CENTRAL GOVERNMENT MANAGEMENT

A New Approach

The Audit Office

CONTENTS

LIST OF DIAGRAMS

FOREWORD

This report was originally presented to the House of Representatives as part of my Report on the Public Accounts for the year ended 31 March 1989. It identifies and comments on the changes to central government management expected to result from the passing of the Public Finance Act 1989.

I applaud the passing of the Public Finance Act 1989. It heralds fundamental changes to central government management practices in New Zealand. The changes that are expected to flow from this legislation and those initiated by the State Sector Act 1988 are enormous, ambitious and, in large part, unprecedented anywhere in the world.

B. H. C. Tyler
Controller and Auditor-General
October 1989

1. INTRODUCTION

Changes to central government management, which will result from the passing of the Public Finance Act 1989, have gone largely unnoticed and, to date, their implications have not been widely recognised.

The following report identifies some of these implications and, I hope, will motivate members of the general community, Members of Parliament, Cabinet Ministers, Chief Executives and departmental staff to actively participate in implementing these changes. This participation is necessary if the legislation is to have its intended result.

The changes extend far beyond the financial management areas of central government. The new legislation provides the opportunity to change the way the community perceives public service, and, consequently, the way Government works.

It had been my intention to produce a report designed to assist Chief Executives and Members of Parliament to manage these changes. After extensive discussions with them, I found the greatest need was for complete and understandable information about the intended nature and extent of the changes. What follows is intended to address that need.

The discussion considers the background to the changes (pages 2-5) and identifies the major reforms to be implemented (pages 5-18). It then looks at the implications of the changes for the community, Members of Parliament, Cabinet Ministers, Chief Executives, central agencies and departmental staff (pages 18-22). Finally the report concludes that, to effectively implement change, consultation with the participation of all these people is required (page 22).

2. BACKGROUND

Q. What is so important about the way central government is managed?

Central government is big. It is therefore vital that we value both the impact central government has on the community and the need for all New Zealanders to hold the Government to account (see Report of the Controller and Auditor-General on the Public Accounts for the year ended 31 March 1988, B.1 [Pt.II], page 12). The influence of central government is enormous, and, while it cannot be easily measured, its size is demonstrated as follows:

In the 1988/89 year, central government:

- Spent $37,600 million or $11,195 for every person;
- Collected $37,612 million or $11,199 for every person;
- Owed $38,161 million or $11,362 for every person;
- Owned land and buildings with a value in the region of $8,392 million or $2,498 for every person; and
- Had business investments and other assets of at least $19,750 million or $5,880 for every person.

The size of central government and its nature means it influences our daily lives in ways we have routinely come to expect yet often ignore.

Despite this, the Government does not have unlimited physical resources. Those it does have are held in trust for the community. All of this imposes on the Government a responsibility to ensure that its organisations are managed to achieve its objectives effectively, efficiently and equitably in ways compatible with the accountability of those organisations to Parliament.

Q. What is wrong with the way central government has been managed until now?

Until now, the management of central government has concentrated on being accurate, honest, equitable and reliable. It has done this remarkably well. Central government has implemented new approaches to management and has kept in touch with developments in countries with a similar central government structure. It adopted Programme Budgeting in 1968-9, Indicative Planning by Cabinet in 1972 and by the Planning Council in 1977, and corporatisation in 1986.

The advances made over the last 20 years have made it possible to identify underlying weaknesses remaining in the way central government is managed and, therefore, the opportunities which exist to improve its management.

Until now, the public, Parliament and Cabinet Ministers have had no way of being certain they were receiving value for money from the public service. Chief Executives and other managers have had no reliable means of being certain they were delivering value for money.

There are several reasons for this. First, there has sometimes been a lack of clarity about what was intended to be achieved. Second, the focus of control has only been on cash. Taxes were collected, records of "from whom" and "why" were kept and Parliament appropriated all the money collected to specific uses.

Parliament authorised what Ministers were to spend the money appropriated on (that is, *inputs*), within broad programmes. For example, money was appropriated to identified Police activities, but without any logical link between what those activities were intended to achieve and Police's overall mission.

