INFLUENCE OF BUDGET EFFICACY ON HOUSEHOLD EFFECTS IN KENYA

Cyrus M Munyua[1] Karatina University o Box 1957, Karatina

Email: cmmunyua@gmail.com Mobile: 0715-951-054

ABSTRACT

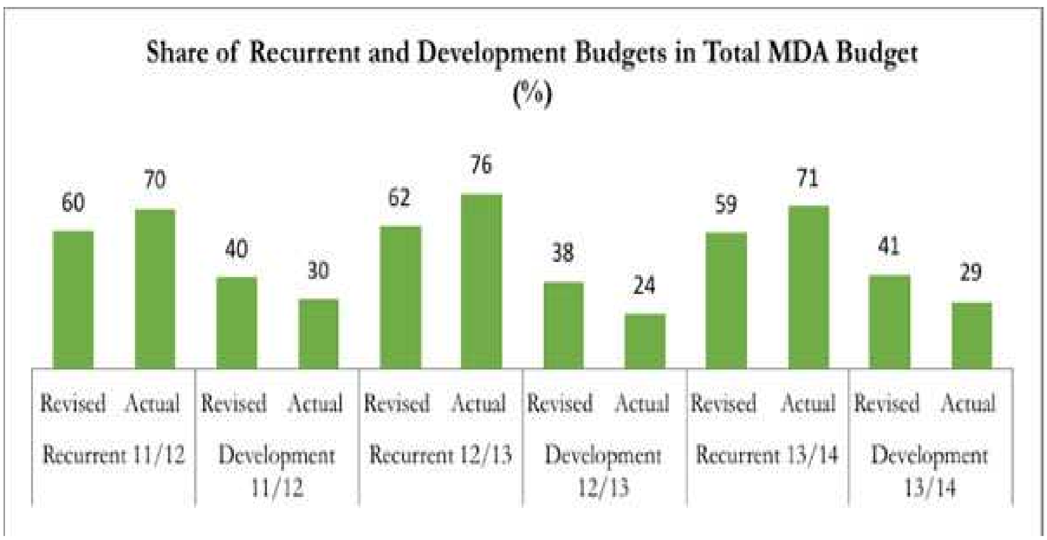
The purpose of this study is to find out whether Budget Efficacy influences household effects under Fiscally Decentralized economy as it is today in Kenya. The study was anchored on the theory of fiscal federalism and Agency Theory and adopted a positivist research philosophy in determining the research strategy and method of this strategy. A Census involving the 47 county governments was conducted based on population size, nature of the county i.e rural or urban set up and size of the annual budget support from the national government. The Study adopted the Survey and Evaluation Program (NASSEP V) frame that the Kenya Bureau of Statistics currently operates to conduct household-based surveys to also conduct a household survey in the county governments on household effects in Kenya. The study employed an inductive ex post facto cross sectional quantitative survey design. Secondary panel data was collected from County Treasuries while Primary data was collected through household surveys and Fiscal and Monetary Departments of county assemblies. Data for the period 2015-2017was used to run an univariate and multiple regressions using STATA software. Both descriptive and inferential statistics were generated and provided results for interpretation. The study established a significant association between budget efficacy and household effects. The findings of this study are expected to empower citizens through access of information on the real meaning and effects of fiscal asymmetric decentralization while policy makers will know the strength of the correlation between fiscal asymmetry and household effect in order to match monetary policy with the needs of lower government levels for implementation of the country's financial framework.

Key Words: *NASSEP V, Budget Efficacy, Household Effects, Positivist Philosophy, Fiscal,Policy,Actual Expenditure*

1.0 Introduction

The basic objective of budgeting is to give those targets and plans financial values, hence making an early progress in an easily measurable manner to transform the strategic ideas into understandable operative actions. Although recent literature indicates diverse meaning and definitions of the word budget, budgeting has been around as long as money existed and is often attributed to the British monarchy in the 1700's. The parliament of the British monarchy was put in place to establish some form of check and balances although that time; budgeting was mainly self-serving. The first control was put on the military so that the King could not create a force to overthrow the parliament. However, much of the laws were rarely written down and there were no regular review or any auditing or reporting. The expansion of the budget introduced the idea of a true budget and hence brought about more accountability and control (Hanninen, (2013).

