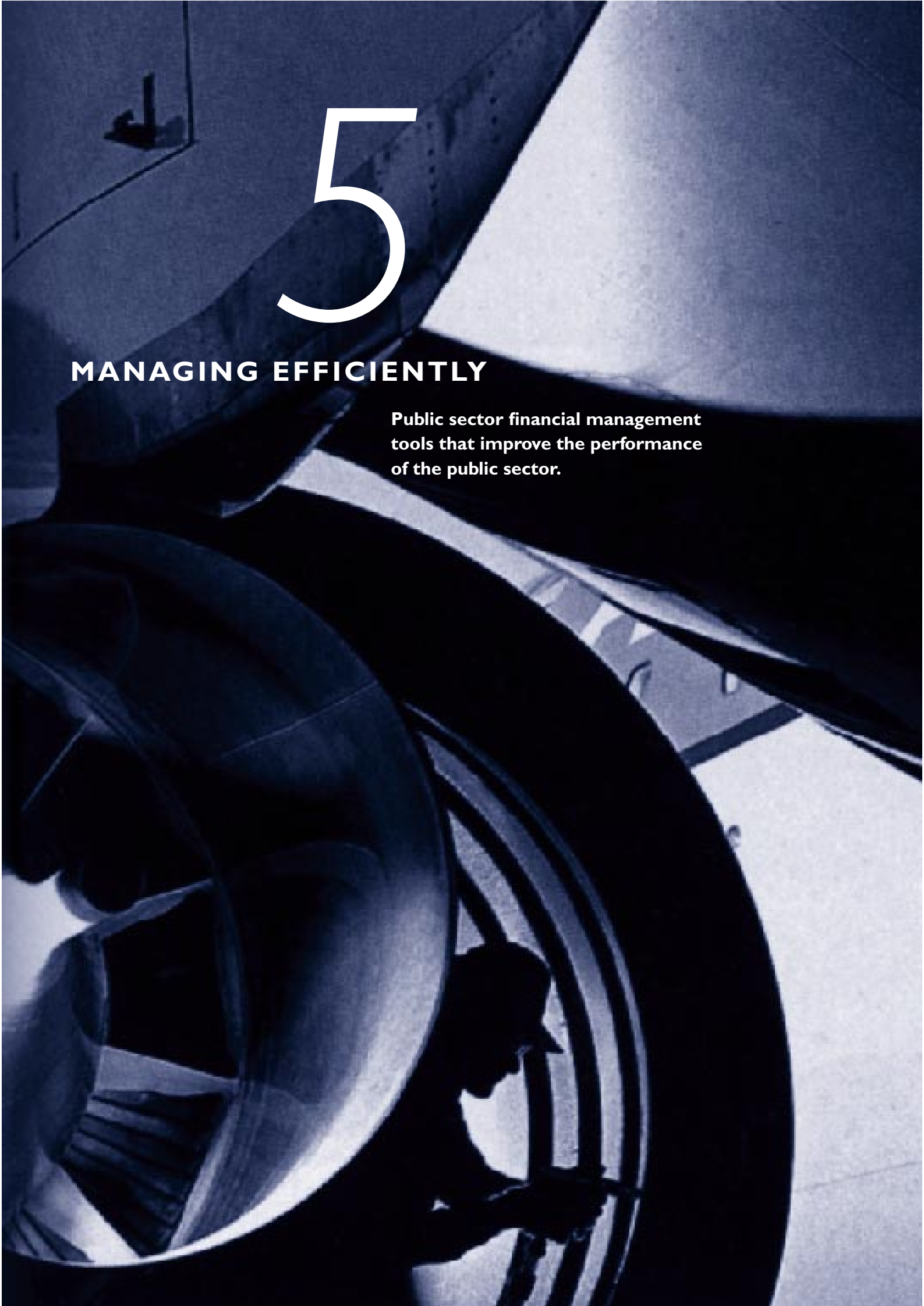


5

MANAGING EFFICIENTLY

Public sector financial management tools that improve the performance of the public sector.



Introduction

This chapter outlines some specific mechanisms for “fine-tuning” the system to gain efficiencies and better value for money. While not specified in legislation, these mechanisms are important features of the system assisting the government to manage efficiently.

