

Public Financial Management: Planning and Performance

Public Policy and Management: Planning and Performance

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Public Financial Management: Planning and Performance

Course Introduction and Overview

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1 Introduction

Welcome to *Public Financial Management: Planning and Performance*. We hope that you will find the course stimulating and useful. Even if you do not have a background in public finance we think you will be able to learn a lot and do well in the assessment for this course. There is technical material and language that may seem to outsiders to be jargon, but we aim to explain the reasoning behind all new terms as we introduce them and to avoid unnecessarily technical language.

It is an interesting time to be studying public finance for several reasons. First, there are changes in the way that the public sector ‘does its business’. Bureaucracies with strict hierarchies of public employees carrying out their duties according to a fixed set of rules are giving way, or have already given way, to different ways of working. In some cases there have been programmes of decentralisation and delegation of authority so that managers and professionals at relatively junior levels now have to take decisions based on the best information, including financial information, available to them.

In professions across the public sector – whether medical, educational, legal, engineering or custodial – people are making choices about investments, about how to achieve efficiency, how to stay within budget and how to improve performance. Whether reluctantly or willingly, people are having to understand costs, budgets, financial statements about cash flows and expenditures, even when they are not in accountancy.

In other cases, services are increasingly contracted out to commercial companies, to NGOs or to communities rather than being provided directly by public employees. These arrangements require a different set of disciplines – of monitoring other people’s performance, of assessing value for money of contracts rather than employees’ performance.

To cope with these and other changes, the ways in which public finances are managed have also changed. The days have gone of accounts consisting only of the recording of cash spent, except perhaps at the very frontline of services. Management accounts now commonly include a record of money that has been committed, rather than only of cash spent, allowing managers near the frontline to manage their spending with more confidence. In many countries budgets and accounts are no longer concerned just with the cash allocated and spent but also with the resources used in providing services – capital resources and assets as well as people and materials. The further away from cash accounting the systems get the less they look like our personal accounts and the more we need to learn about the relevant concepts to enable us to understand and run them.

A second reason why public finance is interesting now is that in many countries what people are being held to account for is also changing. It is often not sufficient to have accounts that show that money has been spent as governments intended – politicians and the public want to know how *well* it has been spent, whether it has been used *efficiently* and whether it has *achieved the purposes* for which it was allocated. This widening of accountability, combined with the delegation of accountability lower down in the organisations, has placed a burden on accounting systems and on the

managers and professionals who have to understand and operate them. Computer systems make financial management easier but managers need to understand the concepts underlying the numbers and the consequences of the financial information that is provided.

Some of these tendencies have led to a narrowing of the differences between private sector and public sector budgeting and accounting: the public sector is now also interested in performance, in the use of assets in service provision and in performance defined as efficiency and effectiveness. Some parts of the public sector now operate on very commercial lines – with revenue and profit targets, competition for customers or contracts – requiring approaches to costing, budgeting and financial reporting that are very similar to those of the private sector.

A third reason why planning and budgeting are currently interesting is that the responses to the financial crisis by governments have put a strain on budgeting systems – the developments in performance-related budgeting in the UK and in France, for example, were made during times of spending growth. When the emphasis of budgets is on deficit reduction and spending cuts, the link between spending and performance may be more difficult to establish.

These trends and tendencies are by no means universal. While some governments have embraced commercial-style accounting and financial management, others have resisted. Some have adopted changes reluctantly but have been forced to change by lenders or donors who have made financial management reform a condition for further lending.

In this course we do not take the view that there is a single best practice in public financial management. The best approach is the approach that produces the desired results. If a simple cash-accounting system is adequate to run the financial affairs of, say, a school responsible for the salaries of its employees and the consumables used, then the added complications of asset valuation and accounting for asset use may not help those responsible to manage better. This is especially the case where the decisions made at school level do not include decisions about asset sales and acquisitions. What we try to show is that there are approaches to financial management that can be tailored to the approach to management and governance that governments have adopted.

This implies that a single approach may not be right within one country at all levels of government. For example, if there is a centralised system of tax collection and a distribution of tax receipts to provincial or municipal governments, then the planning, budgeting and accounting requirements at national and provincial or municipal levels will be different. Similarly, if a public entity operates on commercial lines it needs a commercial-style set of financial procedures. An airport, for example, that is financed by landing charges and franchise sales needs a management accounting system to track revenues and forecast profits or losses. On the other hand, a school whose sole income comes from a government grant needs to track expenditures against budget but would not need a sophisticated system for recording revenues. Both may be operating in the same juris-

diction. We will try to point out which techniques and methods seem appropriate in which contexts.