Budget reforms have been undertaken not only in Kenya but also in Ghana, Malawi and Mozambique but researchers have postulated the difficulties faced by government staff due to political governance and budget politics which affect the functioning and reform of public financial management systems. A fundamental problem in analyzing Fiscal policy is analyzed by determining the intended recurrent vs development budgets and comparing these to the actual expenditure pattern at both national and county levels.



(source: Institute of Economic Affairs)

Studies have indicated important gap between formal systems and informal practices, such as clientelism, patronage and rent-seeking. They further reveal that dysfunctions and distortions occur at all stages of the budget process. This paper underscores the importance of budgeting and undertakes to find out the influence of budget efficacy on household effects in Kenya

Household and Income Inequality:

A household may be defined as a unit consisting of one or more people who live in the same dwelling and also share meals or living accommodation, and may consist of a single family or some other grouping of people. A household effect therefore refers the basic unit of analysis in many social, microeconomic and government models, and is important to the fields of economics and inheritance . A County government with a high population of poor people largely contributes to the national poverty index. Kakamega County which was ranked the highest among poor counties in Kenya has an index of 4.77% and contributes to the national poverty index 25 times more than Lamu County which has a 0.19 poverty index (GOK 2014)

Households are the owners of the factors of production and are therefore likely to be affected by Fiscal policy shocks. The welfare of individuals can therefore be affected by fiscal decentralization which transfers the financial responsibilities from the national government to the county government. This agrees with the key economic rationales for decentralization advanced by Musgrave (1959) and Oates (1972), who argue that decentralization may improve governance in public service provision by improving the efficiency of resource allocation. In this vein, many developed countries have increased their degree of fiscal decentralization. Europe is on top of the already federalized Austria, Germany, and Switzerland, Belgium, Italy, and Spain have recently introduced widespread reforms in order to enhance regional autonomy (Ezcurra and Rodriguez-Pose 2010).

Reforms that have taken place in Kenya includes the decentralization of Revenue and Expenditure which is anchored on the Constitution of Kenya 2010 and supported by various Acts of Parliament, which guides the implementation of the constitution. The provision of public goods and services is informed by Article 201 and regulated by the Public Finance Management Act 2012, which sets the principles of management of public service and emphasizes on public participation as a requirement in budget formulation (Wakiriba, J. W., Ngahu, S., & Wagoki, J. 2014)

1.2 Problem Statement

The importance of Fiscal Policy as a tool on income redistribution and resource allocation has been emphasized by a number of scholars such as (Bastagli, Coady, and Gupta, 2012) and subsequently broadened by International Organizations like the world Bank and IMF. Accordingly, Kenya has increased her annual budget and devolved her fiscal responsibilities from the national government to the 47 county governments and expanded revenue collections with a view to reduce household income inequalities and hence improve the living condition. Government spending has gone up by two-thirds, from Sh1.6 trillion in 2013/14 to Sh2.64 trillion in 2017/18. Government borrowing has also increased from Sh1.7 trillion in 2013 to Sh4.4 trillion in 2016/2017. Despite the above mentioned tremendous economic outturn, Poverty only declined marginally, from 56.5 % in 1990 to only 48.5 % in 2010 far below the

28.2 % target by 2015, according to the World Bank (Blanchard, O. J., Jaumotte, M. F., & Loungani, M. P. 2013).

This study therefore takes cognizance of the fact that all fiscal policy is important in income distribution and key to fiscal decentralization. Although devolution is still new in Kenya, five years is sufficient to notice a change in the welfare of people in a devolved unit and especially given the amount of money that has been disbursed to county government during the last four years. Fiscal Policy as a control tool is the ideal image to view the effects of decentralization by interrogating the government's fiscal policy in order to answer the study question whether Fiscal Policy influences household effects in Kenya

1.3 Objective of the Study

The general objective of this paper was to find out the influence of Fiscal Policy on Household Effects in Kenya.

