

6.0 Improving the Management of Finance

6.1 Setting the Framework

6.1.1 Reforming financial management

The principles of *financial management* are stewardship, purchase and accountability.

The public service is responsible for protecting the value of the physical and financial assets owned by the government. Failure to maintain buildings or property, allowing their value to fall, and failure to protect financial assets from misappropriation or from devaluation, represent failures of stewardship.

The public service purchases goods and services on behalf of the government. It can be argued that as a large proportion of these purchases are made internally – by funding departments and Ministries – the public service is purchasing from itself. Sound financial management requires the public service to obtain the best value for money through such internal purchases and through its contracts with private and NGO sector organisations.

The principles of accountability lie behind the concerns for good stewardship and effective purchasing. Public service managers are accountable for their stewardship and for their purchasing to their Ministers and, through them, to the public. Financial management reforms are concerned with holding managers accountable for improved stewardship and purchasing strategies.

Reforming financial management finds full expression in improvements to the budgetary process. The budget is the formal expression of expected or estimated financial activity for a particular period. A budget will normally detail expected revenues and expenditure, and can be separated into revenue and expenditure budgets.

In the public service, budgets are often part of the appropriation procedures, when departments outline expenditure plans on which appropriations are made.

The budget is also an instrument of control. Approval of a budget often determines and fixes the department's operations for the period. Traditionally, public sector organisations have not been allowed to divert expenditure from approved to other purposes and, at the end of the period, unspent funds are normally returned to the centre.

Reforming the financial management process includes a move towards output-based management, and the increased accountability of managers with an accompanying liberalisation of budgetary controls.

Improvement of the budgetary process is a key element of this procedure, especially as the budgetary process is a key tool in financial management and control. The budget must be seen as a flexible document adaptable to changes in circumstances and to different time scales, appropriate to both capital projects and to operating or running costs.

The context for change

Since the mid-1970s, governments have been increasingly concerned to adapt and develop the structures and values of the public service to achieve greater efficiency and more responsive services. Improved quality at less cost has been the imperative. These changes have largely been pushed by continuing economic crises in developing and developed countries, which have in turn arisen from deteriorating terms of trade, over-extended borrowing, and a somewhat abrupt change of policy by the lending institutions during the 1980s.

However, the changes have also arisen from a new set of managerial strategies for the public service which have opened up the possibility that greater results can be achieved from fewer resources by strengthening lines of accountability and defining intended outputs more sharply.

Financial management reforms have been at the centre of the response to these economic crises, and have been equally fundamental to the new managerial strategies adopted in the public service.

Reasons for caution

Financial management reform has failed when:

- *it has been seen as a technical problem with little attitudinal content* – the impact on existing status differentials, areas of influence and, in the worst case, opportunities for budget distortions, can be considerable;
- *it has been implied that new structures can be insulated from weak or undisciplined managerial systems* – few examples of successful enclaves can be found; delegated responsibilities, agency status, and other new structures, are only as effective as the underlying foundations of probity and diligence across the whole public service will allow;
- *it has not been driven* – the absence of a central organisation with the authority and determination to make changes, and the capacity to assist and lead by example, will undermine the reform; and
- *it has led to unacceptably high compliance costs* – to feel committed to the reforms, managers must be able to see the benefits in terms of efficiency or service quality.

Achieving change

The elements of financial management reform are described below. In summary, they fall within a broad value-for-money orientation as follows:

- Improving the management of inputs:
 - introducing capital charging;
 - improving state management;
 - improving physical asset management;
 - improving the procurement process; and
 - using activity-based costing.
- Focusing on outputs:
 - achieving an output orientation; and
 - delegation of financial management.
- Improving management information:
 - strengthening external audits;
 - strengthening internal auditing systems; and
 - introducing accrual-based accounting.

- Improving management systems:
 - restructuring and classification of accounts; and
 - introducing flexible budgeting.

The key mechanisms used in driving these changes are:

- *Application of rates of return*: where outputs, such as goods and services produced, can be measured in financial terms. The rate of return is the ratio between the financial value of the outputs and the value of the inputs or resources used.
- *Imposition of cash limits*: where outputs cannot be measured in financial terms, control and limitation of expenditures can be achieved by making financial resources limited, through strict budgetary controls.
- *Output or performance-based management*: where outcomes, outputs and efficiency targets, and performance indicators are an integral part of the budgetary process.
- *Delegation of authority*: to the delivering departments and agencies, including the right to decide on changes to expenditure plans.
- *Emphasis on accountability*: so that the effective use of delegated authority can be monitored.
- *Performance-based incentives*: all participants in a programme, purchasers, providers, and consumers, should feel the benefits of improved systems.
- *Use of market principles*: provision of services opened to competition, wherever possible. Alternatively, separation of purchaser, provider and regulator functions, wherever feasible and sensible, with maximum usage of market and price mechanisms even inside the public sector.

Examples of change

In *Ghana*, the National Institutional Renewal Programme (NIRP) has an agenda designed to promote a wide range of public service reform and capacity development. In 1995, the NIRP National Technical Group published a Methodology for Capacity Enhancement and Institution Training to provide guidance and assistance to departments.

In 1990, the Government of *Malaysia* introduced the Modified Budgeting System (MBS). The objective of the MBS is to improve the budgetary process, particularly in relation to accountability, allocation of resources and the implementation of programmes by government agencies.

MBS stresses the relationship between inputs, outputs and the impacts of a particular programme or activity. Under this system, government agencies are required to determine their achievement targets in terms of outputs and impacts of every programme or activity for which there are “programme agreements” between the agency and the Federal Treasury.

In providing a performance measurement of programmes/activities, the MBS is in line with the value-for-money concept which strives to achieve three objectives: economy, efficiency and effectiveness.

In *New Zealand*, the Fiscal Responsibility Act 1994 is the last in a series of measures designed to enhance the transparency with which the Government manages public funds. This Act emphasises:

- a requirement for regular and explicit fiscal reporting, including a change to accrual accounting;
- the provision of benchmarks against which fiscal performance can be measured where outputs and outcomes are agreed between management and the Minister;

- a more open and transparent budgetary process;
- review and legislative debate on, and eventual reform of, public sector financial reports; and
- a shift from controls over inputs to controls over outputs.

In the UK, the Financial Management Initiative, launched in 1982, marked the start of a general and co-ordinated drive to improve financial management in government departments. One of the key aims was to devolve responsibility for budgets and financial control to line management, units and individuals, giving them clear objectives and full information necessary for appropriate decision making.

The Multi-Department Review of Budgeting in 1986 focused on the need for top management to set priorities, manage resources and review the performance, and for achievements to be reviewed regularly.

The Government Purchasing Initiatives aimed to develop professionalism in government purchasing and to set up a unit to improve value for money through best practice.

The Next Steps Initiative aimed to improve efficiency through the devolution of a number of executive functions of government onto independent agencies whose Chief Executives are directly responsible to Ministers for their performance.

Other useful material (current as of 1996)

From Problem to Solution. Commonwealth Strategies for Reform. Managing the Public Service. Strategies for Improvement No. 1. Commonwealth Secretariat, 1995 (ComSec)

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6.1.2 Achieving value for money

In the complex, politically-led environment of the public service, value for money is just one measure of management success – to be set alongside other measures which emphasise probity, accountability, equity, and loyalty, both to the ideals of a neutral public service and to the priorities of the elected government.

Achieving value for money is, however, a key mindset in the search for management effectiveness in the public service.

All public service organisations produce outputs, which consist of goods and services; and outcomes, which are the consequences or impact which those outputs have on society or the community.

Value for money is the maximisation of three main elements, known traditionally as “the 3 E’s”:

- *Maximising economy* implies minimising the cost of resources or inputs used (spending less).
- *Maximising efficiency* entails increasing the amount of goods and services produced from a given level of human, financial or other input (spending well).
- *Maximising effectiveness* is increasing the impact of the goods and services produced for the community (spending wisely).

Value for money can be expressed as a series of ratios:

$$\text{VFM} = \frac{\text{Amount of input}}{\text{Cost of Input}} + \frac{\text{Amount of output}}{\text{Amount of input}} + \frac{\text{Degree of desired impact}}{\text{Amount of output}}$$

Economy *Efficiency* *Effectiveness*

The context for change

Public demand for an increase in the range and quality of services, together with the extension of the role of government in all aspects of economic and social activity, has placed increasing demands on frequently diminishing public service resources.

One consequence of this pressure on resources and the growth in public expectations has been the introduction, in the public services of many Commonwealth countries, of a range of public management reforms emphasising the need to increase cost-effectiveness and improve the quality of output. Value for money, with its emphasis on economy, efficiency and effectiveness, is a key mindset in achieving these reforms.

Achieving value for money is an orientation in which performance and value-for-money audits or assessments assist managers to determine:

- the causes of inefficiencies and uneconomical practices;
- real customer requirements;
- the full costs of outputs which will assist in pricing or budgeting procedures;

- opportunities for rationalisation or possible economies in the use of capital equipment and capital expenditure programmes;
- opportunities for other economies, such as reduction in overheads and inventory reduction; and
- opportunities to develop other sources of income generation.

Value-for-money audits also determine whether performance indicators agreed under any output-based management systems are appropriate; and whether internal auditing procedures are adequate and effective.

Reasons for caution

Achieving value for public money through effective financial management in the public service is fundamental to performance improvements. It is a journey rather than a destination; an orientation and not a set of pre-defined systems and techniques.

Achieving value for money requires that managers be motivated and able to achieve improvements in economy, efficiency and effectiveness. This, in turn, requires that they be able to identify and, where feasible, determine the cost and quantity of the inputs to their operations and the quantity and impact of the outputs. A range of techniques are available to assist them in uncovering these variables and in assessing options for improving performance – from performance audits to market-testing. These are techniques to be selected from, in order to pursue the larger goal.

Commonwealth experiences suggest that in emphasising value for money, a risk arises that means are confused with ends – that techniques are seen as goals to be aspired to, rather than devices which assist in the change process but which might have a limited life. A value-for-money orientation requires that managers be focused on the key elements of inputs and outputs, but flexible in their use of techniques for achieving change.

Achieving change

There are two components to the establishment of a value-for-money orientation in public service managers:

- Conveying the key concepts

Traditionally, the public service has been seen as a series of inter-related and tightly prescribed positions, each with specific areas of responsibility and each contributing to an unchanging whole. The elements of value for money – economy, efficiency and effectiveness – and the key concepts of cost and volume of inputs, and volume and impact of outputs, require that tasks within the public service are seen as a process leading from human and financial inputs to community or national impacts or outcome.

- Providing a repertoire of techniques

With the key concepts clear, options for improving value for money can be assessed at work unit, department or Ministry levels. The techniques to be employed must be selected pragmatically, according to the skills available and the potential cost of utilising an approach which is over-elaborate for its context.

The majority of techniques in which managers may need training, and where they may need access to centrally co-ordinated assistance, are covered in this Portfolio. Examples of these techniques which are particularly relevant to achieving value for money include:

- conducting performance or efficiency audits;
- introducing full or activity-based costing, in association with capital charging, if appropriate; and
- market-testing to be followed by contracting out of services.

Examples of change

In *Malaysia*, the main thrust of the reforms has been through improving the budgetary procedure and controls systems. The objective of the Modified Budgeting System (MBS) is to improve the budgetary process, particularly in relation to accountability, allocation of resources and the implementation of programmes. MBS stresses the relationship between inputs and outputs; and departments are required to determine their achievements in terms of outputs and outcomes. Thus, in providing for performance measurement, MBS also helps to secure value for money.

In *New Zealand*, the emphasis is on improving standards of reporting and accountability coupled with reforms to budgeting procedures which take account of changes towards output or performance-based management. Departments present budgetary estimates in terms of desired objectives and expected outputs. These are then translated into performance indicators against which management is evaluated.

Together with the introduction of accrual accounting and capital charging, the true cost of goods and services is known, enabling comparisons and thus promoting value for money.

In the *UK*, the concept of value for money is often seen as the driving force in reforming financial management in the public sector from which all other initiatives follow naturally.

Value for money frequently arises in an auditing context. Part of the remit of the Audit Office is to conduct value-for-money audits as part of the external audit procedure. However, it is common for value-for-money audits to receive priority within an organisation's normal management structure, often as part of the internal audit procedure. Value for money is also one of the criteria used in making purchasing decisions, in particular, whether to use internal or external sources.

Application of the value-for-money concept, with its emphasis on total costing, has also encouraged the application of capital charging and consideration of all assets and liabilities, and the introduction of accrual accounting.

Particular areas directly subject to value-for-money criteria include the following:

- internal appraisal of capital projects;
- post-contract reviews of projects; and
- special reviews of services, either whole units of government or expenditure programmes.

Compliance is assured through the external auditing arrangements, where the Auditing Offices are empowered to undertake regular value-for-money audits. As a result, internal auditing procedures take account of these requirements.

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6.2 Improving the Management of Inputs

6.2.1 Introducing capital charging

Capital charging is the accounting for the full cost of capital assets used in the provision of goods and services. This allows a calculation of the true economic cost of goods and services, enabling comparison with other providers to be made.

The context for change

Accounting for the cost of capital through a policy of explicit capital charging is conducive to good financial management in the public service. Capital charging makes clear the full costs of goods and services produced by departments, so that Ministers can make more informed decisions about the costs and benefits of government policies. The specific objectives in doing this in a public sector entity are to provide the information and incentives needed for efficient management of the government's investment.