Some commentators and advocates of public financial management reform talk as if there is a progression from simpler to more sophisticated systems and that the latter are always better. This can, in our view, lead to the development of rules and systems that are not supported by the right technologies or skills and, in the worst cases, can actually make financial management worse.

While most of the issues discussed in the course are technical, they are not without dispute and dissent. Just as in the private sector there are many examples of 'creative accounting' to make profits look better (or worse) than they really are, so public sector accountants are not above 'creativity'. A favourite is reclassifying expenditure as 'capital' (financed over the period of the asset's life) when it used to be 'current' (to be financed out of this year's receipts) to make this year's current accounts look better. Some people in the accounting profession argue that some of the accounting for deals done under Public Private Partnerships represents at best misleading reporting and at worst false accounting. At a time when European governments were trying to keep their borrowing low to comply with treaty obligations to support the launch of the Euro currency, such accounting adjustments were valuable weapons. We take the view that one of the functions of public financial management is to keep the politicians honest and the public informed. This applies as much to simple systems as to sophisticated definitions of assets used and capital consumed.

This course is almost entirely about the expenditure side of public financial management: issues of taxation, borrowing, debt and aid are dealt with in the course, *Public Financial Management: Revenue*; accounting for public expenditure and the audit of public accounts are dealt with in *Public Financial Management: Reporting and Audit*; while issues concerning the financial relationships between tiers of government are covered in *Decentralisation and Local Governance*.

This course starts with a discussion of three elements of the context:

- the macroeconomic framework of the budget
- the accountability framework of the public sector
- the impact of 'new public management' on financial management.

Unit 2 is about the coverage of public budgets and their structure and classification: this unit will help you to read budgets and understand how budgets reflect policy choices.

Unit 3 is concerned with costs and costing systems, and discusses the different ways in which costs can be calculated or estimated according to how the costing information is being used.

Units 4 and 5 are about accounting and budgeting. They explore recent developments in public sector financial management at national levels of government (Unit 4), and at sub-national levels of government (Unit 5).

Unit 6 is about budget implementation and control: it covers the processes between setting a budget and implementing it, what can be done to make

sure that the budget is implemented properly – or if not, to know exactly what has gone wrong and how to correct it.

Unit 7 asks how far financial management can be used to improve public sector performance and explores a variety of experiences in trying to integrate budget management with public sector performance. The unit uses case studies of budget management in various countries to illustrate its discussion.

Unit 8 deals with the relationship between politics and budgeting: while all policy decisions implied in budgets are subject to political approval, the processes by which budgets are made involve both legislatures and executives. It considers whether there is any single, best system of public financial management. This unit shows how politicians and the public can be better involved in the process, with case studies from a variety of countries.

During the course you will be asked to do some calculations and to analyse financial statements. While this is not a technical training course, we believe that this sort of practical engagement with costing and accounting issues will help to develop your understanding of the conceptual issues involved.

2 The Course Authors

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Norman Flynn is Programme Director of the Public Policy and Management programme. His publications include *Moving to Outcome Budgeting*, *Scottish Parliament 2002*, *Miracle to Meltdown in Asia* and *Public Sector Management*. He has held academic posts at London Business School and London School of Economics and was Chair Professor of Public Management at City University Hong Kong. He has been a visiting professor at University of the West Indies, Innsbruck University and Strathmore Business School, Nairobi.

3 An Overview of the Course

Unit 1 The Context of Financial Management

- 1.1 Introduction
- 1.2 What is a Budget?
- 1.3 The Macroeconomic Framework
- 1.4 Accountability
- 1.5 'New Public Management' and Financial Management
- 1.6 Conclusion

Unit 2 Budget Coverage, Classification and Structure

- 2.1 Introduction
- 2.2 Coverage of the Budget
- 2.3 Classification of the Budget
- 2.4 Budget Composition
- 2.5 The Line Item System vs Programme Systems

Unit 3 Costs

- 3.1 Some Definitions of Cost
- 3.2 Costing Systems
- 3.3 Cost-Volume-Profit Model
- 3.4 Absorption or Full Cost Recovery
- 3.5 Activity-Based Costing (ABC)
- 3.6 Managing Costs
- 3.7 Price-Based Costing
- 3.8 Relevant Costs

Unit 4 Accounting and Budgeting: National Level

- 4.1 Approaches to Public Accounting and Budgeting
- 4.2 Cash Accounting vs Accruals Accounting
- 4.3 The Macroeconomic, Fiscal framework and the Medium-Term Expenditure Framework
- 4.4 The Role of the Ministry of Finance
- 4.5 Budget Timetable

