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Foreword

The OECD Journal on Budgeting is a unique resource for policy makers, officials and researchers in public sector budgeting. Drawing on the best of the recent work of the OECD Working Party of Senior Budget Officials, as well as special contributions from finance ministries of member countries and others, the Journal provides insights on leading-edge institutional arrangements, systems and instruments for the effective and efficient allocation and management of resources in the public sector.

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Table of Contents

Budgeting in Thailand <i>by</i> Jón R. Blöndal and Sang-In Kim	7
The United Kingdom Private Finance Initiative: The Challenge of Allocating Risk <i>by</i> David Corner.....	37
The “Control” of Public Social Security Institutions in Belgium <i>by</i> Marc Evrard and Philippe Scutnaire	57
Accountability Institutions and the Policy Process: The United States Experience <i>by</i> Paul L. Posner	71
Introducing Financial Management Information Systems in Developing Countries <i>by</i> Jack Diamond and Pokar Khemani	97

Budgeting in Thailand

by

Jón R. Blöndal and Sang-In Kim*

Thailand has a sophisticated budget formulation process which has delivered solid fiscal results over time. This article discusses aspects of the budget process, including strategic performance budgeting, central development planning, the steps in the budget preparation timetable, and the roles of the spending ministries, the Bureau of the Budget and the Central Fund. The role of Parliament in the annual budget process is also described, including a discussion of the electoral reforms introduced by the new constitution of 1997 and the related restrictions, and the roles of the Scrutiny Committee on the Budget and of the Office of the Auditor-General. Finally, the article explores budget implementation and management issues in more detail: budget appropriations and financial management practices; organisational structures (including two new types of government organisation, the autonomous public organisation and the service delivery unit); and human resource management. The common theme is to increase flexibility and reinforce the performance and results orientation of the budgeting system.

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Introduction

For the 2005 meeting of Asian Senior Budget Officials, the OECD carried out a review of the Thai budgeting system in the same manner and using the same methodology as it does for the regular peer reviews of the budgeting systems of OECD member countries. It is envisaged that such reviews become a regular feature on the agenda of future meetings of Asian Senior Budget Officials.

The objective is to provide a comprehensive overview of the budgeting system of the country under consideration and thus to act as a basis for the discussion of that country's budgeting system. As a result, countries in the region will become more aware of each other's budgeting systems.

It should be noted that this review focuses on budgeting at the national level only. It does not discuss budgeting at provincial and local levels of government, nor the management of fiscal relations across levels of government.

A mission, consisting of Mr. Jón R. Blöndal and Mr. Sang-In Kim, visited Bangkok in September 2005 to carry out the review. During this visit, the mission met with senior officials from the Bureau of the Budget, the National Economic and Social Development Board, the Ministry of Finance, the Public Sector Development Commission, the Civil Service Commission, the Comptroller-General's Department, and line ministries including the Ministry of Health and the Ministry of the Environment. The mission also met with senior officials from the National Assembly and the Office of the Auditor-General. The mission would like to express its gratitude and appreciation for the warm and cordial reception by the Thai authorities and the uniformly frank and useful discussions with Thai officials.

In particular, thanks are due to Mr. Vudhibhandhu Vichairatana, Director-General, and Mr. Somnuk Phimolsathian, Deputy Director-General, Bureau of the Budget, for their support throughout the review. Finally, the mission would like to thank Mr. Dechapiwat na Songkhla, Budget Advisor, and his staff team for organising the mission's visit and for their excellent and invaluable assistance throughout this review.

The views expressed in this report are those of the OECD Secretariat and should not be attributed to governments of OECD member countries, or to any organisation or individuals consulted for this review. The review was completed in December 2005.

1. Budget formulation

1.1. Introduction

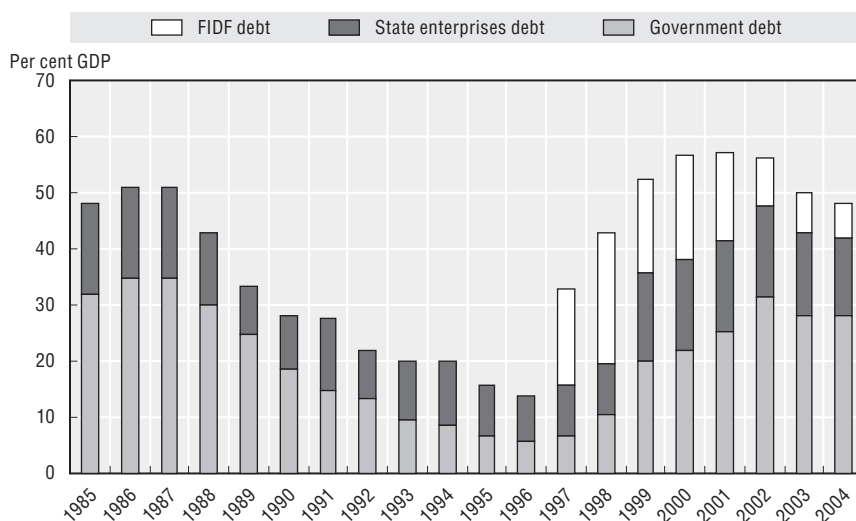
Thailand's total public debt stood at 48.2% of GDP at the end of 2004. The public debt is composed of the accumulated deficits of the budget itself, the debt held by state enterprises, and the debt assumed by the government in connection with the bailout of the financial system following the economic crisis in 1997.

The performance of the budget has been very solid over the years. Prior to the onset of the economic crisis in 1997, the level of outstanding debt-to-GDP stood at less than 5%, with the government having recorded surpluses for each of the previous ten years. Following the 1997 economic crisis, the central government recorded deficits in the following six years, with debt peaking at 31.4% of GDP in 2002. Since then the budget has been in modest surplus and the debt ratio in decline.

The state enterprises sector includes a number of capital-intensive utilities and transportation enterprises which account for most of the total debt in this sector. Their debt is not a function of financing perennial losses. Most of the enterprises are profitable, and the sector as a whole has a positive net worth and is a net contributor to the budget.

The third category is the Financial Institutions Development Fund (FIDF), which assists distressed financial institutions and provides deposit guarantees. This was the vehicle used to bail out the financial system following the economic crisis in 1997. This fund has steadily been improving its balance sheet with total outstanding debt at 6.2% of GDP in 2004 – down from nearly three times that share in 1997.

For the purposes of this report, the outstanding feature of these statistics is the highly disciplined manner in which the budget has been formulated, approved and implemented in Thailand. As part of its fiscal sustainability framework, the government has committed itself to running a balanced budget from now onwards. This, coupled with economic growth, will exert a strong downward track for overall public debt as a share of GDP.

Figure 1. Public debt

Source: Office of Public Debt Management of Thailand, www.pdmo.mof.go.th.

1.2. Strategic performance budgeting

Thailand's excellent record of aggregate expenditure control over the years was facilitated by a centralised budgeting process based on line-item input budgeting. Budgets were approved on a very detailed level and pre-approvals for individual expenditures were required in-year.

It was recognised, however, that allocative and operational efficiencies were not optimal in this environment. As a result, in the mid-1990s, efforts were begun to re-orient the budget process towards a greater focus on performance and results. At the same time, efforts were made to reduce input and other central management controls and to empower spending ministries and agencies to take on more responsibility for their own activities.

Thailand embarked on these reforms cautiously. Rather than being introduced comprehensively as a new overall budgeting process, individual spending ministries and agencies had to fulfil exacting criteria before being granted greater flexibility. This was to ensure sound public finances and to minimise any potential for abuse. These criteria, known as the "hurdles", were however set at such a level that hardly any organisation actually fulfilled them. Indeed, most OECD countries would have found it difficult

to meet them. The criteria included, for example, requirements for accrual budgeting.

A new government was elected several years following these initial reforms, a government with a keen interest in upgrading the management of the public sector. It was not satisfied with the slow pace of the “hurdles” approach. It decided that **all** ministries and agencies would move to the new performance and results budgeting system – which was termed “strategic performance budgeting”. This became effective with the budget for fiscal year 2002/03.

Concern was voiced that this universal move was too rapid and that some ministries and agencies were not up to the task. The concerns were two-fold: one centred on the development of a performance and results framework; the other focussed on the relaxation of central input controls.

In this regard, it should be borne in mind that this reform initiative builds on years of preparations. A special performance office had been established within the Bureau of the Budget with the launch of the original reforms in the mid-1990s. It acted as a consultant to ministries and agencies in how they could best define their outputs and develop appropriate performance measures. On average, each ministry and agency has about four final outputs. A sample review of final outputs showed them to be of high quality by international standards – both in terms of definition and quantitative measurement. (Requirements for accrual costing of each output were dropped.)

All ministries and agencies must submit regular performance reports (key performance indicators) throughout the year and at the end of the year, showing their progress in achieving the agreed outputs. In addition, the budget office regularly monitors individual aspects of the performance of individual ministries and agencies in a system modelled after the United States PART initiative (Program Assessment Rating Tool¹).

It should however be emphasised that alongside the performance and results budget, there is also an input-based budget, as not all government agencies have been able to establish robust costing of outputs. The budget is therefore presented in both a performance and results and an input-based format.

The relaxation of central input controls has essentially involved merging appropriations for operating expenditures into two categories – one for salaries and one for other operating expenditures. Ministries and agencies in essence now have full discretion over the latter category. The government now also pre-approves (apportions) spending by ministries and agencies in bulk at the beginning of the year. In addition, the government is establishing

a number of specialised agencies – known as **autonomous public organisations** and **special delivery units** – that have greater flexibility. This is discussed further in section 3.3.

1.3. Central development planning

Thailand has a long history of central development planning. The first five-year plan, the National Economic and Social Development Plan, came into effect in 1961. The current five-year plan, the ninth, concludes in 2006. The early plans were focused mainly on infrastructure and other economic development activities, although later plans were broader and encompassed various social aspects as well.

These plans were developed internally by a cadre of elite government officials, although later plans formally incorporated various public consultation mechanisms. These plans were more than indicative; they literally set the agenda – including overall budget priorities – for successive government administrations.

A major change in Thailand's system of central planning occurred in 2005. In fact, central planning as practiced up until then was abolished. Following national elections, the re-elected government decided to adopt a system of four-year **Government Administrative Plans**. This document is meant to translate the political manifesto upon which the government was elected into the administrative actions that must be carried out in order to fulfil the political manifesto. The four-year timeframe coincides with the electoral term of the government.

The symbolism of this reform cannot be overstated: instead of governments responding to a five-year plan drawn up by technocrats, the government machinery now has to respond to the will of the popularly-elected government. Interestingly, the five-year plans are not being discontinued. However, their character will necessarily change markedly although no final decisions have been made in that regard (at the time when this report was written).

The Government Administrative Plan is divided into nine separate strategies:

- “Reduction of poverty.
- Quality development of society and human resources.
- Conformation of balanced and competitiveness of economic structure.

- Administration and management of natural resources and environment.
- Maintain foreign affairs policy and international economy.
- Development of nation laws and regulations and promotion of good governance.
- Promotion of democracy and social popularisation process.
- Sustain national security.
- Comprehensive national administration and implementation.”

As can be seen, the nine strategies are comprehensive and cover all areas of government. As such, they are necessarily quite general at the top level, but they do cascade down into more and more detail and highlight specific priorities.

The year 2005 was a transition year as the Government Administrative Plan was being introduced. All government ministries and agencies had to prepare annual plans on how they would implement the Plan. This was similar to the requirements for the previous five-year plans. As the government’s budget is to reflect the Plan, preparing the annual budget submissions and the annual Plan are generally conducted in unison by ministries and agencies. The Plan and the Budget – on an annual basis – are officially parallel mechanisms but in practice work together as one.

The Office of the National Economic and Social Development Board produces both plans. It prepares the contents of the five-year plans whereas it translates the government’s manifesto into the new four-year plans. The Bureau of the Budget is integrally linked with the preparations of both.

1.4. Annual budget preparation process

The fiscal year in Thailand starts on 1 October. The annual budget preparation process begins ten months earlier, *i.e.* January. The first step is to determine the economic assumptions applicable for the budget. As the government is committed to operating a balanced budget (nominal surpluses), the calculations of economic activity and the revenues it will generate will in effect set the overall ceiling for total expenditure during the year.

The calculation of the economic assumptions used in the budget is carried out jointly by four key central economic agencies, colloquially known as the “**Gang of Four**”. These are the Bank of Thailand (central bank), the Ministry of Finance (taxation; cash and debt management), the

National Economic and Social Development Board (macroeconomic analysis; central planning machinery) and the Bureau of the Budget itself.

**Box 1. Budget preparation timetable
(as applied for the budget for fiscal year 2006)**

Fiscal year = October-September

January-February	Gang of Four prepares economic assumptions. Bureau of the Budget updates baseline projections. Spending ministries prepare and submit their initial budget bids.
March	Aggregate budget ceilings established for individual ministries.
April	Spending ministries submit second budget bids, in line with their ceilings.
May	Budget finalised. Budget submitted to Parliament.

Each of the four agencies makes its own estimates of key macroeconomic variables, with the Ministry of Finance having the principal information on tax revenue. The initial estimates of the four agencies generally differ and a two to three-week process of informal dialogue ensues before a consensus forecast is established. The heads of the four agencies formally endorse the consensus forecast and submit it to the Prime Minister for final approval. This would conclude in February.

In the past two years, the forecasts have underestimated economic activity, and revenue collections have been significantly higher than expected. This would appear to indicate a conservative bias in the economic assumptions used in the budget, revealing a preference for erring on the side of prudence. In both years, a supplementary budget was presented to Parliament late in the fiscal year for approval.

At the same time, the Bureau of the Budget will be updating its baseline estimates (medium-term expenditure framework) for the continuation of current government policies – including the financial impact of prior decisions whose full expenditure impacts only materialise in subsequent budgets. This will involve a review of last year's operational and financial performance with frequent yet informal contacts between analysts at the Bureau of the Budget and officials at spending ministries. It should be noted that the baseline forecasts for out-years are not published; they appear in an internal Bureau of the Budget document only.

Box 2. The Bureau of the Budget

The Bureau of the Budget is a central agency responsible for budgeting. It reports directly to the Prime Minister. Its official primary responsibilities are to:

- Develop macro-fiscal projections and set medium-term budget ceilings;
- Help budget-dependent agencies prepare their annual budget;
- Assist the executive branch during the parliamentary budget approval process;
- Execute the annual budget – with responsibilities shared with the Ministry of Finance;
- Monitor and evaluate government-wide programmes.

The Bureau of the Budget is divided into a number of analytical divisions that “shadow” spending ministries as well as various “whole-of-budget” divisions, including for co-ordinating the budget process and budget policy, and for following through on the performance and results focus.

The Bureau of the Budget is headed by a director-general, assisted by five deputy directors-general. The Bureau has a total staff of 800.

Parallel to this, spending ministries will be working on their budget submissions. The sophistication of the internal budget procedures varies tremendously from ministry to ministry. In some cases, they are based on elaborate internal strategic planning exercises. The complete reverse is the case in others. Regardless, ministries submit their initial bids in February, *i.e.* at about the same time as the Gang of Four will have arrived at their conclusion.

Spending ministries submit their bids before the overall expenditure ceilings are decided. These initial bids are generally wildly in excess of any realistic expectations of funding – spending ministries appear to view them as a “marketing” device to influence the level of their final spending ceiling.

At this stage, the Bureau of the Budget is in a position to formulate the budget framework for the following year. Based on the work of the Gang of Four, the total resources available for next year’s budget will be known. The update of the baselines for current activities will have been completed, thus revealing how much money is left for new initiatives. It should be highlighted that the Thai economy is expanding at a rapid pace compared

with OECD member countries, thus making relatively large new resources available each year.

Box 3. Evaluating new bids from spending ministries

The Bureau of the Budget evaluates each bid for new funding against three dimensions:

- Is it in line with government priorities?
- Is the agency that makes the bid the correct administrative unit to be carrying it out?
- How does it contribute to empowering lower levels of government?

As noted earlier, government priorities are formally enunciated in the four-year Government Administration Plan. This is the first point of reference, and all bids must demonstrate their alignment with the Plan. As discussed, the Plan however encompasses all activities of government and is therefore, by definition, of a general nature – although specific policies are of course highlighted.

In addition to the four-year Plan, the Cabinet generally designates a number of areas separately as priorities. These are referred to as the “National Agenda”. These may be very large activities such as supporting the reconstruction and development efforts following the tsunami. Or they can be smaller activities such as campaigns to reduce smoking.

Parliament also authorises a comparatively large discretionary fund – the Central Fund – to the Prime Minister to meet new priorities during the year. The use of this fund is *prima facie* a strong indication of the government’s priorities.

Aside from the identification of specific activities as priorities, the government has set itself a number of overall benchmarks for the allocation of expenditure. For example, it aims for capital expenditure to amount to one-fourth of the total budget each year. Similarly, it aims to significantly reduce the share of salaries and other employment costs as a proportion of the total budget – from 40% to 30%.

As can be seen, there are numerous vehicles for highlighting government priorities. In the end, it is a political decision as to which priorities to fund and at what level. The Bureau of the Budget – reporting directly to the Prime Minister – is uniquely positioned to play this role.

The Bureau of the Budget will propose expenditure ceilings for each ministry. These will be submitted to the Prime Minister for approval. Each minister is then required to submit a new spending request by the end of April.

These ceiling decisions have no relation to the initial bids submitted by ministries – which draws into question the rationale for asking spending ministries to submit two sets of bids. Spending ministries are granted an aggregate ceiling which they can reallocate among their various programmes and agencies – subject to final approval by the Bureau of the Budget. This is, however, exceedingly rare. As a general rule, spending ministries do not have either the capacity or the will to reallocate among their various programmes and agencies. This is accentuated by the fact that the Bureau of the Budget maintains direct contacts with agencies attached to ministries, rather than dealing only with ministries. This is also a reflection of the capacity issues in certain ministries.

Box 4. The Central Fund

A special feature of the Thai budgeting system is the existence of the Central Fund, which is organised in accordance with the Budget Procedures Act of 1959. This is a large fund – amounting to 20% of total government outlays. About 80% of the Fund is pre-determined in the budget formulation and approval phases. The other 20% operates as an in-year discretionary fund for specific purposes, such as “Enhancing the Nation’s Competitiveness and Sustainable Development”, or for emergency projects. This serves to create additional flexibility in budget implementation. The existence of this Fund does not appear to have undermined fiscal discipline, as the Fund is generally not used to supplement appropriations for government entities.

In evaluating the bids, the Bureau of the Budget establishes an internal budget committee headed by the budget director and five internal sub-committees. The sub-committees reflect the organisation of the Bureau into five analytical areas. Each sub-committee is headed by the respective deputy director-general responsible for that area. The sub-committees bring together the respective analysts that “shadow” the respective ministries and agencies. A representative from the co-ordination division (budget policy division) and the performance office are also members. Following the review of the sub-committees, the internal budget committee reviews their conclusions, makes any amendments, and submits the conclusions to the

Prime Minister for his final approval. The Cabinet then formally approves them.

The operation is surprisingly fast – both due to the fact that the Bureau of the Budget is well versed in the priorities of the government and due to the frequent informal contacts with spending ministries which results in the main contents of their submissions being known ahead of time.

1.5. Conclusion

Thailand has a sophisticated budget formulation process which has delivered solid fiscal results over time, as demonstrated by Thailand's overall level of public debt. The budget process has traditionally been highly centralised, which has contributed to strong aggregate fiscal discipline.

In order to improve allocative and operational efficiency of public expenditure, initiatives are currently in place to reduce the centralisation of the budget process. In the area of budget formulation, a crucial role in these reforms is played by line ministries. They have to be willing and able to reallocate resources among their various departments (agencies). To date, they have shown great hesitation in doing so. Specific initiatives are called for to strengthen this function in line ministries. The Bureau of the Budget could limit – or end altogether – direct communications with departments (agencies) and only work through ministries. This would be a powerful symbol of change. Furthermore, consideration could be given to the reallocation of resources among departments being one of the performance criteria for ministries and their senior executives.

The relationship between the budget and the new four-year Government Administrative Plans is a work in progress as the latter were only introduced this year (2005). This could be an opportunity to reinforce the top-down nature of the Thai budget process by no longer requesting initial budget submissions from line ministries and departments, but rather having the Plan inform the top-down allocations in the first instance. At present, the initial budget submissions are wildly in excess of final allocations and thus appear to be irrelevant to the top-down expenditure ceilings in any case.

Thailand has a highly developed performance and results orientation to its budgeting system. The definition and measurement of outcomes and outputs is impressive by any standards. At the same time, the budget is also presented on the traditional input basis. It would appear to be the case that the budgets of ministries and departments are often formulated on the basis of inputs which are then “translated” into outcomes and outputs. In order to reinforce the performance and results focus, consideration could be given to

modernising the format of the budget and not presenting input information where possible.

Finally, it is worth noting that Thailand uses various quasi-fiscal measures as well for the implementation of public policy, such as government-directed lending by government financial institutions. A recent report by the International Monetary Fund (IMF, 2004) assessed such measures and concluded that they did not represent a significant fiscal risk. Nonetheless, it is important for the Thai government to have a comprehensive fiscal framework in place that incorporates the measures. This is recognised in Thailand, and work is already in progress towards that end.

2. Role of Parliament

2.1. Introduction

The effective role of Parliament in the budget process has been limited throughout Thailand's history, albeit for different reasons at different times. During the long periods of military rule, parliamentary oversight – by definition – did not exist. During the early periods of civilian rule, Parliament's role was undermined by chronic party infighting, localism and instability which characterised this time. Today, due to the unprecedented success of a single political party and its strong internal discipline, the influence of Parliament as an institution *vis-à-vis* the executive has been reduced.

In addition, specific constitutional provisions guarantee the prerogative of the executive in budgetary affairs. These provisions came into effect with the new 1997 constitution; previously the Thai Parliament had no such constitutional restrictions on its authority. Nonetheless, the Thai Parliament has an elaborate process for scrutinising the government's budget proposal and does in fact succeed in making amendments to the budget proposal, albeit not on a large scale.

2.2. The National Assembly

Thailand's legislature, the National Assembly, is a bicameral institution consisting of the House of Representatives and the Senate.

A new reform-oriented constitution was approved in 1997, the “democracy” constitution. It is meant to rectify the deficiencies identified in the earlier periods of civilian rule and defines today's political landscape. It is worth highlighting several electoral provisions of the 1997 reform constitution.

The Senate had traditionally been appointed, with senators generally being former military officers and senior government officials. The new constitution makes them directly elected. Senators are however only elected in their personal capacities and cannot have any political party affiliations. The Senate is to be “above” politics. The Senate has limited legislative responsibility in the area of budgeting. It mainly fulfils a “watch-dog” function. For example, it is responsible for appointing members to bodies such as the State Audit Commission, the Election Commission and the National Counter-Corruption Commission.

The Senate consists of 200 members elected for six-year terms. The electoral districts correspond to the country’s 76 provinces, with the larger provinces having multiple members.

The House of Representatives which had been elected through proportional, multi-member constituencies was replaced by a dual system of single-member constituencies and a national party list. Constituency MPs are explicitly tasked to represent local interests as they had traditionally done. The introduction of single-member constituencies was meant to accentuate that role, promote competition between political parties, and prevent competition within political parties. Traditionally, candidates from the same party within a constituency campaigned as much against other fellow party members as they did against other parties. This undermined the roles of political parties and served to destabilise Thai politics. This reform was meant to alleviate that.

Political parties must also establish a national list of candidates for seats in the House of Representatives. They are elected indirectly, *i.e.* the number of candidates elected from the national list is a function of the number of constituency MPs the respective party received. MPs cannot serve concurrently in the Cabinet. In practice, this means that only MPs elected from the national list become ministers. The objective is to promote a cadre of highly qualified MPs to serve as ministers and to have an elite group of MPs focused on national issues as opposed to local issues. Constituency MPs are not prevented *per se* from becoming Cabinet ministers. However, if they do, a new election for the affected constituency must be called to replace the MP joining the Cabinet. In the case of the national list, the next member on the list simply moves up and replaces the member leaving to become a minister. The national list is also seen by political parties as an opportunity to showcase their Cabinet hopefuls.

