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DRAFT
The Governance of the Wider State Sector: Principles for Control and Accountability of Delegated and Devolved Bodies

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1. Origins and purpose of the paper

The public organisations in “the wider state sector” are those that form part of the central state but have some autonomy from direct control by ministries or other central organs of the state. The organisations of the wider state sector have existed in most OECD Member countries for most of their modern history, in some cases for centuries. There has been a growing interest recently in the governance of these organisations because of the claimed advantages of a measure of autonomy for their efficiency and effectiveness.

In 1999, the OECD published its Principles of Corporate Governance (OECD, 1999), based upon experience with the legal, institutional and regulatory framework for private sector corporate governance in Member countries. The OECD Public Management Committee agreed in 2000 to work on a similar project on the governance of public agencies and authorities. The purpose of this paper, which is part of that project, is to propose principles for the governance of public organisations to ensure that the exercise of delegated or devolved authority is consistent with overall good governance in the public sector.

In developing these principles, acknowledgement needs to be made of the recent considerable development of public sector governance work by other national and international agencies. In particular, this paper draws on the reports on public and private corporate governance of SIGMA (SIGMA 2001), the International Federation of Accountants (IFAC 2000) Chartered Institute of Public Finance and Accountancy (CIPFA) in the United Kingdom and the Australian National Audit Office (ANAO 1999). Reference has also been made to the OECD’s own Corporate Governance Principles (OECD 2000).

The approach taken in this paper is that, while there is no universally accepted set of best practices for public governance, there are some principles of good practice which, in broad terms, are endorsed in all of the reports mentioned. It does not recommend any particular configuration of external control of public organisations, recognising that every government must judge for itself what is an appropriate degree of policy or managerial autonomy for a public organisation. However, it is assumed that where governments have established such organisations it has been with a view of achieving benefits from increased autonomy and that the issue for those governments is what measures of control are required to safeguard governments against the associated risks.

Because of the many and varied organisational arrangements within governments, the scope of these principles cannot be based on any universal classification of public organisations. The principles are intended to apply to any central or local government organisations that provide public services, regulatory or administrative functions and are ultimately accountable to a government for these functions but have some degree of independence from direct external control of their decision-making or management of resources.

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The arrangements under which the state may transfer authority to public organisations are varied. PUMA makes a distinction, between delegation — defined as the transfer of authority to entities that remain legally part of the core state, and — and devolution — defined as the transfer of power to entities that are legally separate from the state. A distinction can be made between an administrative and a statutory transfer of authority:

- The political executive may delegate authority to entities by administrative act rather than amendment to the law. The implication is that the delegation can be withdrawn by administrative act only. In most cases, this administrative delegation transfers authority to entities that are legally part of the core state, such as departments that are directly responsible to ministers, under an agreement or directive setting out their powers and responsibilities. The same considerations may apply to organisations which are similarly directly responsible for their operations to Presidential offices or to legislatures.

- Usually, a greater degree of transfer of power is implied when the state transfers authority to legally separate entities. In many cases, this transfer of authority has to be enacted in a specific law which spells out their general powers and responsibilities and their relationship to the final authority of the state. The implication is that specific powers are entrenched in the sense that they can only be modified or withdrawn by amendment or repeal of the empowering legislation.

What these arrangements have in common though is that the state retains final authority over such organisations. The political authorities are ultimately responsible for their acts, and the organisations in turn are ultimately accountable to the state for their performance.

The ability to act independently of direction from a higher authority (such as a minister or President) is not necessarily closely related to organisational form. In some countries, organisations which are part of the core state may have greater managerial freedoms delegated to them than separate legal entities in others. To complicate matters further, public officials in “core” ministries or departments may have extensive statutory powers.

With these complications in mind, the paper does not attempt an organisational typology. The important test to apply in considering the relevance of the principles is, whatever the legal form of the organisation, whether the administrative or legal arrangements result in the organisation being able to act independently of political direction in significant aspects of policy or management. The concept of policy and managerial autonomy is discussed later in the paper.

The scope of the paper is however not generally intended to apply to the following:

- constitutional bodies such as courts of law or audit institutions, excluded because the autonomy provided is constitutional and not at the discretion of the executive or legislature;
- state-owned enterprises which substantially trade in competitive (private) markets;
- private companies or not-for-profit organisations even if they are largely funded from public revenues;
- organisations created solely as a consequence of a transfer of authority from central to regional offices of ministries or departments; or by devolution of responsibility from central to local government.
2. Definitions

2.1. Good governance

2.1.1. Meaning of governance

At its most general level, governance in this paper means the constitutional, legal and administrative arrangements by which governments exercise their power as well as the related mechanisms for public accountability, rule of law, transparency, and citizen participation.

