departments/committees in Portugal – Gross cost in Portugal v. net cost in the UK – In the UK must include a “capital charge”, corresponding to an opportunity cost for the use of capital

LOCAL GOVERNMENT ACCOUNTING SYSTEM MAIN FEATURES	
Broad Categories	**Major Differences**
Form and contents of financial (including budgetary) reporting	• Individual statements in Portugal v. consolidated statements in the UK • Budgetary together with financial statements in Portugal v. financial statements eventually with some budget to actual comparisons in the UK • Performance reporting in the UK • Results statement in Portugal v. revenue account in the UK • Cash flow statement: budgetary statement in Portugal v. financial statement in the UK • In the UK – statement of responsibilities
Financial (including budgetary) reporting information objectives	• In Portugal: – Disclosing the cost of services provided is not a purpose – Controlling economy, efficiency and effectiveness is a purpose not explicit • In the UK: – Budgetary control is not a purpose – Local legislative committees do not require accountability – Protecting the creditors is not a purpose • Information requirements by debt providers: credit-based financing system in Portugal v. capital market-based financing system in the UK

Table 2 – Summary of the local government accounting systems: Portugal v. United Kingdom

In our point of view, not all these differences are equally important. We believe that the most significant regard:

– The cost of services, due to the concept of "service" itself, and particularly given the consideration of the "capital charges" in the UK. Therefore, here the revenue account uses an accrual basis different from that used in business accounting, also including cash numbers, taking into account the legal requirement for annual balanced revenue budgets. Yet, these features seem to be very particular to the British system, not necessarily extended to other Anglo-American countries.

– The accounting basis for budgetary accounting, with budgets still essentially cash-based in Portugal. This we believe relates to the tradition of local government accounting in both countries. While in Portugal it has been only cash-based budgeting, in the UK budgeting has been integrated in the accounting system, with the same form, contents and accrual basis. The recent tendency has been opposed in both countries: integration in Portugal and separation in the UK. Accordingly, while in the UK the separation has led to divergence in the accounting basis though still accruals, in Portugal the integration has led to introducing (full) accrual-based financial and cost accounting within a system for which this was totally unfamiliar.

This "revolution" however, has not reached budgetary accounting basis yet. In our understanding, this is because the accruals concept is very difficult to understand by the main (external) users of the Portuguese local government financial and budgetary reporting – deliberative committees and The Court of Accounts – for which cash-based information for controlling the budget execution is still the most important.

– The importance of budgeting and budgetary control

The integration in Portugal has not diminished the role of budgeting in determining the development of the accounting and reporting systems; financial and cost accounting functioning is still basically guided by budgetary transactions.

The separation in the UK has led to budgeted numbers to be reduced (if not banned from) within the financial reports.

Referring to the previous item, this is therefore related to the main purposes of the local government financial reporting, which in turn are determined by the requirements made to the system by its users (information needs). As presented in Table 2, there are some relevant differences on this matter between Portugal and the UK, which are going to be picked up for the discussion in the next section.

– Outside government debt providers, as one of the most relevant external users of the local government financial reporting. The differences here relate to the features of the financing systems dominating in each country: credit-based in Portugal and capital markets-based in the UK. Different prevailing financing systems determine the type of financiers (creditors v. bondholders), who are supposed to have different information needs subsequently making different demands of the local government accounting and reporting system.

In summary, we observe similarities between the local government accounting systems prevailing in both countries, namely in the form and contents of the reports produced. Nevertheless, differences still remain as to their aims and purposes.

On the other hand, we also consider that at broad level more commonalities than differences seem to exist between the two systems. While acknowledging that those are hard to balance, we believe that this raises the question whether the international dichotomy of Continental European v. Anglo-American governmental accounting is valid. However, at a more detailed level, we still recognise the existence of considerable differences that justify the classification of the two systems in eventually different groups. Brusca Alijarde and Benito López (2002, pp.166-176) made an attempt in this direction, classifying the local government accounting systems of Portugal and the UK in separate groups, using cluster analysis: the former is included within the group of accounting systems with a medium-high degree of development; the latter within the group of accounting systems with a high level of development.

