Chapter Two: Calling the Tune

Financial Management Reform addresses the issues of performance measurement and accountability. The Government manages vast resources on behalf of the people of New Zealand. Its use of these resources must be effective, efficient and equitable. The people of New Zealand and Parliament, as their representative, must be able to judge whether Government is using resources to good effect.

In the past, Parliament and Ministers could not be sure they were receiving value for money. Chief Executives and other managers could not be sure they were delivering value. There were several reasons for this:

- Cash was the focus of control. Government collected taxes and Parliament authorised the expenditure of this revenue on various programmes. Departments were held responsible for how much money they spent on each programme; not for how efficiently they used their resources.
- Relationships between the aims of these programmes and the overall aims of the Government were frequently unclear.
- Many departments kept few records of assets or liabilities. Assets were paid for in the first year and then disappeared from the reporting system. There were rarely records of depreciation or formal methods of planning for replacement.
- Reports of the Government were on a receipts and payments basis and did not cover the full range of Government activities.
- There was a lack of clarity about roles: Ministers would become involved in administration details, departments tried to achieve outcomes.
- There was a lack of clarity about what each department and the Government as a whole intended to achieve.
- Even the term "objective" was a problem. In some departments, and for some programmes, objectives were described in terms of desirable social outcomes. In others, they may have included statements about the use of resources, or which management systems were to be employed. A department's objectives might have described products or services without the information—quality,

Speaking the Lingo

Throughout this booklet you will see the terms "inputs", "outputs" and "outcomes". Very simply:

Inputs are the resources (such as salaries, accommodation, equipment) which departments use to produce their goods and services. For example, the salary of a policy advisor or money to purchase computer storage media are "inputs" into the production of outputs by the Ministry for the Environment.

Outputs are the goods and services produced by departments. Possible types of output include policy advice, the administration of regulations, the provision of services, the production of goods, the administration of grants and benefits. Departments must be able to define outputs in terms of quality, quantity, cost and time.

For example, "advice on an environmental protection regime for Antarctica" is an individual output from the Ministry for the Environment.

This output is part of the "*class of outputs*", "Policy Advice, Global Environmental Issues".

For internal management purposes, departments will need to know cost, quality, quantity and timeframe information for each output. The information they present to Parliament is about classes of output. There is no absolute recipe for making a class of outputs; groupings will differ from department to department. A class should conform to the following criteria:

- the outputs in the group must be similar.
- the grouping must provide adequate information for Government decision making and Parliamentary scrutiny.
- it must reflect the level at which Parliament seeks to control the activities of that department.

Outcomes are the effects on the community of an output or set of outputs. The Government decides what it wants to achieve. It selects the outputs which will have the desired effect. It then allocates resources to those outputs.

For example, the output class "Policy Advice, Global Environmental Issues" contributes to the outcome "Effective initiatives that contribute to: reduction of the consumption of ozone depleting substances; limitation of, and adaption to, global climate change effects; environmental protection of Antarctica; and achievement of sustainable development as recommended in the Report of the World Commission on Environment and Development."

The Government may decide that an outcome can best be achieved by outputs from several different suppliers. For example, to achieve the outcome "a lowered rate of crime", the Government may "purchase" outputs from the Departments of Police, Justice, Education, Social Welfare and other suppliers. The Government may also decide to use regulation or legislation to assist in the achievement of an outcome.

A Variety of Roles

The Government has different roles in the activities of a Department.

- It is a *purchaser* of outputs (goods and services.) As (often the only) customer, it is interested in the price, quantity, quality and delivery date of the output. A Minister of one portfolio may buy outputs from several different departments. A department may sell to Ministers of several different portfolios.
- It is the *owner* of the resources of the Department. As owner (on behalf of the people of New Zealand), it wishes to ensure that its capital assets are used efficiently and maintained wisely. Each department has a Responsible Minister overseeing the ownership interest.
- It is the funder of benefits and grants that the department distributes on its behalf.

quantity, time and cost—by which performance could be measured.

