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Accountability and Control of Public Spending in a Decentralised and Delegated Environment

by
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This article provides an overview of different accountability and control issues in public spending. In a decentralised environment, public spending needs some degree of fiscal discipline, favourable institutional relationships, a stable negotiation framework, management co-operation, permanent and transparent reporting, and reliable and co-operative control structures across levels of government. The article discusses elements such as the role of the supreme audit institution in external and legislative control, the creation of audit committees to reinforce internal control, the use of performance contracts between ministries and agencies to ensure accountability and the search for efficiency, the use of third-party providers in public service delivery (including public-private partnerships) and the implications for government monitoring and control, and the use of performance information and programme evaluation.

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1. Introduction

OECD countries over the last decades have diversified the ways they provide services to citizens. For example, many countries have given sub-national governments more power and money to craft government assistance programmes. Central governments have also created public law agencies that are under contract with the central government ministries under purchaser-provider arrangements. Or ministries have partnered or contracted with private sector entities to deliver public benefits. These developments, designed to make spending more efficient and more responsive to citizen needs, are moving spending and service delivery out of traditional central ministries to institutions outside their direct control.

In delegating and decentralising spending, central governments face a host of accountability and control issues over the use of the funds. First is the need to preserve financial discipline over both central and local government budgets. Second is the need to ensure that funds are spent in accordance with programme design and intent. Third: as countries incorporate performance and other management techniques into the budget and accountability process, they need to ensure that giving autonomy and flexibility in exchange for performance agreements will allow fiscal and managerial accountability. This is done in an environment where local governments are sovereign and have their own constituencies to deal with, where private sector entities are often more skilled in negotiating contracts, and where agencies are to some extent outside of ministerial control and/or ministerial responsibility.

2. The institutional response

The way in which OECD countries have answered these issues in terms of organising their accountability and control systems is varied and tends to be adapted to the management needs of public spending (OECD, 2005, Table 3.1). The usual picture shows internal and external control systems working at each level of government, with a national supreme audit institution overseeing the whole system – although in federal states its role is mainly restricted to federal government control. International audit standards are generally applied, both for internal and external audit. Units in charge of direction/co-ordination of internal control, such as audit committees or central internal audit units, are increasingly common, not only in ministries, agencies and state-owned enterprises, but also at Cabinet level.

While the decentralisation process has mainly meant reinforcing their own control systems by each level of government, delegation of public spending has also implied adapting the type of control to focus on efficiency and results.

3. Accountability and control issues in decentralised public spending

Understanding decentralisation as the process where spending powers along with political authority and competences are given to sub-national governments, a number of issues appear in terms of accountability for the use of public funds, either transferred by the national government or legally assigned to sub-national and local governments:

- Does decentralised public spending lead to a lack of budget discipline?
- Are the transferred/assigned funds sufficient for sub-national and local authorities to accomplish their duties?
- Does the institutional relationship allow each level of government to be accountable for its specific spending decisions and duties and ensure that the transferred funds are used efficiently, respecting laws and regulations and as intended or approved by Parliaments?
- Do financial and non-financial control mechanisms ensure the achievement of objectives?
- Do information and reporting systems allow monitoring and adjusting of spending policies and programmes?

3.1. Fiscal discipline between levels of government

Fiscal discipline between levels of government is an important issue that is closely linked with the budget discipline undertaken by most OECD countries. Some European countries must ensure that public spending levels and public debt stay under a percentage of their GDP following the EMU criteria, while other OECD countries must ensure balance in their public accounts. Achieving budget balance or surplus at the sub-national level implies a big exercise of co-ordination or respect to adequate fiscal rules.

Budget discipline in terms of control of budget deficits is only one aspect of public spending, although a very important one. Accountability of budget discipline and compliance with fiscal rules mean assuming responsibility if fiscal targets are not met. Setting up fiscal rules in the framework of fiscal relations across levels of government is a common picture nowadays in OECD countries (OECD, 2003). Nevertheless, some of these fiscal frameworks are quite flexible and there are no sanctions if the rules are not followed.

Fiscal discipline in a decentralised environment requires, at least, clear rules and a co-operative atmosphere. Also, a certain balance between sub-national competences and allocated financial resources is necessary to avoid additional problems and funding shortages in public service delivery that sooner or later would create budget deficits.

Once the setting-up process of fiscal rules has been completed, problems appear generally in terms of implementation. Some of the problems relate to the lack of homogeneity of accounting systems and the lack of reliable, timely and available financial information. Clear and mandatory rules establishing responsibilities; verification mechanisms; and periodic review of the fiscal discipline system can help to alleviate some of these problems and to give real value to the fiscal rules.