If departments or Ministries do not bear the cost of capital, they may be seen as the preferred provider, even when more efficient producers exist. Ignoring this cost is likely to result in poorly informed decision making and misallocation of resources. Having departments bear the cost of their capital allows Ministers to make more informed choices on the basis of the full costs of the goods and services needed to achieve policy objectives. The government is more likely to achieve value for money when capital is no longer treated as being free, because the bias in favour of capital-intensive production is addressed.

Many departments supply goods and services to third parties. If the price charged does not at least recover the total costs, including the cost of capital, then the government is effectively providing a subsidy. If the total cost exceeds the price that the government wants consumers to pay, then transparency could be achieved by making a specific budget appropriation to cover the expected shortfall.

The government should expect the benefit from its investment of taxpayers' funds in a department to at least match that available from competing investments in the private sector. In effect, capital should be used as efficiently by departments as by a private firm with comparable operations and risks.

The capital charge gives managers a signal as to the government's expectations from its investments in the business of the department. It allows asset management decisions to be made at the departmental level rather than continually referred to a control agency. A capital charge gives managers information to make clear trade-offs between tying up government resources in a given asset as opposed to using alternative means of production.

Reasons for caution

Above all, capital charging requires reliable information on departments' net assets which will, in turn, require a thorough inventory of the government estate. This multi-disciplinary operation will require appropriately qualified personnel, including lawyers, surveyors and engineers, to establish title, maintenance required and market value.

Where the inventory cannot be reliably undertaken, and where the conflicts that it generates between user departments and central agencies over title, value, and liabilities cannot be managed at reasonable cost and within a reasonable time frame, capital charging will not be feasible.

Capital charges are most effective when combined with a consistent financial management framework and, ideally, accrual accounting. Together, these changes provide departmental managers with the opportunity, incentive, and information, to produce desired outputs at the lowest cost.

Achieving change

Incentives for efficient performance are also enhanced by delegating control over inputs (for example, cash, fixed assets and human resources) to chief executives, and then linking this increased authority with accountability for the production of agreed outputs. The adoption of accrual accounting provides the opportunity for better decision making through the presentation of a clearer picture of assets and liabilities, while application of a capital charge to net assets and liabilities provides better information on their true cost.

In concept, the idea of a capital charge is quite straightforward. The underlying mechanics, including capital-asset pricing, however, are complex and open to debate. This suggests that although it is possible to implement a capital charge regime in a single budget cycle, it may take some years to bed down and for gains to be fully realised.

One way to make the cost of capital explicit is to formalise the government's investments as debt and equity capital. Interest would be paid to the government on debt and dividends (after tax) on equity. This corporate form is used in several jurisdictions for assessing required rates of return for government-owned commercial enterprises.

For non-commercial government departments, however, it may be more practical to levy a capital charge that emulates interest, dividends and taxes. Departments typically are debarred from incurring debt in their own right and are exempt from income tax.

Where practicable, charge rates should be negotiated with individual departments based on weighted averaged costs of debt and equity capital and expected future growth (holding gains) for private-sector counterparts. This will involve reviewing and agreeing these variables to ensure that a relevant charge rate is arrived at for each department. Where no appropriate private sector comparisons exist, standard rates would need to be set by the government.

The capital base represents the value of the government net investment in a department. The values used need to be capable of being ascertained reasonably and reliably. There should be little scope for "creative" manipulation of the numbers. Audited accrual-based financial statements are likely to provide the best usable estimates of net assets.

The capital charge is applied to each department as an entity, rather than to its various outputs (goods and services produced). In making decisions about existing new investments required to produce their outputs, departmental managers must take the capital charge into account. This does not mean that the charge rate should be applied as a hurdle rate for individual assets in which the department invests. This is because:

- individual assets do not contribute equally to the overall financial performance of the department;
- the risk associated with specific assets or projects may not be the same as that applying to the department as a whole; and

- the capital charge represents only a proportion of the total cost of capital because it excludes the present value of future expected growth.

Examples of change

In *New Zealand*, as from July 1991, all government departments have been subjected to a charge for the level of capital employed in their operations. This reflects the opportunity cost to taxpayers of the funds employed. At the end of each half year, a charge on capital employed is added to the department's costs. The charge is calculated by applying an agreed rate to the department or agency's capital base:

Capital charge = Charge rate x Capital base

Initially, all departments were charged at a standard rate of 13 per cent. However, with experience it became possible to set more individual rates taking account of each department's particular activities.

When the charge was introduced, departments were funded in such a way so that the effect was largely fiscally neutral, that is, departments received full compensation for the charge as it impacted on the output purchased by government. However, the costs of goods and services sold to external customers were also increased proportionately to the capital charge. Departments were then asked to recover these increases through higher prices or by lowering overall costs. It was recognised that this could not be achieved immediately but the overall effect was to promote a more efficient use of resources.

In the *UK*, capital charging operates at two levels:

- Departmental trading units and government agencies must include in their costs (on which their performance is partly based) interest on capital at a rate fixed by the Treasury. This is one aspect of working towards full economic cost.
- In agencies of central government, the National Health Service and latterly local government, interest is charged within the management (internal) accounts to impress upon local managers the real cost of assets held and thereby encourage the efficient use of them.

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6.2.2 Improving estate management

The *estate* is the land, buildings, equipment, and perhaps the infrastructure, owned by the government. This represents in all countries a massive accrued investment.

The context for change

The government estate represents a very significant resource and is commonly one of the most neglected. It is often not recorded or systematically valued, and sometimes is only partially used. Maintenance is often unsystematic, incomplete or belated requiring increased resources for repair and loss of value. Inappropriate, limited, or incomplete utilisation of the estate represents an under-use of scarce capital resources. Management of this estate is now being recognised as a key area for reform and development.

Unsystematic, incomplete or belated maintenance leads to deterioration and damage, requiring increased resources for repair and loss of value. The benefits from improved estate management are:

- cost reductions through better use of accommodation;
- better planning in the nature and timing of major capital transactions, to take place at the best time for the user;
- personnel benefits from more suitable accommodation;
- reduced overall maintenance costs through planned maintenance; and
- identification and release of surplus resources for alternative uses.

Improvements in estate management are associated with a wide-ranging, comprehensive and mutually-supporting range of public sector financial management reforms and relate closely to capital charging. The introduction of capital charging will include payments in respect of the value of accommodation, perhaps on the basis of an opportunity-cost rent. When it is apparent that the estate is not available free of charge, departments are encouraged to consider efficient usage of the estate and transfer surpluses which can then be used for alternative purposes.

Reasons for caution

It is likely that a complete record of the government estate does not exist, that records are out of date, and that there is no central record against which they can be checked. It is also likely that no up-to-date report as to the physical condition and maintenance requirements exists

Correction of these weaknesses will require the implementation of a thorough inventory of the government estate. This will necessarily be a multi-disciplinary operation requiring the use of qualified personnel, including lawyers, surveyors and engineers, to establish title, values and maintenance requirements.

It is possible that conflicts between user departments and central authorities may arise, particularly over title, value, and liabilities.

In any introduction of capital charging it is necessary to delegate part, at least, of the management of the estate to user departments, thus requiring appropriately qualified management expertise at a lower level.

The presence of central authority, both to ensure compliance and to provide assistance, advice and training, is also necessary. As estate management is recognised as a key aspect of management, it should feature as strongly as other topics in management training courses, and form part of the criteria on which a manager's performance is evaluated.

Increased awareness and understanding of the size, nature, value and condition of property should be coupled to increased responsibility and accountability for the estate, in effect introducing the best private sector practice to the public sector.

Achieving change

Managing the estate is part of mainstream activity and so it should feature strongly in mainstream management training courses. The objective is to train managers to take an active and informed view of their asset base. Managerial awareness will increase if managers' performance on their property assets is judged and valued with the same vigour as their people management or financial skills.

In general, the importance of the estate's finances should be made visible to management. They should be included in the "business" plan, as part of the capital budget, which should be available to managers at all appropriate levels.

If a central authority or property-holding and management agency does not already exist, then one should be created, or at least authorised, to set standards, arbitrate disputes, offer advice, assistance and necessary expertise, and should be empowered to ensure compliance.

All departments should be required to conduct a thorough inventory and an in-depth report on the quantity, quality, title, value, use and maintenance requirements, and the cost of the estate under their control.

Steps to introduce some form of capital charging in which departments pay the full costs for accommodation and other estate should be introduced. Direct costs associated with land, buildings and infrastructure should be itemised in a capital budget and should include:

- internal rent;
- depreciation;
- local taxes on property and occupation;
- planned maintenance; and
- utilities and service charges.

Departments should be encouraged to review their accommodation and other estate requirements and to return, or otherwise appropriately dispose of, that surplus to their requirements.

Managers should be encouraged and trained to become "intelligent customers" of their professional advisers, able to instruct them clearly and interpret their advice.

Responsibility for maintenance should be delegated, as far as possible, to user departments which *should be encouraged* to use planned maintenance techniques and appropriate advice, as well as the assistance and training made available.

Examples of change

In *Malaysia*, public property management is the responsibility of the Management of Government Buildings Division of the Prime Minister's Office. Maintenance of Federal properties is the responsibility of the Public Works Department.

Public property management policy is based on the following principles:

- construction and acquisition of appropriate buildings at minimum costs;
- optimum use without waste;
- appropriate maintenance;
- refurbishment or demolition and replacement of dilapidated properties; and
- transfer of surplus properties to alternative use.

Problems of poor maintenance in the past were attributed to financial allocation and to management and organisational problems. Financial allocation problems included:

- insufficient allocation;
- delays in transfer; and
- allocations used for other purposes.

Management and organisational problems were the result of the absence of central organisation over the allocation of maintenance funds. Each department applied for maintenance funds which were then transferred to the Public Works Department which was responsible for the implementation of maintenance work.

Reforms of the system were based on the following principles:

- Funds were allocated direct to the PWD on the basis of estimates based on departmental requests for maintenance.
- Heads of departments were permitted to manage maintenance and to undertake minor repairs, such as contracts to clean buildings and maintain surroundings, maintain and repair air conditioners, electrical fittings, water pumps, plumbing and toilets, etc.

Estate management has also been reinforced by an insurance fund for Government properties managed by the Contract and Supply Management Division of the Ministry of Finance; while the Valuation and Property Services Department in the same Ministry provides appropriate professional expertise in valuation and compulsory purchase, and property management.

In the *UK*, the government estate has been traditionally organised into distinct areas: the Civil Estate, the Defence Estate, and the Operational Estate. The reforms in estate management have been part of a series aimed at improving accountability and value for money, and have included reforms to costs and the introduction of capital charging.

Under the Property Repayment System, the broad cost of accommodation, later refined with increasing works delegation, was recouped from each department.

In 1990, the Civil Estate was effectively divided into the Consumer User Estate (CUE), managed by the Property Holdings Division, and specialised or dedicated-user estates, managed by occupying departments and agencies.

The CUE portfolio is managed as a common resource by Property Holdings (PH) so as to be able to offer departments accommodation at best value for money. PH's objectives are to meet accommodation requirements economically, efficiently and effectively; and to recover the full cost and collect opportunity-cost rents from all departments.

Under the Common User Estate, departments are responsible and accountable for the amount, location, quality of accommodation used, and for payments for them. Departments using the CUE are tied to the PH to enable it to carry out its role.

Under these reforms, accommodation is recognised as a key resource, and departments are encouraged to approach it from the point of view of stewardship, the application of planned maintenance techniques, periodic reviews of needs and use, and to release any surplus or excess.

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6.2.3 Improving physical asset management

The *physical assets* of governments are land, buildings and the variety of value objects procured or used by departments in the course of carrying out their activities. These include stationery, maintenance and other stores, office equipment, including computers, vehicles and machinery, and military equipment.

While individually perhaps of modest value, the total cost of these assets represents a considerable investment. Physical assets are vulnerable to:

- losses associated with spoilage, resulting from inappropriate storage arrangements;
- losses resulting from theft and pilferage, consequent on insecure storage and inadequate stock control and accounting systems;
- losses arising from weaknesses in logistics – the distribution, location and storage of goods;
- losses brought about by inadequate maintenance, which result in:
 - shortened life and the consequent need for early replacement of the equipment; and
 - stoppages and losses of production which follow unnecessary breakdown.

Physical asset management is a key aspect of the public service responsibility for the effective stewardship of national resources, and must cover:

- planning;
- acquisition or procurement;
- operation and maintenance; and
- disposal.

The context for change

The physical assets of the government represent a very significant resource and are commonly among the most neglected. They are often not recorded or systematically valued, and sometimes only partially used. Storage and security arrangements are frequently inadequate often leading to significant losses through spoilage or theft.

Unnecessary or inappropriate purchasing and disposal policies encourage a misuse of scarce resources. Unsystematic, absent, incomplete or belated maintenance leads to deterioration and damage requiring increased resources for repair and replacement.

Proper systematic physical asset management results in the efficient use of resources and, consequently, in increased value for money.

Physical asset management requires:

- a changed focus for managers, shifting concerns from spending for asset creation towards the management of assets to support the efficient provision of services;
- staff development to ensure improved asset management capabilities; and

- clear guidance to encourage the adoption of uniform management practices, systems, standards and forms of accounting.