Under those circumstances, how could anyone be held accountable for anything? How could performance be measured and rewarded if

good, or corrected if bad? In future, Parliament will be told:

- What the Government is aiming to achieve (outcomes).
- The goods and services that the Government will purchase to achieve these aims (outputs).
- The cost of producing these outputs.
- The financial performance expected from the department.

Who's responsible for what?

Under the new system, deciding priority outcomes and selecting outputs are the responsibility of Government. The role of departments is to specify the set of outputs they can offer, including price, quantity, quality, timeframe for delivery and other constraints. Departments become responsible for delivering outputs once they agree with Ministers to provide them and have been allocated resources (inputs).

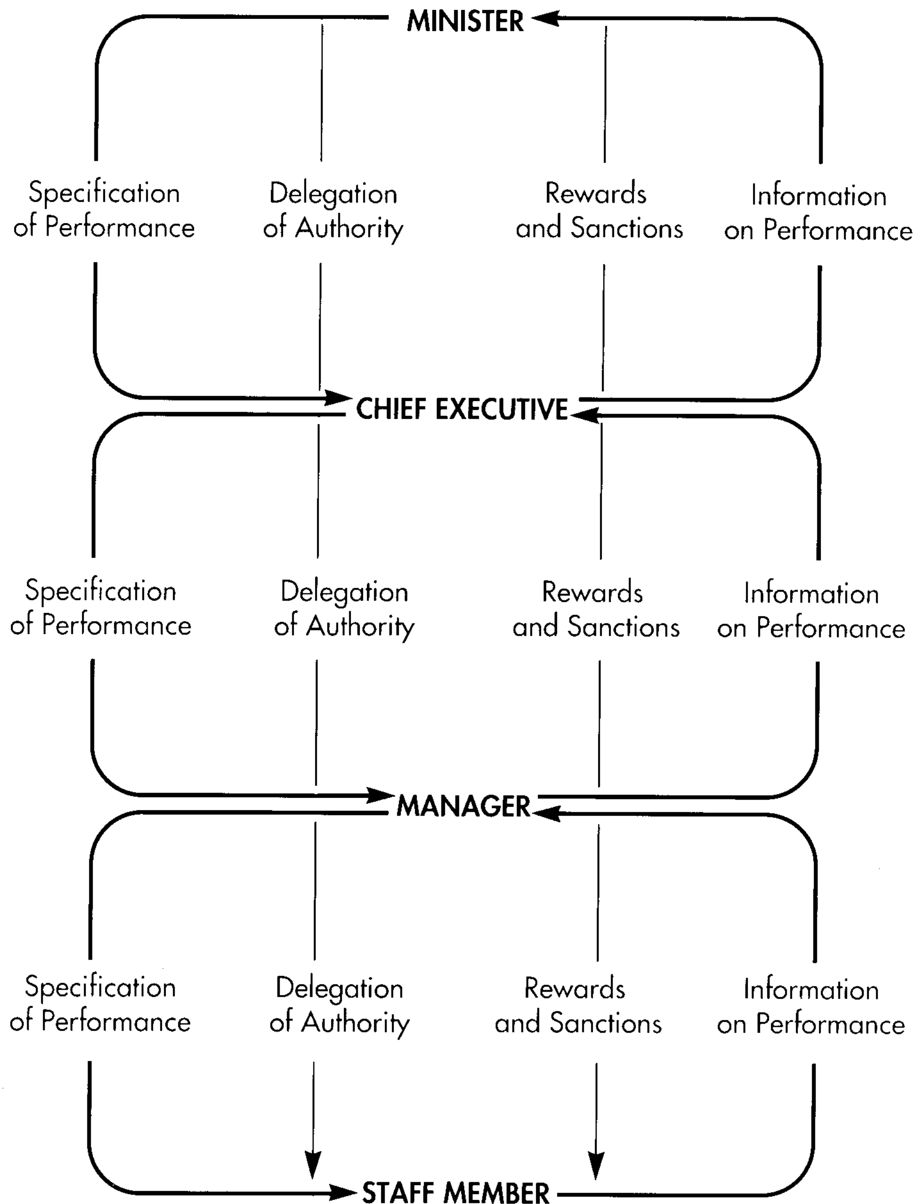
Let's look at the new accountability relationship.