Decision-making is decentralised to the level of management which has the best information. Managers are accountable for best use of the resources entrusted to them and accountability mechanisms and performance measurement are essential parts of the financial management system.

The following “tools” impact on different aspects of the system. SRAs, KRAs and chief executive performance agreements have a strategic focus. Contracting, purchase agreements and advisers, cost allocation and the use of cost information are all concerned with purchase decisions. The capital charge, asset management and strategic business plans are concerned primarily with ownership performance. Each of these “tools” is explained in the following pages.

The Government's Strategic Result Areas and Key Result Areas link the objectives and performances of government departments to the Government's long-term goals.

All government department chief executives have performance agreements with their Responsible Minister. These agreements specify the chief executive's KRAs and other requirements. KRAs are the key issues on which the department will focus for the coming year.

Strategic Result Areas (SRAs)

SRAs are critical medium-term objectives for the public sector that contribute significantly to the Government's longer-term policy goals and objectives. The process of developing and defining SRAs is co-ordinated by the Department of the Prime Minister and Cabinet.

SRAs are used to help link the objectives of departments, and ultimately the individual employment contracts of chief executives and employees, to the Government's goals.

The strategic result areas for the public sector for 1994-1997 are:

- Maintaining and accelerating economic growth
- Enterprise and innovation
- External linkages
- Education and training
- Community security
- Social assistance
- Health and disability services
- Treaty claims settlement
- Protecting and enhancing the environment.

Key Result Areas (KRAs)

Ministers and chief executives identify the major contributions individual departments will make to the Government's medium- to long-term objectives for the public sector set out in the Government's strategic result areas. These contributions are then specified as key result areas (KRAs) for departments.

KRAs are selected issues on which a department is expected to focus over the coming year. These issues are closely related to the Minister's purchase and ownership interests. The KRAs are included in the performance agreements between chief executives and Responsible Ministers. These performance agreements include annual milestones to demonstrate specific results required to achieve each key result area. Progress towards these milestones is assessed as part of each chief executive's periodic performance reporting.

KRAs clarify strategic purchase (output) and ownership (capital increase or decrease) decisions. They cover the capability to deliver outputs efficiently in the longer run.

As an example, the Secretary to the Treasury's performance agreement includes the following KRAs for 1996/97:

- Strategic advice
- Fiscal legislation and reporting
- Improving the value of public expenditure
- Human capital
- Implementation of the Treasury's strategic business plan.

Chief Executive Performance Agreements

The State Services Commissioner recommends departmental chief executive appointments and is responsible for their employment and performance assessment where the department is listed in the First Schedule to the State Sector Act. There are a number of exceptions

including the Police Commissioner, the Chief of New Zealand Defence Force and the Solicitor-General, where special circumstances apply. Chief executives have fixed-term employment contracts with the State Services Commissioner, usually for three to five years.

The performance agreement is a key document between the Responsible Minister for the department on behalf of the Government and the chief executive of a department.

The performance agreement includes key result areas and other ownership requirements, and is cross-referenced to the departmental purchase agreement.

To assist Ministers monitor their departments effectively, chief executives provide written reports against their performance agreements. The frequency, content and presentation of these reports is determined by individual Ministers. Guidelines are available to assist Responsible Ministers in stipulating reports required from chief executives.

Contracting/Output Specification

The idea of contracting is central to the public sector management system.

Outputs to be supplied by chief executives must be clearly specified with a description of the goods and services to be produced including information about quality, quantity, cost, and time and place of delivery. The agreed specifications are included in the Estimates, departmental forecast reports and purchase agreements.

Output appropriations reflect acceptance of the full accrual cost of the specified outputs, not the cash required for inputs. In the future, departments may possibly be required to show their outputs have been produced before the Government pays the "price" and hands over the appropriated output funding.

The idea of contracting is central to the public sector management system.

Chief executives must clearly specify their outputs according to quantity, quality, cost and delivery time. These then become a "contract" with the Government.

Purchase Agreements

Ministers need:

- information to assess the total outputs offered by departmental chief executives
- sufficient detail to compare similar outputs across both public and private sectors.

The Estimates contain information about classes of outputs. Purchase agreements between Ministers and departments specify individual outputs in terms and conditions similar to private sector contracts, though with less detail as they are internal agreements which would not be tested in litigation. The output specifications in purchase agreements provide Ministers with detailed information for decision-making and measuring chief executive performance.

