**THE CONCEPT AND THE ROLE OF BUDGET IN PUBLIC SECTOR**

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***Abstract***

Sistem anggaran pada sektor publik atau sistem anggaran pemerintah mengalami perubahan yang cukup mendasar dalam beberapa tahun terakhir ini. Paper ini bertujuan untuk membahas secara mendasar mengenai perkembangan teori tentang anggaran (*budget*) dalam organisasi sektor publik (*public sector organization*) dan implementasinya di negara-negara berkembang. Permasalahan mendasar dalam mengimplementasikan sistem anggaran tersebut adalah sulitnya mendifinisikan dan mengukur output pada publik sektor. Hal ini disebabkan karena tujuan dari organisasi sektor publik adalah beragam (*ambigous*) dan output seringkali tidak terukur (*not measureable*). Karena itu, berdasarkan pengalaman dari beberapa negara sedang berkembang ternyata penerapan sistem anggaran tersebut tidak berjalan sesuai dengan yang direncanakan.

Keyword: Anggaran, Organisasi Sektor Publik

**INTRODUCTION**

The fundamental problem in public sector organizations, especially in developing countries is the weakness of planning and control in the budget process. Therefore, the budget has become one of the most important tools in the managerial planning and control cycle of public sector organizations. In this case, Wildavsky (1975, p.136) argues that "budgeting provides an accounting for past expenditures and revenues, controls current spending and revenues, and forecasts of the future". It helps to determine the effectiveness of expenditures and allocates resources accordingly. In addition, Jones & Pendlebury (1996, p.27) suggest that the "budget can provide a target of operational effectively and efficiently by detailing the inputs deemed necessary to produce the special output". Even, for the less 'commercial' public sector organizations measures that partially reflect outputs could be included in the budget.

This paper will describe the theoretical aspects of the budget in public sector organizations. The first part explains the concept and definition of a budget. The second section is concerned with the role of the budget, and the last section of this chapter will focus on budgeting techniques.

**CONCEPT AND DEFINITION OF THE BUDGET**

 The budget is a major issue in all organizations in public sector accounting. Budgeting is a universal and essential activity of governments. It is the key to planning and control at all levels of government activity. There are many definitions of a budget. According to Houghton and Wallace (1980, p.41) "A budget is a financial plan for the future". Another definition that seems to be more appropriate for public authorities is that stated by CIPFA (1986, p.1) that "a budget is a financial and quantitative statement prepared prior to a defined period of time of the policy to be pursued during the time for the purposes of attaining a given objective". According to Coe (1989) a budget is a projection of future revenues and expenditures and can also be viewed as a plan for spending and receiving funds.

From these definitions above, it is clear that the terms budgeting and planning are closely inter-linked and that the budget is the expression, in financial terms, of an authority’s policies over the period covered by the budget. It also constitutes a statement of intention against which achievement can be compared. A similar statement has been made by the United Nations (1976, p.19) that "A budget is an allocation of resources prepared in advance, relating to a future period, based on a forecasts of a key variables, adopted to achieve certain policy objectives; relates anticipated expenditures to anticipated revenues and forms a basis against which actual expenditures and revenues can be measured and controlled. Jones & Pendlebury (1993, p.50) have supported this definition by emphasizing the aspect of planning and control in the budget that " the budget provides the essential links between planning and control". In planning, the budget is expressed as the input needed in monetary terms to achieve a series of planned targets and activities within the budget period. In control terms, the budget is prepared to show clearly the inputs and resources.

Wildavsky (1978) defined a budget as a document, containing figures that propose expenditure for certain items and purposes. The words describe types of expenditure (salaries, equipment, travel, etc.) or purpose (preventing war, providing clean water and education), and the figures are attached to each item. A budget therefore constitutes the drafting of a statement in financial terms of the programs of activities of an organization for the coming year. Hence, a budget is closely related to the authorization of programs for their implementation towards the achievement of an organization's objective. In addition, Wildavsky (1975) stresses that a budget is also a statement about the future, and it attempts to link proposed expenditures with desirable future events. Therefore, budgets must be planned to determine future states of affairs, through a series of current actions. Furthermore, a budget also serves as a management plan for the government. The budget is considered the most essential tool of management for the purpose of carrying out organizational objectives, practices and structure and as an instrument for planning, analysis and control.