From a comparison US/UK, Giroux *et al.* (2000, p.22) came to a conclusion that we believe as also valid for our comparative study: "In significant ways, differences in accounting and auditing for local governments in the two countries are, as it is to be expected, intrinsic parts of the different structures of their sovereign governments (albeit both of which are characterised of being within liberal democracies)".

We also think that this conclusion can possibly be extended to any comparative-international research within industrialised developed countries, where differences will always be found at several levels. The central issue is analysing whether those differences will be relevant enough to conclude for (local) governmental accounting systems being fundamentally different.

4. An explanation in comparative perspective for the Portuguese Local Government accounting

Perhaps a good way of starting addressing this discussion on the "why" of Portuguese local government accounting in comparative-international perspective with the United Kingdom is asking three questions:

– Why budgetary accounting is as it is?

– Why financial (and cost) accounting is as it is?

– Why they relate (or not) as they do?

Although we are not going to address each question individually, our answers to all of them lay basically upon the following arguments:

– Historical reasons – tradition and evolution process of local government accounting in each country;

– The local government political structure and budgetary process (legal mechanism for the local budget approval and execution);

– The users of local government financial (including budgetary) reporting information and their needs (purposes of the local government financial reporting information);

– The proximity to business accounting;

– The financing system predominating in each country.

Local government accounting (as governmental accounting in general) in Portugal has been traditionally single-entry Budgetary Accounting, i.e. cash-based budgeting, aiming at showing legal and budgetary compliance and recording cash flows. Governmental accounting was not an autonomous discipline, being integrated in Law (due to its legal matters) and in Public Finance (for its strictly cash perspective). Therefore, the main purpose was controlling the budget and it was subsequently very different from business (financial) accounting.

In the UK local government, traditionally budgeting and accounting have been integrated in the same accrual-based system. Accounting and budgeting tasks have been carried out by professionally-qualified accountants (since its birth in the UK in the middle nineteenth century, the accounting profession has included a specific accounting body for local government). Moreover, addressing a specific time and entity, local government accounting and budgeting in the UK had (and still have) much in common with business budgeting and accounting (though the publication of budgets is the rule in local governments, while is the exception in businesses).

In both countries, there has been a changing process in the local government accounting and budgeting system since the middle 1970s. The proximity to business accounting has been increasing.

In the UK there have been significant improvements in accounting practices consistency: local government and business accounting and budgeting have now the same essential characteristics. Nevertheless, within local government, budgeting and accounting have been divorcing.

In Portugal, the major changes have happened since 1990 as a consequence of a governmental accounting reform process at a national level. The new local government accounting system set in the 1999 PALG has been implemented, bringing financial and cost accrual-based accounting to be integrated with budgetary cash-based accounting. There has been, of course, great addition with the two new sub-systems; the budgetary accounting sub-system itself suffered some changes too (e.g. now uses double-entry), especially because the need of integration. Although each sub-system has clearly different functions, the leading role is for budgetary transactions to be recognised in the three sub-systems according to different stages and perspectives.

Therefore, the first reason we believe explains the "why" of both countries local government accounting systems, also elucidating on the importance of budgeting and its link (or not) to accounting, is **the local government accounting tradition and evolution process**.

Within the process of approximation to business accounting, in Portugal it was chosen to add to the single existent cash-based budgetary accounting, patrimonial[7] (financial) and cost accrual-based accounting, closely following the model for businesses (namely the PABA), without reducing the central role of the former. Additionally, the reform did not imply abandoning or replacing the fundamental rules and purpose of budgetary accounting: expenditures and revenues are still recognised on a modified cash basis (with commitments for future expenditures); the main purpose continues to be controlling the budget execution.

In the UK, there has always been a significant proximity between business and local government budgeting and accounting. Yet, more recently, within local government, there has been an increasing separation between budgeting and accounting, with budgets becoming essentially instruments for central government financially controlling local elected councillors (politicians) – authorisation for spending – totally apart from the accounting system, which therefore does not include controlling the budget execution within its purposes. This seems in fact a political issue, within the relationship between central and local government.