After the Budget is agreed, purchase agreements are signed by chief executives and Vote Ministers. They are cross-referenced in chief executives' performance agreements. (Purchase agreements are requested as part of responses to FEC's standard Estimates questionnaire for use in select committees' Estimates examinations.)

Ministers and government departments agree on detailed "purchase agreements". These let Ministers know what goods and services the department will provide, and contain information for measuring departments' and chief executives' performance.

Purchase agreements assist Ministers to:

- decide what outputs to purchase
- negotiate agreed cost, quality, quantity, and delivery time
- record and change decisions
- verify subsequent output delivery
- hold the supplier accountable for delivery of the specified outputs.

Purchase agreements include the following detail:

- term of agreement
- description of outputs
- cost of outputs
- performance measures and standards
- procedures for assessing performance
- reporting requirements
- rewards and sanctions
- procedures for amending the agreement
- procedures for resolving disputes.

Purchase agreements between Ministers and departments specify individual outputs in terms and conditions similar to private sector contracts.

Ministers can choose between outputs, and trade-offs can be made between quantity, quality and cost of outputs. Ministers are able to specify the content and form of reporting that they require against purchase agreements. Regular reporting against purchase agreements allows Ministers to evaluate performance and take corrective action where necessary. As the year progresses and circumstances change, Ministers and chief executives may negotiate changes to purchase agreements without recourse to Parliament unless appropriation changes are needed.

Purchase Advisers

Ministers may decide to use purchase advisers, who may be staff or external consultants, to obtain advice independent of the department supplying the outputs. Departments often take the role of purchase advisers where a Minister is purchasing outputs from a Crown entity or other non-departmental supplier.

Purchase advisers can advise on value for money in output purchase and assist Vote Ministers to purchase outputs that are consistent with Government strategy. Ministers may delegate to their purchase advisers negotiation of some of the detail of the purchase agreement.

Contract Management

Individual Ministers may have purchase agreements with organisations outside departments such as Crown entities and other non-departmental providers. Usually, the management of such purchase agreements with third parties is undertaken by departments on behalf of Ministers, and this management function becomes an output supplied by the department.

For example, maintenance of the electoral roll is contracted to New Zealand Post Ltd, a State-owned enterprise. This service is purchased by way of a non-departmental appropriation to the Minister of Justice. The Ministry of Justice negotiates and manages the contract with New Zealand Post on behalf of the Minister.

Contract management can involve negotiating, monitoring, reviewing and paying for outputs purchased from third parties. Departments managing contracts for Ministers must provide timely advice on performance to those Ministers.

Cost Allocation

Chief executives are expected to exercise a high degree of control over output costs. To do this they must be able to identify the full cost of each output. The full cost of an output is the sum of the labour and materials required plus the appropriate share of the overhead costs including depreciation and capital change. Cost allocation is the process of establishing what proportion of direct and overhead cost should be charged to each output.

Cost allocation is critical to the purchasing process. Incorrect cost allocations would mean that the cost of one output would be subsidised by other outputs. Correct cost information has particular significance where the department produces contestable outputs sold to third parties in addition to outputs produced for Ministers.

Vote Ministers may use their staff or consultants as purchase advisers to assist in obtaining value for money and outputs consistent with their goals.

Some Ministers have purchase agreements with organisations that are not government departments; contracts with these third parties are normally managed by government departments on behalf of Ministers. For example, New Zealand Post maintains the electoral roll for the Government under a contract managed by the Ministry of Justice on behalf of the Minister.

Cost allocation ensures that direct costs (which are specific to an output) and overhead costs (such as salaries) are correctly allocated to each output. This is important to determine the correct cost of goods and services produced.

An accurate costing system is critical for assessing efficiency and monitoring the production of these outputs because the price paid by a third party is often based on cost. Failing to cost contestable outputs correctly might make it difficult for those outputs to remain competitive. Alternatively, if costs are not allocated correctly, taxpayers may unknowingly be subsidising purchasers of the goods and services provided.

Good cost allocation systems not only provide reliable information for purchase decisions, but alert managers to the need to consider a different input mix when input prices vary from forecasts.

Departments must document their cost accounting policies and disclose them in their financial statements. This information helps users assess the reliability and relevance of the output cost information and whether the accounts are comparable with those of previous periods or other providers.