2.0 Theoretical literature review

The Theory of fiscal federalism and the Agency Theory underpins this study. The section also explores the broad literature on fiscal decentralization, Revenue and expenditure responsibilities, size of government and service delivery and the views of various academicians and practitioners. It will be expedient to note that fiscal decentralization is viewed in this study in the context of fiscal autonomy and the extent to which it impels household effects of individuals in devolved governments

The Theory of fiscal federalism

The theory of fiscal federalism was propagated by Oates W (1956). It is associated with decentralization of expenditure responsibilities and centralization of revenue responsibilities for the purpose of achieving 'efficiency' and 'equity' in the federation, which is core to this study. The Theory emphasizes the importance of transfers for addressing the problems of vertical and horizontal imbalances. It is largely normative and assumes that federal and sub-national decision-makers are 'benevolent' and maximizes the social welfare in their operations.

The Theory is also intertwined to the second-generation theory (SGT), especially the theory of market-preserving federalism which assumes that public officials have goals induced by political institutions that often systematically diverge from maximizing citizen's welfare.

However, unlike the FGT which emphasizes on the importance of transfers for mitigating vertical and horizontal imbalances, the SGT gives more importance to incentives generated by sub-national tax collection for fostering economic prosperity. The SGT has had significant implications for the design of transfer systems so that equalization goals can be achieved without diminishing the incentives of public officials to foster thriving sub-national economies. In brief, the SGT is in favor of decentralization of both expenditure and revenue responsibilities; and it gives minimal role to revenue-sharing and inter-governmental transfers. Moreover, it also posits that 'inter-jurisdictional competitions', a 'common market' and 'hard budget constraints', may provide protections against infringements to market operations. The SGT is an emerging theory. Though it approaches the fiscal federalism from different perspective, the SGT does not challenge but complements the FGT which informs this study.

Allocation of Resource Theory

The allocation of resource theory was propagated by Rubin (1990). It is asymmetrical in nature in that it posits normative and descriptive Theories. Financial policy is critical and therefore requires a normative approach in its policy formulation. The Theory also explains why some corporate perform better than others and why some budget items are given more priority compared to others. The normative theory, is generally accepted that it is associated with how nations decentralize expenditure responsibilities and centralization of revenue responsibilities for the purpose of achieving 'efficiency' and 'equity' in the federation, which is core to this study. The Theory emphasizes the importance of transfers for addressing the problems of vertical and horizontal imbalances. It is largely normative and assumes that federal and sub-national decision-makers are 'benevolent' and maximizes the social welfare in their operations. The World Bank (2012) recommends that guidelines and templates need to be developed to guide the formulation of county budgets. More so the World Bank advocate for a country-wide chart of accounts for preparing, executing and reporting the budget. In addition to this, the counties would be expected to develop adequate PFM, Human resource and service delivery capacity. Further the Bank postulates that this can only be realized if choices made are translated into spending hence the need to strengthen planning and the budget process. On the contrary, this is not being fully implemented as reflected in the 2013/14 national budget preparation process where only a few people from selected counties were consulted, which is far below the stipulations in the PFM (Mugambi, K. W., & Theuri, F. S. 2014).

Agency Theory

The Agency Theory arises from a working relationship where one party enters into an agreement to act in the place of a principal. The agent is often tempted to engage in personal interest without reference to the interest of the principle. Agency problem originates from the divergent of as advance by the principle and his agent. The Theory is an attempt to on how to mitigate this problem (Jensent and Meckling 1976). County governments in Kenya receive their allocation from the national government and also collect revenue from their locality, while incurring both recurrent and development expenditure. The public although they participate in the budget process do not have oversight authority, which is vested the elected leaders but unfortunately are also implementers of the county projects. The Kenya National Audit Office who are vested with the audit of county finance are also state agents, hence the principle does not directly involve in county treasury management, hence the choice of this theory in the study is paramount (Hearn, J. J., & Phaup, M. 2016).

Empirical literature review

Budget Efficacy.

Budgeting has been defined as the basis of the management control process in organizations (Hansen et al, 2003) and also traditionally described as a common accounting tool that organizations use for implementing strategies (Ostergren & Stensaker, 2011). The basic objective of budgeting is to give those targets and plans financial values, hence making an early progress in an easily measurable manner to transform the strategic ideas into understandable operative actions (Hanninen, (2013).

Olomola, (2009), postulate that a budget is not only used for mobilization and resource allocation but also the budget does not only function as a mechanism for resource mobilization and allocation, it also serves as a tool for economic management. This emphasized in the Government Integrated Financial Management Information System (Odago, M. O., & Mwajuma, A. A. 2013).