The House of Representatives consists of 500 members, 400 elected directly in the single-member constituencies and 100 elected through the national party lists. Each province is entitled to at least one representative,

with the larger provinces having multiple members. Members of the House of Representatives are elected for terms of four years.

Box 5. Key electoral reforms (1997)

- An appointed Senate was replaced by an elected one. It is to be “above” politics and principally act as a “watch-dog” institution.
- The House of Representatives which had been elected through proportional, multi-member constituencies was replaced by a dual system of single-member constituencies and national party lists.
- Provisions were introduced to promote strong nationally-based political parties as an institution.
- A number of eligibility and disclosure criteria were introduced to promote the “quality” and “honesty” of candidates for the National Assembly.
- It was made mandatory for eligible citizens to vote in elections.

The constitution also seeks to promote strong nationally-based political parties as an institution. Previously, there had been large numbers of very small, often regionally-based parties with MPs often switching party allegiances. A political party needs to secure 5% of constituency MPs in order to qualify for any seats through the national list. This is a prohibitive hurdle for small parties. Small parties would also find it difficult to find the required 100 candidates for their respective national list who would be suitable. There is also a prohibition against MPs switching political parties. All of these provisions are meant to create a more stable political climate.

In order to promote the “quality” and “honesty” of candidates for the National Assembly, the constitution introduced a number of eligibility and disclosure criteria. The minimum age of candidates was set at age 25 and age 40 for the House and the Senate, respectively. All candidates must have a university degree. In addition, all candidates are subject to extensive public disclosure requirements regarding their personal finances and other circumstances.

Finally, the constitution makes it **mandatory** for all eligible citizens to vote in elections. All of these constitutional provisions are meant to promote good governance and a sustainable democracy in Thailand. It is beyond the scope of this report to assess the effectiveness of the individual reforms listed above. It is however beyond question that the new constitution

succeeded in fostering a historic new dynamic in Thai politics. In the first elections held under the new constitution in 1997, one political party won 248 seats out of the 500 in the House of Representatives and was able to form a government with just one coalition partner (although it actually opted to form a coalition with more parties). The government sat its entire four-year term of office, the first government in the history of Thailand to do so. In the subsequent election, the same party won 377 seats in the House of Representatives and was able to form an unprecedented majority in the National Assembly and did not need any coalition partner. Previously, it was not uncommon for five to six political parties to have to come together in order to be able to form a government.

2.3. Constitutional restrictions on the Parliament's budgetary role

The 1997 constitution also provides for several restrictions on Parliament's role in the budget process which serve to guarantee the executive's pre-eminence. Such restrictions had previously not been in place.

Box 6. Key constitutional restrictions

- No amendments to the budget may be permitted for a vote in the House of Representatives except with the prior endorsement of the Prime Minister.
- Members of the House of Representatives may only consider reductions in expenditure. They cannot propose additional expenditures.
- All proposed amendments must be approved by the individual member's political party.
- The Senate cannot make any changes to the budget. It can only make an up-or-down vote on the budget as a whole.
- If the House and the Senate have not finished their deliberations of the budget within fixed time limits, the proposed budget is deemed to have been approved by them.

In order to ensure the pre-eminence of the executive *vis-à-vis* the legislature in budget matters, the Prime Minister – the minister responsible for the Bureau of the Budget – enjoys a veto over any proposed amendments to the budget. The constitution stipulates that no proposed amendment to the

budget may be voted upon in the House of Representatives without the prior consent of the Prime Minister. This provision should be viewed in connection with the respective roles of constituency MPs and party-list MPs, with only the latter becoming ministers. Conceptually, the provision serves to act as a “national” counter to the “local” interests of constituency MPs.

The constitution also stipulates that the House of Representatives can only consider amendments that reduce expenditures. (Expenditures related to the national debt are explicitly excluded from this provision.) As a result, any proposal to increase expenditures would be ruled out of order immediately. Individual members of the House have to secure the approval of their political parties before they can propose any such amendments. Again, this is meant to act as a counter to “localism”, as fellow party members (from other regions) would act as the first discipline on such proposals.

The Senate cannot make any amendments to the budget – it can only approve it or reject it as a whole. This is in line with its constitutional function as a “watch dog” – *i.e.* as senators in their own right and not beholden to any political party, they should only reject the budget as a check against the propriety of the House’s consideration of the budget.

Finally, the constitution imposes limits on the time allowed for the House of Representatives and the Senate to consider the budget. In the case of the House, it is 105 days. A general session of the House lasts 120 days so this essentially means that the House has its entire session to deliberate the budget proposal. The Senate has two days to finish its deliberations and make an up-or-down vote on the budget. If either the House or the Senate has not finished the consideration of the budget within these periods, the budget is deemed to have been approved by them.

Notwithstanding these provisions, the National Assembly carefully scrutinises the government’s budget proposal and does in fact manage to amend it. This is described in the following section.

2.4. Parliamentary budget process

The parliamentary budget process starts with the Prime Minister introducing the government’s budget in the House of Representatives. This generally occurs in May and usually follows the ceremony for the King’s annual convocation of the National Assembly.

Box 7. Budget approval timetable**Fiscal year = October-September**

End May	Budget is introduced in the House of Representative by the Prime Minister. First reading takes place immediately.
July-September	Scrutiny Committee on the Budget reviews the government's proposal.
September	Informal negotiations between the government and the opposition on amending the budget. Second reading: votes on each individual amendment to the budget. Third reading: up-or-down vote on the budget as a whole.
Late September	Senate takes one up-or-down vote on the budget as a whole following a two-day debate.

Following the Prime Minister's budget speech, the leaders of opposition political parties counter with their different economic and social outlooks and how those would be reflected in the budget if they were in power. This is a "macro" debate where different political philosophies are aired rather than any specifics of the budget.

Following this debate – which constitutes the **first reading** of the budget – a vote is taken. This is considered a vote-of-confidence in the government. If the government were to lose this vote, the government would resign and a new election would be called. If the vote is won – as is normally the case – a Scrutiny Committee is selected to examine the government's budget proposal. This is an *ad hoc* committee which is formally selected anew each year, although its membership exhibits much continuity from year to year.

In comparison to parliamentary committees in other countries, the Scrutiny Committee is most unusual in one respect: it is a joint legislative-executive committee with the government nominating about one-fourth of the total membership. In addition, the Minister of Finance serves as the chair of the Scrutiny Committee.

The Scrutiny Committee is very active. In the 105 days it has to consider the budget, its 79 members meet every working day. The Committee meets in plenary in the beginning of the process, when it considers its overall work

programme for examining the government's budget proposal, and at the end when it makes its final recommendations to the House.

The Committee normally divides into several sub-committees to address the different sectors of the budget; most of the concrete meetings (scrutiny) take place in the sub-committees. The number of sub-committees changes from year to year and they do not necessarily coincide with the five sub-committees established in the Bureau of the Budget during the budget formulation phase. The issues for which sub-committees are formed change from year to year – in 2005 a special sub-committee was formed to review IT spending government-wide.

During the sub-committee meetings, the relevant minister, the permanent secretary and the heads of subsidiary departments (agencies) appear. The meetings are not open to the public.

Box 8. Secretariat for the National Assembly

The National Assembly has a professional staff of over 1 500. As such, it is one of the best endowed Parliaments of the world in terms of its capacity for independence from the executive.

The Bureau of the Budget – reflecting the executive's primacy in the budget process – serves as the “substantive” secretariat of the Scrutiny Committee. The deputy director-general of the Bureau of the Budget in fact serves as the official Secretary of the Committee. The responsibility of the National Assembly's secretariat is to ensure that correct parliamentary procedures are adhered to in the Committee's examination of the budget.

Despite the restrictions on Parliament's ability to amend the budget – as noted in previous sections – the Committee takes its mandate very seriously. It is in fact **the** principal (political) accountability institution in Thailand. And its scrutiny does typically result in changes in the government's original budget proposal. These changes are usually agreed by the government and the opposition outside of the normal parliamentary budget process due to Thailand's constitutional restrictions. The changes do not infringe on the overall fiscal policy objectives or sectoral allocations of the government. The changes have more of a symbolic value than anything else. Great respect is accorded to consensus in Thailand, and a government – especially a strong government – feels obligated to make amendments to the budget even though it is not legally obliged to do so.

Following any changes, the budget goes to a plenary session of the House of Representatives for its **second reading**. For the budget, this is a technical session where all the amendments previously agreed “informally” by the government and the opposition are made official. An individual vote is taken on all the separate amendments. The second reading normally occupies several full days.

The final and **third reading** is a pro-forma event where an up-or-down vote is taken on the budget as a whole incorporating the amendments made during the second reading. Following its approval in the House, the budget is transmitted to the Senate which can only make an up-or-down vote on the budget in total.

Once the House and the Senate have approved the budget, it is submitted to His Majesty the King for Royal Assent. Although it has always been the case for the budget, Royal Assent is by no means automatic. The King is revered in Thailand. The Royals have a solid checks-and-balances role on government, on behalf of the people. This was especially relevant during military rule and the period of fragile democracy. The fact that His Majesty has not had to revert to his power also demonstrates that governments would not put him in that position. This is another informal aspect to the Thai parliamentary budget process.

Box 9. Office of the Auditor-General

In line with the new constitution, the Office of the Auditor-General became an independent agency in 1999. Previously, it had been a unit of the Office of the Prime Minister. The OAG performs the traditional compliance, financial and performance audits in the public sector.

Recently, the OAG has been emphasising the development of internal controls in ministries and agencies. It explicitly links (inversely) the frequency of in-depth external controls with the quality of the internal control systems in place.

The OAG is placing greater and greater emphasis on performance audits, with financial audits increasingly being outsourced to private sector audit firms. With Thailand’s emphasis on performance budgeting, the OAG has assumed an important role in sampling and verifying the performance information provided by ministries and agencies.

The OAG has a staff of 1 500 professionals and 700 support staff. The reports of the office are made public and are provided to Parliament. The office is held in very high regard by the public, with many of its recent findings receiving extensive media coverage.

2.5. Conclusion

Budgeting in Thailand is very much an executive-led endeavour. This is due to both specific constitutional provisions which guarantee the executive's pre-eminence *vis-à-vis* Parliament and to the current political environment, *i.e.* the unprecedented situation of a single party enjoying an overwhelming majority in Parliament. This necessarily acts as a strong constraint on Parliament's role in the budget process. Nonetheless, the National Assembly takes its role very seriously and scrutinises the budget proposal in great detail. It does in fact manage to change the government's budget proposal, in albeit limited ways. At the same time, Parliament's extensive scrutiny of the budget has served to greatly increase the transparency of the entire budgeting process.

Parliament has not embraced the performance and results orientation of the budget; Parliament's deliberations generally focus on inputs. This does pose a challenge to the effective sustainability of the outcomes and outputs framework. Despite Parliament's constrained role in the budget process at present, it should be borne in mind that this is a relatively new phenomenon and could change. It is worthwhile to consider what internal institutional mechanisms could be put in place in Parliament to foster fiscal discipline under different circumstances.²

3. Budget implementation and management

3.1. Introduction

Thailand has introduced a number of reforms to its budget implementation and management procedures since the early 1990s. The reform efforts were accelerated by the financial crisis in 1997 and by the effects of the new constitution of 1997, as described in the previous section. This section reviews budget appropriations and financial management practices, organisational structures, and human resource management issues.

3.2. Budget appropriations and financial management

There are five types of appropriation modes in the Thai budget:

- Personnel expenses;
- Operating expenses;
- Subsidies;
- Investments;

- Other expenses.

Personnel expenses refer to the standard costs of personnel classified as civil servants whose posts are approved by the Civil Service Commission or other equivalent bodies.

Operating expenses refer to day-to-day operating costs and running costs, including special personnel allowances in addition to the standard costs of posts. This category is further divided for information purposes into several sub-categories. The key recent reform was to merge these sub-categories into one flexible pool of funds. There are, however, still some remaining restrictions in place for what was described as “legacy” reasons. For example, a Cabinet Resolution mandates that government entities cannot transfer money from the special sub-category for utilities expenses until they can demonstrate to the Bureau of the Budget that they have paid all their bills in full. Previously, government units often did not pay the bills from the (government-owned) utilities.

Subsidies can either be of a general or specific nature. In all cases, there would be separate laws or regulations in place to govern their use. Each subsidy is listed individually in the budget. The possibility of shifting funds between individual subsidies varies but in all cases must have the prior approval of the Bureau of the Budget.

Investments refer to either the purchase of equipment or the acquisition or construction of capital projects. Equipment must be listed individually in the budget if it exceeds THB 1 million (one million Thai baht, or USD 25 000). Capital projects must be listed individually if they exceed THB 10 million (USD 250 000). Transfer between individually listed items is possible with the prior approval of the Bureau of the Budget.

Other expenses are a unique category. Such appropriations can be for personnel expenses, operating expenses, subsidies or investments – *i.e.* any of the four categories described above. These appropriations are however subject to special reporting on their use. The amounts involved are generally not large but they are sensitive from a political point of view. Examples include hiring of consultants and foreign travel of government officials – *i.e.* areas which may be perceived as susceptible to abuse. The use of such funds must be reported specifically.

The Bureau of the Budget may authorise government bodies to transfer funds between the above categories and within them. In general, the Bureau of the Budget is receptive to such requests. There are four guiding principles for such transfers:

- The transfer should not be for new personnel.

- The transfer should not change the output targets nor change the core objective of the budget.
- The transfer should not tie up funds in a future budget.
- The transfer should not be for unplanned overseas trips.

As can be seen, the National Assembly has entrusted the executive with great flexibility in the implementation of the budget. The Bureau of the Budget has taken a cautious approach in delegating this flexibility to individual spending units, *i.e.* such flexibility generally requires the approval of the Bureau of the Budget on a case-by-case basis. It is noteworthy that the Budget Procedures Act gives this authority to the director-general of the Bureau of the Budget, a civil servant. The Central Fund (described in Box 4 above) also provides for in-year flexibility in the implementation of the budget.

There is no system of carry-forwards of appropriations. However, Thailand operates on an obligations basis for budgeting and financial reporting purposes. This means that any amount obligated during the current fiscal year may be spent in cash terms in the next fiscal year.

The strong role of the Bureau of the Budget is also highlighted by the requirement for each government unit to submit a budget implementation plan to the Bureau of the Budget. This goes beyond a cash-flow or apportionment plan to a detailed action plan for how the budget will be implemented project by project. Previously, the Bureau of the Budget would approve individual aspects of the plan on a rolling basis throughout the year. Following the reforms, it is now common practice for the Bureau of the Budget to authorise expenditure for the whole year at the beginning of the year.

After the Bureau of the Budget's approval of the spending of ministries and agencies, the budget implementation plan is forwarded to the Comptroller-General's Department of the Ministry of Finance which is responsible for the government's cash management function. The Comptroller-General maintains accounts for all government ministries, departments and their regional offices in the state-owned Krung Thai Bank. The central bank account for the government is maintained at the Bank of Thailand.

A payment request would be sent by an agency to the Comptroller-General's Department, which verifies that the agency has pre-audited the payment request and then verifies that the money for this item is authorised in the agency's budget implementation plan for the month requested. The Comptroller-General's Department then pays directly from its account in the

Bank of Thailand into the recipient's bank account electronically. In cases where the amount is small or there is no bank account available for the recipient, the money is paid from the account in the Bank of Thailand to the bank account of the agency in the Krung Thai Bank; the latter bank in turn immediately disburses it directly to the recipient.

The payment requests have traditionally been made by paper but are now being made electronically. It takes the Comptroller-General's Department one to two days to process a payment request that is in order. The process for pre-audit in the agency general takes one to two weeks for smaller items and up to one to two months for larger projects.

The Bank of Thailand does not pay the government any interest for the money it has on deposit there. The amount on deposit in each agency's account at the Krung Thai Bank is immaterial and no interest is earned on it.

The Comptroller-General's Department prepares monthly statements of the government receipts and expenditures. These statements are not audited separately. The annual financial statements are prepared by the Comptroller-General's Department within three months of the close of the fiscal year and are submitted to the Auditor-General for certification.

3.3. Organisational structure

Thailand is a constitutional monarchy with the King as the head of state. Under the King, the Prime Minister – the leader of the ruling party – is responsible for the operating of government. The Cabinet is the supreme body which steers and manages all state affairs. The Cabinet consists of 36 members: the Prime Minister and 35 other ministers. A number of Deputy Prime Ministers are appointed for specific issues and areas (presently six). Smaller Cabinet committees have been set up to screen and co-ordinate proposals before submission to the full Cabinet in order to promote policy coherence across government.

The Prime Minister's Office is the nerve centre of the government. With the assistance of several Cabinet-rank ministers attached to the Office and of the Secretariat of the Prime Minister, it co-ordinates and oversees the activities of all government agencies. As noted earlier, the Bureau of the Budget reports directly to the Prime Minister and – along with other elite central agencies – plays a very important role in formulating, guiding, implementing, and monitoring government policy.

A major reorganisation of the machinery of government took place in 2002. It included reducing the number of ministries and shifting their portfolios, re-assigning departments (agencies) from one ministry to another and clarifying their portfolios. The central government is currently organised

around 20 ministries and 143 departments. This restructuring of ministries and agencies was referred to as a “big bang” reform, as it was the largest reorganisation in terms of scale and impact since 1897 when the modern Thai government system was established.

Each ministry is headed by a minister appointed by the Prime Minister, with some ministries having deputy ministers as well. All other ministry staff are career civil servants. The head career official is the permanent secretary who oversees all aspects of the ministry, including the departments (agencies). The permanent secretary may be assisted by several deputy permanent secretaries.

The department which is the main operational component of the ministry is headed by a director-general. Under the director-general there are usually several deputy directors-general. Despite being hierarchically subordinate to their respective ministry, the departments have traditionally enjoyed a great deal of “separate identity” from their parent ministries. In organisational terms, they can be viewed in the same context as executive agencies in OECD countries.

Box 10. Public Sector Development Commission

The Public Sector Development Commission was established in 2002. Its purpose is *inter alia* to build on the 2002 restructuring of government. This commission is chaired by the Prime Minister, or designated Deputy Prime Minister. The Commission has numerous standing sub-commissions and *ad hoc* sub-commissions.

The objective of the Commission is to spearhead reform in public administration by being a permanent and coherent voice for reform. Previous reform efforts were judged by many to have suffered from the disparate – and sometimes contradictory – implementation by the various central management organisations.

The Commission has announced an overall strategy for the development of the public sector, focusing on streamlining and rationalising work processes; restructuring government organisation; budgetary and financial reform; human resource management and compensation reform; change management paradigms and cultural norms and values; modernisation through e-government; and encouragement of public participation. Some of these objectives are already formulated into policy.

In addition to ministries and departments, two new types of government organisations have been created recently: **autonomous public**

organisations (APOs) and **service delivery units** (SDUs). APOs refer to transforming whole departments into this new organisational form. SDUs refer to transforming individual parts of departments. APOs have been in place since 1999; SDUs were created in 2004. These organisations could be understood as the Thai version of full-fledged executive agencies regardless of their names. They go beyond the organisational model of departments to embrace increased managerial flexibility. These units generally enjoy exemptions from the general central management rules in terms of budgeting and human resource management. Examples include receiving lump-sum appropriations for their entire budget allocation and being able to hire staff on terms similar to the private sector.

Finally, it is worth highlighting the significant number of committee-type organisations in Thailand. Their status, functions, and roles vary from powerful boards and commissions attached to central agencies to advisory and auxiliary organisations. The extensive use of such structures can be ascribed to the emphasis on achieving consensus in Thai culture and on promoting public participation, which has been one of the main reform agendas of recent successive Thai governments.

3.4. Human resource management

The Thai civil service is uniformly structured.³ All staff are divided into one of 11 levels (with 18 incremental steps for each level). The bulk of the civil service falls into levels 3 to 8; permanent secretaries represent level 11. Civil servants are appointed for life with a mandatory retirement age of 60. Mobility is very low, with civil servants generally remaining in the same organisation throughout their career; promotions to higher ranks come from within the organisations.

The hiring of civil servants is subject to very extensive sets of uniform central rules. All positions – and redeployment of positions – must be approved on a case-by-case basis by the Office of the Civil Service Commission (OCSC), which is responsible for overall human resource management policy in Thailand.

Recruitment and promotion in the civil service are merit-based. The basic process of entry into the civil service starts with a competitive examination to test general knowledge. Upon receiving a satisfactory score, candidates are added to a “certified list”. Next, candidates will complete a written examination relevant to the specific position they are seeking. Finally, interviews will be conducted with the finalist candidates.

Box 11. Rewarding organisational performance

The Thai government has introduced an incentive system to improve performance of government organisations. This project started on a voluntary basis. In order to motivate departments and ministries to participate, the Thai government allocates a significant budget to reward high-performing organisations.

Each ministry and department participating in this programme must present a performance proposal. The bases for these proposals are the department's and ministry's internal plans that were prepared during the budget formulation process.

The performance proposal has to be agreed with the Committee on Improving the Government Efficiency and Effectiveness (CIGEE), which is a neutral body set up by the Public Sector Development Commission and currently headed by a distinguished businessman. The CIGEE will negotiate a set of performance targets that must be achieved in order to be rewarded.

At the end of the fiscal year, ministries and departments must produce a performance report informing the CIGEE if they have achieved what had been agreed. Upon receiving the report, the CIGEE assesses the performance of the ministries and departments using four balanced scorecard criteria. They are:

- Financial performance, which indicates how money has been spent, and how the results of projects contribute to the fulfillment of main missions.
- Internal process management, which indicates improvements in work processes in ministries and departments. These can include shortening lengthy procedures, and deregulating or amending existing rules and laws to facilitate the achievement of missions.
- Customer and stakeholder satisfaction, which can be measured by surveying the target groups served by departments. Ministries and departments, therefore, must identify their target customers and stakeholders so that the CIGEE can assess their satisfaction.
- Ability to learn and grow, which indicates how well the organisation has prepared for incoming change, and how far it has developed its human resources capacity. To assess this aspect, the CIGEE may need some proof of training results, as well as evidence that a learning organisation is being created.

After assessing performance, the CIGEE will assign scores to the ministries and departments. Only those that meet the CIGEE's assessment criteria are eligible for extra financial rewards. Ministries and departments that receive higher scores will receive a larger extra financial reward than those with lower scores.

After the CIGEE has allocated extra financial rewards to eligible departments, it is the departments' responsibility to reward their own staff. The respective civil servants must have received a good assessment in their annual appraisal to qualify for a reward.

Another channel into the civil service is through government scholarship schemes for study abroad. After scholarship recipients finish their study, they must work in the government for a period of twice the duration of their scholarship.

For each hiring, a separate selection panel is created. Although the OCSC may not be represented on each panel, it must approve the membership of the panels. Specific criteria apply for the highest level positions (levels 9 to 11). For the position of permanent secretary (level 11), the relevant minister selects the candidate and makes a proposal to the Cabinet.

Box 12. Downsizing the civil service

Overstaffing is viewed as a problem in the Thai government. During the last elections, the current ruling party aimed to reduce the share of spending on personnel to 30% of total expenditure from the current 40%. Nonetheless, the government has an 80-20 policy. For every ten persons that retire, eight positions are retired as well while two positions remain open for rehiring. This applies for the government as a whole, and can vary in different organisations.

The government has also launched four rounds of early retirement schemes whereby lump-sum payments are offered for government employees to retire early. In the last round, 48 000 employees participated.

In order to attract more talented candidates and to retain high-performing incumbents, the salary level of civil servants has increased dramatically in recent years, in terms of both base pay and allowances for executive positions and some professional and specialist positions. The pay of civil servants is set unilaterally by the government. The government's overall pay policy is to achieve parity for government employees' compensation with that of the private sector. Thai civil servants are not allowed to set up their own union, nor join other trade unions. Instead, there is a Civil Service Association which can take a stand on conflictual issues and protect the rights of civil servants.

The performance of all government employees is evaluated twice a year. The result of these performance evaluations is directly related to salary increases. High-performing civil servants receive a two-step or one-and-a-half step increase for outstanding and excellent ratings, respectively. For satisfactory ratings, a one-step increase is rewarded. Civil servants who fail

to achieve a satisfactory rating do not gain any salary increment for that particular year. Some have questioned the robustness of these evaluations.

