Public Sector Modernisation: Modernising Accountability and Control

Introduction

In the past two decades, new forms of public sector management, privatisation and new technologies have changed the way the public sector operates, but have also created a need for new ways of making both agencies and governments accountable for what they do. With an increasingly devolved public sector, ensuring conformity with government policy objectives, control of expenditure and monitoring of actual agency performance has become increasingly complex. At the same time, the changing relationship between government and the public sector has profoundly affected the traditional accountability of ministers to the legislature.

The basic idea of control within the public sector is to ensure that an organisation is operating within its legal and policy responsibilities and is achieving the objectives set for it. Systems of control provide assurance that management systems are operating well. Control normally operates at a number of levels. The responsibilities and budget of a department are set by government and the legislature. Thereafter control and accountability are exercised through a wide range of mechanisms which interact with each other. The executive, through the minister's office and the departmental structure, will monitor ongoing performance. The regular budget cycle will offer central financial agencies and the legislature an opportunity to review financial probity, efficiency and performance. The audit process, both internal and external, should provide a regular, independent review of financial management and performance. Overarching these more or less systematic control and accountability processes is the accountability of the executive to the legislature. With changes in public administration in the last 20 years there has been a shift in emphasis from the blunt instrument of central, mainly financial, control over funding to the more diversified model outlined above. With increasing devolution of managerial discretion and financial responsibility, much greater responsibility now rests with particular ministries, departments or agencies to show that their managers have used their money and other resources in a way that accomplishes their set functions efficiently.

Observer oecd

There are more and increasingly varied controls being applied to public service operations. Agencies now produce more comprehensive and (generally) informative accountability information than in the past. Audit scrutiny has become more independent and sophisticated, looking at performance as well as compliance. Audit bodies now seek to guarantee their independence by becoming linked to the legislature. Legislatures themselves have developed more complex procedures to monitor administration, particularly through the use of committees. All this in turn leads to new challenges, notably ensuring that the information, once gathered, is put to effective use. And the problem is likely to become more, rather than less complex, as governments delegate more service delivery functions to entities outside the direct control of ministries.

This *Policy Brief* looks at the changes and challenges facing control systems in OECD countries. ■

What are accountability and control?

The terms "accountability" and "control" at first glance seem straightforward and easy to translate, but they evoke different ideas in different countries. In English the term "control" is used to denote an active authority to manage, whereas in French "*contrôle*" implies a more passive oversight and other terms are used to suggest authority to manage. Even without language differences, the way governments interpret control in different countries varies widely, from controlling the planned use of resources before authorising spending to auditing at the end of the day to determine if the required results have been achieved efficiently. Some governments focus on controlling the financial aspects while others look to control a range of outcomes, a process often described as management control. Accountability, too, is a difficult term across languages and countries. For many, the concept of accountability is limited to the accounting system or is thought of as a reporting obligation. Other cultures use accountability to mean broader concepts: how those entrusted with the powers of the State are held responsible for their actions. These differences in meaning, concept and practice are important when trying to make comparisons between countries and must be acknowledged if countries are to compare experiences and learn from international dialogue on such issues.

The OECD in its work on accountability and control in member country governments uses accountability to mean the obligation of those entrusted with particular responsibilities to present an account of, and answer for, their execution. Control is broadly defined as a process designed to provide reasonable assurance regarding the effectiveness and efficiency of operations, reliability of reporting and compliance with applicable laws and regulations. Control can be subdivided into external and internal control. External control typically means the central audit office, but it also includes central executive branch entities which provide, for example, spending authority to perform a particular function. Internal controls are the management processes, regulations and structures that assure senior management that the actions being carried out are legal, efficient and cost-effective, and comply with regulations. ■

How is control changing?

The main story of control in OECD countries is the move from a system where payments were, in the main, approved in advance by a controller outside the ministry that would be spending the money to a more balanced system of external and internal control where some control has been devolved to agency management. The latter now has greater autonomy to decide how best to use its resources to perform its functions effectively, reliably and in compliance with the relevant regulations. The centralised system emphasised ensuring that all spending was legal and complied with regulations. The devolved system has the advantage of ensuring that the use of resources seeks to achieve the priorities and objectives of the agency.