The budget formulation process would appear to be the most appropriate instrument for ensuring budget discipline in a decentralised environment. In order to formulate the budget, it is necessary to have an institutional framework of negotiation between levels of government. Countries' existing legal frameworks and institutional relationships will influence the process of negotiations. A federal country like Germany, where the states have constitutional rights to set up their own budget, and a quasi-federal one like Spain, with a law imposing budget discipline rules on all levels of government, follow periodic processes of negotiation to set up economic macro magnitudes related to the state/regional/local budgets in order to be compatible with national budget goals.

3.2. Creation of a favourable institutional environment

A **stable framework for negotiation** is a way to build consensus. Negotiation can also create the agreement and co-operative framework. All the political-administrative structures making up this institutional framework for negotiation can benefit from having clear mandates and including political and technical representatives. Most of the difficulties likely to appear when implementing public policies could be softened or eliminated through discussions in this institutional framework. Most OECD countries show institutional relationships with stable negotiating structures: Senate, sectoral committees with territorial representation, sub-national governmental associations, etc. This stable negotiation framework ensures mutual recognition of each participant's needs, urgencies, priorities and medium and long-term scenarios.

A **co-operative management environment** is useful in any situation where public policies and programmes have to be implemented by several levels of government, concurrent in the same policy/programme, usually in charge of different activities. Strong co-ordination and co-operation in most management activities helps to eliminate or at least to reduce a lot of implementation problems, such as delays, misunderstandings, financial shortages and even political controversy between levels of government. Nevertheless, even assuming that political differences will be present as a permanent factor, a scenario for co-operation using the necessary negotiating skills should help reduce the obstacles in the way of implementation of previously agreed public policies and programmes.

3.3. Maintaining the accountability of national and sub-national governments

Permanent and transparent **reporting structures** are necessary for fiscal discipline and for accountability and control in decentralised public spending, dealing not only with specific national grants transferred to sub-national governments but with the total spending and financing activity.

In OECD countries, even in federal ones, central governments supervise the national economy and national policies, generally with a meaningful role assumed by sub-national governments.

Neither the national economy nor any national policy can be implemented successfully without the right information and knowledge of policy/programme implementation. Although it is always possible for a national government to gather operational and outcome information on the implementation of any programme, it would benefit from first examining what data are already available to sub-national governments participating in the programme execution. The data systems necessary for analysing and reporting have to satisfy permanent needs of policy making, decision making and programme implementation. Reporting appears essential to know which measures are necessary in order to improve, readjust or even cancel unsatisfactory programmes.

Setting up adequate **control structures** is essential in any public spending environment. In principle, each level of government develops its own systems of control. That is almost universally valid in the case of executive control structures that are oriented to verify the good functioning of management procedures.

The same is not the case for external control, understood as control performed by somebody who is external and independent of the controlled entity. Although the model and scope differ between countries, supreme audit institutions control national and sub-national financial activity. However, some countries have created audit institutions at regional/state/county level. In some countries, national executive control is performed on sub-national governments, generally on the use made of resources transferred from the national level. In other countries the regional/state/county audit institutions audit local public spending activity. Local governments might have to justify the use of grants received from donors – often both regional and national governments.

Reliable and co-operative control structures across levels of government are necessary to focus, simplify and improve control efficiency. Reliability comes from alignment with internationally recognised control standards. Co-operation between control institutions is a more complex issue. It concerns internal and external control at each level of government and between them. It refers to co-operation between internal control of line ministries or the ministry of finance with sub-national internal control, *i.e.* fixing the standards that sub-national internal control has to apply for the control of national grants transferred to their administrations, allowing to focus national control on sub-national control systems more than on specific programmes or expenditures. It also refers to co-operation between the supreme audit institution and the regional or local audit authorities, when they exist, or with other entities in charge of external control.

Clear rules establishing the scope of external audit institutions and their relationship with managers and other controllers at each level of government are essential. The rules should be driven by the need to ensure accountability in the use of public resources, allowing total audit coverage of public spending by external independent control.

Again, valuable and reliable information is essential for control. The existence of homogeneous statistics and accounting and reporting systems across levels of government can avoid most of the problems encountered when treating financial and non-financial information. The information related to programme results can be difficult to manage when the data structure differs between administrations. Statistics, methodologies, reporting deadlines and structure, etc., have to be discussed, agreed and enforced to ensure homogeneity and to avoid misleading information. Consistent data can be more easily treated by internal and external control, producing more accurate findings and recommendations.

