

- 5.001 In this chapter, we draw attention to a range of issues relating to current expenditure and suggest some improvements. As we defined it previously, current expenditure can be classified into three general types – expenditure on outputs, expenditure on transfer payments, and expenditure on debt servicing and repayments.
- 5.002 Our observations here relate only to the first two types. We see scope for Parliament to get better information through improvements in the way classes of outputs and transfer payments are described.

What Are “Outputs” and Why Were They Introduced?

- 5.003 The Public Finance Act 1989 defines “outputs” as the goods or services that are produced by a department, Crown entity, Office of Parliament, or other person or body. By contrast, “inputs” are the ingredients (materials, labour, plant, land, etc) that are used to produce those goods and services.
- 5.004 An important objective of the Public Finance Act 1989 was to shift the focus of appropriation and expenditure reporting from inputs to outputs. We supported this initiative from the first, and experience has convinced us it has been a very positive development. We believe that it gives much greater clarity to the goods and services that the Government is purchasing with the resources Parliament has approved – rather than (as was previously the case) the general nature and cost of agency inputs.

What Are Classes of Outputs and How Are They Used?

- 5.005 The Public Finance Act 1989 defines a “class of outputs” as “a grouping of similar outputs”. The word “similar” is not otherwise defined and therefore assumes its ordinary meaning. Generally, it has been applied to outputs with similar attributes that are intended to achieve similar purposes.

- 5.006 Only outputs within the same Vote can be grouped into classes. In some Votes the expenditure on a class of outputs aggregates to a very large amount, but in others it remains very small. In the 1999-2000 *Estimates*, there are 332 departmental and 131 non-departmental output classes. The amounts appropriated in them range from relatively small sums to \$1,500 million.

Are There Any Problems with This Usage?

- 5.007 Because the Public Finance Act 1989 provides for appropriations for classes of outputs, there is scope for the Executive to transfer resources between outputs within a particular class without other prior Parliamentary authority. In addition, section 5 of that Act provides that the Governor-General (by Order in Council) may authorise the transfer of resources from one output class to another in the same Vote – so long as the amount transferred does not increase the appropriation for a class of outputs by more than 5% in any year.
- 5.008 Consequently, when the appropriation for a class of outputs is very small, Parliament's control is exercised at a level of fine detail. However, when it is very large, that control is necessarily much less precise and, arguably, much less effective. For example, the 1999–2000 *Estimates* provide for four non-departmental output classes for personal health services. The appropriations for each output class average around \$1,000 million, but Parliament is provided with very little information about what services will be provided. Further, a sum as large as \$50 million could be transferred to that output class without reference to Parliament.
- 5.009 Given such examples, we believe that there may be a case for imposing a statutory limit on the amount that can be transferred between classes of outputs.

How Are Classes of Outputs Described?

- 5.010 Section 9(2A)(e) of the Public Finance Act 1989 requires that the *Estimates* include a description of each class of outputs to be purchased by the Crown. Such descriptions determine, in part, the extent of the activities that may be lawfully funded by the appropriations.

Are There Any Problems with These Descriptions?

- 5.011 A critical factor in the effectiveness of Parliament's scrutiny and control is that outputs must be specified with enough precision. If specification is vague, the Government is afforded a degree of flexibility that compromises Parliament's ability to control supply.
- 5.012 This issue has also been of concern to the Executive itself. In 1991, the Review of State Sector Reforms²⁷ concluded that the processes and principles for specifying outputs needed to be clarified, given that they are the basic building blocks of the Government's decision-making and accountability mechanisms. In 1992, an interdepartmental Working Party on Output Definition made a number of recommendations on output specification and related budget processes.
- 5.013 We are persuaded that many output descriptions can still be improved significantly and that improved descriptions will better meet Parliament's information needs. Since the Public Finance Act 1989 came into force, we have observed a number of examples where output specification seems to have been insufficient to give substance to Parliamentary scrutiny and control. For example, in a previous year Vote Social Welfare contained output classes relating to important social work services that in our view were poorly described and poorly measured.

²⁷ *Review of State Sector Reforms*, Logan B (Convenor), State Services Commission, 1991 – known as the "Logan Report".