Organisational governance is the rules and processes by which organisations are directed and controlled. In the private sector, “corporate governance” therefore refers typically to the arrangements by which corporations are controlled in the interests of their beneficial owners. Organisational governance in the public sector refers to the control of public organisations so that they achieve the purposes for which they have been established and that their activities conform to the general principles of good governance.

Governance of organisations can also be classified as external and internal reflecting the respective responsibilities for governance of organisations of:

- the executive and the legislature and their specific controlling bodies or authorities (“external” governance);
- the governing body and senior management of each public organisation (“internal” governance).

The machinery of external governance of organisations, particularly with regard to the balance of autonomy and control in the governance arrangements, should be established to best serve the overall objectives of good governance. The machinery of internal governance of each organisation should support the requirements of external governance.

2.1.2. Principles of “good governance”

The principles of “good governance” are that governments and their organisations should:

- act legitimately; so that public organisations comply with the requirements of the law and act within the authority conferred on them; observe due process in all their activities and respect the rights and aspirations of citizens and other stakeholders;
- meet publicly-declared standards of performance particularly of economy in the use of public resources, the supply of agreed outputs, and achievement of desired economic, social and environmental outcomes; and
- account to citizens and other stakeholders for their actions in terms of these criteria of legitimacy and standards of performance.

Good governance at the level of governments will therefore be characterised by:

- “integrity” – measured by the extent to which public officials carry out their duties according to the law and without self-interest or favouritism;
• “responsiveness” – measured by the ability of citizens to secure performance to given standards from public officials or to obtain redress if these standards are not met;

• “transparency” – measured by the extent to which citizens are well informed about the actions their governments take and the rules governing those actions.

3. Machinery of governance

3.1. General scope of and requirements for governance

The scope of external governance of organisations is the authority exercised by the central organs of the state such as the executive and the legislature and associated central ministries or other authorities which have responsibilities for control and supervision of public organisations. The scope of internal governance is the systems of direction and control within an organisation which are, at the top level, the responsibility of the governing body and senior management of each public organisation.

In practice, this distinction is not always clear cut. Governments are always finally responsible for the operations of public organisations and, in many jurisdictions, ministers and central organisations and legislators have considerable power to direct the detailed management of line organisations. If governments intend to transfer authority to organisations and need to safeguard their interests when they do so, they need to define:

• the roles in external governance of different branches of government and entities within them;

• a framework for external governance in terms of the establishment, direction, control and review of the operations of public organisations;

• provisions specific to each organisation established under the framework relating to its individual functions and powers and governance.

3.2. External governance

3.2.1. The functions of external governance

There is a wide variation in the constitutional forms of OECD Member governments. In different jurisdictions, significant roles in external governance may be played by offices of presidents or prime ministers; central ministries or departments; legislative committees or agencies; constitutional bodies like public service commissions, audit authorities or councils of state; and the courts. A parliamentary system may base responsibility for external governance on the executive where much of the direction and control will be a consequence of executive decision; a constitutional system with a stronger law-making perspective (such as the United States) may see the foundation of agency accountability as compliance with laws enacted by the legislature and interpreted by the courts. All aspects of external governance, from the creation of public organisations to their detailed direction and control, may be the responsibility of more than one organ of government.
Given this diversity, it is impossible to form one single framework for external governance. Nevertheless there are some functions of external governance that are common to most if not all governmental systems and some principles for exercising these functions. The functions include:

- creation and review of public organisations;
- appointment to positions in top-level organisational governance such as Board members or Chief Executives and review of their performance;
- setting organisational policy objectives, approval of business plans or planning agreements and specific directives on policy or operations;
- authorisation of budgets and those financial transactions which require external approval and (as required) approvals relating to appointment and reward of staff;
- monitoring and review of financial and non-financial operations;
- decisions on appeals from the organisation’s policy decisions or complaints regarding administrative actions.