4. Accountability and control of funding provided to sub-national governments

The financial resources provided to sub-national governments can be of various types. The normal situation includes several sources: share of national taxes (income, VAT), sub-national taxes (mainly on house and land use or ownership), national general grants, national conditional grants, equalisation grants, etc.

At least two main issues arise from the funding system: sufficiency of financial resources and quality of spending. The former applies to the comparison between the expenses needed to accomplish the sub-national duties and the available financial resources; the latter concerns respecting legality and grant conditions and ensuring efficiency.

Whatever the method used to estimate the financial needs of sub-national governments to adequately deliver public services, sufficiency of the financial resources allocated to them by the central government seems to be a key factor for budget discipline and accountability. Otherwise, budget deficits will appear or increase, as the spending pressure on sub-national governments can be even bigger than for national government, both for investment and social programmes.

At each level of government, a clear division of competences and transparency for citizens are pre-conditions for accountability. Each level of government has to be conscious of its legal and conventional responsibilities in public service delivery. Since several levels of government intervene to deliver public services, the role of each level has to be clearly assumed and explained to citizens.

There is a big challenge for governments in explaining to citizens the duties of each level of government and their financial capacities. Unfortunately, lack of transparency can often be used as a political weapon by any level of government, imputing to the others its own mistakes or inactions, with accountability suffering as a result.

The issue of transparency in information to citizens becomes enormously complicated when determining the financial resources needed to implement the policies and programmes. While it is always possible to verify allegations about the distribution of competences, any argument related to the lack or insufficiency of the financial resources needed to implement specific policies or programmes by one level of government is largely more difficult to assess. In fact, the usual accusation from sub-national governments – that there is a lack of funds estimated and transferred by national governments to implement some policies – is based on the inability to find an adequate degree of consensus in the method, formula, procedure and estimations to evaluate the needed financial amounts. Again, the stable framework for negotiation appears essential to avoid this recurrent factor of political debate.

How much the financing problem is a political or a technical one depends on the political atmosphere and the complexity of the model chosen to estimate the needed funds to finance sub-national competences. It is important that any model of competence distribution and funding gets not only a high degree of political agreement on its principles but also a consensus on technical aspects under current conditions and possible evolutions. A flexible approach could consider setting up several stages in the decentralisation process and using the lessons learnt in previous steps when moving on to the next steps.

Legality and efficiency in sub-national public spending have to be pursued by public managers and controlled and verified by control institutions. Sub-national governments set up internal control systems and are overseen by external audit institutions that should guarantee an adequate level of spending quality. Concerning the conditions for grants – being usually established in laws, regulations or programmes setting up the grant objectives and requirements to be accomplished by the sub-national governments – they should be clear, verifiable and easy to implement.

In general terms, the variety of financial resources requires different control mechanisms to be applied by national government. In general, expenditures related to any financial resource can be subjected to control standards performed by the management and audit structures at each level of government, even with the supreme audit institution playing its specific role. But the conditions applied to grants, whether general (categorical grants, block grants) or more specific or detailed, have to be verified by the different levels of government directly concerned (the donor and the recipient), requiring understanding, co-ordination and co-operation at both management and control stages.

5. Accountability and control of delegated public spending: Agencies and other government bodies

Delegated public spending is directly performed by entities other than the central government, with varied degrees of management and legal independence and whose creation and organisation respond to the needs of their specific activity, generally different from the administrative activity of the core government. These entities are responsible for their management, including organising an adequate internal control system, and are subject to ministerial control and also to external control by auditing entities (supreme audit institutions and/or other public or private audit entities). Public service delivery using agencies is a current trend among OECD countries.

In general terms, delegated public spending can facilitate more specialised public management, provide a faster answer to social demands, improve the taxpayer's capacity to identify the entities in charge of public service delivery, and facilitate a more performance-oriented approach.

The traditional issue in the creation of delegated structures is the trade-off between management flexibility and accountability. Problems related to weak co-ordination, lack of clarity regarding roles and accountability, lack of top governance capacity, lack of transparency in management appointment, among others (Laking, 2005), are considered some of the risks assumed by the creation of agencies in charge of public service delivery. Thus, some of the challenges related to accountability and control – such as how to maintain an adequate level of control of agencies, without losing the advantages in terms of flexibility and speciality; or how to ensure that agencies stay accountable to the parent ministry or the government despite the sometimes political character of their top management appointment; or how to make clear to citizens the specific responsibilities of both the centre and the agencies – require considering following some criteria which could help to reduce management problems, public spending inefficiency, and accountability and control risks, such as:

- Goals and basic management lines should be clearly specified and agreed with the parent ministry to avoid blocking and discrepancies.
- There has to be a clear link between the actual competence and duties, the intended goals, and the information provided by the agency on actual results.
- Agencies should provide regular reporting on management and results, using homogenous systems of accounting and statistics and financial and non-financial reporting.
- Audit committees should be set up with authority to:
    - Evaluate management strategy and operation;
    - Oversee and co-ordinate financial audit work;
    - Report to the agency board, the executive/line ministry, and the legislature.