The principal benefits resulting from improved physical asset management include:

- a reduction of spoilage resulting from inappropriate storage arrangements;
- a reduction of theft and pilferage consequent on insecure storage and inadequate stock control and accounting systems;
- adequate stock control systems and increased security permit identification and release of surplus resources for alternative uses;
- reduced overall maintenance costs through planned maintenance;
- savings resulting from better planning in the nature and timing of purchasing and procurement; and
- benefits associated with the availability of appropriate equipment at the proper time, including cost reductions through correct use of equipment.

Reasons for caution

In many situations, there is no complete or current inventory of government assets, nor a central record against which physical condition and maintenance records can be checked. Compiling this information base requires a thorough inventory of all government property. This is a multi-disciplinary operation requiring the use of appropriately qualified personnel to assess values and maintenance requirements.

It is possible that conflicts between user departments and central authorities may arise, particularly over title, value and condition of the goods, especially as many of the goods will have been purchased out of departmental appropriations.

Development of adequate storage and other facilities necessary to preserve the physical integrity of goods and equipment may require expensive new buildings and structures or the modification of existing buildings and structures.

Improving physical asset management also requires the examination and reform of government procurement processes and policies regarding disposal of surplus or obsolete assets.

Such a package of reforms must be driven by a central body with the authority to ensure compliance and the resources to provide the necessary advice, assistance and training.

Achieving change

Stewardship of government property is a mainstream management task. Managers must take an active and informed view of their asset base and performance in relation to property assets, judged and valued with the same vigour as people management or financial management skills. Physical asset management must be part of all business plans, and reflected in the capital and operating budget.

The importance and value of all government physical assets should be made visible to all staff. The most common problem is the assumption that such goods are “free” or easily replaced. In this respect, all government assets should be the responsibility of individual managers who should be accountable for them.

Physical asset management covers three distinct areas: procurement, use and maintenance, and disposal.

1. Procurement

Poor procurement leads to unnecessary and uneconomic purchases. The first step in improving physical asset management is a thorough review or internal audit of the procurement systems.

2. Use and maintenance

As a means to improving the maintenance and use of existing assets, departments should be required to conduct a thorough inventory and prepare an in-depth report on the quantity, quality, title, value, use and maintenance requirements, and cost, of the government property under its control. In the case of goods susceptible to spoilage or damage, the report should cover the storage and security arrangements.

These inventories and reports should be backed up by a full report or internal audit of the stock control and accounting, and maintenance systems.

The cost of the often significant losses through spoilage, pilfering and theft should be underlined by requiring management to report on them as a separate line in the periodic accounts.

In order to avoid unnecessary breakdown and to secure full-life availability of vehicles and equipment, all departments should be required to adopt planned maintenance techniques, using appropriate and duly recorded schedules. Care should be taken to ensure the existence and adequate supply of essential spare parts.

Distribution systems should also be examined regularly. Over-centralisation can result in unacceptable delays in supplying goods to the user. Excessive dispersion will result in costly high stock levels, increased staff and buildings, and, perhaps, problems in monitoring and control.

3. Disposal

Disposal of surplus, obsolete or used assets should be governed by clearly laid down procedures, clearly accountable, and properly audited so as to secure maximum value for money.

Commonwealth experiences indicate that the key to successful physical asset management is the adoption and implementation of appropriate internal management systems designed to secure proper purchasing, use, security and maintenance, and eventual disposal; supported by strong and effective internal and external audit functions.

Good physical asset management practices are encouraged by well-managed programmes of devolution in which responsibility for asset management, and accountability for the results obtained through the use of the assets, are located within the service-providing units.

Examples of change

In *New Zealand*, the Ministry of Works has taken steps to corporatise the Works Consultancy which highlighted the need to have adequate benchmarks in terms of measuring in-house efficiencies in relation to the private sector.

In *Mauritius*, a one-week workshop was held in 1995, attended by overseas practitioners. The objective was to propose an appropriate Asset Management model to strengthen the capacity of the Government to manage all physical assets.

In the *UK*, the Next Steps Initiative, announced in 1988, aims to improve efficiency through the devolution of many executive functions of government to independent agencies whose Chief Executives are directly responsible to Ministers for their performance.

Other reforms in the health service and in education have included the formation of independent bodies with charitable trust status. This process was accompanied by the transfer of physical assets; the recipient bodies were required to produce complete inventories of all assets, develop appropriate procurement and disposal policies, develop internal audits and adopt planned maintenance systems.

6.2.4 Improving the procurement process

Procurement is the overall process of acquiring goods and services to meet customer needs. Procurement consists of a cycle which starts when the need is identified, and ends when the goods and services are paid for.

Purchasing is a component of procurement and requires particular skills in sourcing goods and services, and negotiating contracts and subsequent liaison with suppliers.

The context for change

Public pressure to increase the range and quality of services, together with the extension of the role of governments in all aspects of economic and social activity, has placed increasing demands on frequently diminishing resources.

One consequence of this pressure on resources and the growth in public expectations has been the introduction, in the public service of many Commonwealth countries, of a range of public management reforms emphasising the need for increasing cost-effectiveness and improving quality of output. Improvement of the procurement process, with its emphasis on economy, efficiency and effectiveness, is a key mindset in achieving these reforms.

The public service carries a dual responsibility for improving the procurement process. First, as a very significant purchaser of goods and services, it strongly influences domestic and, in some situations, overseas markets by its procurement activities. These activities can, at best, stimulate national productivity and, at worst, signal to domestic markets that considerations other than price, quality and ethical production policies influence sales.

Second, as the spender of public money, the public service carries the responsibility for ensuring that it obtains maximum value for money in all its procurement activities.

Reasons for caution

The key balance is the extent to which the purchasing function is centralised in a central, specialised service unit, or delegated to user/customer departments. The advantages of a centralised purchasing unit are based on the specialist purchasing skills and the “buyer” power, resulting from accumulated purchases, leading to lower prices.

Traditionally, the public sector has tended towards a centralised procurement unit. However, the weaknesses of this system in practice are:

- a tendency towards slow and unresponsive bureaucracy, undermining efficiency savings with hidden administration costs;
- an inability to react quickly to changes in market conditions; and
- an over-emphasis on bulk purchases leading to excessive inventories with associated storage costs and costs of lost or spoiled goods.

Where delegation has been introduced, weaknesses in the training, expertise and professionalism of departmental purchasing staff have to be corrected. The challenge is to find a pragmatic balance in which specialist procurement can be centrally managed with appropriate technical support, while more generic procurement is delegated.

The balance is largely determined by the degree of competition in the market in which purchases have to be made. A weak market with a few strong and relatively unchallenged suppliers suggests that a strong purchasing authority is required to negotiate favourable terms. In a highly competitive market, prices and quality are determined by market pressures, and delegated purchasing will produce value for money.

The risk is not recognising when the nature of the market has changed. The rapid development of a highly competitive market for personal computers left some central IT procurement agencies in a position of bulk-purchasing equipment, only to discover that Ministries and departments had purchased more suitable equipment at better prices.

Achieving change

Pre-requisites to improving procurement procedures are as follows:

- There should be a clear delegation of the authority to agree prices and to purchase generic supplies. This authority should be accompanied by appropriate performance indicators so that the effectiveness of purchasing can be evaluated.
- Specialist training should be made available to delegated purchasing staff.
- A clear purchasing strategy consistent with overall financial objectives should be developed for purchasing staff.
- Appropriate management information systems should be available to provide information on existing expenditure – how much? on what? and with whom? – together with the existence of appropriate accounting and record-keeping systems.
- Flexible organisational structures are required to cope with rapid changes in demand and market conditions.

Examples of change

In *Canada*, the Public Works and Government Services Canada (PWGSC) is a common services agency which provides both procurement and contracting activities for both material and real property, maintains the government infrastructure (buildings, roads and bridges, and museums), pays government bills, and collects government receivables.

Procurement of commercially-available, off-the-shelf goods and standard services was recognised as being expensive, with an excessive turnaround delivery time. Client departments had long felt the need for authority to purchase off-the-shelf goods quickly and with minimum red tape, especially where price and delivery were common denominators.

In response to this demand, PWGSC introduced a fast-track electronic purchasing gateway using readily available personal computer-based technology. PWGSC clients now have access to electronic catalogues for over 50,000 line items with price, quantity and delivery information. This forms the basis of a system whereby departments can issue their own electronic purchase orders to Canadian suppliers.

Moreover, the introduction of an open-bidding service permits publication of all requirements of goods and contracts for services over a determined value to potential suppliers through a subscription service.

These systems are being developed into a database providing contract histories and up-to-date information on prices, quantities, and usage, with a bid-matching service so that suppliers deemed particularly suitable can be sent appropriate information.

In *New Zealand*, as part of the financial management reform programme, authority for purchasing decisions has been delegated, as far as possible, to the managers concerned. It should be noted that part of those reforms included the lifting of import controls, which after a long period of strict regulation led some sector agencies to favour imported over locally-produced goods.

In 1994, the Ministry of Commerce issued two booklets on Government purchasing in New Zealand – *Guidelines to Suppliers*, and *Guidelines for Purchasers*.

For Government purchasers, the booklet contains a checklist on implementing Government policy, with the emphasis on using the New Zealand Industrial Supplies Office, multi-stage procurement processes, the need for alternative proposals and the importance of encouraging innovation, and the use of new products.

Guidelines to Suppliers is intended to assist suppliers and potential suppliers understand, and operate in, the government purchasing environment. It includes:

- an explanation of the role of the New Zealand Industrial Supplies Office established to support government purchasing policy by facilitating contact between public sector buyers and suppliers through an exchange of information on purchasing requirements and domestic industry capabilities;
- a background to State sector reforms;
- a list of purchasing contacts in government departments and agencies with an indication of likely needs; and
- how and where further assistance might be obtained.

Another aspect of New Zealand Government policy is active encouragement in the use of local and “domestic” products, i.e. products wholly or partly produced under the Australia-New Zealand Closer Economic Relations Agreement.

In the *UK*, the Efficiency Unit of the Cabinet Office in its 1984 report, *Government Purchasing*, concluded that the government was not getting best value for money and identified a number of causes for concern, including:

- lack of professionalism among staff concerned with purchasing;
- inadequate training and career development for staff specialising in purchasing;
- insufficient exposure to commercial experience;
- insufficient awareness of cost and time-saving techniques; and
- inadequate information systems.

In 1986, the Government Purchasing Initiative resulted in the creation of the Treasury’s Central Unit on Purchasing (CUP). CUP’s role was to offer help and advice to central government departments and agencies on best purchasing practice and achieving value for money. Another function consisted in monitoring compliance with recommendations made in the report, *Government Purchasing*.

CUP's role has been extended to provide advice and guidance to departments on the commercial aspects of market-testing activities and project management in the works/construction activities.

Other useful material (current as of 1996)

The Mangers' Deskbook. Treasury Board of Canada. Third Edition. 1993 (CAN)

Government Purchasing in New Zealand – Guidelines for Suppliers. Ministry of Commerce, Wellington, 1994 (NZ)

Government Purchasing in New Zealand – Guidelines for Purchasers. Ministry of Commerce, Wellington, 1994 (NZ)

Government Purchasing. Progress Report to the Prime Minister. HMSO, London, 1992 (UK)

6.2.5 Using activity-based costing

Costs are the total value of resources used in producing goods and services. Accurate costing is an essential part of sound financial management. With accurate costing, goods and services can be priced correctly, hidden subsidies or losses can be avoided, and comparisons with alternative providers made.

Costs are made up from two elements:

- *Direct or variable costs.* These relate directly to a product and will vary with variations in the output of the product. Examples of direct costs include raw materials, components and direct labour.
- *Indirect or fixed costs,* sometimes known as overheads. These cannot be related directly to a single product, but are shared with other products and do not necessarily vary with output. Examples of indirect costs include rents and land taxes, administrative or financial costs.

Traditionally, public sector organisations have concentrated on direct costs, and have tended to ignore indirect costs, such as cost of capital, investment in estate and capital equipment, and administrative and overhead costs.

Total costing or the total acquisition cost does include indirect costs, in particular, the cost of capital.

Where indirect costs are taken into account, they must be allocated to individual departments or products. However, often their allocation among departments and/or products is arbitrary or based on precedents which no longer reflect the current status.

Activity-based costing takes this concept a stage further and consists of tracing individual costs back to the primary activity which led to them being incurred. It is mainly concerned with the indirect or fixed cost elements. Under activity-based costing, these are no longer apportioned on a traditional or arbitrary basis. Instead such costs are allocated as closely as possible on use or volume. In other words, it is a method of changing indirect costs into direct costs.

Activity-based costing is a powerful technique within the repertoire available to public service managers. It is a means and not an end, and should be used where and when appropriate and realistic.

The context for change

The growth of public demand for the extension of the role of the government in all aspects of economic and social activity has resulted in a greater demands on limited and frequently diminishing economic and financial resources.

As the activities of government have widened and become increasingly complex, the importance of accountability for, and efficient management of, public resources is being recognised.

Efficient use of all resources can only be guaranteed if all costs are taken account of, including indirect costs, and, in particular, the cost of capital.

Activity-based costing:

- provides accurate service-cost information, facilitating management decision taking;
- provides a better understanding of the impact of indirect costs;

- recognises differences in input consumption;
- exposes examples of hidden cross-subsidisation;
- enables a more equitable allocation of costs by enabling departments to pay for resources consumed; and
- identifies opportunities for developing cost centres. These are different parts of the organisation, based on major groups of activities and products, which can be viewed as discrete entities and whose performance, in financial terms, can be analysed, monitored and controlled separately.

