

Public Financial Management: Planning and Performance

Module Introduction and Overview

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1 Introduction to the Module

Welcome to *Public Financial Management: Planning and Performance*. We hope that you will find the module 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 module. 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 module 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 jurisdiction. 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 module 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 module is almost entirely about the expenditure side of public financial management: issues of taxation, borrowing, debt and aid are dealt with in the module, *Public Financial Management: Revenue*; accounting for public expenditure and the audit of public accounts are dealt with in *Public Financial Management: Financial Reporting and Public Financial Management Audit and Compliance*; while issues concerning the financial relationships between tiers of government are covered in *Decentralisation and Local Governance*.

2 The Module Authors

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practice. He has consulting and training experience in a range of countries, including the United Kingdom, People's Republic of China, Cuba, Belarus, Ukraine, Kazakhstan and Singapore. He is a trustee and director of Skill-share International.

Norman Flynn was previously 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* (7e, Sage 2017). 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 Study Resources

This study guide is your main learning resource for the module as it directs your study through eight study units. Each unit has recommended reading either from the key text or from supplementary readings which are included in the module reader and case studies for this module.



Key text

The key text for this module is:

Allen R, R Hemming & BH Potter (Eds) (2013) *International Handbook of Public Financial Management*. Basingstoke UK/New York: Palgrave Macmillan.

Written by the most authoritative experts in the various fields, this manual provides an overview of the whole field of public financial management. You will only read those chapters devoted to planning and performance.

4 Module Overview

Unit 1 The Contexts of Financial Management

- 1.1 Introduction
- 1.2 What is a Budget?
- 1.3 The Macroeconomic Framework
- 1.4 The Legal Framework
- 1.5 Accountability
- 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 versus 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 versus Accruals Accounting
- 4.3 The Macroeconomic, Fiscal Framework and the Medium-Term Expenditure Framework
- 4.4 Policy Formulation and the Budget Process
- 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 Case Study South Africa Basic Education
- 5.8 Accounting for Services Provided by Third Parties

Unit 6 Budget Execution

- 6.1 Introduction: Budgetary Control
- 6.2 Controlling Operations
- 6.3 Taking Action
- 6.4 Risk of Policy Failure
- 6.5 Case Study

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 Case Study 2: Performance Budgeting in France
- 7.5 Case Study 3: Performance Budgeting in Poland
- 7.6 Performance Budgeting in Asia
- 7.7 Case Study: Education Funding in South Africa
- 7.8 Conclusion: Will Performance-Based Budgeting Ever be Fully Implemented?

Unit 8 Budgeting and Democracy

- 8.1 Introduction
- 8.2 National Legislatures and the Budget Process

- 8.3 Case Study: Canada
- 8.4 Participatory Budgeting
- 8.5 Case Study: Australia
- 8.6 Conclusions on Budgeting and Democracy
- 8.7 Is There a Single Best Method of Financial Management?

Unit 1 starts with a discussion of three elements of the context:

- macroeconomic framework of the budget
- the legal and institutional framework in which budgets are made
- accountability framework of the public sector.

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 Unit 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.

Examples and case studies from a range of countries are complemented by a more detailed case that runs through Units 2 to 7. This is about the budget for school education in South Africa, how the budget is classified, costs are derived, resources allocated and performance monitored.

5 Learning Outcomes

When you have completed this module, 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.

6 Studying the Module

When you work through the materials, there are various exercises, from the study guide 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.

Virtual Learning Environment

You will be asked to submit your assignments and receive feedback through the Virtual Learning Environment (VLE), and to ask questions of your tutor. The VLE 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 VLE to discuss issues with your fellow students. You will be prompted to do so occasionally as you progress through the module. Because public financial management varies greatly across the world, you should find it valuable to check your understanding and experience with your global classmates.