The move towards more internal controls on the use of money and other resources applies to all OECD member countries, but their starting points were very different. At one end of the spectrum were the externally controlled systems of classic continental European systems like France, Italy, and Spain where delegated treasury controllers (delegated by the Ministry of Finance or National Treasury to ministries) and quasi-legal "courts" of auditors approved and oversaw spending before funds were allocated. At the other end were the Westminster and Nordic countries that were also externally controlled, but after the funds were spent. Each group of countries seems to have moved relative to its starting position. Some countries have abandoned external delegated financial controllers in favour of internal auditors but have been slower to relax input controls. Meanwhile, other countries have delegated and decentralised more decision-making authority and are now confronting the challenges of risk management and more complex management controls.

These changes are not the result of a single event or reform, but rather of a steady accumulation of many influences and the gradual evolution of systems. These include:

- The growth in the size of government, including the sheer magnitude of transactions.
- The growth in the complexity of government (*e.g.* government trying to correct social problems).
- The emergence of technology to improve the efficiency and oversight of the transactions.
- The growing focus on the performance of public services rather than simple conformity with law.
- Increasing delegation of decision-making power to government units closer to clients.
- The use of entities outside direct government control to deliver services, including agencies, lower levels of government and third parties such as private contractors.

These changes have been set against a backdrop of maturing economies and the need to limit aggregate government spending. Many of the changes in budget rules have been accompanied by or resulted in changes to accounting regimes, structural changes in public agencies, managerial freedom and the like. Each change has posed challenges to accountability and control systems. The new focus on performance and results, for example, creates a need for ways to measure and review them. Decentralisation can create a danger of agencies or departments that are accountable to several bodies and managers that are fettered by a multiplicity of reporting requirements as central agencies try to retain control. Innovation and increased flexibility require ways to manage the associated increased risk of mistakes.

Generally, there have been more, and more varied, changes to the internal control process than to the external controllers, demonstrating the rise in importance of internal control. It is true that as most governments have incorporated performance in their budget and management systems, the increasing use of value for money and performance audits by external auditors has been virtually universal. However, this move to more value for money auditing has been partly in response to the move towards internal control of financial transactions. The role of audit offices in promoting accountability has increased significantly with the move to devolved responsibility and internal control. Audit institutions have asserted their independence, distanced themselves from the executive and strengthened their links with legislatures. ■

Why introduce internal control?

Internal control is designed to ensure that a ministry, agency or department carries out its required functions effectively and efficiently, that its financial reporting is reliable, and that it complies with the relevant laws and regulations. For most countries, such internal controls are focussed on controlling allocation of spending, accounting procedures and financial statements. Some have also added more sophisticated management controls, but these in no way substitute for the financial ones. Countries also differ in their use of effectiveness and efficiency audits as well as risk management techniques.

All OECD countries have internal control units but most have moved away from controls before spending is made to audits of results. What the control bodies do with the information they gather, and the degree of decentralisation of internal control units, also vary markedly from country to country. Most countries have both internal controllers and auditors. The OECD/World Bank budgeting survey 2003 shows that of 28 countries queried, only three – Iceland, Sweden and Turkey – currently do not use internal auditors, and in three others – the Czech Republic, Germany and Greece – the use of internal audit is not widespread.

There is also a steady increase in the use of performance information by management, although this is not necessarily monitored by the internal control entities. In most countries, the performance information is incorporated into the formal budget formulation process, but is not always taken into account when making decisions about budget allocations. When internal control incorporates non-financial aspects, the result is a performance-oriented audit closer to financial performance or value for money (economy, efficiency and effectiveness) than to a results information audit. Thus countries moving away from financial control to wider management control regimes tend to focus on programme effectiveness rather than whether the performance data is accurate. When non-financial performance data is audited, it tends to happen at individual service agency level rather than in line ministries.