Three spanning general principles can usefully be applied to the exercise of these functions.

i.) Grouping organisations into classes

Most of the external governance functions listed above will be better served if they apply to classes of organisations. Governments can distinguish for example between ministries or departments directly under the control of the political executive, devolved or delegated organisations, and state-owned enterprises or other fully commercial organisations. The creation, resourcing, direction and control of public organisations – and in particular decisions on the balance between autonomy and control for classes of public organisations – can then be systematic rather than ad hoc.

ii.) Assigning specific governance responsibilities

In real political life, the governance of public organisations is often contested both between and within branches of government. Legislatures may seek detailed control over the budgets and operations of departments and agencies. Central and line ministries dispute control of the operations of specific agencies. Organisations are sometimes created by one organ of government specifically to bypass or neutralise control by another. But these ambiguities can be usefully reduced, at least within and between ministries or Offices of the President, by assigning formal responsibilities for each function of external governance to a specific individual or office.

iii.) A generic law for organisations

Principles i) and ii) above can be given effect in a framework law for creation and governance of public organisations. The purpose of each organisation and the basis for its governance can then be transparently determined and debated. The general procedures for external control of public organisations should also be established in law and may determine different categories of control for different classes of organisation.
Not all law regarding public organisations can necessarily be brought into one statute. Specific aspects of governance – for example public finance or public employment – may be covered in other statutes. However the following matters need to be covered either in a framework law or in other statutes:

1. procedure for creation and removal of the organisation – for example by resolution of the legislature under the general law, enactment specific to the agency or Presidential decree within the approved classes and purposes of organisation;
2. how and in what legal form the functions and powers of each organisation will be defined;
3. the powers and duties of responsible individuals or offices (ministers or government departments for example) regarding the external governance of the organisation;
4. process and criteria for appointment and removal of Chief Executive and/or Board members;
5. the basis and content of agreements with or directives from the responsible external authorities regarding policy or operations;
6. financial management: preparation and approval of budgets, banking arrangements, stewardship of assets, borrowing authority, setting fees and charges, financial statements and audit, accounting standards, compliance with rules or instructions of the Ministry of Finance or other financial authority;
7. application of law and regulations governing appointment and employment of staff;
8. power to establish codes of conduct for behaviour in public organisations.
9. requirements for reporting and review.

3.2.2. Key governance processes

i.) Policy agreements and directives

The general functions and powers of an organisation should be set out in its founding document together with the basis for the Executive’s power to direct the policy of the organisation. The founding document should also indicate any powers limiting the operations of the organisation, and outside of general public sector financial, employment or other law, that the executive reserves to itself. The external governing authority responsible for each organisation should conclude an agreement with the organisation covering one or more years of its operations and annually reviewed setting out the principal results expected of it over the period of the agreement and the basis for funding its financial outlays. This agreement should be published. Any other formal directives to the organisation should also be made in writing and published.

ii.) Financial management

The general law relating to public finance should provide for the authorisation and accounting by public organisations of: funding from the state budget; borrowing or other liabilities; issue of guarantees for liabilities incurred; financial investment and banking; and acquisition and disposal of assets. Except for fully commercial activities, where private sector accounting standards should apply, standards should generally follow general government accounting principles.
iii.) **Employment and remuneration of public employees**

The general law governing public sector employment needs to specify the employees who form part of the civil service and are therefore subject to general civil service rules regarding appointment, conditions of employment and pay. The status of employees of public organisations and the extent of central control of their pay and conditions may vary from government to government but a common minimum requirement might cover principles of open advertisement of vacancies and appointment on merit of all public sector employees and publication of the salary scales of senior officials in public organisations.

iv.) **External reporting and audit**

Public organisations should be required by law to publish annual reports on their activities and achievements, including their financial accounts. The reports should include comparisons of actual with budgeted revenue and expenses and of actual non-financial performance compared with targets set for the organisation in its planning agreement with the government. As far as possible, financial statements should follow a consistent set of government accounting principles and the reports of commercial organisations should comply with generally accepted private sector accounting principles. The annual report should include statements of compliance with all applicable laws, regulations and government directives. There should be common standards set by the government for reporting financial and non-financial performance. A committee of the legislature should examine organisations on their performance.

The supreme audit institution should either audit all public organisations or have the power to delegate the audit to another auditor under its supervision. All reports of audits should be made available to the legislature.

**3.2.3. The planning and control cycle**

There needs to be an overall process put in place for developing and reviewing the plans and budgets of public organisations. The timetable will need to cover in an integrated way:

1. development of the government’s overall medium-term strategy and fiscal framework and its relationship to organisational strategies and expenditure plans;
2. preparation and approval of planning agreements for each organisation including expenditure plans;
3. development of budget requests from expenditure plans and of the overall appropriation request from individual requests;
4. submission of the annual appropriation requests to the legislature and scrutiny of individual organisations’ plans and budgets by the appropriate legislative committee;
5. authorisation of budgets and procedures for release of funds;
6. regular reporting by organisations on financial and non-financial performance during the year;
7. preparation of annual reports and financial statements and provisions for audit;
8. review of organisational financial and non-financial performance by central agencies and the legislature.
3.2.4. Creation and removal of public organisations

Decisions to create – and to review the continued existence of - public organisations should be made on the basis of the organisations’ contribution to the general principles of good governance in the public sector. In particular public organisations should (a) improve the effectiveness of implementation of public policies; (b) improve economy and efficiency in the use of public resources; and (c) meet citizens’ expectations of the legitimacy of the government’s decision-making and operations.