It will be very difficult for any government to realize its vision without having a comprehensive budget because a government's accounting system is cash based as opposed to the accrual basis of accounting. The budget document lays down the direction for the entire economy and determines who gets what and when, as well as a basis for the provision of funds to implement new initiatives/policies through legal, rational and acceptable means (Bengali, 2004).

A government budget is one of the accounting tools used to plan the government revenues for a specific future fiscal period. It is also considered as a general law which gets approved by the legislative authority represented by the parliament. This means that the government general budget depends mainly on estimation and approval. The promulgation of the Constitution of Kenya 2010 completely changed the way public budgets were previously done in Kenya. It introduced a new legal framework and institutions to ensure transparency, accountability and public participation in management of public finances by providing a way which involve ordinary Kenyans in the budget making process, a complete turnaround from the previous regime where the budget making process was the work of a select few (Adili 2015)

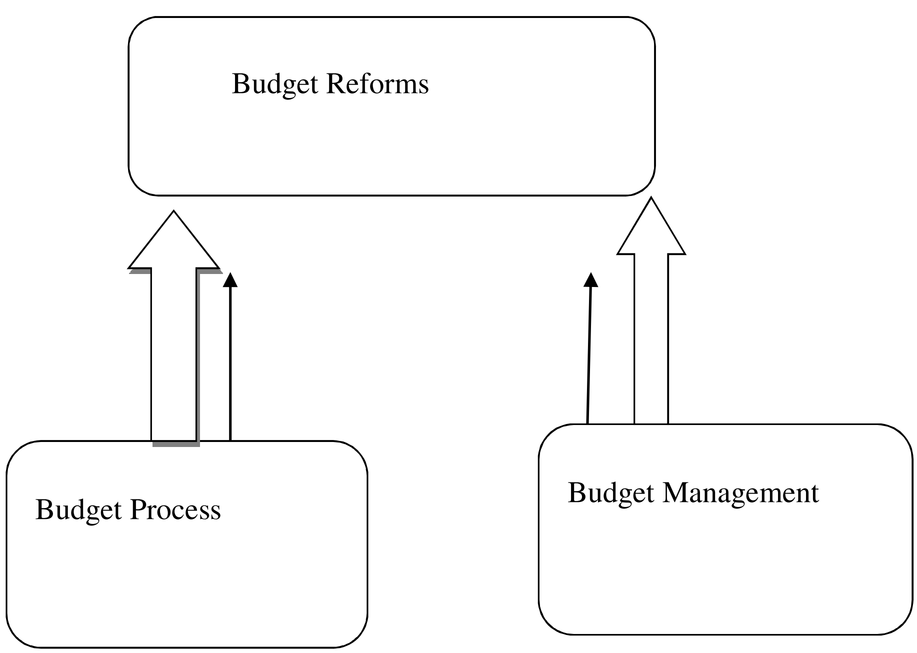
Comparison of the trends of tax revenue with those of expenditure, both as a percent of GDP over the last decade in Kenya reveals that expenditure has persistently been growing at a faster rate than tax revenue growth, for example. For 2015/16, out of an estimated budget of Ksh 2,247 billion and projected revenue of 1,358 billion, the expected fiscal deficit is Ksh 889 billion up from 740 billion in 2014/15 revised budget. A paucity of empirical literature attributes this escalation of budget deficit to devolution related expenditure, for example Pierre and Peters (2011) indicates that an effective budget must first of all be adopted by a duly constituted authority, and it must be adhered to. The government must also avail the information on budgets to the public, who must have been involved in its preparation and despite the fact that revenue is always limited; the available resources must be matched with the expenditure (Pierre and Peters 2011).

Lienert & Sarraf, (2001) also assert that lack of basic ingredients of sound budgeting in most African countries, which includes Kenya, has justified the description of their budgetary performances as disappointing, and underscores the need for reforms in public financial management in general and budget management in particular. In Nigeria for example, there was a lot of wasteful spending during a similar period of the stage of devolution like Kenya is now (Ben-Caleb & Agbude, 2013).

Abdullahi et al, (2012), posit that a national budget need to be well designed for it to be effective and efficiency in its implementation and to monitor the performance of government staff who are the managers of governments units and departments. Recent reforms in Kenya have seen budgeting move away from the previous days during the unitary system of governance where it was the preserve of the executive.