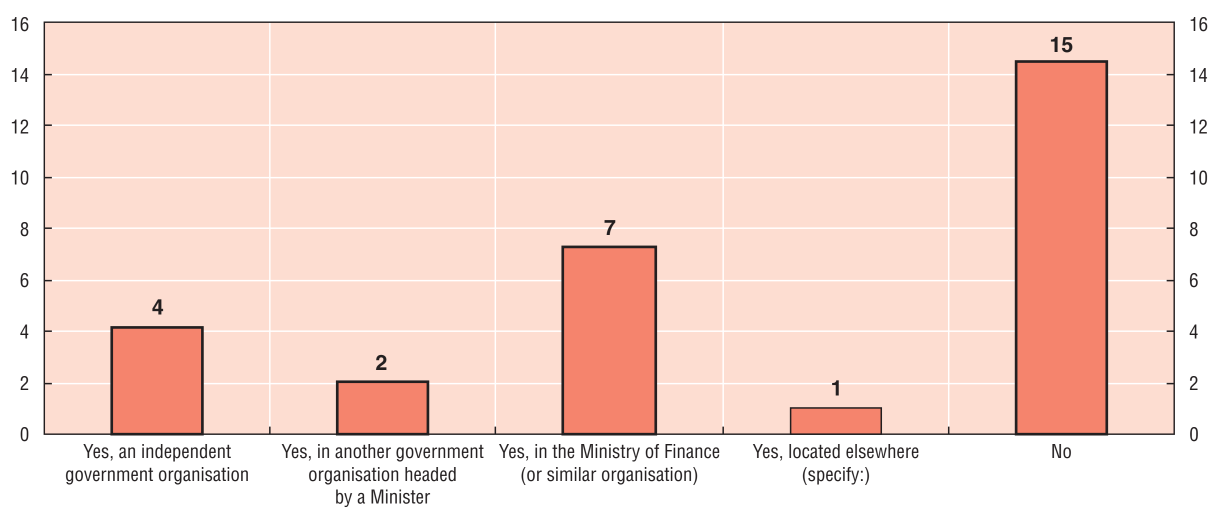
Recently, a few countries, such as Australia and the United Kingdom, have formalised risk management techniques in their management control structures, and other countries are actively interested in this development. Ireland is planning to implement risk management techniques soon, while Japan is beginning to manage risk at ministry and agency level. These are the countries that had more elaborate internal controls as a starting point and have gone the furthest in relaxing input controls and managing by performance and contract. However, most other countries follow a more classical approach of external audit risk assessment, since individual managers lack a global view of risks, both financial and non-financial.

One problem cited by countries is inconsistency in internal control and overlap with external auditors. Because internal control is handled within the management of the particular agency or department, its independence, impartiality or objectivity are called into question. In response to these problems, about half of OECD countries have created central co-ordination, policy and/or monitoring units to oversee departmental internal control systems (see Figure 1). Half of these units are located in the finance ministry. These range from units that actively audit the internal auditors to small units which set standards and co-ordinate specific overlapping issues. Some countries have explicit links between the external audit institutions and internal control units. The supreme audit institutions (SAI) evaluate the internal control system for the extent and depth of their own auditing work. Substantive tests, systems appraisal, accounts verification and the like are often introduced in response to the evaluated performance of the internal control system, the reliability of its findings and recommendations and its actual effect on management procedures and actions.

While there has been a trend to control through results, control before allocating resources still exists in important ways. Top-down budgeting requires stronger control at the start of the process, with input rationing, rules, control systems and incentives to ensure that departments and government as a whole receive and spend no more than they were allocated. Performance-oriented budgeting and management requires a limited return to centralised planning of performance requirements but also more performance reporting, audit and evaluation after the event.

In OECD countries, most internal control reports are issued and used at levels below the ministerial level. Only a few countries including Italy and the Slovak Republic report beyond the senior management level. In the case of Ireland, for instance, the internal audit units report to the audited unit's managers, to the accounting officer and to the audit committee. The managers can comment on the findings and recommendations, and the managers' comments are incorporated into the draft prior to submission to the audit

Figure 1. **Is there a central office for controlling and monitoring audits?**
Number of OECD countries



Source: Question 4.1.I. OECD/WB Survey 2003, *http://ocde.dyndns.org*.

committee and accounting officer. The former uses the report to formulate audit plans and provide advice on actions to be implemented and the accounting officer uses it to develop improvements in the internal control system.

In the United Kingdom, the head of internal audit of any department also reports to the accounting officer with the necessary information to issue the annual statement on internal control, providing the accounting officer with an opinion on the body's arrangements for risk management, control and governance.