A rapid promotion scheme and the creation of a senior executive service (SES) have also been recently introduced in order to make the civil service more attractive. The rationale is to increase the pool of talented workers at the top in order to drive public sector reform and to provide leadership for government organisations. Interestingly, membership of the SES is limited to the highest levels of the civil service. It covers only position levels 9, 10 and 11 – a total of only 496 individuals as of 2004.

As noted earlier, autonomous public organisations (APOs) and special delivery units (SDUs) are exempt from the central management rules that apply to the civil service in general.

3.5. Conclusion

Thailand has been making significant reforms to its budget appropriations and financial management, organisational structures, and human resource management practices in recent years. The common theme has been to increase flexibility and reinforce a performance and results orientation.

Thailand has embarked on a process of creating a series of special bodies: autonomous public organisations (APOs) and special delivery units (SDUs). The creation of these units allows them to “escape” from the current management rules. At the same time, reforms to the various input controls and central management rules have proceeded cautiously. In the longer term, there needs to be convergence between these reforms – *i.e.* the APOs and the SDUs are only spearheading an overall reform of these controls. The risk is that more and more entities will simply be separated out of the “traditional” public sector without reforms to the various central controls proceeding apace.

It should also be noted that reforms to introduce such flexibility in OECD countries have generally been accompanied by demands on the respective organisations for special savings. This follows the logic that increased flexibility should bring about increased operational efficiency. Thailand needs to ensure that these reforms support the maintenance of aggregate fiscal discipline.

Notes

- ¹ For a discussion of PART, see Blöndal, *et al.* (2003).
- ² For a discussion of such institutional mechanisms, see Blöndal (2001).
- ³ The discussion here refers to the general civil service. Specialised services are excluded, such as those for the legislature and the judiciary.

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The United Kingdom Private Finance Initiative: The Challenge of Allocating Risk

by
David Corner*

Since 1992, the United Kingdom has used a new type of public-private partnership for the delivery of public services: the Private Finance Initiative. In the design of PFI projects, the assessment of risk, and who is best able to manage it, needs to be carefully considered. Using data from government reports and case examples in the British public sector, this article explores aspects of procurement including, among other things, due diligence, public sector comparators, and the consequences of taking back the responsibility for delivering the service (taking back risk). PFI contracts can deliver better value for money than traditional methods of procurement if risks are transferred to the parties best able to handle them. The article concludes with a discussion of guidelines on generally accepted accounting practice and indicators for assessing risk.

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1. Introduction

The United Kingdom (UK) has been at the forefront of the development of innovative approaches to engaging the private sector in the delivery of public services. In 1992 the UK embarked upon a new type of public-private partnership, known as the Private Finance Initiative (PFI). Under the Private Finance Initiative, private sector firms take on the responsibility for providing a public service including maintaining, enhancing or constructing the necessary infrastructure required. A total of 563 Private Finance Initiative contracts had been let by April 2003, with a total capital value of £35.5 billion (HM Treasury, 2002-3), and accounting for more than ten per cent of total investment in the UK public sector in 2003-4.

This article explores the value for money of the Private Finance Initiative. It argues that there are powerful performance incentives in Private Finance Initiative contracts which at least potentially offer significant improved performance compared to past practices. It suggests that Private Finance Initiative contracts enable risks to be better estimated than in the past, but that the real success of Private Finance Initiative projects also depends on the degree to which risk is genuinely transferred from the public to the private sector and optimally shared. It also considers some of the difficulties this presents for accounting for Private Finance Initiative projects. It draws on the work of the United Kingdom National Audit Office and the House of Commons Committee of Public Accounts which have both examined and reported to the United Kingdom Parliament in detail on a number of individual Private Finance Initiative projects as well as other general issues arising from the initiative.¹

2. Risk under conventional procurement in the public sector

Public service delivery is a risky business. The operation of any organisation, public or private, involves risk. But public service agencies operate across a diverse range of activities, markets and locations. Many of the projects they have responsibility for delivering are large or unique. They may not have precedents on which to draw to help guide implementation. And they are usually more exposed to political and reputational risk. Despite this it is only in the last ten years, that public sector policy makers and implementers have turned their attention in earnest to risk management techniques.

Effective risk management involves anticipating, preparing for, and mitigating adverse outcomes, without eradicating, or unnecessarily

hindering, beneficial risk taking. Well managed risk taking also presents opportunities to innovate, experiment and develop new ideas where more traditional ways of working are not able to deliver real change; for example, in providing an environment where radically new or different approaches can be developed in the confidence that the associated risks will be well managed. Indeed the greatest risk of all may be not taking any risks, where services and the way they are delivered do not anticipate change or evolve to meet new demands from citizens.

Constructing and operating a public building entails a number of risks. These include the risk of construction overruns, higher than expected costs of maintenance, increases or decreases in demand for the services provided in the facility, and changes in legislation or the regulatory regime affecting how the building or the services it houses are delivered. In a traditional construction contract the public sector has accommodated a number of types of risk: design and construction risk – delivering to cost and time; commissioning and operating risks – including maintenance; demand (or volume/usage) risks; residual value risk; technology and obsolescence risks; regulation and similar risks (including taxation, planning permission); and project financing risk.

For each project, some risks are more relevant than others. In a road project, the key risks will be demand and design/asset construction and maintenance, whereas in a prison project, the key risks relate to availability, performance and operating costs alongside design/asset construction and maintenance.

The record of conventional public sector procurement in assessing these risks is not good. The full costs of projects have often not been calculated accurately beforehand, risk management procedures have often been weak and there have been insufficient incentives to ensure that projects are driven forward successfully. Recent examples in the UK include the following:

- The initial cost estimates of Guy's and St Thomas's Hospital rose by £124 million to £160 million and the completion date slipped by over three years (NAO, 1997-8b);
- The cost of the Trident submarine shiplift and berth at Faslane rose from an estimate of £100 million to a final cost of £314 million and was delivered two and a half years late (NAO, 1993-4);
- The London Underground Jubilee Line extension was delivered two years late and cost £1.4 billion more than original estimates; and

- The top 25 equipment projects in the Ministry of Defence experienced cost overruns amounting to £2.8 billion with average delays of three and a half years (NAO, 2003-4).

A recent National Audit Office study found that only 30 per cent of conventional procurement construction projects were delivered on time and only 27 per cent were within budget (NAO, 2001-2a). An independent report commissioned by the Treasury found that outturn costs of conventional procurement construction projects were between 2 and 24 per cent higher than the estimate in the business case (HM Treasury, 2002).

3. What is the Private Finance Initiative?

Under conventional procurement, the government typically enters into one contract with a builder to develop a government-designed asset and then either operates this itself or enters into a second contract for operation. A common problem is that the operator or service provider, having no role in the design and construction stages, finds that the asset has been designed or built in a way that limits flexibility when it comes to delivering services more efficiently. This often results in substantial operating cost implications over the typical 25-30 year life of the asset.

The Private Finance Initiative is a form of public-private partnership that combines procurement, where the public sector purchases capital items from the private sector, with an extension of contracting-out, where public services are contracted from the private sector. It differs from privatisation in that the public sector retains a substantial role as the main purchaser of services or as the enabler of the project. It also differs from contracting out since the private sector provides the capital asset as well as the services. A Private Finance Initiative contract is intended to provide a continuing commercial incentive for synergy, flexibility and efficiency right through from initial design, build and operation.

Under the most common form of Private Finance Initiative, the private sector designs, builds finances and operates facilities based on specifications of outputs determined by public sector bodies. The requirements of the public service body would normally be framed not as precise input specifications and designs, but as an output specification defining the service required; for example supporting hospital beds for a certain number of patients, or prison accommodation for a specific category of inmates. Under a Private Finance Initiative contract the public body usually pays a stream of committed revenue payments for the use of the facilities over the contract period. Once the contract has expired, ownership of the asset may

remain with the private sector contractor or pass to the public sector, depending on the terms of the contract.

For example, in 1999 the Ministry of Defence identified that improvements were necessary to the accommodation and working environment available in its principal office building and decided to redevelop it. This was a large and complex project. It involved moving over 3 000 staff into other central London accommodation, carrying out an extensive redevelopment, disposing of surplus properties and then moving staff back into the redeveloped building. In May 2000, the Ministry of Defence let a Private Finance Initiative contract with a net present value of £746 million (at 2000 price levels) to a private sector consortium called Modus. The 30-year contract covered the redevelopment and limited refurbishment and provision of support to other buildings needed to accommodate staff while redevelopment was undertaken, followed by the provision of maintenance and facilities management services (NAO, 2002-3).

Private Finance Initiative deals have ranged from very small projects, such as a £100 000 scheme to improve information technology facilities at a local school, to Europe's largest construction project – the Channel Tunnel Rail Link, worth £4 billion (NAO, 2000-1b). Private Finance Initiative contracts have been signed in over twenty different sectors and by over one hundred different public sector organisations within central and local government and the National Health Service. The largest users of Private Finance Initiative have been the Department for Transport which accounts for about 20 per cent of all Private Finance Initiative projects by capital value and the Department of Health which has signed about 120 separate Private Finance Initiative contracts (HM Treasury, 2002-3).

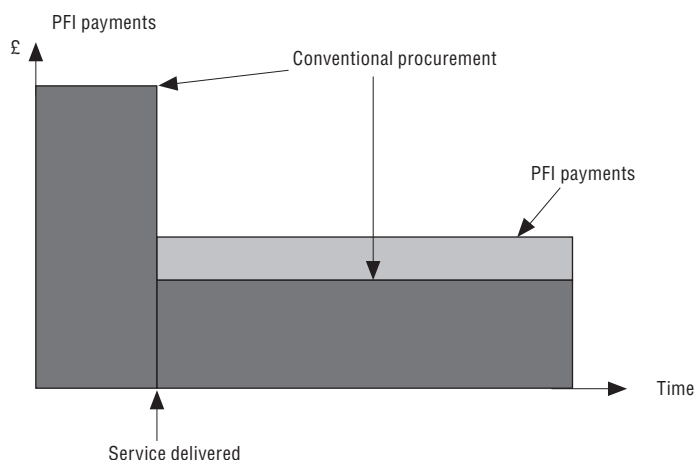
The UK's Treasury has stated that one of the main objectives of Private Finance Initiative is to transform public sector bodies from being owners and operators of assets into purchasers of services from the private sector. Private firms become long term providers of services rather than simply upfront asset builders, combining the responsibilities of designing, building, financing and operating the assets in order to deliver the services demanded by the public sector (*ibid.*).

4. The potential advantages and disadvantages of Private Finance Initiative deals

Private Finance Initiative contracts are generally long term arrangements involving public expenditure over extended periods, often for 30 years or more. The public sector does not have to find the money up-front to meet

the initial capital costs. But the cash payments thereafter will generally be higher than in an equivalent conventionally-financed project (Figure 1).

Figure 1. Timing of payments under the Private Finance Initiative and conventional procurement



Source: Public Accounts Committee (2003).

The Private Finance Initiative approach can enable the public sector to undertake projects which they would be unable to finance conventionally since they do not need to find all the money for the capital asset during its construction. Private Finance Initiative deals can therefore be attractive in the short term. But there is a risk that this attractiveness may distort priorities in favour of those projects which are capable of being run as Private Finance Initiative projects. For the Private Finance Initiative route to be worthwhile, the higher financing costs of raising funds in private markets and any other potential disadvantages need to be more than outweighed by the benefits achieved. Some of the potential advantages and disadvantages of Private Finance Initiative deals are set out in Table 1.

5. The public sector versus private sector decision

Up until recently the main tool public bodies have relied on in evaluating up-front whether a Private Finance Initiative option provides better value for money over conventional procurement is a public sector comparator. A public sector comparator is a costing of a conventionally

financed project delivering the same outputs as those of the Private Finance Initiative deal under examination.

Table 1. Potential advantages and disadvantages of Private Finance Initiative deals

Advantages	Disadvantages
There can be greater price certainty. The public sector body and contractor agree the annual unitary payment for the services to be provided. This should usually only change as a result of agreed circumstances.	The public sector body is tied into a long-term contract (often around 30 years). Business needs change over time so there is the risk that the contract may become unsuitable for these changing needs during the contract life.
Responsibility for assets is transferred to the contractor. The public sector body is not involved in providing services which may not be part of its core business.	Variations may be needed as the public sector body's business needs change. Management of these may require renegotiation of contract terms and prices.
Private Finance Initiative brings the scope for innovation in service delivery. The contractor has incentives to introduce innovative ways to meet the public sector body's needs.	There could be disadvantages, for example, if innovative methods of service delivery lead to a decrease in the level or quality of service.
Often, the unitary payment will not start until, for example, the building is operational, so the contractor has incentives to encourage timely delivery of quality service.	The unitary payment will include charges for the contractor's acceptance of risks, such as construction and service delivery risks, which may not materialise.
The contract provides greater incentives to manage risks over the life of the contract than under traditional procurement. A reduced level or quality of service would lead to compensation paid to the public sector body.	There is the possibility that the contractor may not manage transferred risks well. Or public sector bodies may believe they have transferred core business risks, which ultimately remain with them.
A long-term Private Finance Initiative contract encourages the contractor and the public sector body to consider costs over the whole life of the contract, rather than considering the construction and operational periods separately. This can lead to efficiencies through synergies between design and construction and its later operation and maintenance. The contractor takes the risk of getting the design and construction wrong.	The whole life costs will be paid through the unitary payment, which will be based on the contractor arranging financing at commercial rates which tend to be higher than government borrowing rates.

Source: Public Accounts Committee (2003).

The use of public sector comparators has been the subject of considerable debate. The accuracy of public sector comparators is limited because they are prone to error owing to the complexity of the financial modelling that is often used. They are also dependent on uncertain forecasts. And a great deal depends on assumptions about the time cost of money – *i.e.* the discount rate.

There is a risk that the users of the public sector comparator will believe that it is more accurate than it could ever be. Decisions can be made on the basis of small and spurious differences between the public sector comparator and the Private Finance Initiative option. In the case of the Private Finance Initiative contract for a new accommodation programme at the Government Communication Headquarters, the management made a highly uncertain assumption that a conventionally procured building would have overrun its budget by 24 per cent. That alone accounted for the comparative cost saving that the Government Communications Headquarters estimated the Private Finance Initiative deal would offer, but was simply an average over past projects and hid the wide range of possible outcomes (Public Accounts Committee, 2004-5).

The UK House of Commons Committee of Public Accounts believes there have been many cases where the public sector comparator has been incorrectly used as a pass or fail test. In these cases the desire to show that the Private Finance Initiative deal is “cheaper” than the public sector comparator has led to manipulation of the underlying calculations and erroneous interpretation of the results (Table 2). There are likely to be qualitative and non-financial differences between the options that cannot simply be subsumed in a difference in forecast cost. The UK Treasury has recently recognised this and instituted reform of the public sector comparator as only a single element within an approach which is intended to provide a more sophisticated long-term and analytically robust approach to appraisal and investment evaluation (HM Treasury, 2002-3).

This article goes on to suggest that a key element of the evaluation of the value for money of individual Private Finance Initiatives is the success with which risk is genuinely transferred from the public to the private sector and optimally shared between the two sectors.

6. The allocation of risk

The main benefit of transferring risk from the public sector is that it should generate the incentives for the private sector to supply cost effective and higher quality services on time. Risk and reward go hand in hand. Private Finance Initiative suppliers usually only start to receive their service

payments when a flow of services actually starts, and continued payment depends on meeting performance criteria.

Table 2. Weaknesses in the use of public sector comparators

Private Finance Initiative deal	House of Commons Committee of Public Account's findings
Dartford and Gravesham Hospital	The NHS Trust did not detect significant errors in the public sector comparator. The Trust also did not quantify the full effects of changes in contract terms and of the sensitivity of the deal to changes in key assumptions, as the deal went forward. Had the Trust known that the savings were marginal when negotiating the deal, it might have made different decisions and achieved better value for money (Public Accounts Committee, 1999-2000b).
Airwave	A public sector comparator was not prepared until late in the procurement, and after a decision to use the Private Finance Initiative had already been made. It is therefore doubtful that the use of a comparator added to the decision-making process (Public Accounts Committee, 2001-2b).
Ministry of Defence Main Building	The public sector comparator gave a central estimate for the cost of a conventionally financed alternative to the Private Finance Initiative deal as £746.2 million, compared to an expected deal cost of £746.1 million. Such accuracy in long term project costings is spurious, and the small margin in favour of the Private Finance Initiative deal provided no assurance that the deal would deliver value for money (Public Accounts Committee, 2002-3a).
West Middlesex Hospital	The NHS Trust's advisers strove to make slight adjustments to the calculations, well within the range of error inherent in costing a 35-year project, so that the Private Finance Initiative cost appeared marginally cheaper than the public sector comparator (Public Accounts Committee, 2002-3b).

Private sector management skills are better harnessed and incentivised by having private finance at risk. The transfer of project financing risk generates incentives for the private sector to supply services on time and of a higher quality as they only start to receive payments when a flow of public services actually starts, and continued payment depends on meeting specified performance criteria.

The lenders to a Private Finance Initiative have a powerful incentive to identify, allocate and ensure the effective management of all the risks the private sector assumes in a project. One of the valuable features of private sector financing of Private Finance Initiative projects is the extensive due diligence work that private sector risk-takers carry out on projects. But the returns to financiers need to be commensurate with the risks that they are

actually taking and this in turn depends on the market being well informed and truly competitive. In some Private Finance Initiative projects the Committee of Public Accounts has found this not to be the case (Table 3).

The assessment of risk, and who is best able to manage it, needs to be carefully considered in the design of Private Finance Initiative projects. Value for money will be achieved where there is optimum transfer of risk such that individual risks are allocated to those best placed to manage them. If the public sector seek to transfer risks which the private sector cannot manage, value for money will reduce as the private sector seeks to charge a premium for accepting such risks.

Table 3. Examples of inadequate competition

PFI deal	Committee of Public Account's findings
Immigration and Nationality Directorate (Public Accounts Committee 1999-2000a)	Key figures, on which future increases in productivity would be measured and payments to the contractor calculated, had not been finally agreed until more than a year after the contract was signed. Such important issues need to be finalised before a contractor is selected and the benefits of competition fall away (Public Accounts Committee, 2003).
Dartford and Gravesham Hospital (Public Accounts Committee, 1999-2000b)	The NHS Trust selected two firms to submit final bids but one of the firms did not submit a bid. The Trust therefore ended up with only one final bidder on this major pathfinder project for the use of the PFI in the NHS. The bidder's final bid was 33 per cent higher in real terms than its indicative bid. The Trust did not undertake a detailed analysis of the reasons for the increase in the final bid, especially given the absence of other bids. Such action might have helped the Trust to secure a greater price reduction in the subsequent negotiations (Public Accounts Committee, 2003).
Newcastle Estate (Public Accounts Committee, 1999-2000c)	In this deal the Department of Social Security appointed a preferred bidder whilst important issues remained unresolved. Exclusive negotiations with the preferred bidder continued for 18 months (Public Accounts Committee, 2003).

The principle governing risk transfer is that the risk should be allocated to whoever from the public or private sector is able to manage it at least cost. An optimal sharing of risk between the private and public sector should recognise that there are certain risks that are best managed by the government and to seek to transfer these risks would either not be available or not offer value for money for the public sector. The government pays for inappropriately transferred risks through higher service charges. The optimum allocation of risk, rather than maximising risk transfer, should be the objective, and it is vital to ensure that value for money is not diminished.

This is illustrated by the case of the Private Finance Initiative contract to develop a benefits payment card system. In May 1996, the Department of Social Security and Post Office Counters Ltd jointly awarded a contract to Pathway, a subsidiary of the ICL computer services group, for delivery of the benefits payment card. The project was intended to replace by 1999 the existing paper-based methods of paying social security benefits with a magnetic strip payment card, and to automate the national network of post offices through which most benefits are paid across Great Britain and Northern Ireland. The project was vast in its scale and complexity, and estimated to cost some £1 billion in payments to Pathway. It was also one of the first information technology contracts awarded under the Private Finance Initiative. After delays and problems the government decided to cancel the benefits payment card with upwards of £1 billion in abortive costs, the write-down of assets and delayed reductions in benefit fraud.

The contractor chosen was selected because they were willing to take on a level of risk for preventing benefit fraud which the other two bidders for the contract would not accept, even though the contractor came third on eight out of eleven technical and management criteria. At the time, there was a mistaken view that Private Finance Initiative bidders should compete on the level of risk they were prepared to take on, rather than achieving an optimum allocation of risk (Public Accounts Committee, 2001-2a).

Private Finance Initiative schemes need to transfer to the private sector risks where the supplier can influence the outcome. The supplier is able to influence the likely performance of the building and its services by the quality of the design, construction and refurbishment work undertaken. The quality and frequency of maintenance also has an important bearing on on-going performance. Therefore, risks transferred should usually include design, build, financing and operating risks.

The ability to secure risk transfer on worthwhile terms means ensuring that the scope of a contract is sufficiently widely drawn. If the private sector has clear ownership, responsibility and control, it will take all the risks it can manage. If the public sector seeks to reserve to itself many of the responsibilities and controls that go hand in hand with ownership, and yet still seek to transfer the risk, the private sector will simply increase its price (and thus potentially damage value for money).

The National Audit Office recently surveyed a number of PFI contractors and the public sector bodies that had contracted them (NAO, 2001-2b). It showed that in some projects there is disagreement on whether risks have been allocated to the party best able to manage them. Only two-thirds of contractors shared the public sector bodies' view that risks had been allocated appropriately. Seventy-nine per cent of authorities thought

the risk allocation was totally satisfactory but only 53 per cent of contractors had this view. Contractors recognised that risk allocation was an important area where there were often problems. All the contractors who were dissatisfied with the risk allocation thought that risks had been inappropriately transferred to them rather than inappropriately retained by authorities.

For example, in the case of the first Private Finance Initiative contracts awarded to design, build, finance and operate roads, payments to operators were based primarily on traffic volumes which are, however, notoriously difficult to forecast. This was done to test the ability of the private sector to bear one of the risks involved in running tolled roads, but it created a new financial risk which bore both on the public sector and on the private sector and which neither party was able to manage effectively (NAO, 1997-8a). Bidders included a premium in their pricing for taking this risk which is likely to have reduced the value for money offered by these contracts. Private Finance Initiative contracts can deliver better value than traditional methods of procurement if risks are transferred to the parties best able to handle them. In this case risk transfer was confused with risk creation, which is simply likely to increase costs to the public sector.

Some contractors may be too willing to accept inappropriate risk. Some authorities may have been tempted to transfer as much risk as possible to the private sector. But if contractors accept inappropriate risk to win the competition, the subsequent realisation of those risks within a very competitively priced contract may lead to problems for the contractor and, therefore, for the authority. The due diligence carried out by contractors' banks may sometimes stop contractors taking on too much or inappropriate risk but this work is done on behalf of the bankers themselves and may not give full reassurance about project risks to other parties.

Some public sector authorities may transfer risk back to themselves. The essence of Private Finance Initiatives is that authorities provide contractors with an output specification of the services they require. Contractors then have the responsibility and risk for deciding how they will provide those services. If public sector bodies tell contractors how the services are to be provided, they are transferring the risk back to themselves. Contractors sometimes attempt to define the technical solution, or have expectations on how a service should be provided, which limits contractors' freedom to propose alternatives.

In the case of the road contracts mentioned above, following their signing, the operators put forward more than 3 000 variations and innovative ways of varying standards, which the Agency accepted. This suggests the core requirements in the original tender documents were too tightly drawn to

encourage novel ideas. However, the exploitation of private sector innovation is critical to the success of the Private Finance Initiative in delivering improved value for money.

Under Private Finance Initiative contracts not all risks can be or are suitable for transfer to the contractor. It is clearly important that authorities continually monitor risks to which they may be exposed and take steps to manage them. For example, under the terms of the Ministry of Defence's Fixed Telecommunications Service contract, it had become exposed to the possibility of having to pay the contractor (British Telecom) compensation of up to £12 million because the anticipated numbers of users paying for secure speech services was not sufficient to enable British Telecom to recover its initial investment in developing this service. Proactive management by the Ministry, working in conjunction with British Telecom, enabled a satisfactory resolution of this situation which involved changes to required volumes of users and the mechanisms for funding British Telecom's investment in the service. On this basis, British Telecom agreed not to press for the compensation to which it was entitled under the contract (Public Accounts Committee, 2003).