Also, while accurate and detailed records were kept on what the cash was spent, there was no similar detail of assets owned or acquired. Assets were fully paid for in the year of acquisition and subsequent non-cash costs and values associated with owning the assets (for example, depreciation of buildings and revaluation of land) were not identified and considered by Parliament.

Thus, when considering the implications of new policies, governments did not consider the non-cash costs because information on them was not available. Had this been available, it is possible that the policies adopted may have been different.

There have also been deficiencies in the way central government has previously reported its activities. I have identified these deficiencies on many occasions (refer, for example, B.1 [Pt.II], 1986, page 55). Until now, governments have reported very simply. In effect, they have provided a statement of accounts based on the receipts and payments through only one of the bank accounts operated by them, the Public Account.

These problems are experienced by governments in other countries too. The result has been that governments have not been able to consciously consider all relevant aspects when making and implementing policy.

Q. How will the Public Finance Act 1989 change things?

The Government is the trustee for the community's considerable resources. It holds them in trust and also uses them to provide advice, services and goods to the community. In future, Parliament will appropriate resources in a way which is more consistent with the community's needs.

Parliament will require identification of:

- What the Government is trying to achieve – its intended *outcomes*; and
- The advice, goods and services that the Government is producing (*outputs*) to achieve those outcomes.

This clarity will give impetus to real improvements in the management of public resources.

Consistent with that emphasis, changes are being made to ensure that managers in the Public Service will have clearer and more appropriate objectives in their individual positions and, within their defined boundaries, greater ability to manage resources.

One of the great advances made is that it is now explicitly recognised that outcomes are the responsibility of Ministers and that Chief Executives have responsibility, and are accountable, for outputs.

Q. We've had lots of changes in the past. What makes these changes so significant?

Over the years, there have been many attempts to improve the way central government is managed. There have been continuing efforts to change the way public servants think about their work. They have been persistent in their efforts to apply the principles of good management. One example is the adoption of Programme Budgeting.

Past changes have contributed to better government. But they have not been sufficient to repair the underlying weaknesses identified above.

Q. What makes the current changes more likely to succeed?

Current changes involve the most fundamental management reorganisation of central government yet attempted and, in the process, are designed to address constraints inherent in

Q. What are "inputs", "outputs", and "outcomes"?

- "Inputs" are the resources (salaries, accommodation, equipment, etc) used by departments to produce their goods and services.
- "Outputs" are the goods and services departments produce. Outputs include policy advice, the provision of services and the administration of grants and regulations.
- "Outcomes" are the effects of outputs on the community. Outcomes provide the rationale for the allocation of resources to outputs.

An example taken from the Ministry of Agriculture and Fisheries is:

An **input**, the salary of a scientist, is part of the cost of an **output** "Marine Fisheries Catch Levels". An output forms part of the **class of outputs** "Policy Advice (Fisheries)". A "class of outputs" contributes to the Government's intended **outcome**, "Enhancing the national benefit through the conservation and management of the Fisheries of New Zealand".

the previous system of central government management. The changes affect Parliament, Ministers, Chief Executives and departmental staff. Ultimately, they will affect all members of the community in their interactions with the public service. The culture of departments, the way public servants respond to members of the public, the administrative efficiency of departments and the way value for money is determined may all change.

Many of the underlying problems were the result of perverse incentives. Parliament set the focus of management initiatives, controls and reporting by appropriating cash and monitoring performance against that appropriation. As a result, a manager was probably more likely to be rewarded for not overspending than for being effective.

Q. How are these changes "largely unprecedented anywhere in the world"?

Other similar governments – Canada, Australia and the United Kingdom – have attempted to change central government management. But none of these countries has separately allocated responsibility and accountability for outcomes and outputs. Nor have they made such extensive changes to the focus of parliamentary appropriation.

By altering that focus to outcomes and outputs, and making consequential changes in management and reporting, the alterations to central government management in New Zealand are innovative and unprecedented.

3. THE CHANGES

This section describes the changes to central government management in some detail. It discusses the key changes to the appropriation process and reporting to Parliament. While the changes can be described separately, they affect and reinforce each other.