**THE ROLE OF THE BUDGET**

From the definitions of a budget above, a budget can be seen to play several distinct roles. They may be designed to accomplish a number of purposes. Otley (1987) categorized these different purposes and roles of budgets into five broad groups; authorization, forecasting and planning, co-ordination and communication, motivation, and performance evaluation. Meanwhile, Jones & Pendlebury (1996) pointed out that the main functions of the budget are determining income and expenditure, assisting in policy making and planning, authorizing future expenditure, providing the basis for controlling income and expenditure, setting a standard for evaluating performance, motivating managers and employees, and coordinating the activities of multi-purpose organizations. Wildavsky (1978) asserts that the purposes of a public sector budget are accountability, control, as mechanisms of efficiency and effectiveness, and as an instrument of economic management and planning.

Premchand (1983), on the other hand, mentions that the purpose and associated features of budget are as a tool of accountability, as a tool of management, and as an instrument of economic policy. The budget, as an instrument for accountability, means that government agencies are responsible for the proper management of funds and programs for which funds are appropriated. It is a tool of management, because a budget specifies the cost, time, and nature of the expected results. Furthermore, the budget as an instrument of economical policy indicates the direction of the economy, expresses intentions regarding the utilization of a community’s resources, and promotes economic growth, and balance in the national economy. Coe (1989, p.59) describes four purposes for a budget, as a policy document, an operations guide, a financial plan and as a communication device.

In relation to the stages of management, Goode (1984) asserts that the purpose of a budget is as a framework for policy formation, a means of policy implementation, a means of legal control, and a source of public information on past activities, current decisions, and future prospects. The first purpose requires decisive action to attain objectives and the adoption of selected proposals to further particular national objectives. The budget as a means of policy implementation needs the implementation of economy and efficiency standards. Moreover, the budget as a means of legal control means that budget decisions should be in conformity with legal requirement. The last purpose of a budget, as a source of public information, requires the executive and legislative branches of a government to explain and justify their decisions and actions.

From some purposes of budgeting techniques stated above, there may be different views between countries about which purpose is relatively more important and which is less important compared with other purposes. Jones & Pendlebury (1996) mentioned that the main purpose of the budget in practice is to emphasize the budget's role in the cycle of planning, control and accountability. This is because the budget is the financial plan against which financial out-turns must be compared to effort control. However, in the context of developing countries i.e. Indonesia and Malaysia, the budget as an instrument of economic policy may be the most important view. The main objective of most developing countries is to create an equitable and prosperous society. This objective would be achieved if the government budget could allocate and distribute public resources properly, and stabilize the national economy.

The second most important aspect of a budget is as a means of legal control. This purpose is closely related to accountability. The process of budget formulation and execution should be appropriate to the legal requirement. Hence, this function is aimed at preventing the improper use of public funds and directing the use of funds which are authorized and appropriated for designated activities. In the case of developing countries, the abuse of power, corruption and improper use of public funds are often carried out by government officials. This deviation could be prevented if the process of budget formulation and execution was in line with the legal requirement. Rubin (1996) mentions that a budget oriented to accountability not only has more and different kinds of information in it, but it is also closely related to actual events. This means that it is not just a policy statement without much concern for implementation.

The budget as an instrument of economic management and planning is the third most important use. Most developing countries, generally, have faced some problems such as unemployment and inflation. These problems could be overcome if the government had the ability to manage the economy through varying the rate of public spending in order to achieve efficiency. The failure to plan the economy seems to have been equated with the apparent failure of the government to utilize its resources judiciously and efficiently.

The fourth importance is the budget as a tool of accountability. Government should clarify the budget presentation either in relation to expenditures, revenues or the officials responsible. This clarification is important to give information to parliament and the public, and also to avoid the questions and criticisms which may emerge in relation to the budget presentation. Hence, the public could understand the government's policies and activities clearly.

The least important aspect is the budget as a means of use of the co-ordination. Because the budget lists the officials responsible, some of them could coordinate with each other in implementation to raise effectiveness and efficiency. Hence, the budget should demonstrate the interdependence of the various budgeting units in order to eliminate or minimize incompatibilities and conflicts in its implementation.