Where a Private Finance Initiative project concerns the delivery of an essential public service the public sector body may have no option, if the project fails, but to take back responsibility for delivering the service. In these circumstances it would be misleading for the contract to be drawn up on the basis that the risk of failing to deliver the service had been wholly transferred to the private sector supplier.

If contractors successfully manage the risks that have been allocated to them and deliver the services required they can expect to earn rewards commensurate with the level of risk that they have borne. But commercial discipline is undermined if contractors get the impression that risks will be taken back by the public sector if they materialise in any serious way. There are a number of examples where central government has done just this.

For example, in one case the Private Finance Initiative contractor was required to build and operate a new museum in Leeds for the Royal Armouries. However the government effectively bailed the company out to the tune of over £10 million when it ran into financial difficulties and faced imminent insolvency. There were no contingency plans in place, as it was considered that the risk of the project's failure lay with the contractor. However the business risks ultimately lay with the public sector as the government were unwilling to countenance the closure of the museum and therefore stepped in to rescue the project (NAO, 2000-1a).

The need to ensure that services to the public are maintained means that the risk of ultimate failure is one that sometimes cannot be transferred to the

private sector. In the case of an operational facility, such as a hospital, it would be normal in current contracts to have provisions enabling the public sector partner to take over the assets and their operation in the event of failure and/or to seek a new private sector partner. The contract might provide for the private sector partner to receive compensation for the transfer of assets to the public sector, thus addressing the problem of security for the project's financing.

Private Finance Initiative deals need to be structured so that, if the contractor gets into difficulties, there is a strong incentive for the financier to step in and either get the contractor back on track or, if that is not possible, replace the contractor with an alternative. Only where both these options fail should the public sector body normally step in. Even here this should not mean that the contractor is rescued or should not still pay a substantial financial price in the event of a rescue.

Good risk management requires a thorough appraisal of all the possible risks attached to a deal and the development of contingencies should the risks crystallise. This emphasises the importance of developing a successful partnership-based relationship between the public sector body and a contractor. Such a relationship is assisted by the right contractual framework, which includes allocating risks appropriately, establishing clearly defined quality of service and value for money mechanisms, and building in arrangements to deal with change. It is also essential that both parties to the deal understand their respective objectives, assess the prospects for a partnership, and make efforts to understand each other's business. As a deal progresses, the risks inherent in it will change and risk management arrangements therefore need to be reviewed regularly as deal risks change over time.

7. Accounting for the allocation of risk

Generally accepted accounting practice draws a distinction between property and services, the former accounted as an asset and the latter as current expenditure. When a property has been built through conventional procurement methods, the public sector is almost always considered to bear the risks of ownership and the capital invested in that property is booked as an asset in the government's account and counts against the public sector borrowing requirement.

Generally accepted accounting practice also requires both private and public sector bodies to account for the economic substance of a transaction, rather than simply its legal form. This means that a party in a contractual relationship that reaps the benefits and bears the balance of risks of

ownership of a property has an asset of the property and must report this on the balance sheet. But this raises difficulties for Private Finance Initiative projects where, as we have seen, value for money depends on sophisticated allocation of risk between the private and public sectors.

The UK Accounting Standards Board has recognised these difficulties. It has issued guidance to help public sector bodies and their auditors determine ownership for balance-sheet purposes (UK Accounting Standards Board, 1994). It is based on an assessment of which party bears the majority of potential variations in returns relating to the Private Finance Initiative property. The UK Treasury has issued a Technical Note to supplement the Accounting Standards Board guidance (HM Treasury, 1997). The methodology recommended by this guidance for assessing which party has the majority of these risks identifies three sets of indicators that should be considered: qualitative, quantitative and other indicators.

The qualitative indicators are based on the concept that if the contractor defaults and, despite this, the debt financiers still get a full pay-out, if the equity input is minimal, or if the purchaser effectively determines the nature of the property, then these all indicate that the asset should be on the purchaser's (*i.e.* the public sector's) balance sheet.

The quantitative indicators are those risks – demand risk, design risk, residual value risk, etc. – that are capable of some sort of allocation and evaluation. And there will be some risks (the “other indicators”) that are so uncertain that it would be foolhardy to attempt a meaningful quantification, for example the risks of financial impacts arising from future changes in technology or public policy.

It is possible that a qualitative analysis of such indicators and risks for a particular project will give a clear idea of which party should include the asset on its balance sheet. The Treasury guidance states that “where demand risk is significant, it will normally give the clearest evidence of who should record an asset of the property”, and that “where it is significant, residual value risk will normally give clear evidence of who should record an asset of the property” (HM Treasury, 1997).

However it may not always be clear who should record an asset of the property without further detailed quantitative analysis of the risks to the property costs and revenues. The audited body and its advisers will typically start this process with some brainstorming by risk assessment workshops to consider all the potential risks and their likely quantum and who bears them. This process might not be carried out just for accounting purposes – it might be part of a wider process in assessing the likely benefits or otherwise of a Private Finance Initiative proposal generally.

The outcome of this exercise could be a risk register with a preliminary broad brush evaluation of the quantum of each identified risk for each of the parties. This should consider the probability of each of the identified risks materialising, the average financial impact and range and distribution of possible outcomes. This may then be refined by statistical methods to combine the range and impact of the risks through modelling techniques. The net present value of the quantified risks for each party would be compared and, subject to the qualitative and other indicators not providing a strongly contrary indication, the asset would be attributed to the party bearing the majority of the quantified risk.

There are a number of difficulties and judgements surrounding a quantitative risk analysis, and different interpretations of demand risk have arisen with public sector bodies and their advisers seeking to exploit these to ensure off-balance-sheet accounting. Small changes in “guestimates” and assumptions used in quantitative analyses can tip the results so as to provide an off-balance-sheet assessment when a more rounded and intuitive view based on all the relevant risk considerations would provide a different answer. This has led to a situation in the health and local authority sectors where Private Finance Initiative hospitals and schools are commonly not recorded on either the public sector’s or the private sector’s balance sheets. These difficulties tend to stem from a mechanical application of quantitative techniques combined with inaccurate assumptions and contentious argumentation to downplay the role of demand risk rather than a commonsense application of “generally acceptable accounting practice”.

An obvious effect of the Private Finance Initiative is to reduce the current public sector balance sheet and replace it with a stream of future liabilities. A private contractor picks up the bill for the construction of a new prison while the taxpayer guarantees it an income spread out over the lifetime of the asset so that today’s capital investment becomes tomorrow’s current spending. The signing of Private Finance Initiative contracts usually involves a commitment on the part of government to a future stream of payments for the services provided.

Future liabilities are recorded and published by the UK government but up until recently it was difficult to disaggregate those that were commitments as a result of the Private Finance Initiative. In response to a recommendation from the Treasury Committee in 1996 (HM Treasury, 1996-7), the Treasury now publishes forecasts of the committed expenditure for public services flowing from private sector investments under the Private Finance Initiative. Payments under Private Finance Initiative contract were estimated in April 2004 to rise to between £6.1 and £6.3 billion each year between 2006-7 and 2016-17 before declining to between around £2.5 billion each year between 2027-28 and 2029-30. In total over the

25-year period some £123 billion is committed (NAO, 2001-2b). These figures represent best estimates. Actual expenditure will in future years depend upon the payment mechanism details for each contract.

8. Conclusions

This article has argued that the success of the Private Finance Initiative cannot be judged solely of itself, but in relation to the record of conventional public sector procurement projects, which is not good. One of the benefits of its introduction has been to focus greater attention on the need to identify and manage better risks in the delivery of public sector procurement projects, not just those involving private finance. But the real success of Private Finance Initiative projects depends on the degree to which risk is genuinely transferred from the public to the private sector and optimally shared.

Notes

- ¹ These reports can be read at www.nao.org.uk.

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The “Control” of Public Social Security Institutions in Belgium

by

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The Belgian government delegates some of its tasks to semi-public bodies in what is known as functional devolution. There are 15 public social security institutions in the sectors of employment and unemployment, pensions, family allowances, health and disability insurance. To increase the accountability and efficiency of these institutions, a new management method was introduced in the mid 1990s: the administration contract. This article discusses how this contractual arrangement has worked in practice: the legal framework; negotiations with the government and the responsible ministry; the budget implications; the use of business plans and scoreboards (indicators); the role of the Court of Audit. The administration contract system is a clear move towards a results-based management approach. Lessons learned from the first round of contracts (2002-05) have resulted in guidelines for the second round and improvements for the future.

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1. General background

Belgium is a federal state comprising a federal entity funded by fiscal and non-fiscal revenues and sub-federal units, the Regions and Communities, all of which are autonomous within the limits of the powers vested in them. The latter are funded by non-fiscal revenues, the Region's own fiscal revenues, an allocated proportion of taxes (VAT and personal income tax) and borrowing.

Alongside these entities are the decentralised authorities, the provinces and the municipalities, whose resources come from taxes and transfers. These authorities have autonomy in the management of provincial and local matters.

Social security is another key pillar of the state. Table 1 shows the aggregate expenditure account for federal government and social security.

Table 1. Aggregate expenditure account for federal government and social security

	In billions of euros		Percentage of GDP	
	2004 estimated	2005 adjusted	2004 estimated	2005 adjusted
1. Primary expenditure	76.59	79.49	27.0	26.8
Federal government level	29.96	31.34	10.6	10.6
Social security	52.93	54.54	18.7	18.4
Transfers from federal government level to social security	-6.31	-6.39	-2.2	-2.2
2. Other government levels	32.37	34.34	11.4	11.6
3. Consolidated expenditure	108.96	113.83	38.4	38.4
Federal government level	23.66	24.95	8.3	8.4
Social security	52.93	54.54	18.7	18.4
Other bodies	32.37	34.34	11.4	11.6

Source: Preamble to the Act adjusting the general expenditure budget for budget year 2005.

2. Semi-public social institutions

The Belgian government delegates some of its tasks to semi-public bodies in what is known as functional devolution. The public social security institutions are decentralised authorities. There are a total of 15 such institutions with corporate body status in the following sectors: employment and unemployment, pensions, family allowances, health and disability insurance (see Table 2). These institutions are subject to the supervisory authority of the responsible minister (Employment, Pensions, Social Affairs, etc.) and, for decisions that have an impact on budget or finances, to the Budget Minister. The Minister for the Civil Service steps in when provisions of the administration contract affect personnel.

Table 2. Public social security institutions

Social Security Crossroads Bank
Occupational Accidents Fund
National Institute for Health and Disability Insurance
National Office for Family Allowances for Salaried Employees
National Pensions Office
National Social Security Office
National Annual Holidays Office
National Social Security Office for Provincial and Local Administrations
National Employment Office
National Institute for Social Security Insurance for the Self-employed
Unemployment Benefit Auxiliary Fund
Health and Disability Auxiliary Fund
Mariners Benevolent and Social Security Fund
Occupational Disease Fund
Overseas Social Security Office

Prior to the introduction of the administration contracts mentioned above, the legal status of public social security institutions, called semi-public social institutions, was governed by two acts:

- **The Law of 16 March 1954 concerning the audit of certain public service institutions.** Although it has been amended, sometimes substantially, this law is still the main basis for the audit of semi-public organisations other than those concerned here, of course. It essentially contains financial and budgetary provisions applicable to the four categories of institutions (A, B, C and D), the last of which was introduced in 1986 for public social security institutions. The budget of semi-public social institutions was set by their managing bodies and approved by the relevant minister and the Budget Minister. Five accounts had to be drawn up every year. Audits were carried out by a government statutory auditor.
- **The Law of 25 April 1963 on the management of public interest social security and social welfare bodies,** which relates more specifically to administrative levels (management committee, person responsible for day-to-day management) and the powers and functioning of the management committees of the bodies to which the law applies. It introduces joint management.

Following the work conducted by the Royal Commission on Social Security from 1981 to 1985, a preliminary draft social security code was produced and plans were made to computerise the social security system. They culminated in the Crossroads Bank project.

In 1990 and 1993, the *Collège des administrateurs généraux* (the senior civil servants who head the semi-public social institutions) presented two memoranda to the government. The memorandum of April 1990 concerned the conditions required for the efficient management of the social institutions. The memorandum of April 1993 presented a solution to the efficiency issue based on the “management contract” and scoreboards as management tools.

In February 1995, Belgium’s Council of Ministers approved a bill for reforming selected public social security institutions based on the use of **administration contracts** as the most suitable management method. The bill was incorporated virtually in its entirety into the Royal Decree of 3 April 1997 on measures to increase the accountability of public social security institutions (*Arrêté royal du 3 avril 1997 portant des mesures en vue de la responsabilisation des institutions publiques de sécurité sociale*).

3. Administration contracts

3.1. Legal framework

Administration contracts date back to the Law of 26 July 1996 on social security and pension reforms which incorporates the initiative by the *Collège des administrateurs généraux*. With a view to increasing the accountability and efficiency of the semi-public social institutions, that law provided for the option of designing a new functional framework for these bodies by issuing a royal decree subject to consultation in the Council of Ministers. According to Article 47, the objectives to be achieved were to:

- Clearly define, in the form of an administration contract between the government and the body concerned, the tasks to be undertaken by that body in order to fulfil its legal duties, measurable targets, efficiency and quality, and the method of calculating the management appropriations to be allocated to the performance of these tasks;
- Grant these bodies broader managerial autonomy within the framework of the administration contract by:
 - revising administrative rules and procedures for budgets and accounts, the personnel framework, recruitment and employment of statutory and contract staff and the allocation of management funds;
 - strengthening the role of management bodies;
- Focus administrative and budget control on compliance with the legislation and with the objectives of the administration contract by strengthening the role and responsibility of government auditors;
- Make these bodies more accountable by introducing a system of incentives and penalties in line with the extent to which administration contract objectives are achieved.

The new framework described in the Law of 26 July 1996 was implemented by the Royal Decree of 3 April 1997 on measures to increase the accountability of public social security institutions. When that Decree was presented for Royal Assent, it was made clear that while the political authorities had been and continued to be jointly responsible with the social partners for framing social policy, the semi-public social institutions should, in contrast, have greater decision-making power as well as greater accountability, which would allow them to achieve the objectives defined by

policy makers in an efficient manner and to adapt to a changing environment as appropriate.

Having outlined the solution to the challenges of saving the social security system and its level of performance, the Royal Decree went on to introduce, among other things, administration contracts between the political authorities and the institutions. These are outlined in greater detail below. Fifteen semi-public social institutions (out of 20) signed administration contracts (Royal Decree of 3 April 1997 which entered into force on 1 January 2002).

3.2. The administration contract in detail

3.2.1. Definition

An administration contract is an agreement between a delegating body (the state) and the agency (social security institution) which performs the task. The latter must provide a certain number of products (services) and in order to do so is given sufficient freedom in its internal organisation and in the use of its allocated budget. By applying this method, a clear commitment is made to contractual accountability.

3.2.2. Contents

Administration contracts set out the rules and special terms and conditions under which a public social security institution is to carry out the functions attributed to it by law. In practical terms, administration contracts regulate the following (Article 5 of the Royal Decree of 3 April 1997):

- the tasks that the institution carries out in the exercise of the duties attributed to it by law or by a government decision;
- quantified targets for efficiency and quality in relation to these tasks;
- rules of behaviour when dealing with the public, where there is direct contact with the public;
- methods enabling the measurement and monitoring of progress on objectives and rules of behaviour;
- the method of calculating and determining the management funds to be made available for these tasks;

- the method of calculating and determining the maximum amount of funds for staffing reserved for statutory agents;
- rewards for meeting commitments under the administration contract, to be specified by Royal Decree subject to consultation in the Council of Ministers;
- possible solutions or penalties in the event of failure of one party to comply with the commitments arising from the administration contract.

3.2.3. Aims and innovations

The aims of the administration contract are to determine the (financial) contribution the government will make to the objectives set out in social legislation and to give the public social security institutions the chance to develop a whole new management culture. Changes to the previous system include:

- formally defined outputs;
- allocation of the necessary inputs;
- allocation of wider discretion in the use of resources;
- agreement on monitoring progress and accountability;
- explicit contracts which spell out all of the above.

It is worth noting that administration contracts apply only to the management of public social security institutions (management budget including income and spending on running the institution, such as staffing and operation). They do not apply to the budget for the institution's duties, *i.e.* income and expenditures for the duties they are required to carry out by law, which are more of an issue of what social security covers or of spending on social benefits.

3.2.4. Negotiation of administration contracts

The parties to the negotiations are:

- the government, represented by the responsible minister assisted by:
 - the Budget Minister regarding any provisions with a budgetary or fiscal impact;

- the Minister for the Civil Service regarding any provisions that relate to matters pertinent to public social security institutions for which the Minister is responsible;
- the public social security institution, represented by senior management and by the person responsible for day-to-day management and that person’s deputy, on the understanding that the administration contract will be submitted to the management committee for approval.

The administration contract does not come into force until it has been approved by Royal Decree subject to consultations in the Council of Ministers, who ensures that it conforms to government social, fiscal and economic policy. The first contract was concluded for a period of three years and subsequent contracts can be concluded for at least three years and not more than five years.

3.2.5. Business plan and scoreboard

In accordance with Article 10 of the Royal Decree of 3 April 1997, each institution is required to draft a **business plan** which shows the objectives and short-term strategies for each service of the institution and sets out how each of its allocated tasks will be carried out, and will thus contribute to achieving the objectives defined in the administration contract. The business plan covers a period of one year. It is an internal document and is not contractual.

Article 10 of the Decree also provides for a **scoreboard** that measures progress towards achieving objectives using indicators that are calculated periodically. Prior to the Law of 26 July 1996, the agencies had developed “scoreboards” with the aim of improving the management and quality of their services. These scoreboards are management tools that are intended to show the relationship between objectives (in terms of operating norms), the resources allocated and utilised (in terms of costs) and the services delivered (in terms of outputs)¹. These scoreboards entail the concepts of indicators and norms. They enable management to take whatever corrective action is needed to achieve the objective within the given timeframe. They are a crucial management tool for monitoring, reviewing, assessing and correcting performance against the objectives that have been set. The scoreboards and indicators should not be drafted in the sole aim of measuring but should contribute genuine added value (Eraly, n.d.). The indicators are used to measure or assess how much progress has been made towards achieving the objective or, in other words, to show results quickly and clearly. A Royal

Decree can determine the fields for which common indicators must be included in the scoreboards of all public social security institutions.

3.2.6. *Budget*

The principle introduced by the Royal Decree of 3 April 1997 is to allow for greater financial and budgetary flexibility, but also for financial investment. Finance should be linked to variables that reflect the objectives. It must be possible to set programme budgets and, for multi-year planning, to establish an overall budget of resources for personnel, operation and investment.

The budget is annual and includes all revenues and all expenditure for one calendar year. It consists of a “mission” budget covering the statutory duties of the institution and a management budget covering the management of the institution (payroll, operating and investment expenditure). As outlined above, administration contracts relate solely to the institution’s management budget.

The draft budget drawn up by each management committee is approved by the responsible minister after a favourable opinion by the relevant government budget auditor, who verifies that the budget complies with legal and regulatory provisions and also with the provisions of the administration contract relevant to budget and finances. Double-entry bookkeeping rules apply.

The rules for budgeting, bookkeeping and accounting are set out in a Royal Decree of 22 June 2001 regulating the budget, the accounting and the accounts of public social security institutions subject to the Royal Decree of 3 April 1997 on measures to increase the accountability of public social security institutions (*Arrêté royal du 22 juin 2001 fixant les règles en matière de budget, de comptabilité et de comptes des institutions publiques de sécurité sociale soumises à l’Arrêté royal du 3 avril 1997 portant des mesures en vue de la responsabilisation des institutions publiques de sécurité sociale*).

3.2.7. *Supervision and monitoring: contract evaluation*

The public social security institutions are subject to supervision by the responsible minister and, in the event that decisions have an impact on the budget or finances, by the Budget Minister. This day-to-day supervision is the responsibility of two government statutory auditors, one representing the responsible minister and the other the Budget Minister. These auditors have

the right to take action if any of the decisions taken do not conform to the law, the statutes, the administration contract or the general interest.

The two supervisory ministers jointly designate one or more corporate auditor(s) to check the accounts and certify their accuracy and integrity for each institution. Performance evaluation (qualitative and quantitative) is conducted by the responsible minister. A strictly budgetary evaluation is conducted by a social security management committee.

The administration contract is re-evaluated each year and, if necessary, adapted to changing conditions by applying the planned objective parameters. This process takes into account socio-economic aspects and/or new objectives: index, number of social security beneficiaries. The re-evaluation process is conducted jointly by the government auditors, the institution's management committee and the person in charge of the day-to-day management of the institution. The joint evaluation process focuses on the execution of the contract and produces a joint report.

An overall evaluation is conducted by the Belgian Court of Audit.

4. Evaluation of administration contracts (2002-05)

4.1. Critical analysis of the first administration contracts for the period 2002-05

Experience with the first administration contracts suggests that the contractual arrangements set up under the contract system suffer from two drawbacks:

- Difficulty in entering into the “contract” approach. For the government, the temptation is to impose across-the-board savings measures, reducing proposed budget envelopes, or to impose further tasks without adjusting the envelopes accordingly.
- Difficulty in committing to strategic negotiations.

4.2. Audit by the Court of Audit

The Court of Audit conducted an audit of the first contracts (Court of Audit, 2005), which it submitted to the Chamber of Representatives. The audit, conducted to assess the government's ability to use administration contracts as a management tool, pointed out the strengths and weaknesses of the process and identified ways to improve it, which the Court set out in the form of recommendations. The Court highlighted the following points.

- Role of the state: One inadequacy pointed out was the government’s inability to adapt its organisation to this new mission.
- Quality of administration contracts:
 - Resources were not determined on the basis of the results to be achieved or of the successful completion of tasks.
 - The state did not assure itself of the quality standard of the objectives and indicators proposed by the institutions when negotiating the first administration contracts.
- Monitoring and evaluation of administration contracts:
 - The state had not issued any regulations in this area; hence the reports were patchy in quality, and cross-comparisons between the different institutions posed problems.
 - The system of results-based rewards or penalties provided for under the law was not always implemented.
 - Nevertheless one important positive point, in addition to the phasing in of a cost accounting system (or cost calculation), was the development of fine-tuning tools (scoreboards).
 - Despite the fact that the public social security institutions had voiced the need to revise objectives, no changes had been made to agreed contract objectives apart from some budget adjustments.
- General recommendations: The Court concluded its audit with some general recommendations on the points highlighted in its report.

5. Current situation

Currently administration contracts for the period 2006 to 2008 are being re-negotiated with the responsible minister and the Budget Minister. The expectations of the federal government regarding the 15 contracts that are to be re-negotiated, according to the Social Security Administration, are worth noting:

- Social Security Charter to be more fully incorporated and implemented;
- Introduction of provisions to optimise transparency, readability and clarity of information contained in the administration contract and in future reports on its implementation;

- A margin for improving the planning of objectives to be built in for the full term of the contract.

The same Administration has also set guidelines for drawing up management budgets which are intended to address certain issues:

- Ensure the degree of budget stability necessary for carrying out the core duties of social security institutions;
- Ensure the necessary linkage between the funds allocated and the objectives to be achieved;
- Incorporate activities that would develop and modernise public social security institutions by developing projects spanning several years and defining long-term investments.

In addition to these guidelines, some other matters for attention were highlighted:

- A better match between objectives and performance indicators;
- Stronger linkage between objectives and costs;
- Better selection and planning (more realistic) of projects;
- Wider use of cost accounting;
- Strengthening of internal control systems;
- Effective implementation of internal audit activities.

6. Conclusion

Contractual arrangements emerged in public governance as an alternative to privatisation and decentralisation methods (Eraly, n.d.). The theoretical basis is as follows: relations between the government and bodies accountable to it are governed less by the supervision and control approach and more by the *ex post* control of results.

The administration contract system is a clear move towards this type of contractual approach, a results-based management approach. In this system, public social security institutions are encouraged to make a series of commitments to government, to set objectives and to achieve results. In exchange, they have greater management autonomy over their funds, their operations and their staff.

Following a first round of contracts, it has to be said that all is not yet perfect: for instance, the legislation on the introduction of rewards and

penalties, which are the keystones of greater accountability, has not yet been implemented. As is clear from the report by the Court of Audit, this is not the only point that could be improved upon. In this respect, the guidelines established for the second round of administration contract negotiations suggest that the new contracts will be another step forward.