Unit 5 Accounting and Budgeting: Sub-National Level

- 5.1 Translating the national budget into operational budgets
- 5.2 Structure, Performance, Discretion, Block Grants and Contracts
- 5.3 Fund Accounting
- 5.4 Resource Accounting and Budgeting
- 5.5 Which Techniques at Which Stage?
- 5.6 Budget Timetable at Sub-National Level
- 5.7 Accounting for Services Provided by Third Parties

Unit 6 Budget Execution

- 6.1 Introduction: Budgetary Control
- 6.2 Controlling Operations
- 6.3 Monitoring Budget Execution
- 6.4 Taking Action
- 6.5 Summary

Unit 7 Budgeting and Performance

- 7.1 Introduction: Accruals Accounting and Output and Outcome Budgeting
- 7.2 Defining and Measuring Non-Financial Items, Especially Outputs and Outcomes
- 7.3 Case Study 1: Output and Outcome Definitions
- 7.4 Output and Input Budgets
- 7.5 Case Study 2: Outcomes and Outputs in Budgets in England
- 7.6 Case Study 3: Performance Budgeting in Canada

7.7 Conclusion: Will Performance Management and Budgeting Ever Be Fully Implemented?

Unit 8 Budgeting and Democracy: Conclusions

- 8.1 Introduction
- 8.2 National Legislatures and the Budget Process
- 8.3 Case Studies – the USA, the Netherlands and Brazil
- 8.4 Conclusions on Budgeting and Democracy
- 8.5 Is There a Single Best Method of Financial Management?
- 8.6 Review: The Journey from Bureaucracy to NPM as it Affects Public Financial Management
- 8.7 Is PEFA the Answer?

4 Learning Outcomes

When you have completed this course you will be able to:

- explain how public budgeting fits into the macroeconomic framework
- apply ideas about accountability to the production of various forms of account for public services and public money
- discuss how changes in public management require different forms of public accounting
- read a budget and a set of national accounts and explain the differences between budgets and accounts in different jurisdictions
- explain costs and different ways of measuring them and how costs are used in budgets
- discuss the budget process at national and sub-national levels and the techniques appropriate at different levels
- apply budgetary control methods
- use financial management to enhance the performance of public organisations.
- discuss how public financial management interfaces with politics and political choices.

5 Study Materials

There are two textbooks.

Andreas Bergmann (2009) *Public Sector Financial Management*, London: FT Prentice Hall.

Bergmann is a professor at Zurich University and brings an international perspective to public financial management. This book provides a 'high-level' view of public financial management, with occasional coverage of the more detailed day-to-day issues.

The second text starts from a more practical viewpoint.

Anwar Shah (editor) (2007) *Budgeting and Budgetary Institutions* Washington DC: World Bank.

This book arose out of a series of education and training events run by the World Bank, and is written by leading experts in public finance. While Part II of the book is about Africa, the principles, analyses and discussions of practice in Part I are applicable universally. We will not be using all of Part II on the course, but if you are working in a developing country context, you might find the examples useful.

In addition, there are readings that are mainly case studies of practice in a variety of countries. These are contained in the Course Reader. The course contains case studies of budgeting in a variety of settings, in both developed and developing countries. While context matters in the choice of budgeting and accounting methods, it is the view of the authors that there is probably not one single set of best practice.

To successfully complete the course and the examinations, we recommend that you read all of the articles and chapters in the Reader before the examination.

This part of the course is written to introduce you to the scope and the learning objectives.



Reading

At this point, especially if this is your first course in public financial management, we recommend that you turn to Bergmann and read Chapter 1.

Andreas Bergmann
(2009) *Public Sector
Financial Management*,
Chapter 1 'Public sector
financial management'.

In this introductory chapter, Bergmann sets out the scope of his book, but more importantly, the scope of public financial management. He starts with a definition of the public sector, including the general government sector and the public corporations. While there is international agreement about what constitutes the public sector, national definitions require interpretation.

He then goes on to define public financial management in two useful ways:

- the task-based approach, which defines the tasks of public financial management
- the institution-based approach, which describes the various bodies involved in planning, spending and accounting for public money.

In this part of the chapter he uses the term 'public sector controlling', by which he means performance management, and 'public sector assurance' which is otherwise known as 'audit'. At this stage we do not need to worry too much about language in this field, except to note that learning about public financial management in English can lead to problems of translation from and into other languages¹.

He then goes on to discuss 'Integrated approaches', specifically the Public Expenditure and Financial Accountability ('PEFA') framework, which has been developed by a consortium of organisations concerned with economic development. PEFA is used to assess financial management in developing countries but it also provides a useful framework to help us grasp the scope of the financial management system elsewhere. We will return to PEFA at the end of course, in Unit 8.