Where the buck stops

How does Financial Management Reform help to ensure accountability at all levels of the state sector? There are two factors:

- Resources are allocated to specified outputs.
  "Specified": outputs must include quantity, quality, timeframe and cost information.
  "Outputs": the focus is on what is to be produced, not on what is to be spent.

- Accurate and complete financial reports are crucial to the system. Chief Executives and Managers need accurate, timely information in order to run their departments efficiently and effectively. Parliament and the public need regular reports from which to measure performance. The reporting structure is examined in more detail in Chapter Six.
  As a result, Chief Executives and Managers in the public sector will have a clearer idea of what is expected of them. They will have outputs to which they have agreed. They will have greater control over the resources they require. They can therefore be held responsible if they fail to meet performance standards.



What are the Estimates?

Every year, government departments and Crown agencies must request the money they need for the coming year. This request and supporting information is presented to Parliament at Budget time in a formal document known as the Estimates (the full title is, Estimates of Annual Appropriations and Departmental Budgets of the Government of New Zealand).

In the Estimates, a Minister requests appropriations for classes of outputs, showing as clearly as possible how these link to the outcomes the Government is seeking. Prior to presentation of the Estimates, Chief Executives will define and agree with Ministers:

- what their departments will produce and why.
- how much the Government is prepared to pay for these outputs.

Appropriation

An allocation of resources for a specified purpose. In their Estimates, departments specify how much they need to produce particular outputs. The Government makes an appropriation for each class of outputs, for capital investment and for the payment of benefits and grants.

The performance agreements between Chief Executives and their Ministers should include the agreed outputs and the agreed financial performance of the departments.

Obviously, Chief Executives cannot achieve their agreed performance without the support of their managers. Managers, in turn, are dependent on their staff. In order to achieve their own performance goals, they will require staff to meet objectives and to fulfil responsibilities.

So accountability feeds down through the structure. The State Sector Act, 1988, established the status of Chief Executives as employers of staff within their agencies. This increases their authority to determine rewards and sanctions for their staff.

The Government can also offer rewards and apply sanctions in its role of purchaser and owner. In the private sector, customers will keep returning to a company whose performance and prices have been satisfactory. On the other hand, if customers are not satisfied—if goods and services are not cost effective, or delivery dates are not honoured—they will look elsewhere.

The new emphasis on outputs allows the Government, as customer, similar flexibility. A desirable social outcome could be accomplished by a mixed set of outputs from several different departments and other suppliers. Good or bad performance will encourage the Government to change the mix; to buy more from one department and less from another.

The Government also has an ownership interest in the department. As owner, the Government may wish to increase or decrease its investment in a department. In the private sector, an owner of a small business (say, a trucking company) will invest capital to build up a successful business but will cut down on the level of investment (decide not to replace vehicles) or even draw money out (sell trucks) when the business no longer meets the needs of customers or when the owner's objectives change (decides to go into the message courier business).

Similarly, as owner of the resources of the public sector, the Government may invest or disinvest in a particular department according to performance (efficient production of particular outputs) or when the relative importance of its outcomes changes.

Key Points

The principle of accountability is at the heart of Financial Management Reform. The Government and its agents are responsible for the way in which they use public resources. Good performance should be rewarded and poor performance identified and remedied. The new system:

- demonstrates public accountability (in producing outputs and managing resources) through formal external reports.
- assists the Government to make decisions concerning the allocation of limited resources across desired outcomes.
- assists in the negotiation and evaluation of the performance of Chief Executives in terms of their performance agreements.
- identifies areas within departments where activities need to be modified in the light of past performances.