**THE BUDGETING TECHNIQUES**

The conceptof budgeting techniques have been developed to improve the budget process by strengthening links with planning, strategic choice, accounting, execution and evaluation. This section will briefly discuss these budgeting techniques: Traditional Budgeting, Planning Programming and Budgeting System (PPBS), and Zero-Base Budgeting (ZBB).

***a. Traditional Budgeting***

Wildavsky (1978, p.502) mentions that "traditional budgeting is annual (repeated yearly) and incremental (departing marginally from the year before)". It is conducted on a cash basis in current dollar. It is also in the form of line-items such as personnel or maintenance. This system is essentially a financial plan of estimated expenditures expressed in terms of kinds and quantities of objects to be bought and the estimated funds needed to finance them during a specified period, usually one year (Babunakis, 1976).

The traditional budgeting system, therefore, provides a means for national governments to promote accountability with regard to the utilization of funds and to ensure every expenditure matches the original plans. It serves as the basis for establishing the financial accounting procedures and controls required to meet defined accountability and compliance requirements (Kenneth S. 1978). In modern times, traditional budgeting has also become an instrument of economic management and of planning (Wildavsky, 1978).

Furthermore, one of the main characteristics of this type of budget is that its stability of allocation, not only in absolute allocation but also in proportional terms, the marginal increments due to inflation or other consequences, is relatively constant from year to year. The main features and purpose of this approach are central financial control and accountability. At present, most developing countries use traditional budgets system that are based upon 'classical rules' which adhere to the principles of centralization, vote accounting, the gross budget principle, annuality and specification (Jones & Pendlebury, 1996, p.5).

However, there are considerable criticisms of traditional budgets. One of the fundamental weaknesses of the budgetary process is the use of the revised current year estimates of revenue and expenditure as the starting point for determining the budget for the next year (Jones & Pendlebury, 1996). The traditional budget is concerned with inputs rather than outputs. This means that traditional budgets do not provide a means of making policy and resource choices, and monitoring performance. As the traditional budget has failed to relate purpose to cost, it was thought to be ineffective as a tool for making economic decisions.

The second weakness of traditional budgeting is that there is an insufficient relationship between the annual budget and longer-term development plans. This is because incremental budgeting stresses short-term objectives and neglects the long-term nature of government planning and objectives. Thus, it can't solve the problem facing developing countries, in particular it can't allocate limited resources among competing needs, and to realize the formulated plans.

The third weakness is that centralization of budget preparation and rigid departmental divisions makes it difficult to achieve overall national objectives, to deal with conflicts and overlaps and gaps between departments. Single-year budgeting and the incremental approach often result in wasteful spending of money at the end of the fiscal year, thus economy suffers. In addition, an incremental approach means that the bulk of expenditure is never properly examined. Performance is measured by whether funds have been spent and not whether objectives have been achieved.

Finally, the separate budget process for recurrent and capital or routine and development expenditures may be arbitrary, impeding proper evaluation of services, their needs and their costs as a whole. In many developing countries, capital expenditure may be seen often erroneously, to be of greater developmental value than recurrent expenditure e.g. new buildings versus paying teachers or maintaining roads.

However, the traditional budgeting system has benefits. It is simple, easy to control and it reduces conflicts. According to Aronson (1981, p.99) it ensures that the legality, public trust, probity, financial responsibility and solvency of local governments is maintained at all times by utilizing the budgeting principles of comprehensiveness, unity, accuracy, clarity, and publicity. Jones & Pendlebury (1996) mention that 'the most important reason for using incremental budgeting is that many of the activities carried out in previous years are either mandatory, or are so fundamental to meeting organization goals, that they will have to continue year in year out'. They argued that "it seems sensible, therefore, to concentrate only on the changes from the previous year, because these might be all that are controllable. Wildavsky (1984, p.13) states that:

"The budget may be conceived of as an iceberg with by far the largest part below the surface, outside the control of anyone. Many items in the budget are standard and are implied re-enacted every year unless there is a special reason to challenge them."