Furthermore, in Portuguese local governments, contrary to those in the UK, authorisation for spending is not given by central government. There is a political process at local level, totally independent from the central government (although similar to that happening there), through which the local budget is legally prepared and presented by the executive committee to the local legislature (local council – deliberative committee), to be discussed, approved and published at a certain time. Therefore, there is a political commitment from local politicians with the cash-based budgeted numbers approved (budgetary statements). This legal requirement is not (yet) extended to the approval and publication of any forecasted patrimonial (financial) accrual-based statements (e.g. forecasted Balance Sheet or Results Statement). On the other hand, local budgets are also authorisations for spending given by the council to the executive. These are still understood and recognised in terms of cash,

[7] This means accounting for all property or patrimony belonging or under control of each entity within the Local Government general regime, which implies that the so-called "public domain assets" (such as infrastructure and historical and cultural heritage) must be listed in the Balance Sheet and depreciated if that is the case. However, since by legal restrictions these assets cannot be sold or mortgaged to solve liabilities, the accounts under this sub-system are not presented in a financial perspective, following instead a patrimonial perspective, from which the term "patrimonial accounting" is derived.

in our point of view given the difficulties in comprehending the accruals concept by those non familiar with accounting, namely politicians. This does not mean that Portuguese local politicians are not concerned about costs (of activities or services) and efficiency, which is proved by the importance already given to cost accounting in the new local government accounting system (PALG). However, costs are still not considered in both local governments budgets and budgetary accounting.

Even so, local councils in Portugal have also to approve annual accounts that, given the traditional central role of budgeting, include cash-based budgetary information (budgetary statements reporting on the execution of both the budget and the investments multi-annual plan) together with the new added accrual-based financial information (financial statements reporting on the entity's financial and patrimonial situation, as well as on the annual economical result). The central role of budgetary information, which in practice still embraces the majority of each local government financial reporting, in our opinion, is due, on the one hand, to the aforementioned difficulties in understanding the accruals concept. On the other hand, it might also be justified by the legal mechanism underlying the budgetary process (from approval to execution). Because the law requires local councils to publicly approve and commit to only the annual budgeted cash-based numbers, these are those fundamental to be controlled through an equally reliable instrument: the accounting and financial reporting system, in particular the annual accounts, which are also required to be approved and published by a legal mechanism similar to the budget approval. Notwithstanding the inclusion of accrual-based financial statements in the accounts, these are still relegated in practice to second place (Carvalho and Jorge, 2003).

In the UK there is no use of law through which the local budget approval by the legislature is expressed. In fact, there is no separation between local legislature and executive. Additionally, local governments' budgets were traditionally inseparable from the accounts: budgeting and accounting integrated within the same system. Hence, it might be said that budgets have been important tools supporting local governments internal control and management, especially considering that local governments accounting used to mean always comparing budgets with actuals. On the other hand, local budgets are also authorisations for spending given by central government to local councillors. These have a political commitment to their main external financial resources provider – the Treasury –, which therefore has the power and responsibility for controlling the way they are applied (i.e. budgetary execution). Over the past thirty years however, it seems that the role of budgets as tools for internal management has been reduced, considering the increasing divorce between budgeting and accounting. Moreover, once budgetary control, though financial, tends to be of political nature, there is no need for accounts to report on the budget execution. Thus, budgeting is totally separated from the formal accounting and financial reporting system.

Consequently, another important factor in our explanatory theory concerns **the local government political structure and budgetary process**, in particular **the legal mechanism for the local budget approval and execution**.

Based on arguments presented in section 2, we also believe that another important factor explaining why local government accounting systems are as they are in Portugal and in the UK, concerns **the main purposes (uses) of the accounting information produced and reported**. As argued, these are strongly determined by **the information needs of the main users of the local government financial (eventually including budgetary) reporting**.

Subsequently, we argue that different purposes of local government financial (and budgetary) reporting also determine the importance of budgeting and budgetary control within the accounting system. Yet, in the users/users' needs approach, this is in the last instance conditioned by what users find as important to satisfy their information needs.

Considering that internal users are the same in both countries then, accounting information might be used for similar internal purposes. However, this is not the case with external users and their needs (purposes they require for the information included in the local governments financial and budgetary reporting). The relevant external users are legislative/deliberative committees (only for Portugal), oversight bodies, namely auditors (in Portugal specifically The Court of Accounts) and external financial resources providers (Central Government and outside government debt providers).