Notes

- ¹ Report to the King on the Royal Decree of 3 April 1997 on measures to increase the accountability of public social security institutions, in application of Article 47 of the Law of 26 July 1996 on social security reforms (*Rapport au Roi de l'Arrêté royal du 3 avril 1997 portant des mesures en vue de la responsabilisation des institutions publiques de sécurité sociale, en application de l'Article 47 de la Loi du 26 juillet 1996 portant modernisation de la sécurité sociale*).

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Accountability Institutions and the Policy Process: The United States Experience

by

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Accountability is now acknowledged as an important element in good governance in the public sector. The term itself is complex, covering many aspects including: the move from accounting to accountability; the need to increase transparency; the importance of the political interface; the distinction between internal and external accountability; the use of accountability information; the interaction of accountability systems with other systems to affect programme results; and more. There is an important difference between formal accountability systems, based on audit and management control, and informal accountability systems that define the implicit standards for performance and the expectations for implementation. Do accountability systems in fact promote performance and trust or undermine them? This article discusses accountability provisions and institutions in the public sector of the United States and provides perspectives on the roles of accountability institutions and professionals in the broader realm of public management. The article identifies three different models of accountability in the United States context: federal, partnership, and third party.

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In many OECD countries, the term accountability has grown to an iconic status, with a symbolic imagery that permits this chameleon-like term to be attached to a wide range of causes and agendas (Dubnick and Justice, 2004). Indeed, the use of accountability in political debates takes on a valence quality where only its proponents are viewed as having a legitimate case to be made (Baumgartner and Jones, 1993). In the world of budgeting, there have been efforts to increasingly link accountability concepts and institutions with budgeting. The movement of countries such as Australia and New Zealand toward accrual budgets has been inspired by the perception that budget decisions were not connected to the accounting statements and reports prepared by financial managers. By recasting the basis for budgetary cost measurement to an accruals basis, the retrospective world of financial accounting and the prospective world of budgeting were joined. Performance budgeting represents another approach to institutionalising accountability within budgeting, this time for results or outcomes. Both reform movements are testament to the uniquely central role that accountability has come to play in policy debates in general and in budgeting in particular.

Notwithstanding the greater centrality of accountability as a public management concept, public policy makers and managers often have little connection or dialogue with those agencies and officials who are the guardians and champions of accountability – what I will call accountability institutions and professionals in this article. In many respects, accountability professionals appear to have their own criteria, standards and terms of art that are little understood by managers and policy makers. Often terms such as “accountability”, “oversight” or “transparency” can have different meanings to those trained in different disciplines and agencies.

In this article, I provide perspectives on the roles that accountability institutions and professionals have come to play in the broader realm of public management. This article raises some troublesome questions about the interaction of accountability institutions with public officials and managers that call for more thought and research by the entire public administration community. Ultimately, important dilemmas are posed for leaders in the accountability community itself, as they must reexamine fundamental and long-held role definitions and standards to become more relevant in addressing the public management challenges facing modern countries in the 21st century.

When it comes to accountability, I should forewarn you that those of us in the accountability professions are among its most vigilant advocates. Those professions include a growing array of institutions with an interest in promoting greater internal and external accountability for either finances,

management operations or programme results, including external and internal audit agencies, financial management offices, evaluation and planning offices, information systems offices, procurement offices and grants management offices. In the United States in recent years, these offices have been institutionalised as a result of a wave of management reforms passed by Congress in the 1990s institutionalising financial management reform, performance management, information systems reviews, procurement reforms and now human capital reform.

Although I cannot pretend to represent the accountability officials from all of these functions, I can say that for offices like the United States Government Accountability Office (GAO), accountability is an article of faith, one of those fundamental principles that serve as the underpinning of the mission and unique role that these institutions play in our system. As such, one can depend on these institutions to faithfully articulate the case for accountability provisions and institutions.

From this perspective, accountability is defined as holding agents to account for meeting standards and expectations of various principals – including executives, legislatures, various publics – for the use of financial resources, compliance in meeting legal obligations, efficiency of operations and effectiveness in achieving results and goals. Ideally, accountability systems should provide for transparent reporting of these issues, identification of causes of shortfalls, and processes to correct behaviors to bring them in closer conformance with standards.

However admirable and even heroic such a posture may be, those of us in these professions nonetheless have our own particular blinders when it comes to accountability that may not permit us to take a broader view of the tradeoffs associated with various formulations of this concept. We are prone to having universalistic norms and prescriptions for accountability that may not be sufficiently sensitive to various institutional contexts, public objectives and tradeoffs. Some lampoon these perspectives as “more rules, better enforced”. While this is a caricature at best, thoughtful officials in these institutions wonder about the fit between our standard prescriptions with changing environments carrying differing tradeoffs. For instance, the United States response to aid the victims of Hurricane Katrina has inspired questions about the tradeoffs between traditional accountability and control mechanisms with the need to provide expedited funding to recipients with urgent needs. What are the “minimum” requisites for accountability in this rapidly evolving scenario? Similarly, when the President and Congress have decided to devolve authority to states and local governments for particular federal programmes, the resulting accountability provisions remain controversial. Standard prescriptions for federal agency reviews and controls over grantee applications and activities may not hold in a setting where

authority and accountability are intentionally pushed downward in our system (Posner and Wrightson, 1996). Indeed in some third party governance settings such as many tax expenditure programmes, the principals defining the goals for the programme are not federal, but private firms and individuals. In these settings, the vastly different federal role would be expected to cascade into reformulated accountability provisions as well, but little thought has been given to how these issues might be adjudicated across differing tools of governance (Posner, 2002).

These cracks in the firmament are among the many questions those of us in the accountability professions need to address as we seek to keep up with the fluid nature of public agendas and shifting governmental roles, responsibilities and institutional innovations. The objective of this article is to air some of these vexing questions about accountability in the public sector for further consideration by the research community. My questions could be viewed as soundings from an academic in the field, one who served for many years as a senior manager with the United States Government Accountability Office. The following represent questions about the relationships between accountability institutions and the broader policy process that need to be more fully understood. Addressing these questions may help public policy makers and managers develop a better understanding of what expectations are reasonable for accountability institutions; it may also help accountability institutions revisit their own frameworks about how to better serve political and managerial principals in public service.

1. Why do political leaders support accountability professionals?

The relationships between public accountability professionals and political principals underpin the growth of accountability institutions in government in recent times. In the American system, public accountability professionals work for many principals; however they are expected to be loyal not to a set of principals but a set of professional standards. The audit institutions of government in fact are required by standards in that field to be “independent” of political principals. This usually is reinforced by the special status associated with the head of these agencies, who are often appointed for fixed terms where they serve various masters. Unlike political appointees, they typically do not serve at the pleasure of their political superior.

While the independence of these offices is vital to their legitimacy, significant questions remain about how they relate to political principals. The Comptroller General, the head of the GAO, is answerable to the entire Congress which guarantees a measure of leverage and independence due to the variability of that body. The inspectors general work within federal

executive agencies, but they too have independent relationships with congressional committees responsible for oversight.

If accountability professionals have such independent status, then why do political leaders tolerate such gadflies who can easily upset their equilibrium and bases for support? In fact, tensions typically exist between the two worlds: the GAO was cut by 25 per cent in 1995 partly because the new congressional leadership perceived the agency to be outside the new political consensus.

The key question is: What public functions do audit offices and other accountability institutions perform for political leaders in legislative and executive branches that make them tolerable, if not always likeable? How do accountability professionals manage these relationships to promote their goals and political sustainability?

The answers to these questions may lie in several areas. First, there is growing recognition that independent expertise has important leverage in policy debates; expert-based policy ideas in fact have overcome special interests in areas ranging from deregulation, banking reform and emissions trading. In an important new work, Kevin Esterling shows how interest groups and Congress alike attempt to assemble expert support for policy ideas prior to their introduction in the legislative process, a testament to the recognition that political leaders are held accountable for policy success and failures – at least in the perception of official Washington elites (Esterling, 2004).

Second, independent information helps settle and channel political debates. Rather than debate the veracity of information, the presence of credible institutional information can help leaders focus debates on broader issues. The independence and respect accorded to the Congressional Budget Office are an example of how much legislators need an independent referee to resolve fact-based questions, thereby controlling the scope of conflicts.

Third, accountability institutions perform the service of helping legislators set the agenda. Armed with years of institutional knowledge and deep familiarity with programmes and management, these institutions can provide a set of credible issues for members to focus on that can gain some certainty of support within expert communities.

A fourth factor may centre on the strategies pursued by audit institutions in courting and generating political support. Most of the work done by the GAO is at the request of members of Congress from both parties. The agency must delicately steer between responding to these legitimate information needs to set their agenda while sustaining their independence in developing findings and reports. The broader engagement of these

institutions with media, universities and other actors also can sustain their reputations which can promote support and limit interference. However, the involvement of accountability professions in reviewing programme results and effectiveness carries obvious political risks for audit institutions – many have charters that limit their coverage of these issues and constrain them from making recommendations on policy and programme design issues (Schwartz, 2000).

2. What factors determine whether political leaders listen to accountability professionals?

Every accountability institution typically monitors its own performance measures to ascertain how they impact on policy and management. In the case of the GAO, the agency monitors the savings that flow from its work, the kinds of changes that Congress and federal agencies have made in response to the recommendations and reports of that agency. Inspectors general also have reports detailing their accomplishments.

Conventional wisdom, however, suggests that the accomplishments from these agencies and other professions are the exception and not the rule. Many would argue that oversight is one of the least rewarding activities for members of Congress, vastly overshadowed by the political benefits entailed with enacting new legislation and providing constituent service. A study of the Israeli Knesset's use of audit reports finds that the legislators are not avid users or consumers of this information in their deliberations (Schwartz, 2000).

This same pessimism has cast a pall over the congressional demand for other accountability information. For instance, the 1993 Government Performance and Results Act passed by Congress in fact has generated performance plans and reports across the entire federal government, but Congress has largely been viewed as not engaged in using this information either to authorise programmes, appropriate funds or conduct oversight. Similarly, congressional use of the financial information arising from the 1990 Chief Financial Officers Act has been reportedly sparse – many members and staff have difficulty understanding the accrual-based financial statements and the somewhat technical language of audit reports on these reports.

Nonetheless, there are countertrends here that bear further examination. Although public administration has not focused sufficient attention on the role of legislative institutions in management, it is clear in the American system that, as a day-to-day proposition, Congress insists on being a co-manager of executive agencies, exercising its considerable influence through

its power of the purse, limits on staffing, approvals of appointments and other authorisation of programmes. While arguably a lagging actor in using information from accountability reforms, in fact Congress has been the author of these reforms. And it was Congress that created the GAO in 1921, the inspectors general in 1978 and nearly all of the major management reforms since 1980 (Light, 1995). Nothing in the literature would have prepared us for the emergence of Congress as a champion of management reform, with the President's Office of Management and Budget serving as a sometime naysayer on some of these reforms.

Moreover, research by leading congressional scholars suggests that congressional oversight, in fact, is exercised more frequently than imagined, but is driven by a political point of view, not necessarily the input of accountability professionals. The impetus for oversight, in other words, is grounded in its use to solve political, not analytic problems. However, regardless of motivation, the oversight that is done can include the input of accountability professions (Aberbach, 2002).

Accountability reports and actors can frame performance and management issues for the public agenda that are difficult for decision makers to ignore. Fraud and abuse involving defense contractors or doctors become useful to political leaders anxious to position themselves on the right side of issues in an increasingly visible media-driven political culture. Congressional officials are also competing with one another to claim credit for new programmes or to avoid blame for problems. Members of legislatures indeed may find it to their advantage to take the high ground by sponsoring studies – or appearing to – on top of information and studies that gain a compelling place on the agenda.

Political leaders can use accountability professionals to cover their risks in case new policy ventures go awry. They can take credit for new benefits and also know that they will be positioned to assign blame when the programme experiences problems. Thus, for instance, Congress passed new block grants devolving authority to states for certain federal programmes in 1981; yet the same members who voted for this devolution did not hesitate to ask the GAO to assess how states were managing these new responsibilities, leading in part to the reimposition of new federal requirements and constraints in subsequent years.

The question is: What prompts political leaders to use accountability inputs in shaping their agendas, developing legislation, appropriating funds and conducting oversight? What roles do accountability officials play in stimulating these activities and through what mechanisms? What variables affect the use of this information, including the support of informal accountability communities, the presence of divided government, and the

strategies used by the accountability officials themselves in building support for their work? For instance, I am not aware of any studies that have tested the use of accountability information by Congress to ascertain the influence of shifts in control of Congress and the Presidency, notwithstanding the many opinions proffered about the alleged decline in oversight during the past ten years.

3. Why do agency bureaucrats use accountability information?

A comparable question involves the use of accountability information by executive branch leaders, either the central leadership or agency leadership. Most of the GAO recommendations are addressed to agency heads, and over 75 per cent are implemented over a period of time. In addition to specific recommendations, federal agencies have reformed their financial and performance management systems over the past ten years partly as a result of legislative actions and pressures from the accountability communities within and external to agencies, most notably inspectors general and the GAO.

Many factors can be suggested here for agency adoptions. First, agency staff find accountability reports and information useful in convincing their leadership within the agency and in the White House of the need for reforms that they have long championed internally. As might be suggested under the “garbage can model”, audit findings and performance reports can provide a window of opportunity or a problem stream that opportunistic advocates of solutions can use to achieve reforms (Kingdon, 1984). Another important factor associated with adoption entails the fear of being shamed by public or congressional attention to the recommendations should they fail to adopt. The latter force may be particularly important in a separation of powers regime where the legislature has independent and powerful roles to play in agencies’ political and budgetary fortunes. Interestingly, in the United States, the adoptions of GAO recommendations occur even though the agency itself has no formal incentives and sanctions to trigger adoption. However, incentives and sanctions may be factors prompting adoption of accountability recommendations and systems in other nations.

Competition can be a particularly powerful incentive within bureaucracies. If bureaus perceive a competitive advantage to adopting accountability in the competition with other actors for resources and influence, this can be an important factor. Agencies may be motivated to adopt recommendations or initiate new accountability systems either to compete with fellow bureaus or to compete with central actors, such as agency leaders and budget offices. The PPBS system introduced by Secretary McNamara in the Pentagon in the early 1960s became deeply

rooted in the Defense bureaucracy when the military services realised that they had to acquire the capacity to do systems analysis and evaluations to stay competitive with the Secretary's "whiz kids". Similarly, the OMB Program Assessment Rating Tool being used by the current administration to assess programmes throughout the agencies has inspired some agencies to improve their evaluation information to be able to compete with the OMB in budget debates in the Congress and the public (GAO, 2004a). The movement to create report cards assessing agencies and programmes in an open, public process constitutes a strategy to jump start competition among bureaucratic actors for public approbation and the high ground (Gormley and Weimer, 1999).

The foregoing suggests that multiple actors in competitive policy-making environments can inspire a "race to the top" among other actors which can serve to ratchet up attention and resources devoted to accountability reforms and enhancements. Multiple accountability actors within the Congress, the executive and even the public serve to trigger a mutually reinforcing process in this model.

However, other models may also be at work with different results. For instance, under the Single Audit Act of 1984, all federal grant funds were required to be reviewed by public or private audit agencies paid for by grantees. This Act was designed to ensure more comprehensive coverage of grants by audits and replaced more selective, hit-and-miss audits conducted by federal agencies. However, this Act reportedly led federal agency managers to reduce their own attention and resources devoted to management oversight and monitoring during the grant period, armed with the knowledge that the single audit could cover for any serious breaches of accountability in their programmes. The presence of multiple accountability actors in this case triggered a moral hazard, where agencies disinvested in management oversight when it could rely on others to do the accountability work.

Competition among principals may have mixed results in motivating the use of accountability results. On the one hand, this could inspire actors to compete for leadership over accountability reforms. Principals vying for leadership of these initiatives may inspire their expansion. For example, the leadership of the Y2K initiative in the federal government was reportedly lagging within the White House and its budget office until congressional hearings began to expose the risks and grade agencies on their relative preparedness. However, agencies are placed in vulnerable positions when their principals disagree about accountability reforms. For instance, although President Bush and his budget office are pushing for the assessment of programmes under the PART system, congressional appropriators have expressed hostility, putting agencies that must accommodate both sets of

actors in a difficult position. Generally, these cross-pressures carry the potential to undermine the support of agencies for reforms.

The key question entails addressing what factors are at work that promote attention to accountability in bureaucracies. Does the attention paid to accountability vary with the nature of the issue network involved, the standing of the agency within an administration and with the legislature, and the broader standing of their programmes with the public? Does the nature and structure of audit institutions internal and external to the agency have an impact on the bureaucracy's receptivity to accountability information?

4. Tensions between large “A” accountability and small “a” accountability systems

Each major programme area has multiple accountability systems and processes at work. Some are formal systems as discussed above, based on audit and management control systems – what I call large “A” systems. The implications of these systems for management and performance indeed have received considerable attention from public managers and observers. However, less obvious but more pervasive are the informal accountability systems, or what we might call small “a” systems which have an important impact in framing accountability for these areas by defining implicit standards for performance, expectations for implementation, types of information considered to be legitimate and necessary, and actions to be taken in response to perceived problems. Actors involved in this informal system include interest groups, media, central executive reviewers such as budget officers, legislative committees and other observers/researchers with an interest in the programme area – what Hugh Heclo called “issue networks” (Heclo, 1978).

A key issue is whether the formal and informal systems are in harmony and what happens when they are not. In some respects, the formal systems can be viewed as introducing expert, professional accountability systems to supplement or even replace political or hierarchical systems, to use Romzek's categories (Romzek, 1996). Some would argue that the rise of what Edward Wheat called the “activist auditor” is a salutary correction to the dominance of policy systems by narrow political interests and amateur leaders (Wheat, 1991). These professionals have standing to raise important issues on the agenda that have heretofore received insufficient attention in policy communities.

However, the introduction of accountability professionals introduces new tensions and uncertainties as well. The cohesiveness of networks are a major variable here, but the cozy iron triangles can be expected to resist the

blandishment of auditors and send contradictory signals to policy makers and managers throughout the policy arena. Not only can the efforts of auditors and other accountability professionals go for naught, but their political support and basis for legitimacy can be undermined as well. The GAO, for example, has long invested in work examining the cost effectiveness of veterans' programmes and farm subsidies – and the conclusions fell well within the professional consensus of economists that many of these subsidies were poorly designed and targeted and carried significant losses for the economy. However, for the most part, many of these nicely crafted studies became what is known as “Olympic divers” – beautiful documents that made no splash.

The question would involve examining the relationships between formal and informal accountability networks. Do auditors attempt to work within these networks, and what impacts do they have on policy? To what extent do the cohesiveness and degree of insularity of policy networks have an impact on the ability of accountability professionals to gain footholds? What are the consequences for the political standing and resources of auditors and evaluators that fail to gain traction for their findings?

5. Do accountability systems promote performance and trust or undermine them?

The New Public Management (NPM) ushered in a debate over implications of various accountability systems managers and performance. NPM and the reinventing government movement sought a system geared to performance, where managers would be enabled to use entrepreneurial skills to achieve performance goals through greater discretion over managing processes. In this view, accountability systems focusing on inputs and process were part of an accountability paradox or dilemma that traps managers in suboptimising routines and inflexible structures. In this characterisation, the auditors' rigid focus on controls and inputs brings about rule-based management which stifles innovation, experimentation and devolution of authority to the front line managers who know best how to implement programmes. Closely related was the view that traditional accountability controls were premised on distrust rather than trust, which serves to limit the power of government to act on behalf of the citizenry. In this view, an accountability based on trust would empower government to be more effective stewards of public programmes, grounded in dialogue and consensus building around goals and checks and balances among institutions (Braithwaite, 1998). As Philip Cooper aptly notes, the older tools of accountability became the new targets of reformers (Cooper, 1995, p. 174).

Contrast this with the view of auditors. Charles Bowsher, former United States Comptroller General, observed that accountability with a focus on financial controls and performance is essential to creating trust. From this perspective, accountability helps the public as principal gain confidence in the veracity and conduct of its agents. Given the many opportunities for shirking and moral hazards associated with these relationships, a strong and independent audit function is critical to promoting this level of trust. Even supporters of performance reforms understand that some independent review of agencies' performance goals and measures is essential to build credibility and trust among potential political users of this information, lest it be viewed as self-serving statements by self-interested agencies seeking greater support. Supporters of the traditional suites of accountability measures express concerns that weakening financial and compliance reviews and controls will result in a diminution of attention to public laws and their faithful implementation (Moe and Gilmour, 1995).

Central to this debate are differing views of the relationships between different accountability orientations and systems. NPM advocates tend to view financial, compliance and performance systems as being separable and potentially contradictory. Financial and compliance rules are viewed as undermining the focus on performance, with managers unable to make key tradeoffs to maximise results with given resources. Implicit in their view is a hierarchy placing performance in the centre with financial and compliance rules moved more to the background.

The accountability community views these systems as mutually reinforcing. The financial management requirements enacted in the 1990 Chief Financial Officers Act are viewed as being complementary to the performance focus ushered in under the 1993 Government Performance and Results Act. From this perspective, financial and controls accountability promotes valid data about costs while performance metrics and evaluations provides similar data on benefits, giving political principals and agency heads alike a new suite of information that will enrich decisions and accountability.

The politics of reform reinforces the complementary nature of accountability systems. Given the presence of multiple principals, each vested in their own accountability orientation and reliant on differing information, it is likely that reforms to accountability systems will proceed by addition rather than substitution. For instance, congressional appropriators tend to focus on input information as the primary basis for decisions and are attached to long-standing budgetary accounting presentations. They have recently resisted attempts by this Administration's budget office to replace current input-oriented presentations and information on agency budget submissions with outcome-oriented presentations

organised around agencies' strategic plan goals. The Administration would have gained more traction had it introduced this new information as a supplement rather than a replacement of traditional control-based data (GAO, 2005a).

Moreover, the reaction of appropriations committees to this Administration performance budgeting initiative is indicative of the issues posed for principals in a separation of powers system by the NPM model of delegation. NPM offers a tradeoff to principals – loosen input controls to enable managers to achieve greater efficiencies while increasing accountability for performance. However, from a political principal in Congress, this tradeoff appears asymmetrical. Agencies gain discretion at the front end of the relationship, forcing Congress to fall back on untested performance models which offer only a tenuous link between dollars appropriated and results. There is far greater certainty and information on the relationship between dollars appropriated and the purchase of inputs and near-term outputs, such as staff and equipment, than there is between dollars and outcomes which are mediated through complex implementation chains and logic models which have yet to be developed for most programmes.

With regard to the trust dimension, there may be a false dichotomy in the debate. While the traditional accountability focus is premised on the need to guard against abuse, in fact the accountability reforms ushered in during the 1990s in the United States have arguably served to strengthen, not weaken managers in the agencies in the federal government. The financial, performance and information systems reforms have in fact served to institutionalise reforms in agencies' systems and controls that arguably will serve agency managers well should they achieve greater authority. While the public view of auditors stresses their checking and transactional control functions, in fact auditors themselves have been the leading advocates for these more systematic reforms. The prospect of institutionalising more systematic information within programmes and agencies, after all, makes the auditor's job that much easier – it is far preferable to analyse primary data collected by others than to collect and reconstruct this information yourself.

More broadly, powerful currents in the political culture of the United States also suggest another reason why this debate presents a false dichotomy. As Garry Wills has suggested, we want government to be effective, all the while retaining a healthy distrust of political leaders and bureaucrats (Wills, 1999). As one United States Senator observed, American politics can be summed up in two statements: “get the government off our backs” and “there ought to be a law”. From this perspective, it is likely that we will continue to express the view that we can have it all when it comes to

accountability – both controls premised on distrust and systems premised on trust.

The question here would focus on whether we can in fact have it all, in Robert Behn's words (Behn, 2001, p. 37). Are accountability systems mutually reinforcing or offsetting? How can such systems be designed to become more compatible, if necessary? Can we both increase the capacity of agencies to improve efficiency while maintaining the confidence and interest of political principals in accountability for these programmes? Under what circumstances will political principals support greater devolution, and what are the accountability requisites?