- 5.014 One aspect of output description that we believe has caused difficulty is the issue of controllability. Most outputs are wholly, or very largely, services. The Government's direct purpose in purchasing an output is to purchase an immediate benefit or effect that is wholly or very largely within the provider organisation's control.
- 5.015 Such outputs are often described in terms of the activities that the service providers will undertake. If descriptions of such activities are imperfect or incomplete (which they very often are), there is a risk that service providers can legitimately claim to have delivered the outputs purchased by the Government, even though the immediate benefit or effect for which the services were purchased have not been achieved. In our view, service outputs should not generally be described simply in terms of activities, but rather in terms that reflect the desired benefit of effect.
- 5.016 To take an illustrative hypothetical example, the services provided by officials in processing passport applications could be measured by the total number of person hours spent on that activity. A better measure would be the number of passports actually issued, since the issued passports represent the desired benefit being purchased.
- 5.017 To return to the example in paragraph 5.013, the 1997-98 estimates for Vote Social Welfare provided for a class of outputs entitled "Risk Identification and Management", by which the Children, Young Persons and Their Families Service supplied services that dealt with notifications of possible child abuse or neglect. The performance measures purported to address the dimensions of quantity, quality and cost. In particular, "quality" was measured by the time between notification and first contact, and the time between submission of court reports and court hearings – both actually measures of timeliness rather than quality. Output quality could instead have been measured in relation to the way in which investigations were conducted. In other words, the desired benefit being purchased would have been the completion of a competent professional investigation.²⁸

28 The Service has since developed measures of professional quality assurance, although these are not yet fully reflected in the 1999–2000 performance measures. For more information, see "The Information Needs of the Children, Young Persons and Their Families Service", *Report of the Controller and Auditor-General, Second Report for 1998*, parliamentary paper B.29 [98b].

What Are Performance Measures and Performance Standards?

- 5.018 Performance measures provide information on how well organisations are doing in producing their outputs. In central government, performance measures usually address the dimensions of quantity, quality, timeliness, cost and (where relevant) location. Performance standards are statements of how well the organisation *should* be doing – for example, how much quantity, what level of quality – as disclosed by the performance measures.
- 5.019 The Public Finance Act 1989 envisages and makes possible a useful coherence in the information used in the specification of outcomes, outputs and performance measures. The intention is that the Government will choose and specify the outcomes it wants. It will then choose and specify the outputs it believes necessary to promote those outcomes. In doing so, it is implicitly applying policy models of the causal relationships between the outputs and their associated outcomes.
- 5.020 The attributes of the outputs that need to be specified are those which the policy model identifies as being desirable or essential (although usually not sufficient in themselves) to cause the outcomes to occur. Performance measures can be used to specify the required attributes, and to confirm that the outputs actually produced did have those attributes.
- 5.021 The Public Finance Act 1989 makes no specific requirement that descriptions of classes of outputs need to include measures and standards of performance. However, ever since that Act came into force, performance measures and standards have been included in the *Estimates*. It is unclear whether or not they have been intended to form part of such descriptions or have simply been provided gratuitously.
- 5.022 A 1994 amendment to the Public Finance Act 1989 [section 34A(3)(d)(i)] requires each department to include a statement of objectives in its forecast financial statements. This statement must specify, for each class of outputs, the performance to be achieved as agreed with the Minister responsible for each Vote administered by the department.

Another 1994 amendment [section 34A(5)(b)] requires that the information contained in the forecast financial statements must be consistent with the information contained in the *Estimates*.

Are There Any Problems with Performance Measurement?

- 5.023 Since 1989, many of the performance measures actually presented in the Estimates and in departmental forecast reports have been the subject of adverse comment – particularly, in terms of their ability to reflect performance fairly and comprehensively. We expected some deficiencies in the measures initially adopted by departments and have observed a modest evolution each year since then. However, in general, we do not regard the standard achieved so far as nearly good enough.²⁹
- 5.024 This slow evolution may have arisen in part because of the absence of clear and definitive prescriptions of the standards required for non-financial measures. Such prescriptions do exist for financial measures. Both the Public Finance Act 1989 and the Fiscal Responsibility Act 1994 require that financial information must be presented in accordance with GAAP. However, there is as yet no GAAP standard relating to non-financial information.
- 5.025 This is not to say that the issue has not been addressed or that there is no guidance available. For example, in 1995 the Treasury published guidelines³⁰ that addressed output performance measures and gave a number of examples of measures considered suitable for use in particular situations. In addition, the Audit Office has promulgated, for the guidance of our auditors, a standard³¹ that sets out what we regard as appropriate criteria for performance measures.