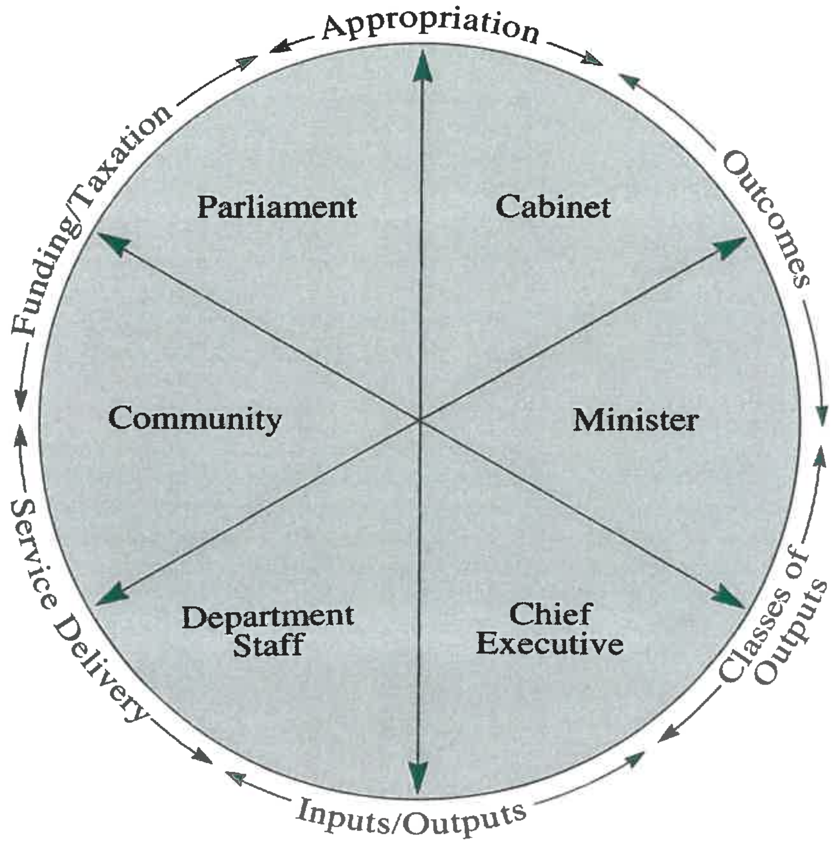
The changes reflect particular roles and relationships between the major participants in our parliamentary system of government. The roles and relationships assumed are:

- The community, that is, the people, are the ultimate owners, consumers and beneficiaries of all the Government's activities.
- Parliament is the collective of the people's representatives and is the means whereby the authority of the people is given to the Government to act.
- The Executive arm of the Government, that is, Cabinet Ministers, is the people's executive agent. Ministers act with the consent of Parliament and exercise sovereign authority on behalf of the people.
- Departments, managed by Chief Executives, are the agents of the Ministers who effect the decisions of the Government which receive the authority of Parliament.

The relationships can be illustrated as follows:

Diagram 1

RELATIONSHIPS IN CENTRAL GOVERNMENT



The four basic groups can be expanded to include six main participant groups: The community, Parliament, Cabinet, individual Ministers, Chief Executives and the Public Service.

Each group communicates most often with the group to either side. Some of these aspects are discussed in detail. For example, Members of Parliament interact with the people in their constituency and with Cabinet collectively. A Chief Executive interacts with his or her Minister and with members of his or her departmental staff.

The nature of that communication is formalised in the areas on the outside of the circle. For example, Parliament grants Cabinet appropriation. Cabinet and Ministers negotiate the "classes of output" which will meet the desired outcomes. Chief Executives and their staff communicate about the inputs to be acquired and outputs to be provided. Public Servants and members of the community both influence the nature of the service delivery. And the community and Members of Parliament together influence the level of funding and taxation to be made available to the Government on the basis of conditions acceptable to both.

In addition, there is a direct relationship between areas lying opposite each other. For example, the service delivery received and provided and the desired outcomes sought by Government are directly interrelated. Similarly, the inputs and/or outputs available from departments are directly related to the appropriation granted. Funding or taxation available to Government can also be directly related to the "classes of output" Ministers and Chief Executives agree to provide to the community.

The changes are designed to reflect these roles and relationships in the administration of central government.