Reasons for caution

The allocation of costs is not an objective science. While direct costs do vary with output, the variation is not necessarily proportional. On the other hand, indirect costs may not be completely fixed and may vary with changes in output. A definite allocation of any cost is partly dependant on judgement and convention. In many cases, the allocation of costs can only be made on the basis of agreed ratios. For example, the use of the comparative financial value of outputs or on occasion inputs is common. However, there are many cases in which answers provided by these methods are only approximate.

In summary, activity-based costing entails some assumptions; and the accuracy and credibility of the information it generates is only as good as the accuracy and credibility of the assumptions on which it rests.

The technique is based on effective and comprehensive management information systems, which may be very labour intensive, and apart from being costly, may tie up scarce trained human resources which may be required elsewhere.

The successful introduction of any form of activity-based costing will also require the active co-operation of management and staff. The term “cost centre” can be highly emotional and it is likely that many individuals will feel threatened by the implications of highlighting the true costs of their departments or products. It is important that the positive aspects of the exercise are emphasised.

Activity-based costing systems need frequent revision as structure and systems change. The symptoms of outdated costing systems are:

- wide variations between actual and budgeted cost information;
- low level of usefulness of information for internal decision making;
- managers’ lack of confidence in official systems;
- parallel, independent information systems are developed;
- operational managers denying ownership of costs; and
- the need for frequent and manual adjustments to results and reports.

Achieving change

The introduction of any reform of costing practices should be part of a broader series of financial reforms achieving improved value for money. Reforms particularly associated with activity-based costing are: introducing capital charging, improving procurement and improving estate management.

Such a comprehensive set of reforms requires a central authority in a position to co-ordinate reforms, ensure compliance, and provide the necessary support with advice, assistance and training.

Introducing activity-based costing requires:

- an analysis of the existing public service operations, service-wide or at the level of individual Ministries or departments, to identify the major activities, or major groups of activities, which comprise those operations;
- an analysis of the direct and indirect costs associated with each activity or group of activities;
- an assessment of the opportunities for continued monitoring of all costs and for the calculation of activity-based costs;
- an assessment of options for regular dissemination of comparative activity-based costs to managers which allows them to:
 - identify changes over time; and
 - identify cost increases or decreases resulting from their management decisions.

Examples of change

In *Malta*, as part of a series of financial reforms, the classification of accounts and organisations was restructured in 1992, and management financial accounting reports based on the Chart of Accounts were available from 1993. Previous classifications had evolved to a point when there was no longer an underlying structure which addressed the reporting needs of operating departments and Ministries.

The revised breakdown of accounts was based on two-fold analyses:

- The Chart of Accounts which identified the nature of the transactions. This provided a breakdown of each cost centre where basic operations could be identified, and where revenues, recurrent and capital expenditure, and below-line transactions, were recorded.
- The Organisational Classification which identified responsibility for transactions, from the highest level down to heads of cost centres.

This reorganisation allowed for the development of reliable and informative reports and facilitated rational decision making on the basis of known costs and benefits.

In *New Zealand*, output costing has been developed as an extension of activity-based costing. It was recognised at the outset that no one costing system would be appropriate for all situations, though all would focus on outputs and cost-incurring activities. Within wide parameters, the following factors were identified as fundamental to the design of a costing system:

- the level of information required by users;
- the complexity and diversity of cost objects;
- the frequency of cost allocation;
- the reporting structure of the department; and
- the cost of maintaining the system.

The *South African* Government has introduced the Medium-Term Expenditure Framework which requires departments to link expenditures systematically to strategic aims; and, as part of a move away from the incremental budgeting of the past, departments will be required to establish clear outputs and priorities, together with key performance indicators, clear monitoring procedures and business plans.

Also in South Africa, a key strategy designed to achieve optimal utilisation of human and other resources is the Medium-Term Personnel Framework. This will be used to determine policies and fiscal allocation in a five-year period. Personnel costs are tied to programmes being offered by the various departments and thus facilitate the costings.

In the *UK*, a number of initiatives aimed at improving value for money include improvements to procurement and accounting and costing procedures. In particular, the introduction of accrual-based accounting systems and of capital charging has facilitated the identification of the full cost of activities. This development was further encouraged by the introduction of a comprehensive market-testing programme which, per se, required the availability of accurate costs of individual activities.

Other useful material (current as of 1996)

McCulloch, B. Accounting and Management Reforms in New Zealand Government. In *Administrative and Managerial Reform in Government: A Commonwealth Portfolio of Current Good Practice*. Proceedings of a Pan Commonwealth Working Group Meeting held in Kuala Lumpur, Malaysia, 19-22 April 1993. Commonwealth Secretariat, 1993 (ComSec)

Pallot, J. Accounting and Financial Management Reforms in New Zealand Central Government: Context and Critique. In: *Administrative and Managerial Reform in Government: A Commonwealth Portfolio of Current Good Practice*. Proceedings of a Pan Commonwealth Working Group Meeting held in Kuala Lumpur, Malaysia, 19-22 April 1993. Commonwealth Secretariat, 1993 (ComSec)

From Problem to Solution. Commonwealth Strategies for Reform. Managing the Public Service. Strategies for Improvement No. 1. Commonwealth Secretariat, 1995 (ComSec)

Improving Output Costing – Guidelines and Examples, Parts I and II. Treasury, Wellington, 1994 (NZ)

Life-Cycle Costing. Guidance Sheet (No. 35). Public Competition and Purchasing Unit, HM Treasury (UK)

Efficiency and Effectiveness in the Civil Service. HMSO, London, 1982 (UK)

Financial Management in Government Departments. HMSO, London, 1983 (UK)

6.3 Improving Management Information

6.3.1 Strengthening external audits

External audit is a check, a process of verification or examination, of an organisation's accounts and records by an independent authority.

The purpose of an external audit in the public sector is to provide assurance to taxpayers as to the integrity of public finances (the financial audit), and also to ensure that value is being achieved in public spending (the value-for-money audit).

The context for change

Since the mid-1970s, governments have been increasingly concerned to adapt and develop the structures and values of the public service to achieve greater efficiency and more responsive services. Improved quality at less cost has been the imperative. These changes have largely been pushed by continuing economic crises in developing and developed countries, which have in turn arisen from deteriorating terms of trade, over-extended borrowing, and a somewhat abrupt change of policy by the lending institutions during the 1980s.

However, the changes have also arisen from a new set of managerial strategies for the public service, which have opened up the possibility that greater results can be achieved from fewer resources by strengthening lines of accountability and defining intended outputs more sharply.

Financial management reforms have been at the centre of the response to the economic crises, and have been equally fundamental to the new managerial strategies adopted in the public service.

These reforms have been accompanied by changes in budgeting procedures and a liberalisation of many financial controls, as managers are provided with the opportunity to manage flexibly to achieve specific objectives.

However, this process of liberalisation also increases the possibility of fraudulent or other misuse of public funds. Consequently, countries have strengthened, or are in the process of strengthening, their auditing procedures through legislative changes; changes in remit, for instance to include value-for-money auditing; and through increased resources, enabling more thorough audits to be undertaken.

Reasons for caution

Changes to, and the strengthening of, the external auditing procedures must be introduced with care, preferably as part of an ongoing comprehensive, mutually-supporting set of reforms, aimed at improving financial management in general.

The understanding and positive support of departmental managers must be secured through consultation and training. It is important that managers should convey a positive message about external auditing, emphasising its role in the identification of systemic weaknesses as a counterbalance to its role in finding fault.

A key precondition to strengthening external auditing is the availability of the necessary human resources. External auditing in the public sector is becoming closer to practices in the private sector. Auditing bodies must therefore be prepared to match private sector skills and training procedures, and must compete with the private sector in training, hiring and retaining skilled personnel.

Systems designed must include provision for ensuring compliance with any recommendations which may arise in reports on audits carried out. A common weakness is the absence of any such provision, which results in reports being shelved while malpractices continue.

Achieving change

Effective external public auditing must be based on certain key principles:

- clear boundaries between the government, which determines policy; the public service which implements policy; and parliament or the legislature, which oversee both policy and implementation on behalf of the public;
- independence of public auditors by statutory prescription of their status, including methods of appointment and removal from office, and of funding arrangements;
- resources should be allocated by the legislature, not the government or the public service;
- statutes should also prescribe the audit remit, and include freedom to determine the nature and scope of work;
- there should be unrestricted access to documentation and the right to seek explanations from those responsible for activities; and
- auditors should submit reports to the legislature, where there should be proper arrangements for their consideration.

Financial audits should be carried out at regular intervals by properly qualified staff, who are part of an independent organisation, with authority to require answers to questions, and with authority to ensure compliance.

The auditor is responsible for ascertaining if:

- all reasonable precautions are taken to safeguard the collection of public monies;
- whether issue and payment of monies have been made in accordance with proper authority and that payments have been properly charged and supported by sufficient vouchers or proof of payment;
- whether the use, control and write-offs of public assets have been made in the proper manner and according to regulations;
- whether all accounts and records are well and correctly maintained; and
- whether monies have been expended for purposes for which they were allocated and the activities for which money was spent have been carried out in the in the most efficient manner.

The independence of the Auditor General, or comparable position, is emphasised by the presentation of annual reports to a strong Public Accounts Committee or similar high profile Parliamentary Committee, able and willing to bring issues of concern to the attention of the full legislature.

Examples of change

In *Kenya*, the Office of the Controller and Auditor General is a Constitutional Office. The external audit function is further strengthened by a Public Accounts Committee which is a Select Committee of National Assembly.

The Exchequer and Audit Amendment Act of 1985 provided for the appointment of an Auditor General (Corporations) to be responsible for auditing the accounts of State corporations in view of their more commercial nature.

In *Malaysia*, the responsibilities and role of the Auditor General are provided for under the Federal Constitution and the Audit Act of 1957 (revised in 1972).

The Auditor General's Reports are tabled in Parliament/State Legislative Assemblies and referred to the Public Accounts Committee(s) which considers financial management on behalf of the legislature. The Committee(s) may take remedial action, compliance of which will be followed up by the Public Accounts Committee.

In the *UK*, although some agencies are audited by private sector firms, most audits are carried out by the National Audit Office (NAO); while local authorities and health authorities are supervised by either the Audit Commission, the Scotland Accounts Commission, or the Northern Ireland Audit Office.

The National Audit Office is headed by the Comptroller and Auditor General, who is appointed by the Queen, on the advice of the Prime Minister and the Public Accounts Committee. The independence of the NAO is assured since the Auditor General is not appointed for a fixed term, his salary is paid from the Consolidated Fund and does not require annual approval, and his removal from office is the prerogative of the Sovereign, following an address from both Houses of Parliament.

The Comptroller and Auditor General alone decides on the extent and conduct of audits and reports made to Parliament. He/she is empowered to appoint staff and determine their rates of pay.

The NAO publishes their value-for-money reports – for Parliament and the public, to provide assurance, information and advice on the use of resources in departments and other audited bodies.

The NAO reports are considered by the Public Accounts Committee, which then makes its own report to Parliament, including recommendations to Government. The Government's response is subsequently laid before Parliament in the form of Treasury Minutes. The NAO later follows up to ensure compliance.

Other useful material (current as of 1996)

The Treasury Board Manual. Canada (CAN)

The Civil Service in Malaysia – A Paradigm Shift (MAL)

Improvements and Developments in the Public Service, Malaysia (MAL)

Public Audit Manual, National Audit Office/Overseas Development Agency (UK)

Helping the Nation Spend Wisely – A Guide to the National Audit Office/National Audit Office (UK)

The Scope, Objectives and Methods of the NAO's Financial Audit. National Audit Office, 1993 (UK)

6.3.2 Strengthening internal audits

Internal audit is an independent assessment of the effectiveness of management systems to ensure that:

- departmental objectives are achieved;
- resources are used economically and effectively;
- established policies, plans, procedures, laws and regulations are complied with;
- assets and interests of the department are safeguarded from losses of all kinds; and
- the integrity and reliability of computer systems are maintained.

While internal audit aims to assist management by providing objective and timely information regarding the strengths and weaknesses of the organisation, it is not an extension or substitute for line management.

The context for change

Public demand for an increase in the range and quality of services, together with the extension of the role of governments in all aspects of economic and social activity, has placed increasing demands on frequently diminishing public service resources.

One consequence of this pressure on resources and growth in public expectations has been the introduction, in the public service of many Commonwealth countries, of a range of public management reforms emphasising the need for increasing cost-effectiveness and improving quality of output. Value for money, with its emphasis on economy, efficiency and effectiveness, is a key mindset in achieving these reforms.

Against this background, traditional systems for financial management do not provide a sufficiently strong emphasis on performance. External audits frequently focus on monetary control and in consequence there is little overall evaluation of departments' activities and outputs.

Internal audit provides management with an additional monitoring mechanism, providing objective reports on ongoing infrastructure changes and on the effectiveness of the management of allocated resources.

Reasons for caution

As in most areas of financial reform, the successful introduction of internal auditing is dependent on the co-operation of managers and employees. The principal danger when introducing internal auditing is negative management, where the audit is seen largely as a system of control, and not as a management aid or tool which will, in the long term, encourage best practice and success in improving quality and value for money.

Internal audit units must be properly staffed and have a clear remit including the necessary authority to examine all aspects of the organisation's operations. Absence of appropriate authority will limit the value and reliability of the audit.

Reports from internal audit units must be published and circulated partly to ensure individual awareness of weaknesses, and partly to allow for assurance that recommendations will be acted upon.