Accordingly, in the Portuguese local government accounting system, considering the arguments we have just provided for other factors important in our theory, budgetary information remains the most important because the main external users of local governments' financial reporting still find controlling the budget as the main role of the accounting and reporting system. These users are in particular deliberative committees, The Court of Accounts and, to a lesser extent, Central Government.

In the UK, empirical evidence (e.g. Jones, 1992, and Jones and Pendlebury, 2004) has showed that auditors and Central Government are the main external users of local government's financial reporting. Regarding the first, their major function is to provide an opinion about local governments' financial statements, in particular on compliance with the law and on the fair presentation. Therefore, they are not concerned with budgetary statements – budgetary information is not important for them. A different situation appears to happen with the Central Government, namely the Treasury: as main financier, it seems to have a special interest in controlling the budget execution. However, this rather statutory process of a political nature, aims essentially at financially controlling the local politicians, thus being totally separated from the accounting system. This is also related to the aforementioned mechanism of budget approval and execution.

Nevertheless, we may say that in both countries, budgeting somehow affects the way local government accounting systems work: even though this influence is clearly larger in Portugal, it also exists in the UK, in particular concerning the revenue budget and account.

As to financial (and cost) accounting in particular, it has been acknowledged the **proximity of the local government accounting system to that used in business accounting**. In our point of view, this might also answer why these (sub)systems are as they are in both countries: they have been following/adapting the business financial accounting system prevailing in each country. Since the business accounting systems used in both countries have some differences, these have been taken into local government accounting.

Accordingly, we believe some arguments presented in the literature for eventual differences in business accounting, might also be considered here. Picking up Nobes' (1998) perspective, one important factor explaining international differences in businesses financial reporting, which can be adopted to local governments, might be **the financing system prevailing in each country**, represented by the type of **outside government debt (external financial resources) providers**.

As highlighted, the prevailing financing system in Portugal is credit-based, while in the UK is capital markets-based. Despite the fact that the main (long-term) debt provider in the UK has been a central government agency, local governments are now returning to capital markets. Consequently, while banks are the main creditors in Portugal, in the UK, capital markets predominate as important financiers after Central Government. These financiers might be another category of external users of the local governments' reporting, making different information requirements, specifically to financial accounting.

Indeed, as explained, because local governments debt in Portugal does not seem to be default-free (though it might be seen as of low risk) lenders might have an interest in their accounts. Also in UK local governments, because default-free conditions seem to be changing, lenders might become possibly interested in their financial reporting information.

On the other hand, the proximity of local government accounting to business accounting in both countries (where lenders, both within capital markets and as creditors, have a especial interest in companies' financial statements to assess the risk) might lead us to consider that lenders would also be interested in local governments' financial reporting: they would have a particular interest in information regarding the entity's economic and financial situation and its capacity to repay the debt outstanding, thus not interested in budgetary information.

Moreover, the proximity to business accounting has also brought to local government accounting some particularities of the former, sometimes not so important within the latter context.

In the Portuguese case there are several examples of rules and procedures required in the PALG that were copied from the PABA that are not very relevant for local governments: R&D expenses, legal reserves, valuation criteria for stocks, among others. An outstanding feature is the patrimonial perspective: all patrimony, namely assets, belonging to the entity or under its control must be disclosed in the balance sheet. This explains the public domain assets (infrastructure and historical and cultural heritage); yet, unlike business companies, these cannot legally be used for the entity's debts/responsibilities, so the relevance of this disclosure is rather debatable.

Similarly, protecting the creditors seems to be amongst the purposes of local government financial reporting information in Portugal. In fact, as in businesses, local government financial reporting aims at showing a true and fair view of each entity's patrimony, financial situation and annual economic-financial result, in order to protect those with some special interest in it. In business accounting, those whose interests are to be protected are essentially creditors and tax authorities. In some cases, taxation rules still have a considerable influence over accounting rules. Although accountability for taxation purposes is irrelevant in the local government context[8], protecting the creditors was an objective carried from business to local government accounting (notwithstanding local governments creditors' need to be protected as well), which therefore also demands rules detailed by legal pronouncements, so as to benefit that purpose.