In the case of Spain, internal auditors report to top managers and to the central unit in the finance ministry. Special reports can be addressed to ministers and the cabinet. The central unit provides the cabinet with an annual report containing the most relevant features, findings and recommendations on the financial activity. ■

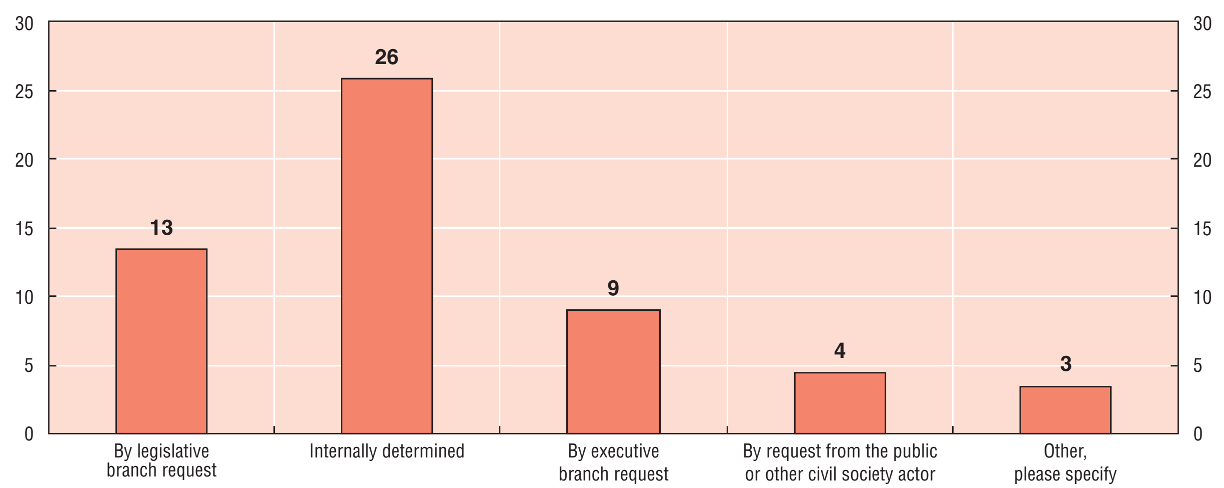
What about external controls?

External audit works together with internal control to ensure that planning, budgeting and use of public resources conform to a country's laws, pursue the objectives defined by parliament and government and are linked to the real world of programme operation. The role of the supreme audit institution (SAI) has evolved from the traditional task of verifying legality and regularity of financial management and of accounting to encompass efficiency and effectiveness of financial and programme management. The US Government Accountability Office, given the constitutional framework of the United States, stands alone in pushing beyond this to provide policy advice and make management recommendations. Budget offices and finance ministries in general also perform external controls – reviews of spending, processes, performance and value for money evaluations.

The most significant changes to the role of SAIs have been to secure the independence of auditors as well as to reinforce the links between the audit office and the legislature. Either at constitutional or statutory level, most SAIs are now independent of the executive. In Nordic and some other countries, the audit offices have been made independent offices of the parliament. In most countries, the audit office determines its own workload, with some countries allowing audit subjects to come from the parliament (40% of OECD countries) or even the executive itself (25% of OECD countries).

Some differences appear in the scope of institutions overseen by the SAIs, including, for example, control over regional or local governments and State enterprises in Italy and Japan. Also, some SAIs, particularly in some continental European systems, continue to have a jurisdictional role for enquiring into and sanctioning individuals' use of public resources.

Figure 2. **How are audit subjects determined?**
Number of OECD countries



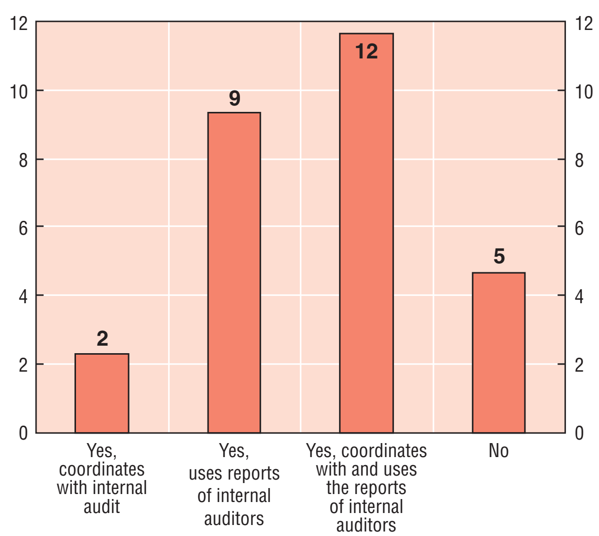
Source: Question 4.5.n. OECD/WB Survey 2003, *http://ocde.dyndns.org*.