Kazeem O. F, Hakeem O. F, and Reuben O. O, (2014) posit that budgeting is a useful tool that can guide Devolved governments to evaluate whether governments policy and objectives are actualized especially poverty eradication which directly improves household effects which was the focal point of this study. ustapha, Rashid and Nasir (2011) also assert that there is a close relationship between expenditure and household income which is in continuum with this study focus. Further.

Previously in Kenya, budgeting, policy and planning have not been conducted in an entirely integrated and comprehensive manner which has resulted into inconsistencies and incoherencies in Kenya's development platforms. The MTEF model has now been adapted for use, which is designed to instill discipline in managing and planning national resources by establishing an explicit link between the policy framework and the budgetary process. It seeks to bring a better integration of policy reforms, budgeting and expenditure management and attempts to link sector objectives to national priorities and thereby achieve greater result from existing level of resources, otherwise the debate on the effect of budget deficit on private consumption has stimulated a burgeoning literature in macroeconomics (Niesner, J., Jecha, D., & Stehlík, P. 2013).



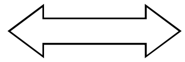


Figure 1: Budget Reforms, Budget Cycle and Budget Management Conceptual Relationship

Source: Journal of Accounting and Auditing: Research & Practice

Significance of the study

This study aims at analyzing the Impact of budget efficacy under a devolved system of governance on the household effects in Kenya. The study adopts a comparative manner for the last five years with a view to preempt any unforeseen negative impacts on the household effects through ignorance of the advantages of devolution or non-control of its weaknesses that there may be.

This study will be beneficial to both citizens and policy makers because citizens in spirit of the need to know principal need to be empowered through access of information on the real meaning and effects of budget efficacy under a devolved system of governance based on the fact that decentralization is a continuum and therefore a process which need to be appreciated by the citizens of a country experiencing this system of governance for the first time. The political class will also benefit from the findings of this study as the peoples representatives endowed with legislative obligation because they will be able to make an analysis of the existing budgetary policy and therefore find out whether there is a tradeoff between the two systems of governance i.e. central and decentralized system and therefore come up with policy recommendations on the way forward based on the researcher's findings.

Critique of Existing Literature

The idea of devolving the budgetary function from the national government to the 47 County governments in Kenya was informed by a well thought Theory of Fiscal decentralization which postulates that locals have the knowledge of needs at grassroots and therefore best placed in the determination of the allocation of resources. This introduced the idea of a true budget and hence brought about more accountability and control (Hanninen, (2013). However there has been a lot interruption by the political class in both national and county governments which have undermined the gains of fiscal decentralization contrary to Lienert & Sarraf, (2001) who assert that lack of basic ingredients of sound budgeting in most African countries which includes Kenya, has justified the description of their budgetary performances as disappointing. Kenya, s decentralization process was done in a dichotomous nature as opposed to a continuum manner which allow step by step devolvement of functions, The study by Ben-Caleb & Agbude, (2013) in Nigeria cannot therefore be generalized in Kenya who underscores the need for reforms in public financial management in general and budget management in particular. This is also because a study by Sabahi (2013) on budgeting efficacy in Kenya finds that more than 50% of Kenya's 47 counties did not face significant budget deficits. The conditions given by Donors also affect the fund management due to the conditions attached to the fund.

3.0 Research Methodology

The study adopted a positivist research philosophy in determining the research strategy and method of this strategy. A Census involving the 47 county governments was conducted based on population size, nature of the county i.e rural or urban set up and size of the annual budget support from the national government. The Study adopted the Survey and Evaluation Program (NASSEP V) frame that the Kenya Bureau of Statistics currently operates to conduct household-based surveys to also conduct a household survey in the county governments on household effects in Kenya. The study employed an inductive ex post facto cross sectional quantitative survey design. Secondary panel data was collected from County Treasuries. Primary data was collected through household surveys and Fiscal and Monetary Departments of county assemblies. Data for the period 2013-2017 was used to run univariate and multiple regressions using STATA software. Both descriptive and inferential statistics were generated and provided results for interpretation. These help to answer the question formulated in the study. The answers have agreed with our hypotheses. The study examines how budget efficacy can influence on the household effects in Kenya.