There is a temptation for internal audit units to become involved in a critical examination of policies. Examination of the appropriateness of outcomes and the effects of the policy should not be part of an internal audit.

Achieving change

Internal audits are systems-based audits, the prime responsibility of which is to ensure that various control systems are operating effectively. The following areas must be covered by internal audit:

- the reliability and integrity of information;
- compliance with policies, laws and regulations;
- safety of assets and resources;
- efficiency in the use of resources; and
- accomplishment of aims and objectives.

Commonwealth experience points to a four-stage strategy for improving internal audit:

- The introduction of standards for internal audits, disseminated by a manual or policy document;
- The creation of internal audit units at Ministry or department level, and the provision of a central monitoring point for the frequency, coverage, and standards of internal audits;
- The institution of comprehensive training programmes for internal auditors;
- A programme review by a central auditing monitoring unit to ensure that departmental internal audit teams are complying with the required standards, to identify areas for improvement, and to disseminate best practice.

Examples of change

In *Malaysia*, in 1979, the Treasury Circular No. 2, “Implementation of Internal Auditing in Federal Government Agencies”, set the scene for the introduction of internal auditing in government departments. In 1993, a total of 17 Ministries and departments had set up Internal Auditing Units (IAUs).

IAUs are responsible for carrying out independent observations on the agency’s activities and operations on a regular basis, reporting findings; and making recommendations with regard to corrective measures which may be required.

As far as the organisational structure is concerned, the IAU is part of the agency in which it is set up and is directly responsible to the Chief Executive of that agency. Operationally, IAUs receive directives and supervision from the Financial Management Unit in the Ministry of Finance.

The Government of *Malta* is proceeding with the gradual introduction of internal audit in major Ministries. By July 1993, initial training programmes were complete and the first teams of internal auditors were deployed in four Ministries. The Ministry of Finance established a Central Audit Policy Unit and draft Audit Standards were completed.

In *Trinidad and Tobago*, it is increasingly accepted that the internal audit should be clearly distinguished as a separate career path, that training of up-to-date methodologies should be provided, and that senior positions should require the holders to have an appropriate professional qualification.

Following these developments, the Government is considering the introduction of Audit Committees, modelled on the best private sector practices, into the public services, while at the same time introducing computer audits to secure the integrity and reliability of management information systems.

In the *UK*, there is no statutory obligation for government departments to conduct internal audits; however, failure to do so may result in criticism by the Public Accounts Committee of the House of Commons in Parliament. Permanent Heads of Department are personally accountable to Parliament, and the internal audit is an important source of information and advice.

In 1981, the Public Accounts Committee criticised the general standard of internal audit in government and charged the Treasury to ensure that standards were improved. The main causes for concern included:

- the audit of computer systems was inadequate;
- a lack of personal skill and management within the audit;
- inadequate personnel policies; and
- inadequate direction from the centre.

In 1983, the Government Internal Audit Manual (GIAM) introduced standards for the internal audit. This manual was updated in 1988 and again in 1994. Comprehensive training programmes for internal auditors were introduced, together with a Basic Training Standard set out in GIAM.

The Treasury Internal Audit Development Division was set up to ensure compliance and in 1985 was established as a separate division. Reports are circulated and principal finance officers receive a letter containing detailed observations. The Head of the Government Accountancy Service and the Chief Accountancy Adviser subsequently write to Permanent Heads of Departments asking for confirmation that any necessary action has been taken.

Other useful material (current as of 1996)

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Provost, L. The Changing Role of Internal Audit. Institute for International Research. Internal Audit Conference, Wellington, 1992 (NZ)

The Internal Audit in the Public Service. Management Leaflet No. 14. State Services Commission, Wellington, 1986 (NZ)

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Government Information Systems Audit Manual. HMSO, London, 1993 (UK)

6.3.3 Introducing accrual-based accounting

Traditionally, public service organisations have used cash accounting systems which only recognise transactions when cash is received or paid, and in which financial results are reported on the basis of differences between cash received and cash paid.

While cash-based accounts give an accurate view of an entity's cash flows, accrual-based accounts give a fuller picture of the operations and overall financial position. *Accrual-based accounting* relates activities to the period in which costs are incurred or revenue is earned, regardless of when or whether money changes hands. It keeps track of assets and liabilities, and records changes in their values.

Accrual accounts therefore differ considerably from cash-based accounts. For example, accrual accounts:

- show as assets, the value of amounts due but not yet paid to the government for goods and services supplied or for taxes levied during the period;
- show as liabilities, the value of amounts due but not yet paid by the government for goods and services supplied, or for taxes refundable during the period;
- report non-cash assets, such as buildings, state highways and military equipment, and reflect changes in their value through depreciation and revaluation;
- include non-cash liabilities, such as accumulated employee leave entitlements and unfunded pension liabilities; and
- show certain changes in the value of the government's financial assets and liabilities due, for instance, to exchange rate movements.

All of these items would have been omitted or ignored under cash accounting. However, accrual reporting should not be seen as replacing cash reporting. The latter reveals flows affecting the government's liquidity and financing requirements. The two systems are complementary and data from both are relevant to assessments of financial performance.

The context for change

In the context of pressure to improve effectiveness within the public service changes, reform of financial reporting systems is fundamental in order to encourage accountability and delegation, and to provide up-to-date information to assist management decision taking and resource allocation.

Cash accounting systems do not consider the depreciation of capital assets, interest on capital, or internal charges, all of which are at the core of accrual accounting.

Accrual-based accounting systems, based on both balance sheets and operating statements:

- reflect the true financial state of an organisation;
- establish accurately the resources used;
- indicate the extent to which costs are recovered;
- permit the calculation of the return on capital; and
- generally provide means of setting efficiency targets and other indicators.

Some of the advantages of accrual accounting can be illustrated by considering the choice which a government might face between paying higher public salaries immediately, and providing greater employee pension benefits in the future. A decision to increase those benefits instead of salaries would be reported differently under cash and accrual accounting frameworks.

Under cash accounting, higher pension benefits might appear artificially attractive even if they ultimately cost more because the cost is unreported until the year in which the liability is actually paid. Experience has shown that this offers a false sense of sustainability and makes it harder to ensure that sufficient resources are available when the obligations finally have to be met.

Under accrual accounting, by contrast, the cost of higher pension entitlements would be reported as employees accrue the benefits (that is, as they work and earn the eventual pension) possibly years before the benefits are paid out. An increase in the future liability during a given period is reported as an expense, and the accumulated sum of such liabilities appears in the balance sheet.

Accrual reporting thus gives a clear view when financial implications extend beyond a year and encourages a longer-term focus in decision making. It also facilitates more meaningful assessment by Ministers and legislators of the performance of government entities (including departments), and of managers responsible for them.

Reasons for caution

The introduction of accrual accounting is a major administrative step, strongly dependent on the availability of appropriate accounting skills. It can only be part of a comprehensive, integrated series of financial reforms aimed at improving accountability and achieving value for money. It is particularly associated with capital charging and reforms to the budgetary process, such as end-of-year flexibility and delegated budgetary responsibilities.

In moving towards accrual accounting, two fundamental issues have to be addressed: the establishment of an opening balance sheet; and the combination of all the diverse types of public sector agencies under the same accounting standards.

The establishment of an opening balance sheet will highlight the absence of systematic records of asset values, including buildings, liabilities and receivables, and capital; the calculation of which is time-consuming and contentious. Many departmental accountants, trained under a cash-accounting regime, will need extensive re-training to undertake this task.

On the question of common accounting standards, different departments with different characteristics may argue that special circumstances require the adoption of special rules. A multitude of special rules will subsequently present difficulties in managing an already complex system.

The introduction of accrual-based accounting will require extensive modification and updating of most management information systems.

The challenges of utilising accrual-based accounting systems for the public service are such that strong support will be necessary from the national professional accounting body.

Achieving change

There are two possible strategies available: the modification of the existing cash-based accounting systems or the introduction of a new tailor-made system.

The existing cash accounting system can be adapted to include accruals and non-cash items, such as capital costs, rentals and superannuation. Supplementary accruals-based information can be produced by memorandum-based trading accounts and capital-asset registers.

This approach may be more practical in large departments where the design and implementation of a completely new system might not be practical within a reasonable time scale.

The introduction of accrual accounting is dependent upon the national accounting profession having established a body of generally accepted accounting practice. The underlying principles and standards must be applied consistently over time and backed up by quality audit assurance.

The questions to be considered prior to adoption of accrual accounting are as follows:

1. Is the accounting system ready for accrual accounting?

This broad issue can be divided into a number of subsidiary questions:

- Has an adequate time frame been established to convert the accounting system from a cash-based to an accrual accounting system?
- Has the Chart of Accounts been revised for accrual accounting?
- Is the fixed asset information available for accrual accounting?
- Have the overhead allocation policies been established for reporting on each significant activity?
- Are the administrative procedures for operating the accounting system defined and efficient?
- Is the existing accounting software likely to present any difficulties in adopting accrual accounting?

2. Do the users understand accrual accounting?

- Has an education programme been established to improve the understanding of accrual accounting statements?
- Are the objectives of introducing accrual accounting clearly established?
- Which groups within the organisation should be included in the education programme?

3. How is the accrual accounting information to be presented and used?

- Will accrual accounting be used for monthly internal management reporting as well as periodic external reporting?
- Will budgeting and management planning use accrual accounting?

The introduction of accrual accounting requires good project planning that addresses the conceptual, technical and educational issues involved. A project timetable and regular monitoring is required, as well as the active involvement of senior staff. Without this involvement, they will neither understand nor use the financial statement prepared on an accrual basis.

Examples of change

New Zealand was one of the first countries to provide government and public sector financial reports which include a balance sheet of assets and liabilities and an accrual-based operating statement of income and expenses.

The introduction of accrual-based accounting was seen as a wide-ranging financial management reform aimed at improving public sector efficiency. The main thrust of these reforms has been towards achieving an output orientation. Key elements of the initiative were delegating decision making, increasing accountability, and improving financial reporting, including through the introduction of accrual accounting.

The Public Finance Act, 1989, required all departments to have an accrual-based accounting system in place within a two-year time frame (before July 1991). In fact this objective was achieved within 18 months, i.e. by January 1991, and in the 1994/5 Budget Estimates, all Crown entities were required to submit accounts prepared on an accrual basis.

The key issues, preparation of an opening balance sheet and determination of accounting standards, were resolved as follows:

- The issue of the balance sheet was resolved by requesting all departments to prepare and maintain a register of major capital assets and liabilities. This exercise included valuations of all main assets and liabilities which were subsequently agreed.
- On the question of accounting standards, the strategy was to use the standards outlined in the Generally Acceptable Accounting Practices of the New Zealand Society of Accountants. The advantages of this were that it avoided the Treasury having to determine precise accounting rules, thus saving time, and it enabled private sector resources to be used.

In the long term, the use of similar rules in both private and public sectors encourages openness and comparison.

In the *UK*, “core non-commercial” elements of the public sector traditionally presented accounts on a cash basis.

However, with the introduction of delegated budgetary responsibilities and the emphasis on efficiency in resource allocation, and in achieving value for money, together with the creation of Executive Agencies under the Next Steps initiative, the need for a refinement of existing accounting arrangements was recognised.

In November 1993, the Chancellor announced the decision, in principle, to introduce resource-based accounting to all non-commercial departments.

Other useful material (current as of 1996)

From Problem to Solution. Commonwealth Strategies for Reform. Managing the Public Service. Strategies for Improvement No. 1. Commonwealth Secretariat, 1995 (ComSec)

McCulloch, B. Accounting and Management Reforms in New Zealand Government. In Administrative and Managerial Reform in Government: A Commonwealth Portfolio of Current Good Practice. Proceedings of a Pan Commonwealth Working Group Meeting held in Kuala Lumpur, Malaysia, 19-22 April 1993. Commonwealth Secretariat, 1993 (ComSec)

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Efficiency and Effectiveness in the Civil Service. HMSO, London, 1982 (UK)

Financial Management in Government Departments. HMSO, London, 1983 (UK)

Better Accounting for the Taxpayer's Money: Resource Accounting and Budgeting in Government. HMSO, London (UK)

6.4 Focusing on Outputs

6.4.1 Achieving an output orientation

The New Zealand Public Service provides a useful definition of an output:

“An *output* is an identifiable good or service supplied outside an organisation. In the case of government departments, outputs include goods and services for Ministers, other departments, the public and the private sector. Possible types of output include policy advice, the administration of regulations, the provision of services, the production of goods and the administration of grants and benefits. It is important that departments are able to define their outputs in terms of quality, quantity, cost and time.”

An output orientation entails moving the focus of accountability towards the goods or services actually produced rather than on the production processes.

In its most developed form, an output orientation requires the restructuring of departmental budget estimates and financial reports so that they are presented in terms of the goods and services produced. More generally, an output orientation is a focusing of managerial concern on the goods and services produced by the public service, while recognising that many financial and reporting systems still concentrate on staff and financial inputs almost exclusively.

This entry describes the issues addressed by the Public Service of New Zealand in restructuring its budget processes; however, this radical development may not be considered appropriate or feasible in other settings.

The context for change

The degree of precision in the specification of outputs varies according to the use to which the information is to be put. The uses of output information are:

- parliamentary accountability;
- Ministerial decision making concerning output purchasing; and
- internal management decision making.