The SAI's own organisation follows the criteria of audit typology, sector of activity and type of institution to be audited. In Spain, the SAI is organised by institutional sector (ministries, agencies, public companies, etc.), whilst Germany, Sweden and the United States follow an approach closer to the sector of activity, such as employment services, transport, education or health and welfare. Staff specialisation gives a stable structure in the SAI's organisation, but it is also a good practice to rotate auditors to look at different sectors or entities.

As internal control focuses more on financial management and the rise of automation has made financial auditing less burdensome, the external auditors have almost universally started looking at programme effectiveness or value for money. However, financial audits still comprise the majority of the SAI workload. Only in a few countries like the United Kingdom and the United States do value for money and effectiveness audits account for more than half of the work performed by the SAI. As the United States moves beyond traditional financial, performance and risk audits, the links with the executive branch must necessarily be stronger and the Government Accountability Office is attempting to balance its objectivity with the need to be intimately involved in management operations. Beyond the United States though, most SAIs either co-ordinate or use reports from the internal auditors. ■

Figure 3. **Does the supreme audit institution coordinate with or use the reports of internal auditors?**

Number of OECD countries



Source: Question 4.5.s OECD/WB Survey 2003, *http://ocde.dyndns.org*.

What are the future challenges?

OECD member country governments have taken on a greater role in the past 20 years by adopting larger, more complex and more ambitious tasks. At the same time, particularly during the last decade, the growth in revenue receipts has slowed, placing a greater burden on government managers to ensure that the resources available to them are used effectively. The need to meet more complex challenges with scarce resources in turn leads to more complex management systems requiring varied internal controls. As government diversifies its services, external auditors must also adapt and expand their oversight.

Reforms to accountability and control systems have paralleled efforts to introduce performance budget and management systems aimed at giving service delivery organisations more managerial freedom to comply with their objectives. Systems that focus on approving spending before the event do not meet the needs of a performance-oriented system. However a system of setting performance goals, then measuring and auditing them also has well-documented limitations. For one thing, in most countries except New Zealand and Sweden, performance data is accepted at face value.

Parliaments have been interested in programme evaluations conducted by auditors, but they have so far lacked significant interest in performance measures. Since the links between available resources and performance are weak, internal control systems still focus primarily on financial measures. While international bodies are working on creating standards for auditors and, to a limited degree, internal control for performance audits and performance information, countries have been slow to adopt them in their systems.

As countries fund service delivery and even policy making at lower levels of government, overseeing and accounting for those funds is difficult. Other levels of government sometimes have their own control and audit procedures that are at odds with national systems. Holding politicians and officials at other levels of government to account is more difficult than in direct line ministries. Moreover, as systems become decentralised there is a need for better co-ordination of internal controls and more robust external oversight.

In the drive to make government more efficient and responsive, governments have turned to agencies and other arm's-length bodies to deliver services. Governments are also going into partnerships with private companies and non-governmental organisations which are subject to private sector audit standards rather than public ones. In addition, private concerns can withhold non-public portions of their records from governments. In these cases, programme managers must rely on internal control of results at the end of the project, which means they have few ways of correcting any problems that occur midway through the work. Most countries still place ultimate accountability on ministers and senior civil servants. With the use of third party providers, the responsibility for carrying out a function or completing a programme is thus further from those who are held to account for the funds which may facilitate the avoidance of scrutiny through traditional mechanisms.

The introduction of automation and other technology has been the true success story in control. In general terms, the information provided is better and more reliable as a consequence of improvements in performance information and the introduction into accounting systems of some accruals information. Also, the use of the Internet allows more possibilities for increasing the interaction with citizens and making government more transparent. Through technology, internal and external controllers have been able to enlarge their scope and types of audit without abandoning their traditional functions of preventing mistakes and fraud and conducting financial analyses.

The fundamental challenge to control systems is managing the move from a situation where managers are above all expected to conform to rules to one where they are given flexibility to achieve wider goals. In other words, the model for control is moving from a fundamental distrust of management to a system that values management and relies on it to take calculated risks and make decisions based on performance. However, public sector managers are ultimately responsible to citizens for the honest and efficient use of their taxes, and are generally held to higher standards of financial probity than those in the private sector. They generally have a lower tolerance for risk and, properly, for financial mismanagement. A handful of countries have attempted to incorporate appropriate risk management into their accountability and control systems, but experience is limited and lessons are few.