New public organisations should be able to meet the following tests:

1. their purpose should be clear and their creation should improve the quality of administration in the public sector;
2. the benefits of the organisation should be defined in terms of one or more of the following criteria:
   • improved economy, efficiency or effectiveness through specialisation of function;
   • improved public credibility of governmental operations through enhanced impartiality or legitimacy of decision-making and operations;
3. more effective communication or joint decision-making with or control by stakeholders with legitimate interests in the organisation’s policies or operations.
4. the functions of the organisation should be clearly distinguishable from other organisations and the relationships between the organisation and other public organisations should be well-defined to minimise unnecessary overlaps of function or disagreements about relative responsibilities;
5. if organisations are to be devolved or delegated the authorities responsible for external governance should ordinarily be able to achieve the results they require from them through general legal provisions, agreements or directives without requiring detailed day to day control over performance or operations.

3.3. Governance in individual organisations

3.3.1. Form and role of top-level governance

i.) Form

The top-level internal governance of organisations will vary according to national practice and the purpose of individual organisations and indeed there may be no single body that carries out the functions of a board in a private corporation. Furthermore, governance functions which in the private sector would clearly be within the competence of a Board or Chief Executive may be shared with supervisory ministries or committees of the legislature and the governing body of the organisation. At the apex of the organisation itself, authority may reside in a single Director or Chief Executive (assisted by an advisory board), may be held jointly by more than one person, or may be vested in a supervisory or a management board.

National practice will vary widely on the form of top-level governance for organisations with ostensibly similar purposes. Within the OECD, delegated organisations generally do not have executive boards at their head, but there is at least one significant exception in the form of agency boards in Sweden. On the other hand, devolved, separate legal entities usually do have boards, but the boards may range from governing boards with independently appointed members and full executive authority over management, through management boards which mainly represent a supervising ministry, to advisory boards with no executive power.
The choice of governance form may depend mostly on what PUMA refers to as “political and administrative culture”. Some countries have historically been comfortable with the idea of most significant internal governance responsibilities being in the hands of career government officials. Others will prefer these responsibilities to be shared amongst a wider range of interests. Some specific considerations which might apply include:

1. a distinction between high-level policy or steering functions and the management of the organisation itself;
2. if the organisation has significant policy functions (such as decision making on individual cases or grants applications) there may be a case, in the interest of perceived transparency and legitimacy, for these powers to be shared with stakeholders;
3. on the other hand, if the organisation has significant management autonomy but requires continuing political direction on the exercise of policy, an executive board is likely to be redundant;
4. the political executive may be more confident in the management of the organisation if the chief executive is supported by an advisory board.

ii.) Role

The role of top-level internal governance in all cases is however to protect the interests of the state in the public organisation by ensuring compliance with all applicable law, agreements or directives; proper performance (economy, efficiency and effectiveness) in the operations of the organisation; and protection of the rights and lawful interests of stakeholders. In particular, the governing body is responsible for:

1. developing and reviewing organisational strategy consistent with overall government policy and specific directives;
2. ensuring that all necessary elements of the organisation’s management are in place and operating effectively;
3. in some cases, appointment and conditions of employment of key personnel;
4. ensuring compliance within the organisation with general principles of good governance and specific codes of conduct;
5. ensuring integrity of the organisation’s financial management and other information systems;
6. ensuring compliance with all applicable law and reporting requirements, control of operations to achieve organisational objectives and effective management of risk;
7. monitoring the performance of the organisation and accounting to parent ministries and other government agencies for performance;
8. ensuring full and adequate communication with internal and external stakeholders and protection of their rights.

Governments should ensure that, whatever the top-level governance structure of an organisation, legal responsibilities are assigned to particular named individuals, such as the Chief Executive, the Chairman of the Board or other official of the organisation.