Cost allocation is particularly important to:

- assist chief executives to control costs and identify opportunities for efficiencies
- provide information for decision-making
- provide information for comparing efficiency of production among departments and with private sector suppliers.

Using Cost Information

For the Government, as purchaser of departmental goods and services, to assess the value for money of outputs offered, it needs price information that is not based solely on production costs.

This is relatively simple where a similar good or service is produced in the private sector and a benchmark price is available. Developing a “price” for outputs such as the provision of policy advice to Government is more complex.

Approaches include:

- introducing prices by competitive tendering from private and public sector producers
- creating a range of shadow prices, based on a daily rate constructed from a set of benchmarks with components for items such as salaries, accommodation and other input costs.

The Government has a responsibility to make sure that it receives value for money from its departments. One way it can do this is by “benchmarking” government services against services provided by private sector organisations.

Good cost allocation systems not only provide reliable information for purchase decisions, but alert managers to the need to consider a different input mix when input prices vary from forecasts.

Capital Charge

The Crown has a large investment in the assets of government departments. To maintain this investment the Government has to raise taxes, borrow and/or divert funds from other Crown investments. The capital charge is an expense derived from the capital cost of the Crown's investment in each department. Departments pay a capital charge calculated on their net worth.⁵ The capital charge rate is reviewed annually as part of the Budget process and is set at a level that reflects the cost of the Crown's investment in a department.

The cost of the Crown's capital investment may be a significant portion of the full cost of goods and services produced by departments. Many departments supply goods and services to third parties. If the prices charged for these do not at least equal the total costs (including costs of capital), the Government is subsidising those goods and services.

The capital charge involves offsetting transactions between the Crown and departments. It does not increase the overall cost to the taxpayer of government services but encourages departments to sell under-used or non-essential assets and thus reduce their level of capital and their capital charge expense.

The capital charge:

- ensures that prices for goods and services produced by government departments reflect full production costs
- allows comparison of the costs of output production with those of other producers (whether in the public or private sector)
- makes explicit the cost to the Crown of maintaining its capital investment in departments
- creates an incentive for departments to make proper use of working capital and to dispose of surplus fixed assets.

Departments pay a capital charge to the Crown every year. The charge provides an incentive for departments to manage their assets efficiently. It also ensures that prices for goods and services produced by the departments reflect full production costs, including the cost of capital.

Ownership Requirements

The Government as "owner" of government departments is concerned to achieve its goals and objectives in a way that reflects the ethic of good government and fulfils the requirements of public accountability.

The *Government* wants to ensure that:

- public resources are used effectively to carry out the Government's objectives
- the Government's priorities are applied consistently across the public sector
- financial and performance risks are managed actively and promptly.

Chief executives are responsible for identifying issues likely to be important to the owner and taking action in line with:

- the Government's overall strategy
- the Responsible Minister's view of the department's direction
- any issues specific to the department, or the business sector it operates in, that need to be considered.

As the "owner" of government departments, the Government needs to ensure the departments are run efficiently and effectively. The chief executives of the departments are responsible, and accountable, for making this happen.

⁵ A department's capital charge base does not include assets managed by the department on behalf of the Crown. It would be inappropriate to levy a department on assets over which the chief executive does not have direct control.

Such actions may be represented in:

- the KRAs negotiated in the chief executive's performance agreement
- the department's strategic business plan
- an information technology plan for the department
- a human resource plan for the department.

Strategic Business Plans

If a departmental asset purchase requires additional capital that increases the Crown's total investment in the department, an appropriation from Parliament is required. This appropriation is designated an appropriation for a capital contribution.

When a Minister requests a capital contribution from the Crown for a department, that department is required to submit a strategic business plan and a sound business case.

A strategic business plan should cover the following areas:

- mission statement
- nature and scope of the entity
- competitiveness analysis
- marketing strategy
- human resource strategy
- capital expenditure and asset utilisation
- information technology (IT) strategy
- organisational strategy
- production strategy
- financial performance.

Chief executives must produce a strategic business plan and a sound business case if they need extra capital from Government, for example to buy an asset. Such funding is called a capital contribution.

Departments need "departmental assets" to produce their outputs, for example computer equipment and vehicles. Chief executives have the authority to buy and sell departmental assets.