The changes have also been designed to provide departmental staff, Chief Executives and Ministers with the incentives to perform in accordance with their roles and relationships. More specifically, the changes are designed to provide positive incentives to perform in accordance with the Government's stated intentions notified to, and authorised by, Parliament.

The new regime of central government management is designed to:

- Link parliamentary appropriation to the **performance** required of government departments and Crown agencies as both suppliers of outputs to the Government, and users of community resources;
- Allow the exercise of Parliamentary control over both the **purpose** for which resources are to be used and the **amount** of resources used; and
- Provide administrative simplicity and transparent decision-making.

APPROPRIATION

The form of Parliament's appropriation has a significant influence on the focus of management within the Government. It is therefore important that Parliament uses the appropriation process to clearly identify and authorise the Government's plans. The new appropriation regime is designed to meet these requirements.

Parliamentary interests

Parliament will, in its appropriations, reflect three different interests that it has in the operations of the Government.

These are its:

- **Purchase Interest:** Parliament is authorising (on behalf of the community) the purchase or production of a range of goods and services (outputs) from government departments and agencies. It is therefore concerned to get the outputs that satisfy stated needs (the right quantity, quality and timing) at prices it is prepared to agree to.

- **Ownership Interest:** The community, represented by its elected representatives in Parliament, owns the assets and resources employed by the Government. Parliament periodically makes a contribution to increasing the level of assets held. Like an individual, Parliament is concerned to ensure that the assets held are being well used and well maintained. In addition, it needs to consider that liabilities or charges in respect of those assets are only incurred after consideration of their long-term implications.
- **Redistributive Agency Interest:** Parliament provides the authority for departments to pass on funds to individuals and organisations. Departments will therefore, by virtue of an appropriation, make "payments on behalf of the Crown" in the form of benefits or grants.

Each year Parliament will separately appropriate for each interest. The legislation which enables government expenditure, the Appropriation Act (or Acts), will include separate details of the costs to be incurred to:

- Purchase "classes of outputs";
  and the funds required to:
- Make capital contributions; and
- Fund payments of benefits and grants to be made on behalf of the Crown.

The appropriations will be grouped together into Votes. Each Vote will contain the appropriations to only one Minister, but a Minister may control more than one Vote. While a department may be the manager of more than one appropriation, only one Minister, "the Responsible Minister", is deemed to have the ownership responsibility for the department. This "Responsible Minister" controls the capital contribution appropriation to the department.

Unless parliamentary authority is first obtained, there will be no ability for the Government to transfer funds between each of the appropriation interests. Only limited ability has been given to the Government to transfer within the purchase interest from one "class of output" to another.

Q. Why are transfers within Votes restricted?

To allow transferability would confuse Parliament's three interests in the Government's activities. Each of those interests is mutually exclusive. People generally recognise that if, for example, money is put aside to pay benefits, that is what it should be used for. Similarly, when Parliament, as owner, approves the decision of the Government to make an investment, it must have confidence that the investment will occur. When, as purchaser, it approves the purchase of a service, Parliament must be confident that the service will be provided and that the appropriation will not be used for some other purpose.

However, in order to allow a degree of managerial flexibility, a limited transferability between "classes of output" will be possible in future. Parliament has made provision for transfers between "classes of outputs" (within a Vote) of up to 5%. Such transfers will be effected by an Order in Council.

Modes of appropriation

There are three bases, or modes, on which Parliament will be asked, under the Public Finance Act 1989, to make appropriations to Ministers. These modes are based on expectations of the related organisation and its ability to manage itself.

The three different modes are:

- **Mode A** – Some departments are not expected to change, or have the means to change, the way they are managed before 30 June 1991. Until then Parliament will appropriate much as it has done in the past. Mode A appropriations will focus on the **cash** needed to buy inputs.
- **Mode B** – All departments will eventually be able to identify the **cost** (including non-cash costs such as depreciation) of supplying outputs. They will also know what assets (including their value) they employ.

  When departments can do these things, the focus of appropriation will shift. Parliament will appropriate to Ministers the **cost** of outputs produced by departments. Where departments are earning trading revenue in a competitive environment, the appropriations will be net of that revenue – hence the term "Mode B Net". Parliament will also annually appropriate, as owner, any additional capital investment needed to enable the department to function effectively and efficiently.