In the UK, the information prepared by the business accounting system does not address the creditors in particular, i.e. financial reporting embraces information more concerned with the prevailing equity-holders' needs, in that greater quantity and diversity of information (relevance) is emphasised, many times at the expense of reliability and accuracy. These features were also somehow brought into the local governments accounting context.

[8] Except in Municipal Business Companies, but these are not the issue here.

Finalising this section, we have, however, to acknowledge that local government accounting systems may be more or less different amongst countries because, in the last instance, sovereign independent democratic governments in each country have the ultimate power to decide on local governments budgeting and accounting rules, according to their will.

5. Summary and concluding remarks

In this paper we basically offered an explanatory theory for the "why" of local government accounting in a comparative-international perspective with the United Kingdom.

We have started presenting some ideas from the literature on comparative-international governmental and business accounting, which we believed as useful to support our theory building, namely because they were addressing possible factors for explaining eventual international differences in local government accounting systems features. From the discussion, in the line with Nobes' (1998) arguments, we came to the conclusion that "specific purposes of local government financial (and budgetary) reporting" seems to be one key reason for international major differences between local government accounting systems, as it is in business accounting. Nevertheless, that factor is strongly determined by "the main users of the financial reporting". On the other hand, the financing system predominating in each country, associated with the "external financial resources providers", is also very important in determining those purposes/objectives, the relationship being reinforced by the fact that external financial resources providers are actually users of the financial reports. Furthermore, some empirical evidence seems to show that for local government both in Anglo-American and Continental European countries, the main users of financial (and eventually budgetary reporting) are internal. As to external users, apart from external audit bodies, those who might be more interested in local governments' reporting seem to be financial resources suppliers that, as Nobes' (1998) also explains, are essentially equity outsiders in Anglo-American countries, while in Continental European countries tend to be fundamentally credit insiders, considering the degree of development of capital markets. Therefore, we finally have argued that "external financial resources providers" is one factor apparently prevailing over all the other factors as a fundamental issue to consider in explaining the major international differences in local government accounting.

We continued summarising a comparison between the Portuguese and the British local government accounting systems internal characteristics, which we have grouped in five broad categories of eventually distinctive criteria: 1) institutional framework; 2) budgeting principles and rules; 3) accounting recognition and measurement criteria; 4) form and contents of financial (including budgetary) reporting; and 5) financial (including budgetary) reporting information objectives. From the process we have highlighted several differences. However, in our understanding, not all of them are equally important, the most significant being: the cost of services provided, the accounting basis for budgetary accounting, the importance of budgeting and budgetary control, and outside government debt providers (associated to the financing systems prevailing in each country). Furthermore, we have argued that, notwithstanding these and other differences at a more detailed level – which will naturally be expected as intrinsic parts of different structures of both countries sovereign governments – at a broad level more commonalities than divergences seem to exist between the local government accounting systems prevailing in both countries, raising the question whether the international dichotomy of Continental European v. Anglo-American governmental accounting is valid.

Finally, we have provided an explanation – an inductive theory – in comparative-international perspective with the United Kingdom, for the Portuguese local government accounting. Our answer to the central question "why local government accounting system in Portugal is as it is, comparatively to the UK?" rests basically upon the following arguments, which we believe explain some of the most significant differences emphasised in section 3:

– Historical reasons – tradition and evolution process of local government accounting in each country;

– The local government political structure and budgetary process (legal mechanism for the local budget approval and execution);

– The users of local government financial (including budgetary) reporting information and their needs (purposes of the local government financial reporting information);

– The proximity to business accounting;

– The financing system predominating in each country.

While all of them apply to both budgeting and accounting (sub)systems, the last two are specifically related to financial accounting.

The main limitation acknowledged in this study relates to its theoretical character. In fact, although the explanations discussed are empirically based, we evidently recognise that they are very debatable, meaning that they are unfinished questions needing further research. Summing up, the main open issue in this explanatory theory is that it needs to be empirically tested to be validated. Therefore, empirical work should be carried out, eventually embracing other countries, both European and Anglo-American, and also central government.

Although the comparative discussion here has focused on two specific (yet representative) cases, we believe the analysis can be extended to other countries, so as complementing comparative international governmental accounting research (CIGAR).

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