4.0 Data Presentation, Analysis and Discussion of Result

The data used for this study were presented, analyzed and discussed. The section also captures the testing of the only hypothesis of this study

4.1.1 Correlation Analysis

Table 1 presents results on association between budget efficacy and household income. The findings indicated that budget efficacy and household income have a strong positive and significant association. This was supported by a correlation value of 0.6163*. The association between the two variables was significant at 5% level of significance. The results implied that an increase in budget efficacy would increase household income.

Table 1: Correlation Matrix: Budget Efficacy

	Household Income	Budget Efficacy
Household Income	1.000	
Budget Efficacy	0.6163*	1.000

* Correlation is significant at the 0.05 level (2-tailed).

4.1.2 Regression Analysis

Table 2 present the regression results on the relationship between budget efficacy and household income.

The results indicated that there was a positive and significant relationship between budget efficacy and household income. This was indicated by a coefficient value of 0.9021 and a p value of 0.000. The results implied that for every one unit change in budget efficacy, household income would change by 0.9021 units holding all factors constant. The coefficient value had a positive sign, which indicated that there was a direct relationship between budget efficacy and household income. An increase in budget efficacy is expected to have a positive influence on household income.

Further, the F value of 85.14 indicated that the model was a good estimate. The p value of 0.000 supported the significance of the model at 5% significance level. The results implied that budget efficacy is a good predictor of household income.

In addition, the R^2 value of 0.379 indicated that budget efficacy explained 37.9% of the total variations in household income. The remaining 62.1% was explained by other factors that were not included in this study.

The Skewness/Kurtosis test indicated that the data was not normally distributed since the probability value was less than 0.05. However, normality was assumed since the number of observations was many.Breusch-Pagan test reported a p value of 0.6182, which was greater than 0.05 and hence the data was homoscedastic. Further, Wooldridge test reported a p value of 0.6758, which was greater than 0.05 and therefore, there was no autocorrelation.

Table 2: Regression Model: Budget Efficacy

	Coef.	Std. Err.	T	P>|t|
BudgetEfficacy	.9020752	.0977653	9.23	0.000
_cons	.3623576	.1221199	2.97	0.004
R squared	0.3798			
Adj. R squared	0.3754			
F (1, 139)	85.14			
Prob.>F	.00			
Skewness/Kurtosis test	Chi2=55.90, Prob> chi2=0.000			
Breusch-Pagan test	Chi2=0.25, Prob> chi2=0.6182			
Wooldridge test	F(1, 46) =0.177, Prob>F = 0.6758			

Specific model:

$Y=\alpha+\beta X$

Household Income= 0.3624+0.9021 Budget Efficacy

4.1.3 Hypothesis Testing

The hypothesis was tested by using the OLS regression.The acceptance/rejection criteria was that, if the p value is less than the conventional p value at 5% significance level, the null hypothesis is rejected, otherwise the null hypothesis is not rejected. The null hypothesis was that there is no significant association between County Budget Efficacy and Household Effects.

Based on results in Table 2, the null hypothesis was rejected since the p value of 0.000, was less than the conventional p value of 0.05. Therefore, the null hypothesis was rejected and this implied that there was a significant association between County budget efficacy and household effects.

5. Conclusions

The study concludes that there is a significant association between Budget Efficacy as indicated in hypothesis $H_{01.}$ and also concludes that budgeting is a useful tool that can guide Devolved governments to evaluate whether governments policy and objectives are actualized especially poverty eradication which directly improves household effects in Kenya. This is also in continuum with Oate (1951) traditional Theory of Fiscal decentralization which emphasizes that locals are able to make better choices and therefore improves efficiency in the provision of Public Service.

5.2 Recommendations

The study recommends that budget efficacy is the ideal tool for reducing income inequalities and therefore improving household effects in Kenya. The Study recommends further studies on the influence of budgeting on household effects. The findings of this study will go a long way to inform the national Treasury on the best practice in the ongoing implementation of fiscal decentralization and assist future policy formulation. It will also be a good point of reference in the 47 County governments' budget formulation strategies in the provision of the Public Service and optimum utilization of the available resources for the benefits of household effects in Kenya. This study finds that there is need for a new budget culture in the public sector. Feedback is also an essential ingredient of the budgetary process, if budget efficacy is to be achieved.

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