- Internal control should be adapted to the agency's activity and management but follow the basic lines of control of the government/line ministry and audit committee.
- External control by the SAI or other entities should ensure independent oversight. Access to any type of internal or external audit work should be guaranteed.

Some OECD countries, like Denmark, Finland and Sweden, have developed a system where agencies are in charge of implementing policies, and they are monitored by ministries which are small in size. Their relationship is driven by a kind of performance contract where goals, targets and financial resources are agreed, and the agencies are accountable for their achievement.

6. Third-party providers: Contracted arrangements and public-private partnerships (PPPs)[1]

Contractual arrangements with private partners or contractors to provide public assets and services are a common picture in OECD countries, where the actors can be any level of government or delegated entities (agencies, state-owned enterprises, etc.).

Outsourcing is the most common market-type mechanism used by governments. More and more contractors directly provide services to citizens and not just services to the government itself. Outsourcing allows governments to design and control contract implementation and to hold the providers accountable for management and performance.

Some usual benefits of outsourcing relate to reduced costs and bigger specialisation, and to the fact that the system for selection of the contractor takes advantage of market competition mechanisms.

A number of difficulties or issues can be described also, such as how governments ensure that the public purpose is met when the contractor holds an advantageous asymmetry of information. Also, issues can arise when the contract is more technical in nature and the government has lost in-house technical knowledge.

Most of these benefits and difficulties can also apply to public-private partnerships (PPPs), which refer to the private sector financing, designing, building, maintaining, and operating infrastructure assets traditionally provided by the public sector. PPPs can also involve the private sector purchasing already existing infrastructure assets and redeveloping them. Public-private partnerships bring a single private sector entity to provide public infrastructure assets for their "whole of life", generally 20-30 years.

The private sector partner then charges an annual fee for the use of the infrastructure assets. This can either be paid by the government or through user charges, or a combination of the two. PPPs are also known as private finance initiatives (PFI, extensively used in United Kingdom) and projects for public services. PPPs have been mainly used in the provision of transportation infrastructure, but other examples include schools, hospitals, office buildings, and water and sewage treatment facilities.

PPPs give rise to specific issues in terms of financing and transparency. As private partners are investing funds to build infrastructure and equipment, there is a big incentive for governments to start projects without any expenditure to be added to the public deficit or financed by issuing public debt. Regular future payments, in terms of – for example – compensation grants to be paid to the partner, can be made without seemingly creating immediate fiscal discipline problems. Here there is a problem of definition, as to when the assets related to a PPP can be considered public investment or private assets and consequently be included in public accounts and public deficit or not. The other problem is financial transparency, in terms of whether or not the whole risks associated with any PPP should be recorded in the accounting system. Accrual accounting and whole reporting of future payments appear critical to ensure that future obligations in this contractual area are controlled sufficiently.

Good management of PPPs, as for outsourcing, requires governments to have legal and technical knowledge about such complex contracts and about the tendering firms' skills and financial capability, as well as administrative transparency in the whole contractual process (selecting the contractor/partner, allocating the share of risk and responsibility between the contractor and the government, etc.), monitoring risk variations during the contract execution, sufficient contractor reporting, and the integration of user/customer reactions (surveys, social participation mechanisms, etc.) in the contract management to make the necessary changes.

In addition, some control criteria applicable to contractual public expenditure require clear allocation of competences and duties to the government and the contractor, clear and complete exposure of expected profits and risks assumed by each party, clarity in contract amendment policy (prices, compensation grants, risk sharing, etc.), effective government control of quality of services and assets delivered, and specialised preventive control on contractual procedures and audit control by independent external control.

7. Performance and programme evaluation: Its application to decentralised and delegated public spending[2]

Performance measures have been incorporated into the management and budgeting processes of many governments of OECD countries, at different levels of government and in autonomous agencies. These performance reforms have been accompanied by greater autonomy and flexibility for managers. These changes have implications for accountability and control, since the use of performance techniques including performance agreements and policy/programme evaluation seeks to help ensure that performance results and/or national goals are achieved at lower governmental levels, and to help shift the focus from compliance to results.