Output-based management may be adopted for various reasons:

- *To improve the capacity of government to scrutinise the output of departments.* Specification of outputs represents a significant improvement in the standard of information available to government.
- *To improve managerial performance.* Associated with the introduction of outputs is the removal of detailed input controls. This gives managers greater freedom to make decisions on the mix of inputs necessary to ensure resources were used to best effect.
- *To enhance departmental accountability, allowing a much clearer statement of what is expected.* The specification of outputs allows Ministers to make more meaningful decisions about what they wish to purchase. It is also easier to judge the efficiency and effectiveness of departmental activity and make meaningful comparisons of performance between departments and the private sector.

Overall, the rationale for an output focus is that it allows a more effective and acceptable relationship between Minister and department. Heads of departments can be held accountable for performance in the delivery of services at an output level, allowing Ministers to assume greater responsibility for the ultimate consequences of government programmes, the outcome.

Reasons for caution

The development of an output orientation rests on a complex set of pre-conditions:

- Output management emphasises increased delegation of responsibility to managers, and the concomitant liberalisation of many financial controls by allowing financial decisions to be taken at departmental or line-management level. Other forms of control are required.
- The existence of a cadre of trained managers, willing, able and qualified to take such responsibility, is an essential prerequisite. The absence of such a cadre will prejudice the success of any reforms.
- Output orientation is intended to deliver increased accountability. It is essential that the appropriate financial reporting systems are in place, both for evaluation and, in view of the liberalisation of financial controls, to permit the strengthening of other forms of control.
- Emphasis on outputs and, in consequence, on performance, will be challenging to managers who have previously seen the public service as based on hierarchy and have taken a procedural view of activities. Confidence-building is essential.
- The implementation of an output-based management system is dependent on the definition of outputs, and the measurement procedures or performance indicators to be applied when evaluating them. It is essential that definition and measurement procedures are clearly understood and are highly practical.

Achieving change

The basic pre-conditions for introducing output-based estimates are:

- departmental accounting systems are able to operate the new procedures;
- the outputs must be aggregated in meaningful clusters; and
- key stakeholders, including Ministers and heads of departments, must recognise the value of the changes.

The introduction of a formal public service system of estimates and reports based on outputs is achieved in a series of stages. It is not realistic to attempt to convert all departments to an output regime at once. Some departments, because of the nature of the services provided, for instance policy advice, are likely to need time to convert.

Departments which receive revenue from third parties, in exchange for particular outputs, also need to be separated into two groups: those where such revenue is immediately directed to a consolidated fund; and those which retain this revenue as part of their appropriation. In principle, identification of outputs and conversion to an output orientation will be easier in the latter.

The outputs themselves must be defined. These will have to be agreed between the department and the central authority driving the reforms, normally the Ministry of Finance. Clearly, output costs will need to be specified with accuracy and precision. In particular, output specifications should include measurable performance indicators, which reflect both volume and quality. Once the specifications have been agreed, the outputs can be included as part of departmental estimates.

Examples of change

In *New Zealand*, the Treasury played a pivotal role in the shift towards an output focus. Departments developed their initial set of outputs through the following steps:

- The department would meet with the Treasury to work through the basic issues.
- These were followed by detailed discussions both with the Treasury and within the department by a steering group reporting to senior management. These discussions would continue until both the Treasury and department agreed on an output specification.
- The agreed specifications were vetted by a quality control panel of senior central agency officials, the purpose of which was to oversee all outputs and develop consistent specification approaches across all departments.
- When cleared by the senior officials, the department would seek endorsement from the Minister, and the Treasury would submit a recommendation to the Minister of Finance that the outputs be issued for inclusion in the Department's annual estimates.

Departments operating under an output orientation are now required to formally produce an annual purchase agreement with their Minister which sets out in considerable detail the exact composition of each output.

In 1990, the Government of *Malaysia* introduced the Modified Budgeting System (MBS). The objective of the MBS is to improve the budgetary process, particularly in relation to accountability, the allocation of resources, and the implementation of programmes by government agencies.

MBS stresses the relationship between inputs, outputs, and the impact of a particular programme or activity. Under this system, government agencies are required to determine their achievement targets in terms of outputs and the impacts of every programme or activity for which there are "programme agreements" between the agency and the Federal Treasury.

In *South Africa*, the Government has introduced the Medium-Term Expenditure Framework which requires departments to link expenditures systematically to strategic aims and, as part of a move away from incremental budgeting of the past, departments will be required to establish clear outputs and priorities, together with key performance indicators, clear monitoring procedures and business plans.

Other useful material (current as of 1996)

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Malaysia, 1992 (MAL)

Scott, G. & Ball, I. Financial Management Reform in the New Zealand Government. The Treasury, Wellington (NZ)

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Bushell P. Specifying Organisational Outputs, New Zealand Society of Accountants Conference, 1989 (NZ)

Efficiency and Effectiveness in the Civil Service. HMSO, London, 1982 (UK)

Financial Management in Government Departments. HMSO, London, 1983 (UK)

6.4.2 Delegation of financial management

Delegation of financial management is one of the areas of broad strategic choice relating to reforms in government financial management.

Delegation of financial management is taken to involve the transfer of authority for certain financial decisions from central government to departments, sections and agencies. The move to shift more empowerment to the managers is based on a belief that decisions are likely to be more effective and lead to greater value for money if made by the people directly responsible for the provision of goods and services.

Delegation of financial management is one of a number of reforms designed to promote increased accountability and value for money in the public service. It is associated with the introduction of an output orientation, the liberalisation of financial controls, and, in particular, reforms to the budgetary process.

A budget will normally detail expected revenues and expenditure, and can be separated into revenue and expenditure budgets. In the public service, budgets are part of the appropriation procedures when departments outline expenditure plans on which appropriations from public funds are made.

The budget is also an instrument of control. Approval of a budget often determines and fixes the department's operations for the period. Traditionally, public sector organisations have not been allowed to divert expenditure from approved to other purposes, and, at the end of the period, unspent funds are normally returned to the centre. Delegation of financial management is designed to rectify weaknesses associated with this lack of flexibility.

The context for change

As the activities of government have widened and become increasingly complex, the importance of accountability for, and efficient management of, public resources is being recognised.

Reforming the financial management process includes a move towards output-based management, and increased accountability of managers with accompanying liberalisation of budgetary controls. The delegation of financial management is a key element of this procedure.

Delegation of financial management is designed to free departmental managers from the constraints resulting from rigidities in the classification of accounts and in financial management procedures. With increased flexibility and authority to both change budget formats and execute virements between activities under a particular programme, managers will be in a position to take prompt action in the face of changing circumstances, needs and technology.

Reasons for caution

Liberalisation of the budgetary process can render existing financial controls and reporting systems inadequate, enhancing the prospects of unauthorised expenditure.

In order to obviate this danger, changes in the budgetary process must be accompanied by appropriate improvement in control agencies through improved financial reporting and auditing procedures, as described elsewhere in this Portfolio. If reform of the budgetary process is part of a comprehensive plan to reform financial management, then increased liberalisation of controls will be necessarily accompanied by increased accountability and responsibility on behalf of managers.

Achieving change

Delegation of financial management will only achieve success if it is part of a comprehensive and mutually-supporting set of reforms in financial management, of which activity-based costing, output orientation, increased accountability and achieving value for money are central.

Prerequisites for successful delegation include:

- the existence of a central responsible body with the authority to drive the reforms through, and insist on compliance and the resources to offer advice, assistance and training;
- the co-operation of managers and other staff responsible for implementation. This co-operation can be assured through consultation, the empowerment of managers through liberalisation of controls, the availability of appropriate training and, perhaps, a system of rewards for excellence;
- the concomitant development of a comprehensive management information system which permits the accurate recording of transactions, and the subsequent preparation of reliable and informative financial reports.

Any liberalisation of detailed controls must be accompanied by a strengthening of both the internal and external auditing systems.

Delegation of financial management is not only in relation to expenditure. Delegation also has an impact on budget-setting. Traditionally, budgets are developed incrementally. Officers in charge of established programmes justify spending incurred in one year, and develop the proposals for the following year as a series of relatively minor amendments. The underlying spending in question is accepted as necessary.

With the introduction of “zero-based” budgeting, every agency has, on presentation of every budget, to justify the programme entirely as if it were new. This discipline encourages a critical and innovative approach, facilitating output orientation and frequently leading to changes in budgetary procedures.

Examples of change

In 1990, the Government of *Malaysia* introduced the Modified Budgeting System (MBS). MBS is not a simple budgeting system but an integrated and comprehensive management system which involves strategic management, performance measurement, and control systems. It has had important repercussions on the budgetary process itself.

By concentrating on outputs and performance, and on expenditure targets, less emphasis is placed on the “line-item” level, permitting a greater degree of flexibility in financial management. For example, the Controlling Officer in an agency or department is permitted to carry out virements between activities without reference to the Federal Treasury.

In *New Zealand*, the comprehensive measures to implement financial management reform were designed to place increased accountability on management for organisational performance, accompanied by a number of measures designed to encourage output and performance-based management. The latter, in effect, liberalised regulations designed to control financial operations.

In *Singapore*, the Block Vote Budget Allocation System (BVBAS) was introduced in 1989. BVBAS is a computerised system; one of its features is to give Ministries a generous measure of autonomy in the management of voted funds, thus encouraging managers, in this case Permanent Secretaries, to manage more flexibly.

In *Lesotho*, since 1987, the Ministry of Finance has been involved in a new financial management approach for the government. Part of this programme includes a new, less controlled and more decentralised budget system. Eventually this process of decentralisation will enable managers to be responsible for their own budget control.

Other useful material (current as of 1996)

From Problem to Solution. Commonwealth Strategies for Reform. Managing the Public Service. Strategies for Improvement No. 1. Commonwealth Secretariat, 1995 (ComSec)

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6.5 Improving Management Systems

6.5.1 Restructuring and classification of accounts

Restructuring and classification of accounts is one of a number of reforms designed to promote improved financial management, increased accountability and value for money in the public service. It is particularly associated with reforms to the budgetary process.

The budget is the formal expression of expected or estimated financial activity for a particular period. A budget will detail expected revenues and expenditure, and is prepared when departments outline expenditure plans on which appropriations from public funds are made.

The line-item approach, specifying in detail activities to be undertaken during the budget period, and the pressure to maintain comparability year by year, encourages rigidity in budget formats and in the classification of accounts.

The context for change

The budgetary process is a key financial tool in financial management and control. It is an extremely flexible document which can be easily adapted to changes in circumstances and to different time scales. This means that it is appropriate to both capital projects and to operating or running costs.

Budgets can be expressed both in terms of inputs and outputs, and facilitate the measurement, evaluation and comparison of organisational or project performance. At the end of the budget period, or at any convenient point within it, planned objectives or outputs can be compared with actual performance, and variance analysis techniques applied.

However, without periodic review and reform, the budget can become an inhibiting factor. The line-item approach becomes fixed and leads to undesirable inflexibility. When controls simply measure or check attainments against planned activities, the process can become more important than the objective it was intended to achieve.

Without increased flexibility and authority to change budget formats, managers will not be in a position to take prompt action in the face of changing circumstances, needs and technology.

Restructuring and classification of accounts in which the existence, number and order of the budget items is changed to encourage innovative thinking and to reflect changing circumstances, is a key element in reforming the budgetary process. It must be seen in the context of:

- *delegation of budgetary responsibilities* – a liberalisation of financial controls giving managers authority and flexibility to move funds from one part of a programme to another, in effect “transfers” between items of expenditure within programmes or departments; and,
- *an emphasis on outputs* – the costed goods and services which the budget enables departments to produce.

Reasons for caution

If budgeting formats are subject to change in different periods, comparison and variance analysis exercises become increasingly difficult. This difficulty can be reduced if the focus of the budget becomes based on outputs and performance rather than on the activities undertaken.

The budget should not be simply a process of listing requirements. It should be also be a management tool linked to internal auditing procedures within departments.

In general, improving the budgetary process should be closely allied to changing the style of management in the public sector from a focus on processes to an output orientation, with emphasis on delegation to, and accountability of, managers.

Achieving change

Any radical change to the structure and classification of accounts will require co-operation, support and input from both the Ministry of Finance and operating departments.

To secure these, a Committee should be set up on which the Treasury and Public Accounts, Ministry of Finance or analogous bodies, operating departments, and other interested jurisdictions are represented.

As it is likely that no single classification system will provide for all coding requirements, a multiple-classification system, with multiple levels of detail within each classification should be developed from the outset.

The effectiveness of any system will depend on individual transactions being properly identified. This will require, as a minimum, a two-fold classification linked to an integrated coding system which requires each transaction to be identified both by nature and source.

The two-fold classification will:

- **identify the nature of transactions** – This classification should provide a breakdown of all of the transactions of each Ministry and department, and each cost centre, to the level of basic line objects where the operations, processes, services, projects, tasks, etc., are identified. These should identify, at various levels of aggregation, the purposes for which funds are spent to achieve their objectives or the sources of revenues received.

This will provide a coded listing of accounts which are used to record revenue, recurrent expenditure, capital expenditure and below-the-line transactions. Each of these account types should be divided into categories, and these are further divided into standard objects.

Each standard object consists of a number of line objects, which are the lowest level at which all expenditures are coded, and are therefore the building blocks of the standard object and category classification.

- **identify responsibility for accounts** – The organisational classification ranges from the highest level of managerial responsibility and identifies who is responsible and accountable for spending public funds.

The organisational classification culminates in a Ministry or departmental vote, which provides the basis for the vote structure by which the legislature appropriates funds.