The criteria and procedures for appointment of board members (where boards exist) and senior management should be publicly known and appointments should be advertised. Board members should also have relevant expertise in the governance of public organisations or in the business of the organisation.
to which they are appointed and be free from disabling conflicts of interest. If there is a board with executive power it should appoint the Chief Executive. There should also be a clear division of responsibilities between the role of Board members and of the Chief Executive. To ensure transparency in remuneration, fees paid to Board members should be set according to a general schedule of fees established for all organisation Boards and should be publicly reported. There should be a policy for immunity or indemnification of Board members in respect of personal suits brought against them if they have acted lawfully and within their capacity as Board members.

3.3.2. Principles of accountability

The principles of accountability in public sector organisations should serve the general principles of good governance. In particular organisations should:

1. have a clear and credible set of objectives laid down in their founding instruments;
2. have clear published annual objectives for their financial and non-financial performance, contribution to the government’s priorities, and standards of management;
3. be required to account to the government and the general public for their use of public resources against the normal public criteria of economy, efficiency, effectiveness and due process;
4. disclose all information necessary to assure the government and the general public of due propriety in their operations such as the remuneration of board members and senior executives and codes of practice and other processes in place to ensure proper behaviour by management and staff;
5. disclose any circumstance or event which is material to an assessment of the risk that they will not achieve their objectives or will affect the government’s overall performance adversely;
6. ensure that they make information about their operations available to all stakeholders, have clearly understood processes for communication with stakeholders and to enable stakeholders to enforce their rights with respect to the organisation.

3.3.3. Accounting to and consulting with stakeholders

The corporate code of practice should include procedures for ensuring compliance with provisions relating to the rights of stakeholders and particularly informing them of their rights and providing for redress when their rights have been violated. There should be a code of good practice for making information about the organisation’s activities and performance available to stakeholders and informing and consulting stakeholders of significant issues relating to the organisation that affect their interests.

The national laws relating to rights of citizens in relation to public organisations (e.g. access to official or personal information, redress of complaints about administration) should apply to all public organisations.

3.3.4. Standards of behaviour

The government should establish a code of conduct for board members and employees of public organisations covering basic principles of conduct in public life. Each public organisation should have an equivalent code of conduct and systems of monitoring compliance with it by Board members, management and employees. Board members and the Chief Executive should be required to declare any interest which might conflict with their responsibilities for governance of the organisation and be disqualified from
participation in any matter affecting these interests. Management and other staff should not have any private interest which would conflict with their duties as employees of the organisation.

3.3.5. **Control and audit**

It is the responsibility of top-level governance to implement an internal control system which will ensure that the requirements of good organisational governance are met. Generally effective internal control will be based on the organisation’s functions, legal powers and duties and accountability requirements and will include:

1. a clear division of responsibilities within the organisation, based upon the written specification for each employee of his or her duties and powers;
2. an appropriate schedule of transfers of authority to specific officials of the organisation and a system for periodically reviewing the exercise and scope of delegations;
3. timely and reliable preparation of management information to enable effective control of the organisation’s activities;
4. an internal audit plan under the control of an Audit Committee either of the board or senior management;
5. an effective integrated relationship between internal control and audit and external audit.

3.4. **Balancing external and internal governance**

3.4.1. **Reconciling control and autonomy**

Effective internal governance provides assurance for the external governing authorities that the organisation is meeting the general requirements of good governance. It is too simple to say that one substitutes for the other. In particular:

1. Some principles of accountability apply whatever the status of the organisation and
2. It may be a matter of substituting one type of external control (say, over outputs rather than inputs) for another.

But the objective should always be to find a balance between external and internal governance which best meets the two general governance objectives of legitimacy (public confidence in the operations of the organisation) and performance (efficiency and effectiveness). The appropriate balance may vary between organisations or may change for one organisation over time.

There are therefore two approaches to deciding on relationship between external and internal governance and specifically on what powers are to be delegated or devolved to a specific public organisation.

1. Some freedoms may be essential to good governance because of the nature of the work of the organisation and really are inherent in the decision to establish the organisation: examples are the power of individual case-based decision making for a regulatory authority; or the ability to manage the “bottom line” which is essential for an enterprise trading in competitive markets.
2. Other freedoms may be contingent on the internal governance regimes meeting certain standards and may therefore vary from organisation to organisation.
3.4.2. “Policy” and “management”

Although the distinction between “policy” and “management” is not always clear cut, a distinction can also be made between the freedom an organisation has to interpret or decide policy and the freedom it has to manage its resources to achieve specific policy objectives.¹ For some organisations (for example, those performing a regulatory function like a Securities or Commerce Commission), autonomy in case decision-making may be considerably more important than autonomy in management of resources; for others (for example, those delivering a specific public service subject to close external policy direction like an immigration agency) the reverse may be the case.