¹ For example, in German 'controlling' has a more strategic meaning than 'controlling' in English. In Australia the basic unit in budgeting is called a 'product', in France an 'action'.

Please do not read the section on accounting models at this stage – we will give an overview of accounting frameworks later.

6 Studying the Course

When you work through the materials, there are various exercises, from the textbooks or based on the readings, that are designed to consolidate your knowledge and skills. We recommend that you do the exercises, most of which take half an hour or less, before you look at the model answers, where they are provided, at the end of the unit.



You will be asked to submit your assignments and receive feedback through the Online Study Centre, and to ask questions of your tutor. The OSC will also be the main way that we will communicate with you about administrative matters.

We would encourage you to also use the discussion area of the OSC to discuss issues with your fellow students. You will be prompted to do so occasionally as you progress through the course. Because public financial management varies greatly across the world, you should find it valuable to check your understanding and experience with your global classmates.

7 Assessment

Your performance on each course is assessed through two written assignments and one examination. The assignments are written after week four and eight of the course session and the examination is written at a local examination centre in October.

The assignment questions contain fairly detailed guidance about what is required. All assignment answers are limited to 2,500 words and are marked using marking guidelines. When you receive your grade it is accompanied by comments on your paper, including advice about how you might improve, and any clarifications about matters you may not have understood. These comments are designed to help you master the subject and to improve your skills as you progress through your programme.

The written examinations are 'unseen' (you will only see the paper in the exam centre) and written by hand, over a three hour period. We advise that you practise writing exams in these conditions as part of your examination preparation, as it is not something you would normally do.

You are not allowed to take in books or notes to the exam room. This means that you need to revise thoroughly in preparation for each exam. This is especially important if you have completed the course in the early part of the year, or in a previous year.

Preparing for assignments and exams

There is good advice on preparing for assignments and exams and writing them in Sections 8.2 and 8.3 of *Studying at a Distance* by Talbot. We recommend that you follow this advice.

The written examinations are 'unseen' (you will only see the paper in the exam centre) and written by hand, over a three-hour period. We advise that you practice writing exams in these conditions as part of your examination preparation, as it is not something you would normally do.

You are not allowed to take books or notes into the exam room. This means that you need to revise thoroughly in preparation for each exam. This is especially important if you completed the course in the early part of the year, or in a previous year.

Understanding assessment questions

Examination and assignment questions are set to test your knowledge and skills. Sometimes a question will contain more than one part, each section testing a different aspect of your skills and knowledge. You need to spot the key words to know what is being asked of you. Here we categorise the types of things that are asked for in assignments and exams, and the words used. All the examples are from CeFiMS examination papers and assignment questions.

Definitions

Some questions mainly require you to show that you have learned some concepts, by setting out their precise meaning. Such questions are likely to be preliminary and be supplemented by more analytical questions. Generally 'Pass marks' are awarded if the answer only contains definitions. They will contain words such as:

- Describe
- Define
- Examine
- Distinguish between
- Compare
- Contrast
- Write notes on
- Outline
- What is meant by
- List

Reasoning

Other questions are designed to test your reasoning, by explaining cause and effect. Convincing explanations generally carry additional marks to basic definitions. They will include words such as:

- Interpret
- Explain
- What conditions influence
- What are the consequences of
- What are the implications of

Judgment

Others ask you to make a judgment, perhaps of a policy or of a course of action. They will include words like:

- Evaluate

- Critically examine
- Assess
- Do you agree that
- To what extent does

Calculation

Sometimes, you are asked to make a calculation, using a specified technique, where the question begins:

- Use indifference curve analysis to
- Using any economic model you know
- Calculate the standard deviation
- Test whether

It is most likely that questions that ask you to make a calculation will also ask for an application of the result, or an interpretation.

Advice

Other questions ask you to provide advice in a particular situation. This applies to law questions and to policy papers where advice is asked in relation to a policy problem. Your advice should be based on relevant law, principles, evidence of what actions are likely to be effective.

- Advise
- Provide advice on
- Explain how you would advise

Critique

In many cases the question will include the word 'critically'. This means that you are expected to look at the question from at least two points of view, offering a critique of each view and your judgment. You are expected to be critical of what you have read.

The questions may begin

- Critically analyse
- Critically consider
- Critically assess
- Critically discuss the argument that

Examine by argument

Questions that begin with 'discuss' are similar – they ask you to examine by argument, to debate and give reasons for and against a variety of options, for example

- Discuss the advantages and disadvantages of
 - Discuss this statement
 - Discuss the view that
 - Discuss the arguments and debates concerning
-

The grading scheme

Details of the general definitions of what is expected in order to obtain a particular grade are shown below. Remember: examiners will take account of the fact that examination conditions are less conducive to polished work than the conditions in which you write your assignments. These criteria

are used in grading all assignments and examinations. Note that as the criterion of each grade rises, it accumulates the elements of the grade below. Assignments awarded better marks will therefore have become comprehensive in both their depth of core skills and advanced skills.