The second reason for using incremental budgeting is that it concerns the complexity of the budgetary process (Jones & Pendlebury, 1996). They argued that "the limits on decision makers' knowledge, information, and cognitive ability mean that aids to calculation such as incremental budgetary are necessary". By concentrating only on new programs, or changes in existing programs, the information that has to be gathered and analyzed can be limited to that which humans can process and evaluate.

Another reason for using incremental budgeting is that it narrows the area open to disputes, thereby reducing conflicts (Jones & Pendlebury, 1996). They argued that "by focusing on incremental changes, arguments over budgetary allocations are confined to relatively small amounts. The vast proportion of the annual budget allocation is undisputed".

***b. Planning Programming Budgeting System (PPBS)***

This system was developed in the private sector, then transferred to public and non-profit organizations in the early 1960s. It was adopted by the US Department of Defense, and extended to all Departments of the Federal Government by President Johnson in 1965. It was implemented, or at least experimented, with in many state and local governments, both in the USA and the UK.

The new budgeting system is capable of making a major contribution to achieve efficiency in the allocation of resources. Thus, it will increase the benefits derived from the government's many activities. In addition, it is a comprehensive financial planning and management system in which alternative ways of providing public services were evaluated and decisions made using sophisticated analytic techniques (Caldwell, K, 1978, p. 12). He argues that PPBS provided the opportunity to introduce program budgeting and cost accounting into the planning and budgeting process. However, in relation to the budget at least, no one really identified and focused on the related program accounting requirements.

The primary purpose of PPBS is to ensure that "the limited resources are allocated in such a way that they will produce the greatest beneficial impact on the overall objectives" (Jones and Pendlebury, 1996, p.70). PPBS is a model aimed at helping management make better decisions on the allocation of resources among alternative ways to attain government objectives (Aurora, 1982). In considering PPBS it is necessary to distinguish between program structure and program analysis that might be undertaken to achieve these objectives (Jones & Pendlebury, 1996). The program structure provides the framework for linking resources and activities to objectives. In this case, PPBS involves cutting across the normal organizational structure so that the appropriate inputs can be drawn together. Meanwhile, program analysis is concerned with the analysis of the costs and benefits of each program so that choices can be made (Jones & Pendlebury, 1996). Colville (1989) has stated that PPBS could require a well-developed cost-benefit analysis or cost-effectiveness appraisal system to take account of expected/planned changes in activities. The consequence of this concept is that the output of each program must be measured in a manner that captures the entire beneficial impacts of the program.

From the above discussion, it can be concluded that the main concept of this technique is that it is primarily concerned with the need to focus on programs of activities rather than departments in planning and budgeting. This means that it was focusing on outputs rather than inputs, and outputs must be measured. As Hofstede (1981, p. 205) states that PPBS represents the idea of 'product management' that assumes that the outputs are measurable. Nevertheless, in measuring the outputs in public sector and non-profit organizations there are serious practical difficulties to be overcome. This is because, it is difficult to define the objective and to measure it. For example in service-oriented organizations such as education, health and environmental benefits. Moreover, Jones and Pendlebury (1996, p.77), argue that "they even if definable, are rarely measurable, and the effectiveness of particular activities in meeting needs can only be judged in very subjective terms".

The other criticism is that the objectives are ambivalent. Hofstede, as cited by Jones and Pendlebury (1996, p.77) argues that "attempts to implement a system of PPBS under such circumstances would represent a fundamental error in the choice of Management Control Models". He points out that the appropriate control model where objectives are ambiguous and outputs non-measurable is 'political' control. Politicians, generally, prefer to state goals as vague as possible. Premchand (1983, p.328) states that "goals are in the nature of political ends and cannot be considered in terms of technical means". Therefore, clearly the objectives considered by the techniques of PPBS are not ultimate ones purpose. In this case, Jones and Pendlebury (1993, p.75) state:

"Even the correct determination of costs is not as straightforward it may at first seem. Many activities are multi-purpose nature and it is not always obvious how the costs of such activities should be allocated to particular 'output categories."

For example the libraries service of local authority may exist to fulfill both the educational needs and the recreational needs of community. An allocation of costs between these two aspects would often be extremely difficult to make. They point out that for many public sector organizations PPBS might, therefore, be thought of as just one more example of a technique that is consequently sound. This is because of practical limitations, and improbability of satisfactory implementation.