3.4.3. Relationship between autonomy and external control

Each of these forms of autonomy carries with it both potential benefits and risks which may call for associated external controls as safeguards. In summary:

i.) Policy

The organisation can decide what goods or services it will produce within a broad policy framework or on the disposition of individual cases within government policy or the requirements of the law.

There are many flavours of policy autonomy including the freedom to decide:

1. Classes of output to be produced: examples include a product range in a government business; clinical services provided in a health service; qualifications or courses offered in an educational institution; or programming on a state broadcasting service.

2. Individual cases within a policy or legal framework: grants for scientific or cultural purposes; application of rules of eligibility for state support or compensation; application of law regulating commercial activity; or prosecution of breaches of the law.

Policy autonomy may be for performance reasons, that the organisation will deliver services more efficiently and with better knowledge of specific requirements of individual consumers or applicants if it has freedom to vary the mix of outputs or it may be to protect decision-making in individual cases from perceptions of political interference. Control may be required to ensure that decisions are taken in accordance with law and respect for rights of consumer or applicant and that decisions are consistent with producing the best overall policy outcome for the government.

If an organisation is given authority to determine the specific goods and services it will produce, the essential external control required is that the government has determined and is able to enforce the broad category of result it wants. For example:

1. For a trading enterprise, the broad scope of the business and the principal financial performance ratios have been defined in a planning agreement; that the enterprise operates in competitive market; and that there are means of ongoing monitoring of the performance of the enterprise and for changing the top level governance of the enterprise if plans are not being achieved.

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¹ The PUMA synthesis paper (OECD (PUMA) 2001) makes a similar distinction between autonomy as managerial and budget flexibility and independence as “the capacity for autonomised entities to make individual regulatory decisions with the assurance that there will be no involvement and no influence of the reporting ministry in those decisions.”
2. For a public health service, the range and priority of services to be provided are defined in clinical charter or by funding agreement and performance can be effectively monitored not only through budgets but through measurement of both the clinical outputs and resultant population health outcomes.

3. For an educational institution, the sector of operation is defined in a founding instrument such as a charter; and a planning or funding agreement defines the priority of different broad areas of learning or (in schools) by defining curricula; and that educational performance can be audited both in terms of practice in the institution and in terms of (comparative) education outcomes.

4. For a state broadcasting service there may be requirements on programming content ratios defined in a planning agreement.

If an organisation has the authority to apply decision rules and case law to specific cases then the appropriate safeguards include that the extent of the authority and how it is to be exercised are defined in law (as in the case of application of rules of eligibility for state support or compensation) and, in grant-funding organisations (say for science or the arts), that there are guidelines for funding priorities and eligibility criteria. Basic controls on the organisation’s performance include publication of decisions (subject to individual privacy), mechanisms for stakeholders to monitor and participate in decision-making, appeal and redress provisions and a reserve power for decision by an external authority.

ii.) Management

The organisation can decide on how it allocates its operating budget or its liabilities and assets to achieve its mission and tasks. The autonomy may be in relation to:

1. Operating budgets: shift from pre-audit to post-audit of transactions; allocation of budget to inputs within an overall limit; appointment or conditions of employment of staff; procurement of goods or services from outside organisations or individuals; setting prices, fees or charges; and appropriation of revenues against agency expenses.

2. Asset and liability transactions: management of bank accounts and current assets and liabilities; purchase or sale of land and other assets; entering into loan agreements or incurring other term liabilities.

Managerial autonomy may be justified to protect the organisation from political micro-management; to focus management action on results required by government; or to realise gains from specialisation by allowing managers to decide how they can best meet required results. Control may be required to ensure that management complies with all applicable law, standards and conventions; that goals and standards and performance management systems achieve the results desired by government; and that the activities of different organisations contributing to the same government policy outcomes are effectively co-ordinated.

What should be common to all delegated or devolved organisations operating in the public sector is the internal governance, accountability and management control framework discussed in the preceding section. With that in place, the specific management measures appropriate for any specific organisation depend on its function and capabilities.

Some measures are appropriate mainly for large commercial organisations which are financed largely by their own revenues and trade in commercial markets. The appropriate legal form for these organisations is private law status and their governance can closely approximate those of private corporations. That is, the

2. The following discussion draws extensively on the recommendations in SIGMA (2001).
main elements of governance will be shaped by the relevant private law, the organisation’s founding charter and shareholder approval of business plans and, normally, of capital transactions big enough to impact significantly on the balance sheet or shareholder risk. The supreme audit authority may need to have oversight of the audit practices of the organisation. Beyond these specific requirements, management control should be governed mainly by normal commercial practice. Specific areas where this will distinguish commercial organisations from other public organisations include:

1. ownership and management of real property assets;
2. borrowing (on the assumption that there is no implicit or explicit shareholder guarantee);
3. setting prices for competitively traded goods and services;
4. employment and compensation of staff on normal private sector terms and conditions;
5. accounting to full private commercial standards.