29 Issues relating to the reporting of service performance have also been addressed in "Reporting on Service Performance for Output Classes", *Report of the Controller and Auditor-General, First Report for 1997*, parliamentary paper B.29[97a].

30 *Purchase Agreement Guidelines with Best Practices for Output Performance Measures*, the Treasury, April 1995.

31 The Audit of Service Performance Reports (OAG-18), *Manual for Audit Service Providers*, Office of the Controller and Auditor-General, February 1996.

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5.026 Apart from the indispensable characteristics of validity and reliability³² that apply to all measures, our standard requires that performance measures be relevant, complete and understandable.

5.027 In our guidelines, performance measures for a class of outputs are:

- *relevant* in that:

- they meet the information requirements of stakeholders, and
- they reflect the objectives agreed between the entity and stakeholders,

- *complete* in that:

- they cover all significant activities being undertaken by the entity, and
- the important dimensions of those activities are portrayed; and

- *understandable* in that:

- the presentation, content and format are clear, and
- targets and achievements are supported by recognised standards or are traceable to agreements.

5.028 A key consideration in determining whether or not measures are relevant is that they address attributes of the output that the policy model identifies as being causally related to the desired outcome. In other words, the logic of the policy model may require that, if the desired outcome is to occur, the outputs that are intended to cause it must have certain attributes. Relevant measures will address those attributes.

5.029 We consider that all performance measures should meet these simple tests and see value in Parliament imposing a statutory requirement that they do.

³² A measure is *valid* when it actually measures what it purports to measure. It is *reliable* when repeated measurement by the same method produces the same result.

What Are Non-departmental Output Classes?

5.030 The Government may seek to obtain services from organisations or entities other than government departments. Some of these may be Crown entities (which the Government effectively controls), but others may be independent of government. Such appropriations are referred to in the Public Finance Act 1989 and in the *Estimates* as “non-departmental output classes”.

Are There Any Problems with Non-departmental Output Classes?

5.031 Because more and more outputs are being obtained from providers other than government departments, we believe that it is important that the nature of the relationship between the Government and providers is clear.

5.032 As presently worded, the Public Finance Act 1989 requires that classes of non-departmental outputs be “purchased”. The term “purchased” is not directly defined in the Act, although a recent amendment inserted the clarifying definition that:

Purchased, in relation to a class of outputs to be purchased by the Crown, includes purchased under an agreement that is not legally enforceable.

This clarification, although welcome, does not, in our view, resolve all the issues.

5.033 A consequence is that all transactions for the provision of non-departmental output classes are purchases and must have the form of purchases. This is achieved by entering into contract-style purchase agreements between the Minister and providers. We question whether this is appropriate in all cases.³³

³³ See also "Appropriations for Non-departmental Output Classes" in the *Report of the Controller and Auditor-General, Third Report for 1997*, parliamentary paper B.29[97c] and *Inquiry into Certain Events Concerning the New Zealand Tourism Board, Report of the Controller and Auditor-General*, April 1999, page 83.

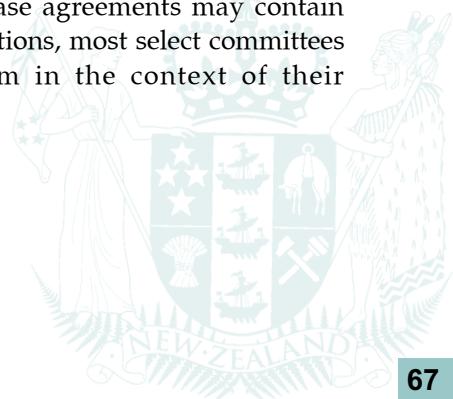
- 5.034 A number of Crown entities (such as the Police Complaints Authority and the Privacy Commissioner) are required by statute to undertake certain tasks and, in doing so, to act independently. The sums appropriated by Parliament and administered by government departments are simply intended to fund those entities to undertake those tasks. In our view it is quite wrong to categorise the economic relationship as that of purchaser and provider.
- 5.035 We believe the word “purchase” should be defined in the Public Finance Act 1989 to have an appropriate meaning. We also consider that the flow of funds from the Crown to some Crown entities should not be characterised as the purchase of non-departmental outputs. An alternative approach would be to treat them as requited transfer payments (see paragraphs 5.041–5.045).