At the moment, control systems are in transition. Control across OECD countries is still generally financial in nature, although less and less exclusively so. Control in advance of allocating resources still exists, and in fact top-down budgeting requires stronger advance control with input rationing, rules, control systems and incentives to ensure that departments and government as a whole receive and spend no more than they were allocated.

OECD countries are increasingly focussing on the performance of the public sector. This has led to varied organisational structures, new reporting regimes and data, new service delivery arrangements and new management techniques. This complexity of government intervention requires new control regimes, from internal audits to external auditors and increasing use of value for money and performance audits. Performance-oriented budgeting and management requires government to specify clearly the objectives and outcomes of a project before allocating resources to it and to develop performance measures that will enable the success or otherwise of a project to be assessed. ■

For further information

For further information on the OECD's work on modernising Accountability and Control systems, please contact
Michael Ruffner (*Michael.Ruffner@oecd.org*)
Tel. : +33 1 45 24 16 32 and
Joaquin Sevilla (*Joaquin.Sevilla@oecd.org*)
Tel. : +33 1 45 24 82 25. ■

For further reading

- Aucoin, P. and M. D. Jarvis (2004), ***Accountability in Democratic Governance and Public Management: A Framework for Understanding the Canadian System.*** Ottawa, Canada School of Public Service.
- Dubnick, M. J. (2002), ***Seeking Salvation for Accountability.*** Annual Meeting of the American Political Science Association, Boston, *www.andromeda.rutgers.edu/%7Edubnick/papers/salvation4.pdf*.
- Jabbra, J.G. and O.P. Bwivedi (1989), ***Public Service Accountability: A Comparative Perspective.*** West Hartford, CT, Kumarian Press.
- Mayne, J. and P. Wilkins (2004), "Believe it or not?: The Emergence of Performance Information Auditing". In ***Quality Matters: Seeking Confidence in Evaluation, Auditing and Performance Reporting.*** R. Schwartz and J. Mayne, (eds.), New Brunswick, Transaction Publishers.
- *Policy Brief:* ***Public Sector Modernisation: Governing for Performance,*** OECD, October 2004.
- For Information on COSO Internal Control: *www.coso.org/key.htm.*
- For Information on External Audit Standards: *www.intosai.org/Level2/2_LIMADe.html.*

The OECD Policy Briefs are prepared by the Public Affairs Division,
Public Affairs and Communications Directorate.
They are published under the responsibility of the Secretary-General.

Where to contact us?

FRANCE
OECD Headquarters
2, rue André-Pascal
75775 PARIS Cedex 16
Tel.: (33) 01 45 24 81 67
Fax: (33) 01 45 24 19 50
E-mail: sales@oecd.org
Internet: *www.oecd.org*

GERMANY
OECD BERLIN Centre
Schumannstrasse 10
D-10117 BERLIN
Tel.: (49-30) 288 8353
Fax: (49-30) 288 83545
E-mail:
berlin.contact@oecd.org
Internet:
www.oecd.org/deutschland

JAPAN
OECD TOKYO Centre
Nippon Press Center Bldg
2-2-1 Uchisaiwaicho,
Chiyoda-ku
TOKYO 100-0011
Tel.: (81-3) 5532 0021
Fax: (81-3) 5532 0035
E-mail: center@oecdtokyo.org
Internet: *www.oecdtokyo.org*

MEXICO
OECD MEXICO Centre
Av. Presidente Mazaryk 526
Colonia: Polanco
C.P. 11560
MEXICO, D.F
Tel.: (00.52.55) 9138 6233
Fax: (00.52.55) 5280 0480
E-mail:
mexico.contact@oecd.org
Internet:
www.ocdemexico.org.mx

UNITED STATES
OECD WASHINGTON Center
2001 L Street N.W.,
Suite 650
WASHINGTON D.C. 20036-4922
Tel.: (1-202) 785 6323
Fax: (1-202) 785 0350
E-mail:
washington.contact@oecd.org
Internet: *www.oecdwash.org*
Toll free: (1-800) 456 6323

00 2005 66 1 p 4