For devolved or delegated organisations which are mostly funded out of the state budget, the same general principles of internal governance apply but there will be different priorities for increasing autonomy. The most significant stages of change will be:

1. achievement of a standard of internal planning, budgeting and control which permits relaxation of tight external controls over inputs;
2. achievement of a quality of performance management based on results which permits a shift in the focus of external control from inputs to outputs.

Some shift from external to internal governance is possible within a framework continued input-oriented budgeting and control. The significant steps are:

1. for those countries still relying on pre-audit of transactions, a shift to post-audit: to delegate authorisation of payments within budget authority; the pre-requisite is an effective internal control system;
2. reduction in line itemisation of budgets to permit greater flexibility in internal reallocation of budgets; this step requires the organisation to meet higher standards of budget planning which in turn will be underpinned by better accumulation of data on costs to improve budget costing models;
3. relaxation of tightly prescriptive procurement or central purchasing requirements to permit organisations to purchase competitively in private markets or contract out some services; subject specifically to a satisfactory organisational system of procurement and contract management;
4. greater flexibility in hiring and compensation of staff, within broad rules regarding open advertising and competition and merit appointments and an efficient, fair (and auditable) staff performance management and appraisal system; SIGMA notes however that staff costs remain a major component of operating expense for most on-budget organisations and are a significant risk for governments both in financial terms and in public perceptions of uncorrupt behaviour – it will be prudent therefore for governments to analyse organisation staff budgets in some detail and to audit hiring, appointment and remuneration decisions.

Shifting the focus of financial management from inputs to outputs is a more significant step. Its presumed benefits are that it enables governments to base their direction and control of public organisations on what they expect those organisations to produce for them; enables organisation management to have full flexibility in the allocation of output budgets to inputs; and provides the foundation for both internal and external pricing of agency services. For part-commercial organisations it is a necessary step towards proper
budgeting for revenue-earning and non-revenue-earning services on the same basis and – if desired – for net budgeting of the full cost recovery services.

The problems for most governments in output budgeting are in establishing stable definitions of outputs and being able to account for outputs but – most importantly – of developing reliable output measures and performance management based on outputs. Caution is therefore advisable in migrating public organisations from an input focus to an output focus. SIGMA recommends that “countries in transition should emphasise input oriented budgeting and control processes while promoting performance management techniques to make those processes more effective, not to replace them.” While non-commercial organisations should aim to move towards a system of budgeting by outputs, a change should only be implemented when these organisations can demonstrate adequate standards of management control and measures of performance which can be closely related to expenses. Financial plans and budgets can incorporate non-financial performance standards and measures and budgets may be structured around outputs or other results-based categories. However, until output budgeting techniques and management controls attain the necessary standard, budgets for non-commercial organisations should require approval of detailed input costs, including staffing provisions, and primary control based on these categories of expense.

It follows that, in most cases, only viable market-based commercial activities should be permitted to account on a net basis. SIGMA note also that where organisations are only partly commercial, special care should be taken to ensure that the commercial and non-commercial activities are segregated to reduce the risk of hidden cross-subsidy.

4. Conclusions

All governments distribute their authority through delegation or devolution to public organisations. The arrangements for this distributed governance vary widely throughout the OECD. There are however some common principles for deciding the balance between external and internal governance of organisations which will best serve the interests of overall good governance in terms of the legitimacy of government action and the quality of its performance. The role of governments with respect to these principles come under the headings discussed below.

At an overall governmental level:

1. assessing the need for all devolved and delegated public agencies against a set of criteria related to good governance and efficient external governance of organisations;
2. defining the roles in external governance of the different organs of the central state and particularly the executive and its constituent central Ministries and departments and the legislature and its statutory officers and committees;
3. integrating these roles into a single cycle of external planning and control for public organisations;
4. taking a single unified approach to external governance through a framework law applicable to classes of public organisations which takes a common approach for each class of organisation to their constitution, direction and accountability;

At the level of individual organisations:

1. the form of top level internal governance of organisations may vary widely, but governments can specify some common principles regarding the responsibility of top level governance for the direction and control of the organisation and its external accountability;
2. beyond a common framework for internal governance governments can identify measures of autonomy and associated safeguards in the following areas:
   a. organisations which have authority to vary outputs or to make individual case decisions require safeguards for conformity with government purpose, assurance for the general public of the legitimate exercise of their power and protection for the rights of individual citizens;
   b. some measures of managerial autonomy, particularly those relating to net budget funding and balance sheet management are mainly appropriate for organisations which trade competitively in private markets;
   c. delegation of authority for allocation of budgets to input categories and administration of rules governing employment and purchasing decisions, should be subject to a well-developed internal governance regime;
   d. a shift in focus of planning and control from inputs to outputs, provided that performance can be properly specified, measured and costed.