70% and above: Distinction, as for the (60–69%) below plus:

- shows clear evidence of wide and relevant reading and an engagement with the conceptual issues
- develops a sophisticated and intelligent argument
- shows a rigorous use and a sophisticated understanding of relevant source materials, balancing appropriately between factual detail and key theoretical issues. Materials are evaluated directly and their assumptions and arguments challenged and/or appraised
- shows original thinking and a willingness to take risks

60-69%: Merit, as for the (50–59%) below plus:

- shows strong evidence of critical insight and critical thinking
- shows a detailed understanding of the major factual and/or theoretical issues and directly engages with the relevant literature on the topic
- develops a focussed and clear argument and articulates clearly and convincingly a sustained train of logical thought
- shows clear evidence of planning and appropriate choice of sources and methodology

50–59%: Pass, below Merit (50% = pass mark)

- shows a reasonable understanding of the major factual and/or theoretical issues involved
- shows evidence of planning and selection from appropriate sources,
- demonstrates some knowledge of the literature
- the text shows, in places, examples of a clear train of thought or argument
- the text is introduced and concludes appropriately

45–49%: Marginal failure

- shows some awareness and understanding of the factual or theoretical issues, but with little development
- misunderstandings are evident
- shows some evidence of planning, although irrelevant/unrelated material or arguments are included

0–44%: Clear failure

- fails to answer the question or to develop an argument that relates to the question set
- does not engage with the relevant literature or demonstrate a knowledge of the key issues
- contains clear conceptual or factual errors or misunderstandings

[approved by Faculty Learning and Teaching Committee November 2006]

Specimen exam papers

Your final examination will be very similar to the Specimen Exam Paper that you received in your course materials. It will have the same structure and style and the range of question will be comparable.

CeFiMS does not provide past papers or model answers to papers. Our courses are continuously updated and past papers will not be a reliable guide to current and future examinations. The specimen exam paper is designed to be relevant to reflect the exam that will be set on the current edition of the course

Further information

The OSC will have documentation and information on each year's examination registration and administration process. If you still have questions, both academics and administrators are available to answer queries.

The Regulations are also available at www.cefims.ac.uk/regulations.shtml, setting out the rules by which exams are governed.

UNIVERSITY OF LONDON

Centre for Financial and Management Studies

MSc Examination

Postgraduate Diploma Examination

for External Students

91DFMC301

PUBLIC POLICY AND MANAGEMENT

PUBLIC FINANCIAL MANAGEMENT

Public Financial Management: Planning & Performance

Specimen Exam

This is a specimen examination paper designed to show you the type of examination you will have at the end of the year for Public Financial Management: Planning & Performance. The number of questions and the structure of the examination will be the same but the wording and the requirements of each question will be different. Best wishes for success on your final examination.

The examination must be completed in **THREE** hours.

You must answer **THREE** questions. At least one question from each Section. The examiners give equal weight to each question; therefore, you are advised to distribute your time approximately equally between three questions.

DO NOT REMOVE THIS PAPER FROM THE EXAMINATION ROOM.
IT MUST BE ATTACHED TO YOUR ANSWER BOOK AT THE END OF THE EXAMINATION

Answer THREE questions, at least one question from each section

Section A

(Answer at least ONE question from this section)

- 1 Answer both parts of the question.**
 - a Why do some governments have bigger deficits than others?
 - b When does a deficit become unsustainable?
- 2** When would a public entity best use a line-item budget and when would a programme budget be best?
- 3 Answer all parts of the question.**
 - a Write short notes on:
 - i marginal cost and average cost
 - ii fixed and variable cost
 - iii absorption costing
 - iv price-based cost.
 - b When would it be appropriate to use each of these when calculating a cost?
- 4 Answer both parts of the question.**
 - a Under what circumstances should public bodies use cash accounting?
 - b When should they use accruals?

Section B

(Answer at least ONE question from this section)

- 5** How does the choice of management system affect the choice of costing system? What are the main causes of budget overspends and underspends?
- 6** What are the advantages and limitation of using the budget process to manage performance of public bodies?
- 7** How can budget systems be designed to help politicians make choices about priorities and exercise control over public entities?
- 8** Do changes in management methods in the public sector necessarily require changes in the accounting methods used?

[END OF EXAMINATION]