Policy/programme evaluation can be used by management as a management tool and also by internal and external controllers to assess whether the intended goals and improvement in performance delivery have been achieved, while maintaining appropriate accountability.

Measuring results is a big issue, both because of the complexity of technical definition of indicators and results and because of the difficulty in agreeing on how to define the intermediate and final objectives pursued by the policies/programmes at each level of government. Reporting on inputs assigned to a policy/programme implies an accounting exercise, usually resolved by the use of generally accepted accounting systems without any other major problem, unless the levels of government use different accounting systems that are difficult to homogenise, or even do not provide timely and complete information. Reporting on outputs and outcomes requires basic co-operation between each level of government in order to develop a consensus about the definition and measurement of objectives and results for spending policies/programmes.

Evaluation focuses on the assessment of a programme's achievements against its objectives. It encompasses **ex post evaluation**, typically to assist in allocating resources or enhancing accountability, and **intermediate evaluation**, usually undertaken during the implementation of the policy/programme. **Ex ante evaluation** can measure estimated economic, financial or welfare impact in the short, middle and long term, assessing also financial risks of the policy/programme to be approved.

Programme evaluation is performed by most OECD countries at the level of management, internal control or external control, but generally following a case-by-case basis, taking into account different factors for selecting the programmes to be evaluated, like overspending, insufficient monitoring, customer claims, welfare impact, etc. However, some countries follow a more systematic approach and include programme evaluation in the budget cycle, *i.e.* the Netherlands, the United Kingdom, the United States and Chile – but mostly at management level (Allen and Tommasi, 2001). The supreme audit institutions of Denmark, Finland, Sweden, the United Kingdom, etc., perform evaluations following a methodology closer to value-for-money audit, either referring to specific programmes or to the whole activity of agencies in charge of one or several programmes.

The following factors can influence the efficient use of performance techniques and programme evaluation in decentralised public spending:

- A clear process of negotiation and decision making between levels of government on policy objectives and financial resources should exist, implemented through performance agreements which set up goals, targets and performance measurement criteria.
- Performance agreements involve defining the information systems, both accounting and statistics, and deciding which control bodies have to verify the achieved results and who is in charge of implementing the necessary adjustments.
- Performance techniques call for specialised control, further than the financial control, focusing on policy/programme evaluation techniques.

Most of these factors are also applicable to delegated spending. The biggest difference appears in the negotiation and agreement between ministers and the agencies' top management. Generally the ministers' political criteria will not be contested by the agencies, though this could happen in the discussion with other levels of government, mainly because of the presence of different political parties in each level. Even the control systems from central government on funding provided by it or on the performance of a co-financed programme will be weakened and rely – at least formally – on sub-national control because of institutional reasons.

Some relevant advantages of the use of performance techniques can be seen, such as: they allow quantifying a set of outputs and outcomes; monitoring of policy/programme implementation can be performed on the basis of more objective and previously agreed criteria; and control activities, both internal and external, can be facilitated since objective targets, means and performance measurement criteria have been previously set up. However, performance techniques can also introduce rigidity or perverse effects in the execution of policy/programmes once the technical aspects in measurement of performance and achievement of targets (reduction of health care waiting lists versus reduction in assistance quality, etc.) have been agreed/approved. A number of challenges/difficulties remain:

- Political situations, such as different political parties governing in central government and sub-national governments, can serve to maintain bad performance programmes or impede the agreement or implementation of new ones.
- Getting a timely and satisfactory agreement between levels of government on policy/programme goals, implementation and measurement of performance information can be sometimes difficult.
- The relevant performance information used by the executive at different levels of government can be considered irrelevant or insufficient by their legislative bodies for decisions on supporting or approving the policy/programme.
- Most OECD countries have inadequate external control to evaluate programme performance. There is a need to enlarge the supreme audit institutions' scope of control and adapt their staff training, even through the creation of specialised performance control bodies.

In the specific case of delegated spending, it is important to have clear lines of responsibility. If this is not the case, questions arise concerning under what circumstances and for which programmes agencies' top management will have to assume the entire responsibility for bad performance, and what is the degree of responsibility of the parent ministry. In order to avoid these situations, monitoring of key programmes by the parent ministry can be considered a valuable control tool that also increases the ministry's responsibility in the performance of the programme.

Notes

1. OECD (2005), "The Use of Market-type Mechanisms to Provide Government Services", Chapter 5 in *Modernising Government. The Way Forward*, OECD, Paris, pp. 129-155.
2. OECD (2005), "Enhancing Public Sector Performance", Chapter 2 in *Modernising Government: The Way Forward*, OECD, Paris, pp. 55-81.

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