At the top of the structure is the Ministry or department which is identified in the estimates by means of a recurrent vote and which is divided into a number of cost centres.

A cost centre is defined as a major programme or activity of a Ministry or department and can be further divided into responsibility centres. A responsibility centre is a sub-section or division within a major programme or activity where there is a manager who is accountable for a budget.

Any new system should be piloted in a sample department prior to implementation. Full implementation should be preceded by the publication of a coding manual with extensive explanatory notes, and by an intensive training programme for departmental accounting officers.

The introduction of a new structure of accounts will have to be accompanied by the development of management information systems based on the new format and should be accompanied by a strengthening of both the internal and external auditing systems.

Examples of change

In *Kenya*, the Office of the Accountant General, under the Treasury, is responsible for developing and evaluating the appropriate accounting systems and procedures to facilitate efficient financial management in Ministries and departments.

The Accountant General is therefore responsible for the planning, co-ordination, design, implementation and control of accountancy systems in the Civil Service, which, together with the accompanying financial regulations, are constantly reviewed and updated.

In *Malta*, the accounting system had been modified to the point where there was no longer an underlying structure that addressed the reporting needs of operating departments, Ministries, the Treasury or the Legislature. Accounting codes were not well understood, nor were they applied consistently, and the resulting financial accounts were generally unreliable for management information services. The boundaries between major types of expenditures depended on local circumstances where the decision to identify a particular financial transaction as operational and maintenance, as special expenditure, or as capital expenditure, was flexible and often arbitrary.

To resolve this problem, a Committee of Advisors was established comprising representatives from both the Treasury and Public Accounts process in the Ministry of Finance, operating departments, and other jurisdictions.

A multiple-classification system, with multiple levels of detail within each classification was developed. A two-fold classification was linked to an integrated coding system which required each transaction to be identified both by nature and source. The two-fold classification consists of a chart of accounts classification to identify the nature of transactions, and an organisational classification to identify responsibility of accounts.

The new system was piloted in a sample department prior to implementation, which was fully implemented in the 1993 Estimates. Full implementation was preceded by the publication of a coding manual with extensive explanatory notes and an intensive training programme for departmental accounting officers.

Development of management information systems based on the new format was concomitant with the design of the new system, and was implemented in February 1993. Codes for recording and reporting transactions according to the new chart of accounts and organisational codes will be used in the Departmental Accounting System.

Other useful material (current as of 1996)

Current Good Practices and New Developments in Public Service Management. A Profile of the Public Service of Malta. The Public Service Country Profile Series: No. 6. pp. 119–122. Commonwealth Secretariat, 1995 (ComSec)

From Problem to Solution. Commonwealth Strategies for Reform. Managing the Public Service. Strategies for Improvement No. 1. Commonwealth Secretariat, 1995 (ComSec)

6.5.2 Introducing flexible budgeting

Flexible budgeting describes the procedures under which departments are enabled to carry forward part or all of the funds allocated to them in a particular period.

In most Commonwealth countries, established financial management practices include the principle that resources, particularly those used for administration running costs or ongoing programmes, are allocated until the end of the financial year, after which any excess or unspent funds are returned to the central authority.

The context for change

One consequence of the growth in public expectations and the consequent pressure on the resources of the public service has been the introduction, in the public services of many Commonwealth countries, of a range of public management reforms, emphasising the need for increasing cost-effectiveness and improving the quality of outputs. Liberalisation of the regulatory and control functions under which public sector resources are used, combined with strengthened accountability for results, has been a key device for improving efficiency.

Traditionally, funds unspent by the end of the year are forfeited and returned to central funds. One of the more deleterious effects of this is the encouragement it offers for spending surges at the end of the financial year as departments seek to disburse unspent funds, resulting in poor purchasing practices.

By allowing excess or unspent funds, or a proportion of them, to be carried forward, managers are encouraged to seek value for money by timely, well-planned and appropriate purchasing.

Reasons for caution

The forfeiting of excess funds at the end of the financial year was intended to discourage departments from seeking resources in excess of their requirements. It is arguable whether the inability to carry over funds has provided a significant downward pressure on the demand for funds, but the concern must remain that allowing flexible budgeting removes one aspect of financial discipline.

Flexible budgeting allows the possibility of concealing known areas of potential savings, with a view to establishing or creating resources to be used for other possibly unauthorised purposes at a later date. Amongst such other dangers, the practice of retaining excess funds in departments can be a misuse of public resources which, if not held by a department, might have been put to alternative uses or returned to the taxpayer in the form of reductions in taxation.

The practice of end-of-year flexibility is contingent on the introduction of other reforms in financial management, in particular, reforms of the budgetary process and of the financial reporting systems. Where implementation is feasible, the introduction of accrual-based accounting enables management to assess precisely the degree of underspend.

An overall prerequisite to the introduction of this reform is the existence of a cadre of managers willing and confident to undertake the range of financial reforms of which end-of-year flexibility is only one.

Achieving change

End-of-year flexibility must be part of the package of financial management reforms which include the general liberalisation of control features to permit a degree of freedom in the application of funds to specific projects. If managers are permitted to make transfers under particular circumstances, then carrying forward funds from one year to another follows naturally.

Commonwealth experience indicates that the principles underpinning the procedures for such flexibility are:

- underspends should first be used to offset overspends in other areas before any carry-over is permitted;
- carrying forward administrative and running costs is to be discouraged;
- carrying over of any funds must be justified in terms of clearly set out criteria;
- the pattern of funds carried over must be monitored in order to give guidance to departments or managers who are allowing project slippage to develop consistently; and
- external and internal audit procedures must be strengthened to reflect the greater flexibility provided to departments.

While technically, the introduction of end-of-year flexibility is through simple legislative procedure and regulatory changes, in most cases it has been preceded by pilot programmes and introduced in stages.

Accrual-accounting systems assist in focusing attention on the medium and longer term, rather than on the present accounting period, encouraging managers to think beyond putative deadlines for expenditure.

Examples of change

In *Australia*, carry-over provisions were introduced as part of the running-cost system in 1987-88. Key features of the scheme are:

- the amount of running costs to be carried over is restricted to a limit defined in percentage terms (e.g. 3 per cent in 1990-91); and
- borrowings must be paid back before further borrowings are allowed.

Experience indicates that use of the facility was considerably less than originally anticipated, and a number of best practice areas are suggested:

- The facility is devolved to the appropriate programme together with the authority to spend and certainty about future years' allocations.
- Financial planning and management should be at programme level on the basis of firm forward estimates.
- Formal planning and reporting systems should include a Board of Management or similar mechanism to oversee budget allocations, performance and outcomes.
- Systematic and ongoing training for programme managers.

In *Malaysia*, there are two types of budget: an operating budget, and a development or capital budget. A Department's operating budget consists of two items: Charged Expenditure authorised by the Federal Constitution, which does not require annual appropriations from Parliament; and Supply Expenditure, which requires annual appropriations voted by Parliament.

The development or capital budgets are administered through Development Funds created under the Development Funds Act 1966. They are approved by the Economic Planning Unit of the Prime Minister's Office and controlled by the Ministry of Finance. The mechanism for administration of development projects is associated with the management of five-year plans, and provides for the review of all annual plans and budgets at half-yearly, or more frequent intervals, when requests for funds are submitted. This system in itself is extremely flexible and in effect ensures the existence of end-of-year flexibility.

Operating budgets are subject to the Financial Procedures Act which stipulates that any funds appropriated for a particular process should be surrendered to the Consolidated Fund if not spent in the period for which they were granted.

In *Canada*, under the reformed budget regime introduced in 1993-94, departments were originally authorised to carry forward two per cent of their operating budget from one fiscal year to the next; a provision which has been increased to five per cent. Procedures were based on a pilot scheme which operated successfully in 1992-93.

The entitlement to carry forward is granted automatically, based on lapses reported in the Public Accounts. Capital funds amounting to five per cent of a capital vote can also be carried forward subject to acceptable justification to the Treasury Board and affordability considerations.

In the *UK*, in principle, money voted for one specific year has had to be spent during that year; if it is not spent, it has traditionally been forfeited. To minimise this restriction, there are now two specific end-of-year flexibility schemes covering capital expenditure and running costs.

In the first scheme, in operation since 1983, departments have been allowed to carry forward into the next financial year any underspending of eligible capital expenditure. Departments have been encouraged to delegate end-of-year flexibility to line or project management level.

The scheme allows for a roll-over of five per cent to be carried over, but any capital underspend must first be used to cover any overspend in other parts of a cash limit. Roll-over in subsequent years is possible subject to strict rules and ceilings.

The Running Costs Scheme, introduced in 1988, is also intended to assist departmental management and budgeting; carry-over is limited to one-half per cent of the year's running cost limit or £50,000, whichever is the greater, and as with capital, any underspend must first be used to offset any excesses elsewhere in the budget. The percentage limit may be revised upwards.

In *South Africa*, the Government has introduced the Medium-Term Expenditure Framework (MTEF) which gives departments more stable resource allocations, projected for five years, which are linked to a rolling-planning process. One of the aims of MTEF was to facilitate the introduction in 1996/7 of multi-year budgeting.

Other useful material (current as of 1996)

From Problem to Solution. Commonwealth Strategies for Reform. Managing the Public Service. Strategies for Improvement No. 1. Commonwealth Secretariat, 1995 (ComSec)

Budget Flexibility: Carryover Provisions Between Financial Periods. MAB-MIC Publication Series. Australian Government Publishing Service, Canberra, 1994 (AUS)

Fiscal Responsibility Act: A Brief Overview. Treasury Briefing Note. New Zealand Treasury, Wellington, 1994 (NZ)

Scott, G. & Ball, I. Financial Management Reform in the New Zealand Government. The Treasury, Wellington (NZ)

Putting It Simply – An Explanatory Guide to Financial Management Reform. The Treasury, 1989, Wellington (NZ)

Efficiency and Effectiveness in the Civil Service. HMSO, London, 1982 (UK)

Financial Management in Government Departments. HMSO, London, 1983 (UK)

The Manager's Deskbook. Third Edition. Treasury Board of Canada, 1993 (UK)

6.6 Financial Management

One component of the holistic approach to Knowledge Management is the reforms relating to *Financial Management*. Financial records arise from transactions or events. These transactions or events relate to customer service interactions and are important measures of performance. Records are fixed, have authority, are unique and are authentic. They are an important part of public sector accountability.

Government is accountable to its citizens and the rendering of accounts to public scrutiny is critical to achieving accountability requirements. The keeping of these records is fundamental to public administration and is critical to financial management. Financial records are the product of doing business and they provide evidence that:

- resources have been received, committed or spent;
- assets have been acquired or disposed; and
- agencies have liabilities.

These records also form the basis for the preparation of annual financial statements. Effective financial management systems provide managers and politicians with the means to:

- monitor and manage resources; and
- strengthen accountability.

Financial management systems need records as inputs to generate outputs. Financial management is the umbrella under which institutions process transactions. Components of financial management systems are often regulatory and scrutinised by the Public Accounts Committee; the Auditor General and the Ministry of Finance. Components of the system also include budgeting, accounting, and internal audit. Information management is central to financial management and includes:

- receiving information;
- processing information; and
- managing information.

These processes constitute the procedural control framework of the organisation whereas support services to financial management include information and communication technology (ICT), human resources and knowledge management.

New Zealand, for example, as part of its reform efforts has specifically focused on financial management. In fact, accountability was built into the system and was not an afterthought. In some countries, the trend has been to move from “making managers manage” to “letting managers manage”, by holding them accountable for what they do, spend and accomplish. This has not been the case in New Zealand, where making the manager responsible for his/her performance has been a guiding principal. This is an effort to improve the efficiency and quality of public services. New Zealand gives managers enormous freedom to act, but they closely monitor their financial and substantive results. The most distinctive features of the New Zealand approach to reform have been:

- performance and purchase agreements;
- appropriation of resources by output classes;
- a split between funds voted to Ministers and money provided to departments; and
- accounting and budgeting on an accrual basis.

The concern in other countries is that not enough attention is paid to accountability whereas in New Zealand the complaint is that the cost of maintaining the accountability regime is too high.

There needs to be a balance, however, between whether accountability has more to do with:

- a purchase than with ownership;
- producing outputs than with the overall capacity of the departments; and
- managers meeting targets than with public programmes being effective.

This is aggravated by the distinct focus on outputs.

CAPAM, in its continuing role in providing information to government officials, academics, and senior managers has developed a curriculum for Financial Management and Control. The six components of the programme include;

1. Setting the Framework

- Reforming financial management systems focuses on the protection and maintenance of assets along with purchasing in terms of value for money. Other aspects include accountability, budgetary processes and change drivers such as rates of return, cash limits and output-based management.
- In order to achieve value for money, governments must consider three concepts:
 1. minimising the costs of resources (Economy);
 2. increasing outputs (Efficiency); and
 3. increasing impact (Effectiveness).

2. Improving Planning and Budgeting

- To achieve strategic orientation, the public sector must set and define the budget process in terms of strategic plans and objectives; set purchase agreements in relation to outputs; develop budget initiatives (impact analysis); and approve budgets with a view for the next two years.
- In order to link short, medium and long-term plans, governments will need to put into place change drivers such as ten-year fiscal projections; a budget process that spans a three-year cycle; and strictly defined priorities and outputs. The system cannot be so rigid that decision makers are not able to change priorities and mix outputs within approved baselines.
- The budgetary relationships between centres and departments should be such that they can negotiate between themselves yet determine and agree upon outputs. In addition, Chief Executives should have in place purchase agreements that define key results.