6. Can we protect performance accountability from itself?

From this somewhat provocative heading, you might guess that I am one of those "old line" public administration types who is skeptical of performance management and its sometimes unctuous claims. Far from it – I have been an advocate of institutionalising greater focus on performance both in management and in the budget process. Mindful of the minefield of failures at the federal level in performance budgeting and management, in fact I have worked with others in the system to learn the lessons of the past in designing the Government Performance and Results Act and educating the federal community on constructive oversight of this important movement.

Having said this, I have a lover's quarrel with the movement and it centres around models of accountability for performance. The checkered history of performance management at the federal level has left its devotees with the following lessons – the failure of PPBS, ZBB, MBO and other such initiatives to become institutionalised can be attributed to the inability of those processes to integrate themselves into the decision-making processes that really matter to managers and stakeholders, most particularly the budget process. Accordingly, under the GPRA, the goal was to ultimately place performance metrics at the center of resource allocation, personnel evaluations and other processes that matter.

There is convincing evidence that the GPRA has largely escaped the fate of its predecessors. It has been sustained for ten years through two different Administrations whose budget offices have placed performance management and evaluation information at the centre of their management oversight of agencies. Notwithstanding the low expectations of its creators, the reforms have become institutionalised within agencies and the information is becoming integrated in agencies' oversight of contractors, grantees, regional offices and other programme agents (GAO, 2004b).

However, in the United States system, the performance movement is at a turning point that could very well prove to be critical to its future evolution. To date, the performance movement has focused on what I will call “strategic accountability” – that is, the plans and information have served to reframe questions for budgeting and oversight, help set new agendas and provide valuable supplements to ongoing accountability frameworks. Such a process takes a considerable number of years in a system involving multiple principals where the definition of performance goals and the articulation of metrics are contentious and contestable. Moreover, considerable technical obstacles need to be overcome in a federal system which relies extensively on a wide range of third party actors to deliver national programmes and objectives. In this case, the tie between the inputs of federal resources and the performance outcomes can be quite tenuous and it requires years of research and agreement to specify the logic models through which federal programmes ultimately reach their performance targets. In a system like that in the United States, many years will be required to articulate performance systems that gain consensus in diverse issue networks and overcome technical measurement and evaluation issues. Even as these issues are worked out, it would be ill advised to expect these systems to have tightly coupled models relating inputs to outcomes. Programmes typically have multiple outcomes, some of which are inherently difficult to measure, involving decisions to weigh their relative importance that are inherently political. Given these uncertainties, performance can play a role that is non-exclusive, supplemental to other forms of accountability and only loosely coupled to resource decisions.

However, the movement is taking a turn toward what I call “instrumental accountability” where performance information is given a central role in allocating scarce resources and making other high-stake decisions. The more performance is used to judge, reward and sanction, I am concerned that it will lose the basis of expert legitimacy that is the ultimate claim that such systems have on decision makers. As the stakes associated with its use grow, so does the threat to the integrity of the models and metrics which are the basis for performance management systems. The price of attempting to align with budgeting is to enter an arena where performance may get too close to the flame of political conflict to survive intact.

Resting on a technically shaky basis, the use of performance as the primary criteria for decisions and even oversight jeopardises its standing by threatening to undermine other important values in the budgeting and broader policy making processes. Many advocates base their accountability models for performance on a naïve rationalism that rests on what I call the “mechanical model”. If performance goes up, the agency or staff get rewarded with increased resources, if it goes down, they get penalised

somehow. While appealing on first glance, such a model squeezes out other important factors that need to be weighed and considered in making decisions – relative priorities, equity considerations, the need for poorly performing programmes to obtain greater resources in the near term to deal with problems, among others. Thus, for instance, it is not at all obvious that the response to a spike in the number of drug abusers would be to penalise the drug programmes and their administrators with a loss of funds, but that is the rather unsophisticated result of these instrumental models. Far more realistic and supportable is what I call the “agenda” model of performance management where performance is not expected to provide the answers for resource allocation and personnel judgements, but rather prompt the raising of new questions.

The question here involves understanding how performance-based accountability systems actually can work to affect decision makers’ perspectives and choices. What does experience suggest about the realistic roles that performance can play in management and policy making? What factors are associated with its use, *e.g.* single *vs.* multiple principals, unitary *vs.* federal systems, fiscal expansions *vs.* contractions? What roles do independent auditors and evaluators play in their attestation and validation functions to provide greater confidence and trust in these systems?

7. How do accountability systems work with other systems to affect programme results?

Accountability is often viewed as that set of information and systems that help us assess how well programmes and operations are doing. However, there are other more important tools we use to influence the outcomes of programmes and policies, and it is important to understand the relative role that accountability systems can play in this broader context.

In the United States, there has been a tendency to view accountability as a process that is triggered retrospectively. In this respect, accountability is the province of specialists, freeing up other policy actors and professionals to concentrate on developing policy proposals and managing performance, safe in the knowledge that their backs are covered by arcane accountability institutions and their routines.

There is considerable evidence that fundamental programme design decisions involving the selection of governmental tool, the design of that tool, the choice of providers and the engagement of particular networks have a major effect on performance. The role of design incentives and sanctions is particularly important for indirect government where traditional hierarchical command and control techniques are not available to principals

to influence compliance with standards (Posner, 2002). Linder and Peters observe that improper design condemns programs to be “crippled at birth”, a malady that the best public accountability systems have difficulty overcoming (Linder and Peters, 1987). By design, I mean the combination of incentives, sanctions, and rules built into the programme at the outset. For instance, the potential moral hazards associated with insurance programmes can at least be tempered with risk-sharing requirements such as coinsurance requirements and expanded capital requirements. Similarly, the fiscal windfall potential of grants can be addressed with effective matching and maintenance of effort provisions (GAO, 1981). In the context of the current response to Hurricane Katrina, in another case, the decision to expand agency managers’ flexibility to procure goods and services through use of government credit cards without competition worried many concerned with the potential for favoritism and cost-ineffective purchases by agency managers. While accountability provisions could provide for reporting, oversight and audits, the fundamental decision to provide this authority already sets in motion an implementation process that is difficult to control at the back end of programme management.

Implementation analysis provides a rich set of variables that influence the accountability and performance under federal programmes. This article will not go into depth on any one of these factors, but a listing illustrates the range:

- The ability of principals to choose providers in a competitive process;
- The degree of congruence among goals and priorities between principals and agents;
- The extent of cohesion on the part of multiple principals either within the same level of government or across different governments and sectors;
- The accessibility of programme clients and providers to courts and media;
- The credibility of incentives and sanctions to motivate performance;
- The extent to which relationships between principals and agents will be continuous over time.

This is not to say that accountability and oversight can never overcome design obstacles. In one study, John Chubb concluded that federal education grants for vocational education were better designed than federal compensatory education programmes, yet the greater oversight and

accountability attention provided to the latter set of programmes promoted more effective targeting and performance (Chubb, 1985).

Moreover, the oversight and accountability of official agencies of government can be reinforced or undermined by other accountability processes. In a notable article, McCubbins and Schwartz observe that Congress frequently provides for what they call “fire alarm oversight” to supplement the scarce resources that accountability professionals can spend overseeing programmes through their normal “police patrol” functions (McCubbins and Schwartz, 1984). By permitting programmes’ clients and providers to appeal to courts, federal agencies and Congress itself, there is conceivably greater coverage and attention to issues that would not be caught up in normal accountability systems. However, as Behn notes, there is cost to primary reliance on complaint-based mechanisms, including undetected “fires” and false alarms (Behn, 2001, p. 76).

Questions here involve the relationship between accountability mechanisms and the larger public management environment. To what extent can accountability professions and systems compensate for failures of programme design and structure? To what extent do accountability professions target their own scarce resources based on an assessment of the underlying vulnerabilities and risks associated with particular programmes and operations? Just as there are standards governing the conduct and coverage of audits and evaluations, can there be similar standards relating to critical programme design decisions that have such an important bearing on programme implementation and results?

8. Are accountability systems inherently retrospective?

Accounting and evaluation are inherently retrospective enterprises. What did the organisation or programme achieve in the prior year and what changes are needed to promote greater integrity, efficiency and effectiveness based on this past track record? Other management and policy systems are more forward looking – budgeting generally has timelines going forward from one to ten years while strategic planning can look even further at longer-term forces.

The retrospective focus of accountability systems in some respects mirrors the alleged timeframes of the political process. Political leaders are said to be short-term focused, where the next election becomes the primary focus reinforcing high discount rates with regard to the future costs of current decisions as well as non-decisions.

Western societies, however, are at the precipice of a major shift in demographics and economies that will raise serious questions about the

sustainability of current policies. Pension and health entitlements, as well as relatively low rates of savings in many nations, will encumber longer-term fiscal futures with an unpalatable combination of high debt, higher taxes or lower spending. The longer decision makers wait to address these issues, the greater the fiscal costs socio-economic dislocation (GAO, 2005b).

The GAO has been among the leaders in the accountability community attempting to redefine the orientation and metrics of financial analysis to focus more attention on longer-term implications of current decisions. David Walker, the Comptroller General, has defined “foresight” as a new line of work for the GAO to supplement the agency’s traditional emphasis on oversight and evaluation. The GAO has developed and updated a long-term model of the federal budget looking out 50 years which permits policy makers to assess whether current policies are sustainable beyond conventional budget windows, and the Congressional Budget Office and the OMB have followed suit. Accrual accounting and budgeting initiatives starting in New Zealand and recently adopted in the United Kingdom and Australia also promise to bring greater attention to longer-term issues by including the net present value of the long-term costs of new liabilities in budgets, thereby forcing decision makers to find ways of financing those costs in the present rather than passing them off to future taxpayers. On the asset side, accrual budgets generally attempt to book the consumption costs of long-lived assets each year, rather than their total upfront costs, although many would argue that this depreciation approach actually understates the costs of commitments and could lead to overspending at the expense of future generations (GAO, 2000). Whatever the form of these emerging accountability mechanisms, the purpose is similar – to force decision makers to become accountable for the longer-term costs of their actions (Schick, 2002).

The questions here involve examining what kinds of accountability frameworks and metrics appear to be feasible and relevant to debates over longer-term outlooks. Which items are measurable and what are the approaches for presenting this information in ways that are understandable by decision makers and publics? What kinds of factors are likely to dispose decision makers to consider this information and change their preferences and focus, *e.g.* economic crisis and market pressures, pressure from intergenerational forces, public values and concerns about future tax increases, pressure from international institutions?

9. How does the shifting nature of the public sector affect expectations for accountability?

As the United States government's role in solving an ever greater range of public problems has grown, so has the mismatch between expectations and the machinery used to address them. Political leaders resort to a little understood range of tools – what several authors called carrots, sticks and sermons – to solve a growing array of more complex and daunting problems dumped on government's doorstep (Bemelmans-Videc, *et al.*, 1998). The rising expectations are a result of an expansive agenda formation fed by ambitious and increasingly anxious political leaders, an expansive interest group system and a “24-7” media culture (Baumgartner and Jones, 1993).

Given the ambivalence most Americans have toward government, the United States government, and increasingly many other nations as well, have resorted to the reliance on a complex web of third parties to respond to these expectations through a growing array of indirect governance tools (Salamon, 2002).

As challenging as accountability is for government bureaucracies, the issues and dilemmas are even more daunting for programmes using third party tools. Agencies that deliver services directly with their own employees have certain accountability advantages: transactions are internalised within hierarchies that are more cohesive and responsive to central leadership (Lehman, 1989). Obvious challenges are presented when the federal government must use independent actors it does not fully control to achieve its goals, especially since, as Don Kettl has noted, transferring who does the work does not relieve the federal government of responsibility for the performance (Kettl, n.d., p. 49).

The major challenge posed by third party government stems from the diffuse political authority embedded in third party relationships. Third party providers have independent bases of political power and potentially conflicting goals and interests. Fundamentally, these relationships are consequently best characterised as bargaining relationships in which the third party partners often have the upper hand in both policy formulation and implementation. This is particularly true in view of the fact that at the outset of third party relationships, federal managers are focused on gaining the participation of third parties to build support for the programme throughout the nation. As Ingram notes, participation is initially more critical to programme survival than promoting compliance with goals, with the hope that goal congruence and compliance can emerge over time (Ingram, 1977). As vexing as the challenges are, third party government in the United States actually can be viewed as an enabler for an expanded federal role. In this

view, most powerfully argued by Robert Stoker, third parties actually expand federal power to act on issues outside the realm of national authority in a federal, mixed market system (Stoker, 1992).

Central to the accountability challenge of third party government, however, is the multiplicity of legitimate perspectives it brings to the designation of programme goals and purposes. By inviting third parties into the design and implementation of these programmes, an expectation is often created, intentionally or not, that some level of programme accountability to non-federal perspectives is legitimate as well. The consequence is an ambivalent accountability where programmes are influenced by interests and values prevailing at many levels throughout the system.

The federal government pursues highly variable strategies for these settings that go well beyond the traditional audit and reporting commonly believed to constitute accountability. Rather, strategies to address third party performance problems embrace such fundamental programme formulation and design issues as initial tool selection, tool design, provider selection, network transformation, oversight and information feedback mechanisms. The challenges are not uniform across all tools and types of third parties. Nor can or should a single accountability strategy apply to all tools and third party relationships. Indeed, we know that even for a single tool like federal grants, different accountability schemes are appropriate for categorical versus block grants to reflect the differential federal roles contemplated under each. Among the factors likely to determine the appropriate choice of tools and accountability strategies are the nature of the federal role intended by policy makers, the nature of the tool itself, the congruence between federal and third party goals, the fiscal role undergirding the tool, and the relative weight placed on universal participation.

I have elsewhere attempted to provide a framework to more systematically identify three different models of accountability tailored to the drastically different federal roles contemplated by principals for differing programmes (Posner, 2002). These models are listed below and in Table 1:

- **Federal:** programmes where specific federal goals define performance expectations and implementation. Here the federal government would be expected to set specific and prescriptive goals and uses coercive and centralising tools like contracts and regulation. Third parties are placed in classic agent roles. To the extent possible, federal agencies would exercise upfront control over provider selection and will maximise opportunities for front-end review and approval of third party plans and actions.

- **Partnerships:** programmes where goals are set through bargaining relationships between the federal government and third parties. Where the federal role is defined in partnership terms, programmes would be expected to define goals in broader terms and use such tools as categorical grants or partial preemption regulatory mechanisms that permit some third party discretion and flexibility within federally set parameters. Under this scenario, federal agencies most likely would have little control over selecting third party providers and must use established networks, but would seek to influence values and priorities of established providers through “fire alarm” and “picket fence” mobilisation strategies. Oversight would be *ex post* for the most part and may be performance-based as well, with indicators and measures jointly agreed by federal and third party officials.
- **Third party:** programmes where goals are set primarily by third parties themselves, and the federal role is defined as supporting third parties to implement their own goals. Principal accountability for these programmes is to constituencies at the third party level who assume roles as truly independent actors. Typically, block grants or tax expenditures best lend themselves to this purpose. Federal agencies under this scenario would take providers as they find them, with oversight constrained to *ex post* reviews of funds and performance, most likely delegated to third party institutions such as state or local auditors or legislative oversight hearings.

Table 1. Different accountability models

	Nature of federal role		
	Federal	Partnership	Third party
Goals	Federal prescriptive	Bargained	Third party
Third party role	Agent	Partner	Independent
Tool choice	Contract/regulation	Categorical grant	Block grant Tax expenditure
Provider selection	Competition/create new networks	All eligible/ influence focus of networks	All eligible
Oversight	<i>Ex ante</i>	<i>Ex post</i> with federal agency reviews	<i>Ex post</i> delegated to providers

As the foregoing suggests, there are no universal prescriptions for accountability across the federal government; rather accountability relationships and models are highly contingent on the federal role and other important factors. In fact, for many programmes, accountability is devolved to other principals in our federal system in public, private and nonprofit sectors. This presents a challenge to accountability professionals, particularly for those models which would define uniform, minimum information, evaluation and auditing roles for federal programmes regardless of the nature of the federal role. For instance, agencies seeking to apply the GPRA to federal grants have reportedly been inspired to assert outcome goals that go well beyond the rather limited financial contribution of the federal government compared with state and local governments. The impulse to nationalise accountability affects not only audit professionals but also their political principals at the national level who have shown little reticence at times about asserting and inserting national oversight and second guessing of third party partners, notwithstanding prior decisions to devolve authority downward in our system.

The residual federal role in accountability remains highly controversial. While accountability is devolved, continued national support is premised on sustaining confidence by national political principals in the results achieved under these programmes. For instance, in the FY2006 budget, the Administration challenged the block grant provided to local governments for community development, charging that little information was available about what goals were being pursued by the over 1 000 localities receiving the funds or what results were actually achieved. This charge has inspired a national debate over whether the accountability for this programme should shift from the devolved model described above to more of a mixed partnership with more prominent federal influence in determining goals and accounting for results.

The major question involves the role of accountability systems and arrangements in addressing the high but potentially conflicting expectations held by federal and third party actors for these programmes. Much research needs to be done to enable policy makers and administrators to make more informed choices of tools, design options and oversight mechanisms. The stakes are indeed high. Prompted by a healthy suspicion of government and contemporary ambivalence, do third party governance tools at the same time lay the groundwork for even more frustration and disaffection with government by promising more than we can deliver through these mechanisms? To what extent can accountability systems promote confidence in third party governance systems while at the same time safeguarding the requisite flexibility and decentralisation of authority that arguably constitute the basis of legitimacy for these programmes? To what

extent can accountability systems be designed to satisfy the needs of principals at multiple levels of government and across multiple sectors in our system?

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Introducing Financial Management Information Systems in Developing Countries

by

Jack Diamond and Pokar Khemani*

In the past decade, developing countries have been encouraged to reform their public expenditure management systems and have increasingly embarked on major projects to computerise their government operations. Most popular among these have been projects to computerise government accounting and payment operations, by introducing government financial management information systems (FMISs). This article investigates the reason for almost universal failure to implement and sustain FMISs in developing countries. It starts with a review of the “received wisdom” in implementing these projects, and then analyses problems in its application in the developing country context to identify key factors to explain why FMIS projects have been so problematic. Based on the identified negative factors, suggestions for addressing them are offered in the hope of improving success rates.

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1. The importance of financial management information systems (FMISs)

In most developing countries, budget execution and accounting processes were/are either manual or supported by very old and inadequately maintained software applications. This has had deleterious effects on the functioning of their public expenditure management (PEM) systems, that are often not adequately appreciated. The consequent lack of reliable and timely revenue and expenditure data for budget planning, monitoring, expenditure control, and reporting has negatively impacted budget management. The results have been a poorly controlled commitment of government resources, often resulting in a large buildup of arrears; excessive borrowing, pushing up interest rates and crowding out private sector investment; and misallocation of resources, undermining the effectiveness and efficiency of service delivery. Further, governments have found it difficult to provide an accurate, complete, and transparent account of their financial position to Parliament or to other interested parties, including donors and the general public. This lack of information has hindered transparency and the enforcement of accountability in government, and has only contributed to the perceived governance problems in many of these countries.

In light of these adverse developments, it is perhaps not surprising that many developing countries have pressed for, or have been pressed into, adopting financial management information system (FMIS) projects to strengthen their PEM systems. The establishment of an FMIS has consequently become an important benchmark for the country's budget reform agenda, often regarded as a precondition for achieving effective management of the budgetary resources. Although it is not a panacea, the benefits of an FMIS could be argued to be profound. First, the improved recording and processing of government financial transactions also allows prompt and efficient access to reliable financial data. This supports enhanced transparency and accountability of the executive to Parliament, the general public, and other external agencies. Second, an FMIS strengthens financial controls, facilitating a full and updated picture of commitments and expenditure on a continuous basis. Once a commitment is made, the system should be able to trace all the stages of the transaction processing from budget releases, commitment, purchase, payment request, reconciliation of bank statements, and accounting of expenditure. This allows a comprehensive picture of budget execution. Third, it provides the information to ensure improved efficiency and effectiveness of government financial management. Generally, increased availability of comprehensive

financial information on current and past performance assists budgetary control and improved economic forecasting, planning, and budgeting.

2. Features of an FMIS

In terms of terminology, an FMIS usually refers to computerisation of public expenditure management processes including budget formulation, budget execution, and accounting with the help of a fully integrated system for financial management of the line ministries and other spending agencies. The full system should also secure integration and communication with other relevant information systems. Because of the integration requirement, the FMIS is commonly characterised as an integrated financial management information system (IFMIS). Unfortunately, using the term “integrated financial management information system” can sometimes be erroneously interpreted as describing a system that can capture all the functional processes, and the relevant financial flows, within public expenditure management. However, the complexity of information systems within the government sector is, to a large extent, due to the multiplicity of functions and policy areas. In many functional areas specialised information systems are in place and will still be required even with the implementation of an FMIS. It should be noted that in this article the term FMIS has been used generically to include an IFMIS.

As the name implies, there are, and should be, three guiding characteristics for a well-designed FMIS:

- **It is a management tool.** When developing an FMIS it is important that it cater to management needs – not just those of the central agencies, but also line agencies. Moreover, as a management tool it should support the management of change. It must be viewed as an integral part of budget system reform – hence not be designed just to meet present requirements, but also to support those needs that are likely to arise as parallel budget reforms are implemented.
- **It should provide a wide range of nonfinancial and financial information.** As a tool of management it should provide the information required for decision making. For this purpose it is anchored in the government accounting system, and should be designed to perform all necessary accounting functions as well as generate custom reports for internal and external use. However, this does not mean that it should exclusively concentrate on financial information. Managers will require other nonfinancial information. For example, personnel information such as numbers of employees, their grade within the organisational structure and rates of

remuneration. For performance-based budgets, performance information will be important to managers, such as the identification of programmes, the objectives or outcomes of programmes, the types of goods and services produced, as well as indicators by which to judge the efficiency and effectiveness of programmes.

- **It is a system.** Its role is to connect, accumulate, process, and then provide information to all parties in the budget system on a continuous basis. All participants in the system, therefore, need to be able to access the system, and to derive the specific information they require to carry out their different functions. The converse is also true: if the FMIS does not provide the required information – that is, has not the right functionality – it will not be used, and will cease to fulfill its central function as a system. Further, by automating procedures and internal controls, it strengthens financial controls and promotes accountability. Box 1 broadly describes the attributes of an FMIS.

Although the FMIS does not capture all the information flows, adopting a comprehensive approach in the development of the project is fundamental to ensure that all functional interdependencies are identified, hence securing the capture of all related information flows. Figure 1 sets the FMIS in a broader context of interrelated information systems, and illustrates the main functional processes from medium-term planning and budget preparation to budget execution and accounting.

An FMIS will consist of several elements with different functions. In the description that follows, the term “module” will imply that the system is a sub-element in an FMIS. The core of an FMIS could be expected to include the following modules and systems:

- General ledger;
- Budgetary accounting;
- Accounts payable;
- Accounts receivable.