What Are Purchase Agreements?

- 5.036 Purchase agreements are documents that have the form of a contract between Ministers and the suppliers of outputs. These agreements set out in detail exactly what is being purchased and the price that is being paid.

Why Are Detailed Purchase Agreements Important?

- 5.037 Imprecise output specification can compromise the Executive’s ability to exercise control over its own agencies. In this respect, Ministers have a remedy available that is not available to Parliament, in that they can make output descriptions in purchase agreements more specific than in the Estimates. Because purchase agreements may contain more detailed output specifications, most select committees now request copies of them in the context of their examination of the *Estimates*.



- 5.038 Purchase agreements do not have the legal immutability of appropriations. Ministers and chief executives may alter the contents during the term of the agreement without other parliamentary authority, provided that the alterations do not conflict with appropriations or the descriptions of outputs in the *Estimates*.
- 5.039 In some cases there is clear merit in using purchase agreements to provide scope for flexibility, particularly when key information is not available when the *Estimates* are being prepared. However, it is essential that a proper balance be struck. Parliament's control can be maintained only if flexibility is not conferred when it is not needed.
- 5.040 We believe that Parliament is entitled to expect that the specification of outputs in purchase agreements will generally be congruent with the corresponding specification in the *Estimates*. If outputs are described very loosely in the *Estimates* but precisely in purchase agreements, the Executive will be arrogating to itself information and a basis of control that Parliament is being unnecessarily denied.

What Are Transfer Payments?

- 5.041 Transfer payments are payments of public money to individuals and groups to provide them with resources that they would not otherwise have. Besides purchasing outputs, the Executive also seeks to advance its objectives by means of transfer payments. These account for between one-quarter and one-third of total Government expenditure.

Are There Any Problems Relating to Transfer Payments and How Can They Be Addressed?

- 5.042 Parliament is supplied with relatively little information beforehand about the Executive's objectives in making transfer payments or after about the effect of those payments.
- 5.043 It is possible to regard transfer payments as falling into one of two categories:
- **unrequited** transfers (for example, many social security benefits) which do not require the recipient to do anything or supply anything to qualify for the payment; and

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- *requited transfers* (such as grants to businesses or community groups), which commit the recipient to doing something in order to receive the grant.
- 5.044 The difference between a requited transfer and an output is that, in the latter case, the Government owns the goods or services supplied and, in the former case, it does not.
- 5.045 This categorisation has implications for the information that Parliament needs in order to appropriate public money for transfer payments. In the case of requited transfers, Parliament is entitled to some general indication of how the transfer will be requited and who will be the likely beneficiary. For both requited and unrequited transfers, we believe that Parliament should receive information about the outcomes to which the transfer payments are expected to contribute.

Summary of Conclusions

- 5.046 The Public Finance Act 1989 shifted the appropriation process from control of inputs to control of the outputs purchased by the Crown. It also provided that Parliament should receive information in the *Estimates* on the linkage between the outputs purchased by the Crown and the Government's desired outcomes.
- 5.047 We believe this was a very constructive change. However, we also believe there is scope for considerable improvement in the way in which outputs are described, and the quality of the performance measures used.
- 5.048 The Crown also purchases outputs from sources other than government departments, such as Crown entities. We consider that some of these transactions are not well-described as "purchases" of outputs, especially when the transactions relate to Crown entities that are charged by Parliament with exercising independent functions. Some of these transactions might be better described as "requited transfer payments".

- 5.049 Purchases by the Crown of departmental and non-departmental outputs are commonly described in purchase agreements between the Minister and the supplying agency. Purchase agreements typically describe the outputs purchased in greater detail than is provided in the *Estimates* or in departmental forecast reports. Purchase agreements are not regulated by the Public Finance Act 1989 and can be changed during the year at the discretion of the Minister.
- 5.050 We believe it is important, from Parliament's perspective, to avoid a situation where outputs are specified only in very general terms in the *Estimates* and departmental forecast reports but with precision in purchase agreements. The *Estimates* and departmental forecast reports should provide sufficient information to meet the requirements of parliamentary accountability; and the descriptions of outputs in purchase agreements should be well-aligned with the descriptions in the *Estimates* and in departmental forecast reports.