3. Improving Management of Inputs

- The introduction of capital charging includes the ability to define government debt and equity capital; calculate charge rates linked to the capital base and the introduction of accrual-based accounting
- Improving estate management relies on obtaining an objective and informed view of the department's asset base; increased management performance in terms of physical assets; a review of asset inventory to determine validity and the need for or surplus of assets; and the cost of maintenance.

- Two basic approaches to improving asset management include the ability to communicate that poor purchasing leads to unnecessary and uneconomic acquisitions; and that the focus on spending for asset creation needs to shift to the use and management of assets to support the efficient provision of services
- Procurement is the overall process of acquiring goods and services to meet customer needs. Improvements in the procurement process, with the emphasis on value for money, is a key mindset in achieving cost effectiveness and improving the quality of outputs.

4. Improving Management Information

- The introduction of accrual-based accounting differs considerably from cash-based accounts. Accrual accounts show:
 - as assets, the value of amounts due but not yet paid to the government for goods and services or taxes levied;
 - as liabilities, the value of amounts due but not yet paid by the government for goods and services or taxes refundable;
 - reports on non-cash assets; and
 - the inclusion of non-cash liabilities.
- The restructuring and classification of accounts is one of a number of reforms designed to promote improved financial management, increase accountability and value for money. It allows managers to be creative in organising their budget process and accounts for reporting. Managers must however be able to identify the nature of their transactions and who is responsible for accounts before creating the new structure of accounts.
- Introducing flexible budgeting allows managers to carry forward part or all allocated funds into another period. Traditionally unspent funds are reallocated into a central fund. By allowing carry-overs this allows the manager the flexibility to make timely well-planned and appropriate purchasing decisions.
- Using activity-based costing allows government to trace individual costs back to the primary activities which led to them being incurred. It also allows for the tracking of indirect and fixed-cost items.

5. Improving Management Systems

- The achievement of an output orientation means moving the focus of accountability towards the goods and services actually produced rather than on the production process. Government needs to adopt an output orientation to improve the capacity to scrutinise the outputs of departments; improve the managerial process; and enhance departmental accountability through clearer statements of expectations.
- Delegation of financial management and control empowers managers to be more effective and leads to greater value for money. This is achieved if the people directly responsible for the provision of goods and services are given that authority.

6. Improving Financial Accountability

- In order to improve financial reporting, reports need to: be in accordance with generally accepted accounting practices (GAAP); be prepared on an accrual basis; include performance measures; and done on a regular, scheduled basis; be GAAP-based and include audited financial statements.
- By strengthening internal audits, management can be assured that there is objective reporting on ongoing infrastructure changes and on the effectiveness of allocated resources. The appropriateness of outcomes should not be part of an internal audit.

- Through the strengthening of external audits, taxpayers can be assured by an independent authority as to the integrity of public finances and also ensure that value is being achieved in public spending.

Other useful material (2nd edition)

International Records Management Trust, "Principles and Practices in Managing Financial Records: A Reference Model and Assessment Tool". London, U.K., March, 2001

Schick, Allen, "The Spirit of Reform: Managing the New Zealand State Sector in a Time of Change". A Report prepared for the State Services Commission and the Treasury, New Zealand, Wellington, New Zealand, 1996.

CAPAM Curriculum, "Financial Management and Control". Toronto, Canada, 2002.

6.7 Auditing and e-government

The transformation from traditional government to e-government will be one of the most important policy issues of this century. It runs to the heart of how governments operate and interact with the community. Auditing is a central management function that ensures this accountability to citizens and their representatives. This is particularly important as governments enter increasingly complex service delivery arrangements which have been made more possible through e-government innovations and technologies.

Accountability is a relationship between two parties. The contract is between the public and those who have been elected. The concept is fundamental to the democratic system. It establishes the right of all citizens to know what government intends to do and how well it has met those objectives or goals. The real issue for the auditing function is accountability. The simplest explanation of accountability is the requirement to answer to somebody for something. Therein lie the seeds of possible confusion, conflict and often public recrimination.

Auditing is essential because the general public wants to be assured that whatever is done in their name is done properly. That is, it is done according to the law and with reference to the community standards of economy and probity at the time. Democratic societies are at least entitled to that assurance. There are at least two basic elements to this accountability question:

1. What does the public expect? and
2. How does it satisfy itself that its expectations are met?

The public asks: Wasn't someone looking after things to make sure that those responsible were doing what they should have been? Where were the auditors? Where were the regulators? Why didn't they prevent it?

The context for change

First, public discontent is most often expressed at times when emotions are running high. That is, we often hear about a concern only after something has gone seriously wrong. The second point is that there is a great deal of public confusion about the role and power of the auditing function.

Auditors are required to maintain the principles which guide their actions and decisions. However, the reality is that the environment in which they operate is constantly changing, which means they need to adjust to those changes and even be part of them.

In reviewing the performance of Commonwealth agencies, it is relevant for the auditor to examine the implementation of any decision plus the advice provided to Ministers by the relevant agencies in the course of government consideration of a policy decision. Is the advice in accordance with relevant policies and does it represent value for money? In many Commonwealth countries there has been a move beyond value-for-money audits to more comprehensive performance audits. This is a particularly important shift in light of the challenges e-government presents. A performance audit can provide a strategic overview and evaluation of the current positions of the public sector in their implementation of e-government.

The primary goal of the auditing function is to contribute to the improvement of accountability and performance in the public sector. Currently, the audit function is working through the following lines of business:

- attesting to the reliability of the financial statements of the government;
- assessing the quality of the government's service plans and reports;
- examining how the government manages its key risks; and
- supporting legislators in the use of information regarding government performance.

New approaches

We can expect to see an emergence and consolidation of new modalities of accountability in the evolving public/private interface and in the context of e-government. One example is the so-called Triple Bottom Line (TBL). The current construct of accountability in the business world, including government operations, is on the threshold of a major paradigm shift. Public and other stakeholder expectations in an increasingly globalised business and communications environment will provide the drivers for a shift away from a traditional input-output based model of accountability towards a focus on economic prosperity, environment quality and social justice.

TBL goes beyond the current orthodox focus on financial performance, the utilisation of inputs, the disposition of outputs, and probity to also take into account the environmental and social consequences of business activity. This view is supported by the passage of "right-to-know" legislation.

TBL reporting could lead to changes to the manner in which public sector organisations report performance and discharge their accountability to their citizenry. The concept of sustainability requires new definitions of performance and the re-articulation of organisational goals. An important aspect for the public sector is the management of reputations, which is an all-pervasive issue for performance assessment. A degree of "trust and confidence" is essential for a sustainable future, particularly where the general public is placing some value on corporations meeting broader environmental and social goals. The situation is reinforced where there are increasing partnerships between the public and private sectors.

There is still a long way to go before TBL reporting has the rigour that characterises financial bottom-line reporting. In these circumstances there is also a particular challenge for those responsible for auditing this form of reporting, particularly where the evidential links are limited. This is an additional challenge for performance measurement and the qualitative assessment of government programs and services.

All public sector organisations are required to be transparent, responsive and accountable for their activities. Citizens are entitled to know whether public resources are being properly used and what is being achieved with them. Consistent, clear reports of performance and publication of results are important to record progress and exert pressure for improvement. Such transparency is essential to help ensure that public bodies are fully accountable and is therefore central to good governance overall. E-government will assist in the distribution of reports and the publication of results. E-governance will allow for citizen input or feedback related to these reports and results.

There are implications of the changing nature of accountability and with the greater involvement of the private sector in the provision of services to, and in particular for, the public sector. This phenomenon has been variously described, under many headings, for example new public management, the purchaser-provider model and entrepreneurial governance. The latest emphasis has been on Public-Private Partnerships (PPP) for service delivery. The changing environment goes further with the greater emphasis on partnering and networking, between and across organisations, involving all levels of the government and sectors of the economy.

Reasons for caution

Put simply, the challenge becomes to identify who is accountable for what. There is a continuum of accountability relationships between the electorate, Parliament, the Government and the public service. However, the ongoing difficulty is to define such relationships in a credible manner that is acceptable to all those parties. Fundamentally, the clearest accountability goal is adherence to the rule of the law.

The challenges for the audit function include a range of issues associated with the greater involvement of the private sector in public sector activities, including notions of partnership; collaboration; networking; and the notion that e-government activities are of growing importance to agencies within the public sector.

Other issues to which the Auditor needs to form opinions and advise on in this e-government environment include:

- contract management;
- record-keeping in a more networked environment;
- privacy and security versus openness and transparency in both the public and private sectors;
- administrative law considerations in a contractual framework;
- equity law and natural justice;
- values and ethics; and
- governance issues.

The objective should be to recognise these challenges and find a balanced framework to ensure that auditing can contribute to improvements in accountability related to e-government programmes and initiatives. The United Kingdom government for example expressed concern that an over-emphasis on accountability would stand in the way of an appropriate risk management environment in which innovation could flourish.

The Public Audit Forum (UK) responded by stating that:

“Public sector managers are of course responsible, as stewards of public resources, for assessing and managing the risks associated with innovation and increased flexibility, and for ensuring the proper conduct of public business and the honest handling of public money while pursuing innovative ways of securing improvements in public services. It remains important to ensure proper accountability but this must not be approached in a rigid way which might mean missing opportunities to deliver better value for money.”

The Forum outlined that auditors will respond to this new environment positively and constructively by:

- adopting an open-minded and supportive approach to innovation; examining how the innovation has worked in practice; and the extent to which value for money has been achieved;
- supporting well thought through risk-taking and experimentation; and
- providing advice and encouragement to managers implementing modernising government initiatives by drawing on their audit work in this area and by seeking to identify and promote good practice so that experience can be shared and risks minimised.

In these ways, it is believed that auditors can support and encourage worthwhile change, while providing independent scrutiny and assurance and fulfilling effectively their statutory and professional responsibilities.

Another challenge is the assessment of the performance of regulatory bodies which pose particular problems for the public auditor. As a general rule, their activities are usually highly technical in nature, and the organisations themselves are sometimes the only source of credible audit expertise.

Risk management

The debate about the responsibilities of external auditors and audit committees has raised the audit profile in both the private and public sectors. The importance of risk management has also entered the management framework in many public sector organisations. Within an audit framework, the suitability of the risk management and an overall governance framework to provide accurate and timely information on key risks is a central issue of control. As such, it is of considerable strategic and operational interest for any audit committee and external audit.

In particular, risk management must address:

- the need to buy expertise (related as much to the range of skills within the Office as to the need for an extended knowledge of the corporate world);
- the quality of data that is gathered – given the size of the project, it is not audited data, but relies on the data supplied by agencies;
- the range of diagnostic tools available and their relative strengths and weaknesses;
- the differences between the environments in which the individual agencies must operate;
- the size and complexity of the project management task; and
- the need to achieve and maintain co-operation with the agencies concerned.

Benefits can flow from a risk management exercise through to policy makers, public sector managers and audit authorities. The benefits can include:

- clear specific criteria for future audit activity and other avenues of assessment;
- credible information on which to base decisions on whether to perform functions in-house or to contract out;
- where functions are to be contracted out, clear and credible performance criteria to be included in tender and contract documentation;
- performance evaluation standards for management to help identify under-performance and reward excellence;
- the benchmarks developed through this method are already being used in other jurisdictions, leading to greater uniformity of performance expectations; and
- in the context of service charters mentioned elsewhere they can help provide for more credible communication with clients or citizens.

In New South Wales, Australia, the Audit Office has developed a “Better Practice Guide” which is designed to assist agencies and government to meet the challenges of exploiting benefits and managing risks with e-government. The Guide specifically focuses on issues at the baseline agency level – the frontline staff and managers. The purpose of the Guide is to assist government Ministries/departments/agencies in being “e-ready”. Managing the transformation to e-government will not happen by chance or overnight. It will be difficult and it will require a careful and managed effort.

The ‘Guide’ includes:

- better practice principles;
- risks to be managed;
- a checklist on performance; and
- HELP references.

The content in the Guide is organised into eight subject areas:

1. Leadership and Governance;
2. Funding;
3. People;
4. Legal;
5. Customer Readiness and Accessibility;
6. Privacy;
7. Security; and
8. Technology and Information Management.

The public sector can leverage off the experience and approaches taken by the private sector in many areas of benchmarking and performance management. However, there are requirements in the public sector environment which are different and need to be treated as such. Partnership arrangements have to recognise this reality and adjust to it. It is not a one-way street. Auditors can facilitate both the understanding and resolution of management, accountability and performance issues.

Opportunities can be taken to be more responsive and improve performance while minimising risk. Fundamentally, good governance arrangements increase:

- participation;
- strengthen accountability mechanisms; and
- open channels of communication within, and across, organisations.

Well-structured governance frameworks will enhance the development of suitable networks and partnerships and facilitate risk management. Private sector frameworks may provide guidance for public sector organisations. By using such frameworks, the public sector can be more confident about delivering defined outcomes and being accountable for the way in which their results are achieved.

Other useful material (2nd edition)

Barrett, Pat, "The Role of Watchdogs in the New Era of Partnerships." International Public Administration Australia National Conference – Beyond Traditional Boundaries, Sydney, Australia, 2001.

The Audit Office of New South Wales, "e-government: Using the Internet and Related Technologies to improve Public Sector Performance." Auditing E-Government Report, September, 2001. www.audit.nsw.gov.au

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