Crown assets are "non-departmental assets", such as national parks and roads. Chief executives cannot sell non-departmental assets.

A strategic business plan helps the Government to determine the appropriate level of investment in a department.

The Government may withdraw capital from a department where it has more resources than it needs now and in the future, or a department may voluntarily return capital and thereby reduce its capital charge.

Asset Management

Chief executives are responsible for asset management as part of their overall responsibility to ensure sound financial management in their departments. They are responsible for capital budgeting, risk management and maintenance.

Chief executives may use working capital and any proceeds from selling a departmental asset to buy or develop a new capital asset, provided the department's total net asset value is not increased as a result. The authority to increase the Government's investment in a department is reserved for Parliament, that is, it requires an appropriation.

Only assets controlled by departments and used in the production of their outputs are included in departmental balance sheets. A department may, however, also have responsibility for managing "Crown assets".

Examples of Crown assets are conservation and heritage assets such as national parks and the National Archives collections. Infrastructure assets such as roading are also Crown assets. Crown assets tend to be those physical assets that may not or could not readily be sold or otherwise converted into cash.

A chief executive managing a Crown asset has no authority to sell or otherwise dispose of that asset.

Cash Management

Public Money

Public money consists of all revenue collected by the Government. This revenue may be from taxes, interest on investments, the sale of goods and services, fees, fines, or other charges. This money is used to fund the activities of the Government and its departments and agencies.

All public money must be held in either a Crown or a departmental bank account.

Banking

There are two types of bank account for public money:

- The “Crown bank account”, the main operating account of the Crown, refers to a suite of accounts opened, maintained and operated by the Treasury or by departments operating under delegation from the Treasury.
- Departmental bank accounts. These may contain the money disbursed to the department by the Treasury, departmental receipts, and receipts from the disposal or sale of departmental assets. All other public money is paid into the Crown bank account.

All public money must be held in either a Crown or a departmental bank account.

Departments are responsible for:

- liquidity, that is, ensuring that their bank account has sufficient cash to meet payments
- making and accounting for payments
- bank reconciliations.

Each department prepares a detailed cash forecast of its expected cash requirements for the coming year. Using this information and other information on output delivery, cash payments schedules are agreed between departments and the Treasury. The schedules may be revised during the year, but total payments must remain within approved budgets. During the year Treasury makes disbursements to departments in accordance with the agreed cash payments schedules.

The Government has contracted Westpac Banking Corporation to act as banker for most departmental and Crown activities. The amounts held in the Westpac bank accounts are “swept” into the Crown Bank Account with the Reserve Bank of New Zealand each night. This permits the centralised Treasury management of the Crown’s cash position, which is the responsibility of the New Zealand Debt Management Office (NZDMO). NZDMO manages the Crown bank accounts, the relationship with Westpac and the Government’s investment and debt-financing activities.

“Public money” is money paid by New Zealanders (through such things as taxes and fines) and used to fund Government activities. It is kept in either the “Crown bank account” (operated by the Treasury) or “departmental bank accounts” (operated by government departments).

Departments are responsible for ensuring the money is used lawfully, and for keeping accurate forecasts and records. The Treasury pays them according to an agreed schedule.

Trust Money

On occasions, the Crown collects money in trust for a third party. This money does not belong to the Crown and is kept separately in trust accounts. These accounts are managed by departments, through delegations from the Treasury, and cannot be used for any other purpose.

Examples of trust money are unclaimed money (such as bank account balances where the named account holder cannot be located) and funds from estates where the beneficiaries cannot be found.

Loans and Securities

Borrowing by the Crown is prohibited except by authority of an Act of Parliament. This prohibition does not include the obtaining of short-term credit from a supplier or the use of credit cards (for up to 90 days' credit).

The Crown is not liable for any debts or liabilities of other bodies except as bound by the terms of any Act or by a guarantee or indemnity given by the Minister of Finance. Under the Public Finance Act, the Minister of Finance has the power:

- to raise loans
- to issue securities
- to lend money
- to give guarantees
- to enter into swaps or other financial arrangements.

Investments

To maximise its return and best manage the financial risks faced by the Government, some amounts are held in marketable securities and deposits. Only the Treasury may invest public money in such securities.

Money collected by the Crown to be looked after for a third party is kept in a separate trust account.