Box 1. Attributes of a well-designed FMIS

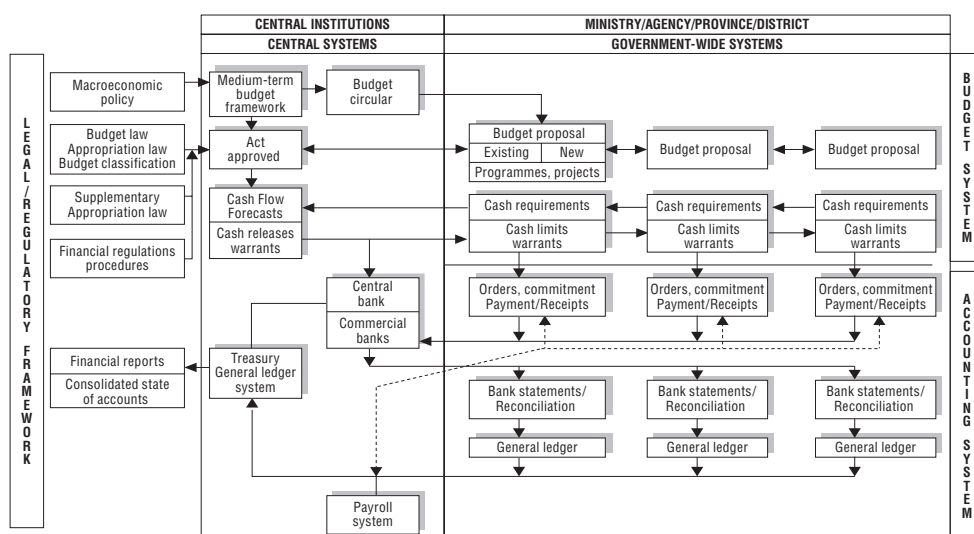
The FMIS should:

- Be modular, and capable of progressive upgrading to cater to future needs;
- Offer a common platform and user interface to the stakeholders in different agencies responsible for financial management, for adding to and accessing the information database (in its absence each agency will have the incentive to develop “its own” FMIS to meet its currently perceived needs);
- Maintain a historical database of budget and expenditure plans; transaction data at the highest level of detail; cash flows and bank account operations including cheques issued, cancelled, and paid, cash balances and floats;
- Have dedicated modules to handle monthly, rolling, short-term (one to three months) and longer-term (three months to end of year) forward estimates of revenues, and expenditures prepared by agencies, and corresponding estimates of the resulting cash flows;
- Have built-in analytical tools to offer trend analysis of various elements of fiscal operations to permit a forward look at the emerging events bearing on the fiscal stance;
- Compile formal government accounts from the database of authorisations and cash allocations, primary revenue and expenditure transactions of the agencies; and treasury operations, avoiding the need to duplicate data entry for accounting purposes;
- Enable real-time reconciliation of parallel but related streams of transaction data – at the agency level: cheques issued with those paid by the banks; at treasury: receipts from banks with the cheques paid by taxpayers; cash balances reflected in the agency ledgers with the cash balances in the banks;
- Mechanise all possible routine tasks at the central and spending agencies – generating various forms/authorisations, cheques, outputting hard copies of key registers and statements, etc.; and
- Be flexible enough to provide user-defined management information, aggregated at the desired level of detail, from the database.

The noncore or other modules are, *inter alia*:

- Payroll system;
- Budget development;
- Procurement;
- Project ledger;
- Asset module.

Figure 1. Institutional framework, processes and information flows



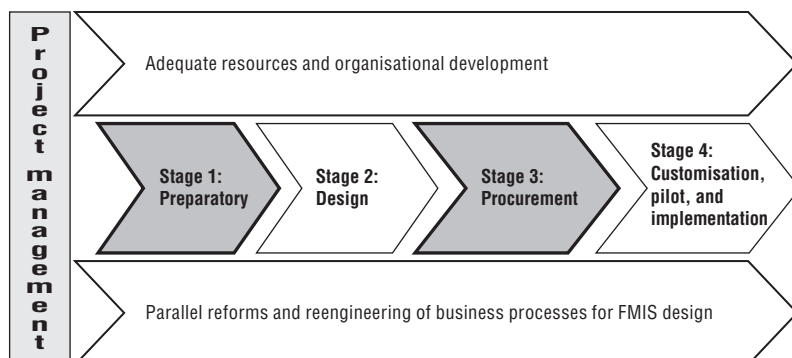
A brief explanation of the functions of each module of a typical FMIS is outlined in the Annex. It is important to set priorities for the system implementation, that will usually start with the core functions, namely budget execution, accounting, payment processing; commitment control and financial reporting.

3. Strategic framework for introducing an FMIS in a developing country

The introduction of an FMIS in a developing country should be regarded as part of a long process of reform. This process takes years to fully implement, costs millions of dollars, and has a substantial recurring

operating cost. Thus an FMIS should be regarded as a major project requiring a structured project management approach.¹ Viewed in this way there are four main stages in the process of introducing an FMIS, which are presented in Figure 2: preparation, design, procurement, and pilot and roll-out. A summary of the main steps within the four stages is given in Box 2.

Figure 2. A framework for introducing an FMIS



These four stages describe the main process followed in the design, procurement, and implementation of an FMIS. As indicated in Figure 2, the successful implementation of this process also requires three supporting elements: sound project management; adequate resources and complementary organisational development; and parallel improvements in business procedures and practices supported by a suitable legal and regulatory framework. These supporting reforms should not be neglected in FMIS design and implementation, and without them it will not be possible to achieve the full benefits of an FMIS.

4. Requirements for introducing an FMIS

Given the problems often encountered in FMIS projects, it is useful to specify in some detail the essential requirements that should be met. As indicated, these requirements have been grouped in three categories: project management; organisational development; and parallel reforms.

Box 2. Main steps in introducing an FMIS

Stage 1: Preparatory

- Preliminary concept design including an institutional and organisational assessment.
- Analysis of the key problem areas and ongoing reform programmes.
- Feasibility study.
- Design project and draft project proposal.
- Formal approval of the project – securing government approval and donors' funding.

Stage 2: Design

- Develop functional specification.
- Outline information technology (IT) strategy, including hardware and organisational issues.
- Prepare tender documents.

Stage 3: Procurement

- Issue tenders for hardware and software and associated requirements.
- Evaluation of bids and award contract.

Stage 4: Implementation

- Configuration analysis and specify any additional IT, infrastructure, and communication requirements.
- Detailed business process and gap analysis mapping required functionality to package and identifying and specifying detailed parameterisation, customisation, procedural (etc.) changes.
- Detailed action plan for phased implementation and the pilot run of the system.
- Agreed customisation and configuration of the system.
- Determine training needs and conduct training of personnel.
- Pilot run – parallel run of the system, resolve initial problems and evaluate system performance for roll-out.
- Roll out system to other ministries and agencies.
- Phased implementation of additional modules.
- Strengthening of internal system support and phasing out consultant/contractor support.

4.1. Project management

As explained earlier, the whole process of developing an FMIS should be regarded as a major project requiring a structured project management approach. The essential elements of sound project management are described below.

4.1.1. Commitment, participation, and management model

The implementation of a government-wide FMIS is a substantial undertaking for any administration, and it is essential that the participants are fully aware of the magnitude of the undertaking. Ensuring project **commitment at the highest levels** of the political system and bureaucracy, and continuous participation from the direct users of the system and other stakeholders, is necessary in all phases of the project.

It is also necessary that the project planning methodologies are used to plan, implement, and monitor the project, with **project management responsibilities clearly identified**. The management model needs to ensure broad in-house participation and involvement of all the relevant stakeholders, which usually are the ministry of finance and other central agencies, the office of the auditor general, the central bank and other banks handling government business, line ministries, and local governments. The finance minister, assisted by the permanent secretary/finance, needs to take primary responsibility for overall management of the project. Since **accounting is the backbone of the information system**, the treasury that is in charge of this function – or in the Anglophone countries, the accountant general – is a key institution. Under the direction of the permanent secretary/finance, the accountant general is usually asked to take the lead role in the design, development, procurement, training, and implementation processes relating to the FMIS. Typically the accountant general must also collaborate with the head of the central information technology department in the design, development, and implementation processes.

It is critical to mobilise internal management resources. The permanent secretary/finance and the accountant general should be assisted by a **well-staffed project management team** headed by a full-time project manager. The project manager should be supported by a full-time technical team consisting of a number of assistant project managers, with specialisations in IT, budgetary and accounting processes. To ensure continuous commitment and participation of top politicians and key stakeholders, it would be useful to set up a **steering committee² under the chairmanship of the finance minister** to manage and co-ordinate the entire process of design, development, and implementation of the FMIS. The committee should have

considerable and authoritative influence, and should meet on a monthly/quarterly basis depending on the project progress. The cabinet and the Parliament also need to be informed periodically by the steering committee on the progress in the implementation of the FMIS.

Necessary measures should also be taken to **strengthen the capacity in the project team** as well as the accountant general's office and the budget office through all project phases. Simultaneously, it is also necessary to develop the necessary skills and capacity of the central IT department to provide strong support to the system. Continuity of key personnel involved in the development and implementation processes is also important for the success of the project.

4.1.2. Strategy for use of external consultants

In addition to in-house resources, an FMIS project requires **careful choice of external technical assistance** during different parts of the process. The external consultant should have extensive experience in public sector financial management including:

- The design, implementation, management, and operation of government accounting, budget, and financial management systems in a developing country environment.
- Experience in the management and operation of modern computerised financial systems in a government budgeting and accounting environment.
- Complementary experience in training, management development, human resource management, and organisational change in developing countries.
- Experience in project management and implementation, working in the advisory and training capacity in developing countries.

The external consultants need to be managed closely because they may tend to pursue their own interests. They should be required to make extensive use of local consulting or training organisations and in-house resources. The in-house resources should be fully involved in the project design and planning, technical implementation skills for both hardware and software, user support skills, etc.

4.1.3. Comprehensive perspective maintained with a modular approach

Although the implementation of an FMIS should be carried out in a modular way, to avoid too much strain on the capacity of organisations, it is important to keep a strategic and comprehensive view in the overall process of its planning and development. International experience in implementing FMISs indicates that these projects often lead to temporary disruptions of the normal functions in the budget and accounts departments. This disruption may last for a period of 9 to 12 months, depending on the absorptive capacities of the organisations involved. The time schedule for the entire project can be expected to be approximately four to five years after all the resources, including consultants, are appointed.

4.1.4. Co-ordination with other development projects

The development of an FMIS in a country is typically part of a comprehensive PEM reform **strategy**. Other important components relating to PEM reform are the development of a medium-term budget framework (MTBF); the design, procurement and implementation of a payroll and personnel administration system; and the development of an auditing system. In addition, there are some other initiatives for donor-funded projects in individual line ministries and local governments. It is essential that all of these initiatives be co-ordinated at a senior central level, so as to avoid duplication of effort and to ensure consistency of outputs. It is also equally important to relate PEM reforms to other reforms in the public sector and the improved delivery of public services.

4.2. Organisational development

At the outset of an FMIS project, it is necessary to ensure the availability of adequate financial resources. Experience has shown that the lack of sufficient resources can serve as a serious obstacle to the successful implementation of the project. Further, there is a need to clarify the future roles and responsibility for different functions. Some of these critical functions are given below:

- **System and data administration:** Co-ordinating mechanisms should be created to ensure that a common set of policies, procedures, and standards are in place for managing data and systems government-wide. This could be achieved by developing a national IT strategy, including the use of information technology and information systems (IT/IS) in the public service.

- **Wide consultation and acceptance:** To be successful, the organisation needs to be prepared for the introduction of the FMIS and be willing to recognise and accept the benefits that the changes will bring about and the costs of implementation in their widest sense. The continuous consultation within government departments is essential. This would be possible with the help of a strong champion for the reforms.
- **New job descriptions in ministries, departments, and provinces:** An FMIS will induce changes in the working environment. As a consequence of these changes, new job descriptions or working processes should be formalised. The civil service should be willing to accept that the FMIS would significantly change their influence and responsibilities. As an example, the operations in the processing of financial transactions will change dramatically from manual bookkeeping to automated operations and processes. The role of both the head of finance and accounting functions, and the auditors (internal as well external) will also clearly change.
- **Motivation:** Defining and deciding upon new structures and working practices is one thing, but implementing them is another. The challenges in organisational development are multiple. For successful implementation, the stakeholders need to participate and be motivated. Motivation and support for the decision of implementing the new FMIS are critical. Participation, information, and adequate training will often strengthen this support.
- **Training:** The training for the staff will not only include training in use of the FMIS for their respective operations and functions, but also training in the new legal and regulatory framework, the new codes and classifications, and the new business procedures put in place. In the initial stage of implementation, there is a need to develop new practices, and the associated training requires a great deal of innovation and tailoring to the specific features and capacity of the organisation. A large proportion of the training should be on-the-job training, and be focused on “super-users”. This implies decentralised on-the-job trainers deployed throughout the implementation period. User support is also necessary as a permanent service.
- **Change management:** The FMIS steering committee needs to develop a change strategy and establish a clear and agreed approach and timetable for implementing the various changes associated with the system. Implementation needs to be phased and flexible, and it is necessary for the ministry of finance to take a lead co-ordinating

role in the whole process. Donors are inevitably required to provide technical and financial support for the entire process.

4.3. Parallel reforms and improvements to business processes

Another significant concern is that without the essential PEM reforms in place, or in the process of being implemented, no major gain will accrue from an FMIS. There is little advantage in introducing an FMIS that merely follows existing PEM working processes and practices. Restructuring of working processes and practices requires new procedures to be formalised and unified throughout the government. In developing countries there often is a lack of financial discipline, which also represents an important challenge. An FMIS is effective only if the underlying budgetary and accounting systems are robust and well managed.

At the same time an FMIS can be a vehicle for change. Experience indicates that an FMIS will induce several reforms in existing systems, including:

- **Structure of the budget and the accounts:** Introducing an FMIS necessitates unifying the codes and classifications (both the budget classification and the chart of accounts). These should be maintained at a central level. The reporting requirements are the basis for defining the structures of these codes and classifications. The new budget classification structure and chart of accounts should be compliant with the classification framework in the IMF *Government Finance Statistics Manual 2001* (“GFSM 2001”).
- **Main budgeting and accounting principles:** Typically, a number of developing countries use a single-entry accounting system in a manual mode, with the budgeting and accounting system on a cash basis. Off-the-shelf systems are normally designed for accrual accounting. With the implementation of an FMIS, financial transactions will be entered into the accounts payable and accounts receivable modules with the due dates, thus allowing for a gradual move toward an accrual basis. The developing countries could take a step toward modified cash basis accounting, while keeping the budget on a cash basis in the early stages of implementing the FMIS.
- **Cash management:** To ensure that the budget and accounts are comprehensive, it is essential that all the cash flows be channeled through the FMIS, and hence that all transactions, both receipts and payments, are processed by the FMIS, including the payroll payments. The FMIS could also aim at rationalising the government

banking arrangements and establishing a treasury single account for optimising the management of government cash balances.³

- **Control structure:** The design of the FMIS should introduce an improved system of internal and external controls for financial management. The internal controls regulate the cycle of recording, analysing, classifying, summarising, communicating, and interpreting financial information. The internal audit function helps the management in evaluating and assessing compliance with these controls. The external control system is exercised through external auditing carried out by the supreme audit institution.
- **Legal framework:** While designing the FMIS, it is necessary to review the regulatory and legal framework and agree on the necessary modifications to the overall framework for government fiscal management. A legislative framework (constitution, finance act and regulations) needs to include: (i) the roles and responsibilities of the treasury, ministry of finance, other ministries, and other stakeholders responsible for the control and management of public finance; (ii) the main form of government funds, receipt and custody of public funds, the annual process, submission and approval of estimates and the procedures for release of funds; (iii) the basis of accounting and the form of annual accounts for audit and presentation to Parliament; and (iv) asset management and control, borrowing and investment.

5. Country experiences with the implementation of FMISs

Given the extensive requirements for successful implementation of FMIS projects, it is perhaps not surprising that these have proved particularly demanding on developing country administrations. A small sample of project experience in Anglophone African countries highlights some of the critical factors determining success or failure.

5.1. Tanzania

Since 1994 the government of Tanzania has implemented an ambitious reform programme to improve public sector financial management, which initially focused on introducing effective and efficient budget formulation and expenditure management systems and processes. Specifically, two projects financed by the Swedish International Development Agency (SIDA) were designed – the Government Accounting Development Project (GADP) focusing on budget execution, and the Interim Budget

Development Project (IBDP) focusing on budget formulation. In 1996, following chronic problems in the financial management of the government, a decision was taken to abolish all payment offices in the ministries, departments, and agencies, and establish a central payment system, and thereby obviate the need for ministries/departments/agencies to have individual bank accounts.

In 1998/99, the government decided to introduce an integrated financial management system (IFMS) in ten selected ministries/departments/agencies. Under this system, a central server was placed at the treasury (in the Office of the Accountant General) to which users were connected by a dedicated network. Also work stations were provided for each of the ministries/departments/agencies from which they could access the system. Each of these government bodies had its own database held in the omnibus database in the central server. The transactions of these government bodies automatically update the database in real time, and thus the general ledgers reflect the real position of balances at any particular point. By the end of 2000 there were over 500 users of the system at more than 85 sites throughout Tanzania. The system has now become the generic public sector financial management system used by the entire public sector. At the local government level, the system has been introduced to 32 local authorities, and a roll-out to an additional 30 authorities was expected to be completed by the end of 2004.

The software package for the IFMS is a medium-sized financial management and accounting package (Platinum SQL Financials from EPICOR). At present, the IFMS is only using a few modules, namely general ledger, accounts payable, accounts receivable, cash management, purchase order, multi-currency, budget module, foreign exchange report writer, and Crystal report writer. The accounts are essentially maintained on a cash basis, though the authorities are planning to use other modules like asset and inventory management, and are working toward accrual accounting.

The benefits of the IFMS have been extensive, with the restoration of expenditure control and improved levels of transparency and accountability. The commitment control system has led to the elimination of overspending, and a substantial reduction in domestic arrears. A number of government bank accounts have been reduced to treasury single accounts maintained at the central bank, and the lag in reconciliation with banking data has been reduced from up to two years to automatic reconciliation on a daily basis. Comprehensive and fully reconciled fiscal data and reports are available on a continuous basis.

Currently, the IFMS in Tanzania appears to be the most successfully implemented system in Anglophone African countries. Its implementation was distinguished by:

- An initial review of the PEM processes affecting budget execution, and the introduction of an improved expenditure control framework and chart of accounts;
- Embedding the reform process in the Ministry of Finance combined with an emphasis on capacity building, particularly in the Accountant General's department, through training, restructuring, and computerisation;
- Revising, developing and managing enabling legislation, accounting principles, systems and organisational arrangements necessary for the management of government budgetary and accounting systems⁴;
- Selecting a mid-range commercial software package, supported by a high quality local consultancy company, an EPICOR partner, that provided strong support to the implementation process including training;
- Availability of adequate donors' resources, combined with very experienced international and local consultants;
- A solid backing at the political level, which trickled down to the management level; with both political and management commitment being strong throughout the entire reform process.

In Tanzania both the authorities and donors perceive the IFMS as a critical tool for achieving accountability in the public sector. Donors are now more receptive than ever before to the idea of using government systems to channel funds. However there is a need to consolidate and deepen the system and build the capacity to ensure its long-term sustainability. The system is primarily performing basic budgeting and accounting functions, and other modules like asset management and inventory management need to be implemented. Further, the system also needs to be interfaced and achieve integration with other main systems like personnel management and debt management systems (see the Annex).

5.2. Ghana

The government of Ghana launched an ambitious multi-faceted Public Financial Management Reform Programme (PUFMARP) in 1996, which aimed to introduce comprehensive reforms to the budget and expenditure management processes. The main components of the PUFMARP include the

introduction of a medium-term expenditure framework (MTEF) and the development of a computerised government financial management information system, termed the Budget and Public Expenditure Management System (BPEMS). In the early years of the reform programme, there was a mismatch between the (fast) rate of progress with the MTEF and the (slow) progress on the BPEMS. The faster development of the MTEF, relative to the BPEMS, caused significant accounting and reporting problems. The new chart of accounts introduced by the MTEF was not co-ordinated with a similar change in the then existing accounting system, although this was rectified after a period of almost two years. However, significant progress has been made in strengthening the budget and expenditure management processes over the past five years. In particular, the authorities have progressed from satisfying 1 of 15 Heavily Indebted Poor Countries (HIPC) Assessment and Action Plan (AAP) benchmarks in 2001, to meeting 7 of 16 benchmarks in 2004, including building a sound regulatory and institutional framework under PUFMARF.

In Ghana, the experience of the design, development, and pilot implementation of the BPEMS has not been satisfying. In the design of the BPEMS, the existing manual budget execution and accounting processes seem to have been automated to a large extent, without consideration of whether there was a better and more efficient method of achieving the required result. The original plan to roll out the system by the end of fiscal year 2001 was not achieved due to a number of factors. After considerable delays, the system was installed, on a pilot basis, at the Ministry of Finance and the Controller and Accountant General's Department in January 2003. The roll-out for additional ministries (Education and Health), planned before the end of 2003, was carried out in March/April 2004.

Despite substantial time spent in developing and customising the software application⁵, the pilot implementation and the roll-out of the system has not progressed well. The Ministry of Finance and the Controller and Accountant General's Department are not fully satisfied with the BPEMS reporting system, and this has been a major area of dispute between the government and the software team.⁶ There were also problems with the new managers (Close Communications) hired by the government for implementing the system.

The overarching concern is the significant delay, and limited involvement and ownership of the BPEMS by the various stakeholders in the design and development of the BPEMS. Somehow, the development process was largely driven by consultants and donors in the formative period of the project. The BPEMS had to be restructured several times, and encountered significant design and implementation problems and delays. The project implementation unit was also restructured several times, and

there have been a number of changes in the programme co-ordinator and programme manager. Local capacity and know-how have always been and are still the major issue, and the government still relies on the assistance of local vendors.⁷ Consequently several significant issues need to be addressed before BPEMS can be made fully functional and rolled out.

5.3. Uganda

The government of Uganda is in the process of implementing a comprehensive financial management reform programme to improve the budget and expenditure management processes at the central and decentralised government levels. In the early years, for a number of reasons, there were considerable delays in the completion of the design and development phase of the FMIS. Finally, the procurement and evaluation process was completed in February 2003 with the award of a contract⁸ for the provision of a turnkey solution including hardware, application software, a wide area network (WAN), and supporting training/change management.

The implementation of the system began in March 2003 with the mapping and necessary configuration, followed by user acceptance and testing operations in February 2004. The pilot implementation phase is currently in progress in six line ministries and four local governments. The pilot implementation covers the core modules of the application, namely budget management, purchase order, accounts payable, accounts receivable, cash management, general ledger, and financial reporting. The software package is essentially accrual-based; however the system provides a facility to allow the generation of cash-based year-end financial statements to meet the audit requirements.

An assessment of the pilot implementation is in progress before the system is rolled out to other line ministries. The pilot run has brought out a number of issues in the system functionality, as well as treasury procedures, and these need to be resolved before closing the pilot phase.

The roll-out has been planned in two phases – the second phase will cover all line ministries and six additional local governments; and the third phase will cover the remaining local governments. The full implementation may take another three to four years. It is necessary to complete the roll-out of the system to the whole government and ensure long-term sustainability to reap the full benefits of the system by: (i) ensuring the availability of adequate resources in terms of staff capacity and maintenance budget; and (ii) progressively extending and deepening the functionality and utilisation of the system.

5.4. Malawi

Since 1995, the government of Malawi has introduced a number of initiatives to improve public expenditure management, most notably the medium-term expenditure framework to improve the budget process, and the integrated financial management information system (IFMIS) to computerise the budgetary and accounting processes. In the latter case, the conceptual framework including technical specifications was completed on time. The governance structures including the steering committee, the project management team, and the implementation structure between the contractor and the government were properly set up.

The design and procurement process was completed in 2000 with the purchase of a package solution⁹, and the pilot run of the customised software started in 2001. There have been significant implementation delays, and the pilot implementation is yet to be approved by the government as successful. The pilot implementation did not follow the standard implementation methodology for this type of software. Some of the planned core modules for implementation have not been completed, while others have not been implemented at all.

This project has encountered numerous difficulties. The project implementation team was not well resourced, and was dismantled even before the implementation was completed. Change management and communication activities did not receive adequate attention, and there are inconsistent views within the implementation team and implementing ministries. The software support arrangements have changed over the years, and there have been various contracts for implementation activities. Some of the contractual work has not been properly fulfilled. The auditing aspects of the system have not been adequately planned and tested for live operations. A fast review of the system conducted by the Accountant General with the help of an outside expert in July 2004 revealed a number of problems with the functionality of the system, so that the roll-out has been delayed until the problems have been resolved. These problems included serious deficiencies in expenditure control and tracking processes.

In general, the implementation phase has not progressed well, primarily because of clearly limited involvement and some neglect of the system by the main players, including the Ministry of Finance, the Accountant General and pilot ministries. There are several significant issues to be addressed before the system can be made fully functional and rolled out.

5.5. Kenya

Since 1997, the government of Kenya has been implementing a project for the “strengthening of government finance and accounting functions” to improve financial management, accountability, and transparency of public funds. During the first two phases over the first three years, a number of diagnostic reviews were conducted and a financial management information systems strategy was developed.