5. **Summary: principles for control and accountability of public organisations**

5.1. **General principles of governance**

1. The governance of public organisations should be consistent with the requirements on government to act legitimately, meet publicly-declared standards of performance and account to citizens and stakeholders.

5.2. **External governance**

2. All governmental systems need to define, preferably in legislation, central external governance responsibilities applicable to classes of public organisations.

3. Framework laws or other statutes need to cover powers and responsibilities of the central organs of the state in relation to creation and removal of organisations; form for defining the functions and powers of organisations; board and senior management appointments; agreements with or directives to organisations; financial management; employment and remuneration of public employees; standards of behaviour and codes of conduct; and external reporting and audit.

4. Governments need to put in place a planning and control cycle covering preparation of strategic and fiscal objectives as they affect public organisations, development of financial plans and budgets; financial control and reporting processes and executive and legislative review of performance.

5. Decisions to create or review public organisations ought to meet tests of clear purpose; benefits in terms of performance, public credibility or reflection of stakeholder interests; clear distinction of functions from other organisations; and ability to achieve objectives through general directives rather than detailed day to day intervention.
5.3. Internal governance

6. The top-level governance of organisations should be determined with respect to the need for a distinction between high-level steering functions and detailed management; the need for credible independence of decision on individual cases or applications versus the requirement for continuing detailed political direction of policy; and assurance to the political executive of the adequate oversight of management.

7. The governing body of each organisation should be responsible for developing and reviewing organisational strategy; effective operation of management and (in some cases) appointment of key personnel; ensuring compliance with principles of good governance, and all applicable laws and directives; the integrity of financial and other management systems; monitoring organisational performance and accounting to the political executive; and ensuring proper communication with stakeholders and protection of their rights.

8. Legal responsibilities in organisations should be assigned to specific named individuals and, where boards are in place, should distinguish clearly between the role of boards and of management.

9. The appointment and remuneration of board members and senior executives should be a matter of public record; board members should have relevant expertise for their tasks; their fees should be paid on a standard public schedule; and they should be indemnified from personal suits where they have acted legally and in good faith in their capacity as Board members.

10. Public organisations should have clear, credible and public objectives relating to their performance and standards of management; should account to the government and public for achievement of these objectives; disclose all information necessary to assure stakeholders they have acted properly and any circumstance which is material to the risk of non-achievement of their objectives; and ensure they have adequate processes of stakeholder communication in place.

11. The national laws relating to rights of citizens in relation to public organisations, especially freedom of information and redress of complaints, should apply to all organisations.

12. Board members and management should avoid any conflict of their private interests with their duties in the organisation.

13. To support external accountability, top-level governance should implement an effective internal control system covering division of responsibilities, delegations of authority, management information systems, internal audit and relation to external audit.

5.4. Balancing external and internal governance

14. Where organisations have authority to decide matters of public policy, the extent of the authority should be defined in law, decision processes should be transparent and decisions should be published (subject to individual privacy) and there should be appeal and redress provisions administered by an external authority.

15. Generally speaking, only commercial organisations trading in competitive markets ought to be able to trade in real property assets, borrow without implicit or explicit guarantee, set prices for goods and services, and employ and compensate staff on normal private sector terms.
16. For organisations funded largely out of the state budget, governments may consider increasing autonomy from control over inputs in the following stages:

   a. increased delegation of payments authorisation within budget authority, subject to an effective internal control system;

   b. reduction in line item categories for budgets subject to adequate budget planning and forecasting;

   c. relaxation of central procurement requirements subject to satisfactory organisational procurement and contract management;

   d. greater flexibility of hiring and compensation of staff subject to adequate safeguards for open advertising and merit appointments and effective staff performance management and appraisal.

17. Governments contemplating a shift in the focus of control from inputs to outputs should do so only when satisfied that all the above conditions can be met and in addition that reliable output measures and performance management based upon outputs can be instituted.
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