Furthermore, Wildavsky, as cited by Jones and Pendlebury (1996, p.77), F.Jablonsky and W. Dirsmith (1978, p.215) state that "PPBS has failed every where and at all times. Nowhere has PPBS has been established and influenced governmental decisions according to its own principles". Jones and Pendlebury (1996, p.78) argue that "PPBS has failed not because of the absence of sufficient data, or measurement techniques, or lack of adequate training, but because of a more fundamental deficiency". Caldwell (1978) argues that the introduction of PPBS has not been successfully everywhere, because of largely misunderstood concepts in an environment which has traditionally been resistant to change and with little consideration of the practical realities involved. As a result, PPBS became a theoretically sound, but operationally impractical way to plan, budget, account for and manage a government's finances. Jones and Pendlebury (1996), argue that PPBS might not work because orthodox planning approaches and cybernetic management control models are not always appropriate for public sector activities.

***c. Zero-Base Budgeting***

Before transferring to public sector and not-for profit activities, Zero-Base Budgeting (ZBB) originated from US private industry. As Pyhrr (1977) asserts ZBB is an emerging process which has been adopted by a variety of industrial organizations in many sectors of the economy, as well as by the state and local governments. ZBB attempts to shift the traditional management approach of the public sector budget process towards a new mode of thinking. ZBB is designed to serve principally as a management tool, but it can also serve to control agency expenditures (Mueller, 1981). In addition, ZBB can be integrated into a more comprehensive policy making process that includes, budgetary planning and management systems.

ZBB is the most radical alternative to incremental budgeting system. It is not only designed to serve principally as a management tool, but it can also serve to control agency expenditure. David Wise (1988) states that ZBB was designed to deal with the problem of budgeting when clear relationships between inputs and outputs are lacking. Its principle is that a budget is made for one year and at the end of that year a new budget must be built from zero. Jones & Pendlebury (1996) state that "the mechanics of zero-base budgeting require that all the functions of an organization are re-evaluated annually from a zero base". However, in terms of budgeting for large complex organizations this is an inconsiderable case.

Furthermore, ZBB is another budgeting technique which was developed specifically for input centers or expense centers. Hofstede (1981,p.206) argues that this technique can be used for operations budgets for input centers in management control. These expense centers that expenses are measurable when the expenses of a responsibility center but not the monetary value of outputs (Jones & Penlebury, 1996, p.31). They point out:

"This is typically the case for public organizations where outputs obviously exist but are either not measurable at all, or is measurable in physical but not monetary terms."

The basic concept of ZBB is that the budget for input centers is allocated by activities (Hofstede,1981, p.206). All activities, regardless of whether they are new or existing, should be justified in their entirety each time a new budget is prepared (Sarant,1978, p.3). They should also be computed into the level of expenses and started from zero level.

Theoretically, the basic component of ZBB is the decision package. While, activity decision packages are designed to describe the basics of any agency in some detail. As a budgeting process, ZBB is a planning and control mechanism and it includes the elements of objective setting, operational decision making, and evaluation. According to Phyrr (1977) its approach is generally characterized as a bottom-to-top communication process that involves two basic steps. The first step is one of differentiation; discrete activities for decision units are analyzed and developed in the form of decision packages within the context of a minimum level of effort (usually below the current level of expenditure). The second step is one of integration; all decision packages are ranked, first within each decision unit, and then vertically across all decision units in the organizational hierarchy. The ranking procedure can be accomplished through cost-benefit analysis or subjective evaluation (Phyrr, 1977).

Meanwhile, Worthley and Ludwin (1979, p.2) mention that ZBB requires that all activities would be identified in decision packages, which are to be systematically analyzed and ranked in order of importance. The ranking process of these activities is concerned with the desirability and availability of resources and tries to establish priorities among these activities. However, since these activities are ranked on the basis of the actual available level of resources, the limited resources may determine the cut-off point beyond which activities will not be funded (Hofstede,1981, p.206). This indicates that at the highest level top management does not need to rank all the organization's decision packages, but only a cut-off level. In this case, Jones and Pendlebury (1996, p.92) state that "this cut-off technique means that we are left with a budgetary process which bears little relation to the concept of zero base budgeting". They point out:

"The behavioral consequence resulting from the use of cut-off techniques must not be overlooked. A system which ensures that all decision packages above some cut-off point are accepted without further scrutiny at higher levels in the ranking hierarchy, might well lead to ranking low priority 'pet' programs above priority and essential programs."