Following a procurement delay of almost two years, a contract for the purchase of the software implementation was finally awarded during late 2002. Hardware procurement was undertaken separately from the software. The pilot phase started with the setting up of core procurement and accounting modules in the treasury as well as two pilot ministries during 2003/04. The project is still in the final stages of pilot testing, and the roll-out of the system is stalled due to lack of IT and communications wide area network architecture. Further, the implementation of the budgeting and cash management modules has been delayed for a number of reasons, and their pilot testing may commence with the 2005/06 budget cycle.

The pilot implementation has raised a number of issues. The engagement of internal and external audit staff has been inadequate, resulting in limited quality control assurance. The revised classification and chart of accounts developed for FMIS is not fully consistent with the IMF GFSM 2001 standards, and it is necessary to eliminate inconsistencies and ensure conformity with that rubric. Further, the new classification structure is still to be adopted for compilation of the budget estimates.

Most important, the project management needs to be strengthened to ensure strategic direction, leadership, and communication. Given this situation, the fiscal year 2004/05 continues to be a pilot testing period, being utilised for resolving the current outstanding software and IT issues.

6. Why do FMIS projects stall in developing countries?

The above review of past experience in introducing an FMIS in developing countries gives some guidance on the key issues to be addressed, and also highlights some risks that should be avoided. The following issues, in particular, that have contributed to the limited success of FMIS projects may be worth noting in the developing country context.

6.1. Lack of clarity in ownership of the system and unclear authority to implement

Public expenditure management in developing countries is often segmented institutionally on vertical rather than horizontal lines. For example, even when the ministry of finance has been given clear leadership, in Anglophone Africa it is not immediately clear who should be in charge of an FMIS project – the ministry of finance proper, in charge of budget management, or the accountant general’s department (typically institutionally separated), in charge of government accounting. Both bodies could be considered as sharing a central role in the development and running of the new FMIS. The accountant general has significant regulatory and control functions, while the budget department has the dominant role in resource allocation. Although it could be recommended that these two bodies be nominated as joint owners of the new FMIS to ensure balanced requirements for the system, at the same time joint ownership may involve a loss in accountability and real ownership of the system. To counter this it is important to get support for and commitment to the project at the highest level, say the minister of finance or his/her deputy. This is important not only to resolve the identified “ownership” problems, but in developing countries to signal authority to push through government-wide reforms in the face of strong ministries that may feel threatened by the level of transparency that an FMIS imposes on them.

6.2. Failure to clearly specify the basic functionality

As a tool of management, an FMIS must be carefully designed to meet agencies’ needs, or functional requirements. Often this original design phase is the most difficult part of an FMIS project, and does not receive the attention it merits. The functional requirements document serves as the blueprint for later phases of the FMIS project. It describes the accounting and financial management tasks the system must perform, the agency’s information requirements, the operating environment, and a plan for developing any necessary programming.

6.3. The failure to spend enough time on the design phase

The functional requirements document that serves as the blueprint for later phases of the system project is critical – if wrong, it is difficult to rectify the situation later. Requirements analysis is important but tends to be an often neglected step. It cannot be rushed: for the accounting function alone, a detailed analysis can take three months to a year.

It is essential that sufficient time be taken during the planning of the project to list all user requirements for information to be derived from the FMIS. This part of the planning phase is time consuming but essential if the building of the system is to proceed smoothly. It is usual for all users of the system initially to simply list all possible information requirements that they seek from the FMIS. A process of review by a panel of major users would result in a rationalising of the requirements to a manageable level. Most important, managers should tell vendors what is required and not the other way round. It also must be recognised that it is unusual for one system to service the information requirements of all users. Although this phase is crucial to the success of the project, it cannot be allowed to run too long and encroach on the time available for the actual building of the system.

In the developing country context, this model approach poses some problems. Without a degree of exposure to a modern PEM environment, what can be realistically expected of managers in specifying such requirements? Often computerisation is being introduced with fundamental changes to current work practices. Without prior experience, how can these managers anticipate the implications of these reforms? Can managers really be expected to plan for these changes and be capable of mapping out how their organisation will get from where it is now to where it has to be in a computerised environment? Not surprisingly, in these circumstances the system requirements document is often externally generated, and much influenced by the vendors. Ideally, it should be the rule that any outside consultancy at this stage should be independent of potential vendors, be undertaken by business rather than IT experts, and be developed in conjunction with the staff in the ministry to cater for local conditions. In practice in developing countries there may be a lack of capacity in the host ministry of finance to fully operationalise this approach.

6.4. Failure to reengineer procedures

Establishing an FMIS should not be viewed as merely computerising existing procedures. Peterson *et al.* (1996) make the case that computerisation promotes two kinds of reform: efficiency reforms that accelerate the operation of existing procedures and effectiveness reforms that change existing procedures. Strassmann contends that the real payoff from IT is when it makes organisations more effective, not simply more efficient (Strassmann, 1985, p. 127). Introducing an FMIS should thus be viewed as an organisational reform. Redesigning information flows – the way those flows are processed, managed, distributed, and used for decisions – usually requires changing operating procedures.¹⁰ Inevitably, the disruption of well-established operating procedures can feel threatening to

individuals who operate them, and hence it should not be surprising that such innovation is resisted.

In developing countries this resistance is compounded by the lack of experience with computers. The tendency to leave system development to the computer supplier often means that these organisational issues are downplayed, and technical considerations dominate in the design and implementation of the project. The result is often a tendency for over sophistication at the expense of user friendliness. Clearly, there is a tension in going for state of the art computerisation that will protect the investment against early obsolescence, as opposed to the need for initially introducing systems that are user friendly with modest achievable goals, but subsequently capable of enhancement as user skills, familiarity, and confidence grow. Often the degree of IT sophistication has assumed too steep a learning curve for developing country users.

6.5. The failure to undertake parallel reforms required by the FMIS

As argued before, the aim of an FMIS should not be to computerise the present processes but to improve work practices. The reform of business practices should be a top priority, but too often there exists a blind belief that computers will solve all problems. At a minimum, reform requires substantial groundwork to standardise manual procedures, including documentation used and processing rules across all users, redesigning and strengthening internal controls, and redesigning reports and other analytical outputs. However, more substantial reforms will take more time. For example, a new FMIS is likely to be most productive when it incorporates major upgrades in accounting. Accordingly, it may be important to review government accounting standards well in advance, and perhaps to consult national accounting bodies regarding the consistency of public and private sector standards in regard to the accounting system.

6.6. The neglect to “sell” the system to agencies

It is crucial for the successful implementation of the new FMIS that agencies accept the need for the new system and that it will provide useful information to assist managers in the management of their agencies. If the FMIS is seen as a centrally imposed tool to further control agencies, then its successful implementation will be threatened. Any agencies that currently have well-developed management information systems should be particularly targeted for selling the advantages of the new system. It is, of course, advisable that those agencies be included on the previously mentioned steering committee.

6.7. Overestimating the information to be included in the system

There is often a tendency to be too ambitious so that the intended scope of the FMIS is too wide and attempts to service all the requirements of potential users. The user specification stage discussed earlier should be used to determine what are the critical requirements for the initial version of the system and what could be left to later versions or removed from the user requirements, since they are not regarded as essential for a cross-agency FMIS.

6.8. Unrealistically short project timetable

Implementing complex FMIS projects takes time. The steps in the project are well known: preparatory requirements analysis, system design, development and testing; procurement and installation; testing of the full system in the user environment, training and conversion. As indicated, it is also well known that the time required for the completion of each step is often grossly underestimated, especially in developing countries. In the past, there has been a tendency to tell top management what it wants to hear. This is reinforced by top managers' short political time horizon when judging reform payoffs. While this might be one reason for the underestimation of time required, additionally the inertia of development agency bureaucracies, coupled with delays inherent in the implementation of complex IT systems, are a disastrous combination. Moreover, owing to the human resource shortages faced by developing countries, it will take them much longer to introduce IT systems than in more advanced countries – experience suggests perhaps two to three times as long.

6.9. The required management input is often underestimated

The experience of advanced countries is that managing complex FMIS projects requires considerable management skill. However, this is typically in short supply in developing countries. Senior managers in developing countries rarely delegate responsibility and frequently are overloaded with work. Moreover, top managers may not be computer literate. The consequence is that often the binding constraint when introducing FMISs is not the technical capacity to create them but the capacity to manage them. Nor is it clear that there is always a good alignment in the incentive structure facing managers.

Bugler and Bretschneider (1993), from the experience of IT reforms in state and local governments in the United States, concluded that the reforms were most likely to succeed if they have the following features: they are easy to use by the manager; they address an external reporting requirement

by the manager; and they are confined to the manager's area of concern. These requirements are hard to attain in a developing country, where top managers lack experience in computerised accounting and are therefore unable to grasp its possibilities for financial management. In developing countries in the absence of computer literacy there is a tendency to leave the system development to the computer supplier, with minimal user involvement. In such an environment there is every likelihood that systems will not be user friendly, will not match the needs of the managers, and will not have a required level of management ownership.

6.10. Lack of incentives for reform

To get FMIS reforms accepted, decision makers must first be sold the idea that the benefits exceed risk. However, officials tend to be risk averse – introducing computer technology is an innovation that is perceived as risky. It is complex, it demands skilled staff, and it needs procedural changes. There is plenty of evidence of past failure. At the same time, in developing countries the IT is usually introduced by expatriates, so there is room for distrust, even hostility. Second, decision makers must be convinced it is needed, *i.e.* that a problem exists and, therefore, needs to be addressed. Basing a reform on conditions imposed by donors, as has sometimes been the case in Africa, does not increase success. Third, decision makers should recognise the urgency of the reform or the need for prompt implementation – often this perception is lacking at the top. Fourth, managers may steer away from difficult personnel issues. Almost inevitably, moving from manual systems to an FMIS allows government to fulfill the same function with fewer staff. To operate the new system will also typically require different types of skill. However, in most developing countries managers in government cannot reduce staff and are severely limited in their capacity to change them. In such situations IT is not necessarily seen as a benefit to management; if anything, from a human resource viewpoint it could make their task greater and more complex.

6.11. Prerequisites do not exist

To successfully develop an FMIS, the project must be solidly based on some basic data on how the present system operates. In the developing country context, information on which to base FMIS project decisions is often inadequate, although a leading cause of this is more fundamental: the lack of capacity within implementing agencies. Also there is a low level of computer literacy in the country, which must first be built up before such projects are truly viable, and sustainable, especially when applied government-wide. A computerised system's greater reliance on

communications, which are admittedly poor in many developing countries, may be another constraint.

It is also important to ensure that measures are taken for the project to be sustainable. It should be recognised that there are recurrent costs associated with the maintenance and operation of major FMISs that must be covered in budgets and that often are not considered. However, perhaps a greater constraint on sustainability arises from inadequate human resources. To overcome this constraint may require a major training programme, which again will take time, but may not necessarily deliver the pay-off anticipated. In most developing countries there is a general shortage of skilled labour, and efforts to improve skills in government are often frustrated by the migration of labour to the private sector for higher pay when workers have acquired sufficient skills.

Is it necessary to get the pay structure right before embarking on such a training programme? This consideration is particularly important for in-house IT capacity, and is a concern faced by developed and developing countries alike. While most FMIS tenders specify a requirement for the vendor to maintain the system for an initial period (usually up to three years), there is also a need for IT capacity in government. Expertise is required for interacting with vendors, to maintain the system and to have adequate data management skills to optimise the system once established. Often this is insufficient to provide the required service to users. Faced with the poor pay scales mentioned previously, one solution is simply to pay retention bonuses to IT staff, another is to outsource the management of IT to a local firm, and yet another is to establish a dedicated government unit to provide IT services to the public sector that allow higher salaries than the average in the public sector. None of these solutions is without problems, which tend to be exacerbated in the developing country context, where there is often a lack of competition in this area. Thus, while recognising that FMISs may be the medium-term solution to many PEM problems, it is likely to be important to first spend the time in the short run in creating a solid base for success.

7. Preconditions for development of an FMIS

A characteristic of many public sector reforms is that they are introduced in an organisation with neither the willingness to accept the reform nor the technical ability to understand and implement the reform, or indeed to maintain it once introduced. As a result, the reforms either do not succeed or are badly delayed, and create distortions that have damaging effects, so that in many cases the reforms are eventually abandoned. The above discussion has identified some of the factors that lead to the

successful implementation of an FMIS, summarised in Box 3. Obviously, this has some implications for technical assistance providers, like the Fiscal Affairs Department (FAD) of the IMF, which has often been called upon to support such projects financed by other donors.

Although recognising the magnitude of the problems faced in this area, it would also appear that developing countries have little option but to persevere with such projects. The FMISs will remain important to a longer-term PEM reform agenda, and it is essential that FAD and other technical assistance providers collaborate, if only to avoid the future problems that could arise if the FMISs are poorly designed, as well as to ease problems of implementation. The question to be posed is what is the optimal way of improving these projects, and what support FAD can offer in this area.

First, since these projects take time, it is most important in planning technical assistance that, even if accepted as a longer-run solution, the FMISs make allowances for the problem of filling an interim period of two to three years prior to their full implementation. In this period, it is often essential to ensure that the existing accounting and reporting systems are maintained, that business practices in the ministry of finance are adjusted to function in the new computerised environment, and that the desired functionality of the FMIS is incorporated in its design. It seems inevitable that this work will need to continue.

Second, before projects are too advanced in preparation, a rigorous risk assessment should be undertaken to ensure that the preconditions for success exist. A judgment should be made that specific preconditions are suitable: that there is commitment of top managers, and that there are adequate project management capacity and co-ordination mechanisms. If not, efforts should be directed to filling these gaps before proceeding with the FMIS. Box 3 indicates the main dimensions of such a risk analysis.

Third, there should be a well-defined exit point for external assistance. Perhaps the most value added is at the upstream stages – the initial design and testing stages – not in implementation where there should be a conscious effort to ensure that local capacity exists to complete this phase.

Fourth, in that design work special attention needs to be paid to specific critical aspects of the project, namely: that there is concurrent reform of the work practices; that there are assurances that the project is not simply computerising the existing procedures; that the accounting core of the FMIS is sound and will generate the information required for ministry of finance management and fiscal analysis; that the general functionality requirements are comprehensive enough to accommodate not just present but also future needs; and that the timetable for implementation is realistic.

Box 3. Preconditions for development of an FMIS

Authorities' commitment and ownership is clear:

- Clear institutional designation.
- Clear authority to implement.
- Active involvement, with no undue delegation to suppliers.

Preconditions are ready for reform:

- Authorities prepared to reengineer work practices.
- Environment encourages reform.
- Sufficient skills and/or training available.
- Users are “sold” on the system.
- Steering group is active and representative.

Project design is sound:

- Adequate time taken on design phase.
- Users fully involved in specification.
- Not too ambitious in scope.
- Timetable is realistic.

Management of project is capable:

- Adequate management skills.
- Managers motivated to reform.
- Full-time implementation team identified.
- In-house or outsourced maintenance capacity identified, in place, and properly costed.

Adequate resources are assured:

- Sufficient funds, since actual costs might exceed anticipated cost.
- Resource demands caused by operating two parallel systems simultaneously.
- Sufficient resources for long-term operation and maintenance of the system.

It is important to ensure that the above requirements are in place, in the order listed. If this will not be possible in a reasonable timeframe, a phased approach is recommended as well as the acceptance of interim solutions, if necessary.

8. Conclusions

There are three main conclusions emerging from this article. First, the introduction of an FMIS in a developing country should be regarded as a component of a wider reform process. These projects, therefore, should not be viewed as isolated interventions, but should be accompanied by, and related to, other reforms in public sector financial management. It is also necessary that the FMIS objectives and outputs are both relevant and consistent with wider fiscal policy reforms.

Second, the decision to introduce an FMIS needs to be accompanied by strong commitment, sufficient manpower and financial resources, widespread internal support, and an agenda for effective change management. Unless these are in place, the chances of success are limited.

Third, the implementation strategy both in terms of functionality and number of entities needs to be phased. The benefits expected from the system develop only over time, and it will be necessary to maintain interim arrangements to facilitate various aspects of financial control and reporting.

Country authorities should be prepared for a long implementation path, and one that involves significant challenges. It will be a complex learning process for all concerned. A number of difficulties are likely to be encountered en route, but the existence of the previously indicated three conditions, along with resolute commitment of key stakeholders, should overcome these difficulties and ensure success of this worthwhile reform.

Annex

The functions of different modules in a typical FMIS

1. Core functions

1.1. General ledger

The general ledger (G/L) module is the foundation of an integrated FMIS. The G/L should record all financial transactions – starting with the allocation of budget funds through the commitments to the payment of goods and services. This module should provide a complete picture of assets and liabilities of the government, as well as associated financial flows. The system should be highly integrated with all other modules of the FMIS as well other systems, if any, that process government financial transactions. The system should facilitate simultaneous posting of all the transactions in the general ledger accounts and in all appropriate sub-ledgers following the rules imposed by a chart of accounts. The system must include facilities for automatic consolidation of accounts of different budget units at different levels of government. The G/L system must have a strong reporting facility to produce all types of financial reports, for use by both internal management and external agencies.

1.2. Budgetary accounting

This module should assist in accurate recording of the approved budget, as well as revisions to the approved budget authorised by the legislature. The system should follow the full classification of the budget, with a facility to incorporate further enhancements to classifications. In the case where the approved budget is not available at the beginning of the year, the system should allow recording of interim budget appropriations per sub-head and allow for its replacement in due course by the approved budget appropriations. The system should record the transfers between appropriations and reallocations/virements between different sub-heads as approved by the ministry of finance during the course of the year. A historic record of the original budget, transfers, and virements should also be maintained. The system

should facilitate maintenance of cash flow forecasts, prepared on the basis of the approved budget and updated through the year based on the revisions, budget transfers, and virements. The system should link the budget classification with the standard functional and economic classifications for economic analysis purposes.

In many systems the above functions are performed by the G/L module itself, and the separate budget module is more comprehensive, dealing more with the development of budget estimates rather than merely recording the budget estimates.

1.3. Accounts payable

The main function of the accounts payable (A/P) module is to process invoices and vouchers for government expenditure, authorise payments, and maintain a record of liabilities. The module must have necessary features to monitor and manage payments efficiently to utilise discounts and avoid arrears, interest payments, and penalties. In some systems the A/P ledger is the sub-ledger of the G/L and interfaces with all relevant systems, such as procurement. The payment processing should be controlled by the approved commitments and the satisfactory delivery of goods and services.

1.4. Accounts receivable

This module must be able to handle all types of inflows that are received by budget units, including nontax revenues such as sales of goods and services, as well as fees and commissions. The module should be able to produce bills, process and record receipts, and record payments.

2. Noncore/other modules

2.1. Payroll system

Some personnel and payroll systems are integrated modules of an FMIS. Another option is to keep the payroll system as a separate system with an interface with the FMIS. The minimum requirements are that the payroll systems must contain the information needed to process payments of the payroll through the FMIS. All payments and receipts should be captured in the IFMIS. Some of the data needed are:

- Benefit items for each employee: basic salary, professional or family allowances, and deductions such as for income tax, health insurance, pensions;

- Budget information: expected increases, budget salaries for next year, overtime rates;
- Bank accounts information on employees, bank code, branch code, accounts number, etc.

2.2. Cash management

The system should assist in maintaining an up-to-date picture of the government's liquidity position and cash requirements. The system could reside in the budget department of the ministry of finance, and collect data from revenue agencies on revenue collections and from the debt management system on debt. These could be supplemented by information flows from external sources like the central bank for consolidation and preparation of cash management plans. In view of the different information flows required for cash management at a central level, some of the information flows will be interfaced with the information retrieved from the IFMIS.

2.3. Budget planning

The FMIS should include functionality for preparation of annual budgets. This module should be able to exchange data with separate applications for macroeconomic analysis and projections, and facilitate the top-down and bottom-up approach for the formulation of budget estimates. Hence, a separate budget preparation system with an interface to the FMIS should assist in the evaluation of the budget proposals. This system should be able to access and generate data from the previous years. While time series and compatibility of codes and classifications are vital features, the budget planning system should also be supplemented with tools for assessing the actual performance of ongoing projects, evaluations, and cost-benefit analysis for new proposals.

2.4. Debt management

A separate debt management system maintaining information on public domestic and external borrowings is required. This includes information on loan documents and transactions and issues of government securities. Some of the financial information from the FMIS is vital for debt management. In addition to accounting information, these systems also provide information required in the formulation of fiscal policy, such as forecasts of drawdown and debt-servicing liabilities. Payments related to government borrowings are carried out in the central debt management system. Loan receipts

recorded in government accounts are processed by the central FMIS and central treasury general ledger, and are subsequently used to update the debt database.

2.5. Revenue administration

Revenue administration is generally supported by a system that has two main objectives:

- The formulation of tax and tariff policies and the subsequent collection of tax and nontax revenue; and
- The assurance that the system should assist in capturing all sources of revenue and ensuring that they are properly accounted for.

The system should interface with the G/L for updating the ledger accounts, and should also provide input data to the cash management system for preparation of cash flow forecasts. The system should facilitate the monitoring and evaluation of the revenue performance against the projections, and set targets for the future.

2.6. Purchase or procurement

The system allows the input of commitment approval levels, records the full or partial discharge of commitments, and shows outstanding commitments at any given time. (The discharge of commitments would be controlled by the A/P module.) This module should have the ability to generate local payment orders after the necessary checks and balances have been met. In particular, an essential feature is that the system must have the capacity to reject procurements (at the stage when local payment orders are issued) when funds are unavailable – that is, where commitment and cash controls would be breached should the purchase proceed.

2.7. Project ledger

This is an optional module that records the listing of projects approved, the total cost of the budget allocation for the current year, the previous years' cumulative expenditures, and the balance remaining to project completion. There would need to be provision to deal with price increases and approved contract variations. This module would need to agree with the expenditure records of the cashbooks, as well as have an interface with the budget preparation module.

2.8. *Assets module*

This is an optional module and should record all assets purchased or built by the government, as well as their disposal when this occurs. Information in this module would come from both the cashbook and the projects modules. Government holdings in public enterprises would also be recorded here.

Notes

- ¹ The United Kingdom government PRINCE (Projects in Controlled Environments) methodology could be usefully applied for managing an FMIS.
- ² The steering committee will need to be representative of major stakeholders and could include the permanent secretary/finance, the accountant general, the head of the central IT department, the budget director and the heads of other finance departments, and the heads of selected line ministries, the central bank, and such other central agencies. Representatives of selected local governments could also participate in these meetings. The accountant general may function as a member-secretary for the steering committee.
- ³ A treasury single account (TSA) is an account or set of linked accounts through which the government receives all revenues and transacts all payments.
- ⁴ To underpin the implementation of the IFMS process, a new Public Finance Act was enacted in 2001, supported by the new financial regulations and a Procurement Act.
- ⁵ The Oracle Financials software application was chosen for the BPEMS. The Oracle contractor demobilised its team twice, for a number of reasons.
- ⁶ The Oracle team has not been able to make much progress in this area because of lack of clear specifications on the reporting requirements, and they have not been able to get the authorities' approval of the design of various reports.
- ⁷ Unfortunately, the local firm was not sufficiently experienced to develop and implement BPEMS.
- ⁸ The contract was awarded to Hewlett Packard (HP) for the entire supplies, and the application software chosen was Oracle Financial Treasury Solution.
- ⁹ The CODA Financials, a medium-sized financial management and accounting software was procured for implementation of IFMIS in Malawi.
- ¹⁰ Hopelain (1984, p. 150) warns that the reverse can prove fatal, that "an IT reform is not a computer recipe for an organizational problem."

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TABLE OF CONTENTS

BUDGETING IN THAILAND <i>by Jón R. Blöndal and Sang-In Kim</i>	7
THE UNITED KINGDOM PRIVATE FINANCE INITIATIVE: THE CHALLENGE OF ALLOCATING RISK <i>by David Corner</i>	37
THE “CONTROL” OF PUBLIC SOCIAL SECURITY INSTITUTIONS IN BELGIUM <i>by Marc Evrard and Philippe Scutnaire</i>	57
ACCOUNTABILITY INSTITUTIONS AND THE POLICY PROCESS: THE UNITED STATES EXPERIENCE <i>by Paul L. Posner</i>	71
INTRODUCING FINANCIAL MANAGEMENT INFORMATION SYSTEMS IN DEVELOPING COUNTRIES <i>by Jack Diamond and Pokar Khemani</i>	97

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