To overcome such undesirable strategies, Jones and Pendlebury (1996) suggest that it should be required not only to establish well-defined criteria for ranking programs, but also to introduce some means of monitoring the adherence to such criteria.

As a practical matter, zero-base budgeting has many potential advantages over other budgetary systems. According to Jones and Pendlebury (1996) the primary advantage of zero-base budgeting is that, unlike incremental budgeting, it does not assume that last year's allocation of resources is necessarily appropriate for the current year. ZBB can be said to produce, in a readily accessible form, more and better management information. A typical comment of managers in the State of Georgia reported by Lauth (1978) is:

"Zero base is a useful management control device. The forms require people to organize and develop their information. Managers are better able, I think, to make decisions on the basis of an improved reporting system."

In this case, ZBB can provide the framework for the design of integrated planning, budgeting, reporting, accounting and evaluation systems. ZBB also can be used to supplement or reinforce existing budgetary planning, and management systems. Jones & Pendlebury (1996, p.91) argue that "the zero base budgeting process forces managers at all levels to identify their specific objectives, to quantify them, and to evaluate the cost effectiveness of the alternative ways of achieving them". They believe is that this improves the quality of management's decisions.

In order to improve management information, ZBB also involves the participation of lower level management in the budgetary process and the smaller the decision units the greater this involvement will become. This increased participation is beneficial; again, from a manager in the State of Georgia:

"I like zero-base. We used to make up the budget in this office with very little communication with the operating people. Now the budget format makes us reach to the lowest levels for information that has advantages for everyone even beyond putting together a budget".

From the above discussion, it seems that zero-base programs have been successful in increasing management participation in the planning and budgeting process, encouraging cost effectiveness, eliminating inefficiencies, and allowing more flexibility in decision making. However, ZBB also forces management to abandon traditional budgeting practices and accept an entirely different approach to resource allocation.

Another advantage for zero base budgeting is that unexpected events that occur during the financial year can be more readily adjusted for. This is because the basic information for modifying goals has already been generated. Although some advantages that have been claimed for zero-base budgeting system there are considerable criticisms too. Wildavsky and Hammond (1985) as cited by Jones and Pendlebury (1996, p.92) mention that 'although the technique is conceptually sound, its fundamental disadvantage of ZBB is that it 'vastly overestimates man's ability to calculate'. This is because the decision package approach was developed. However, even with this development the number of decision packages that a complex organization will generate effectively precludes an annual zero base review for all functions.

A further disadvantage of ZBB is that its involves the development of numerous decision packages. As a result, the administrative burden increases for those involved in the budget preparation. The procedures applied to zero-base budgeting are highly structured and formalized. Thus in practice, it needs highly skilled participants to formulate the budget.

**CONCLUSION**

The functions of a budget are used in order to determine revenue and expenditure, form and implement policies, provide public information and to ensure legal control. In addition, the economic consideration indicates that the budget has some functions such as in allocation, distribution and stabilization.

The role of the budget depends on the budget system which has been supported by the budget structure and classification. The rapid increase in public spending and complexity in government activities have made managerial functions exceedingly difficult. As a result the traditional budgeting system that was adopted could not respond to these variables in order to ensure efficiency and effectiveness in implementing development plans. Thus, the alternative budgeting techniques Planning, Programming and Budgeting System and Zero Base Budgeting developed.

However, the implementation of Planning, Programming and Budgeting System (PPBS) and Zero Base Budgeting (ZBB) in the public sector organization have apparently been difficult, and the experience has been disappointing. The main problem in implementing these budgeting systems is that, it is difficult to define the objectives, and measuring the outputs. This is because objectives are ambiguous and outputs are not measurable. Since, in government activities, the objectives are usually ambiguous, and ultimate outputs are not measurable, the effects of interventions are unknown and activities are often repetitive. Therefore, these budgeting models do not work. In other words, they could not bring about a change in the functioning of planning and budgeting.

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1. Dosen Fakultas Ekonomi Universitas Andalas [↑](#footnote-ref-2)