  All capital expenditure that can be funded from the existing stock of capital invested in a department will be at the discretion of the Chief Executives. Mode B leaves the Chief Executive to determine and manage inputs, including capital.
- **Mode C** – Some departments will be required to operate in competition with other suppliers. They will, therefore, need to provide information on the price of their outputs. These **prices** (including charges for notional taxation, interest repayments and dividends) will allow purchase and appropriation decisions to be made with reference to similar goods and services obtainable elsewhere.

  Capital appropriations will be on a similar basis to that described for Mode B, but are likely to be made with reference to the expected financial return to the community on the amount to be invested.

Modes of Appropriation

The "Modes" are the three ways that Parliament gives authority to departments and agencies. They reflect the differing ways of managing departments.

Mode A: Parliament Allocates Funds for Inputs
This is an appropriation of cash to:
- Acquire inputs; and/or
- Purchase capital assets; and/or
- Make payments of benefits and grants.

This is essentially the same system of appropriation that has existed in the past. Parliament authorises the supply of cash to meet the cost of departmental activities such as personnel, operating costs, capital and benefits and grants.

The only difference between Mode A and the previous method of appropriation is that, in order to reflect Parliament's interests more clearly, capital and operating expenditure are now appropriated separately. Mode A will cease to be used on 1 July 1991 when all appropriations will be under either Mode B or Mode C.

Mode B: Appropriation for the Consumption of Resources
This is an appropriation:
- For costs to be incurred in the production of specified goods and services (classes of output); and/or
- Of public money to increase the level of the Crown's asset holdings in a department; and/or
- Of public money to make payments of benefits and grants.

This Mode changes Parliament's focus of control to the nature and costs of the outputs that are to be provided.

It reflects Parliament's dual role as purchaser of the goods and services and owner of the department more clearly than does Mode A. Departments will report the full cost (including depreciation) of the resources to be used in production. Parliament can then appropriate funds for the supply of all or as much of those goods and services as it requires.

Mode B appropriations can be represented as either Gross or Net.

Mode B Gross is where the appropriation sought in any year reflects the total production of that class of outputs.

Mode B Net is where the appropriation is not for the total production of that class of outputs. Some outputs within that class will be supplied under trading conditions. Authority to spend up to the estimated amount of trading revenue to be received from these trading activities will be given (see page 13).

Funds will be appropriated separately for outputs and capital, reflecting Parliament's separate interests.

Parliament will only make an appropriation for a capital contribution when it is increasing its investment in a department.

In future, most departments and agencies are likely to be funded by Mode B appropriation for classes of outputs and capital or some mixture of Modes B and C.

Mode C: Appropriation for the Consumption of Outputs
This is an appropriation to:
- Acquire goods or services needed by the Government; and/or
- Adjust the level of the Crown's asset holding; and/or
- Make payments of benefits and grants.

In this Mode the focus is again on outputs, but requires that the departments "price" their outputs in a way that allows valid comparison with other potential suppliers. To set notional market prices, departments will need to have a capital structure and pay notional interest, tax and dividends. In this Mode departments will have freedom in how they manage the production of the goods and services that they produce for Parliament.

Capital appropriations will be the same as for Mode B.

Purchase Interest:

In the case of the **purchase interest**, Parliament will appropriate for the costs of supplying specified "classes of outputs" or, in the case of Mode A, "programmes", which contribute to achieving the Government's desired outcomes.

"Classes of outputs" will be groupings of similar outputs. For example, the following are "classes of outputs":

Department of Conservation
"Management services: Conservation Estate" includes the individual outputs "Marine and Coastal Resources", "Terrestrial Resources" and "Historical Resources".

Ministry of Agriculture and Fisheries
"Policy Advice – Fisheries" includes the outputs of advice about "Maori Fisheries Issues", "Marine Fisheries Catch Levels", "Freshwater Fisheries" and others.

Department of Statistics
"Economic and Business Official Statistical Information Services" includes the individual outputs "Business and Agricultural Statistics", "Price Statistics", "Overseas Trade Statistics" and others.

Changing between modes of appropriation

Only Parliament will be able to authorise a change of mode for an appropriation. That authority will only be sought when the Minister is satisfied that the department is capable of meeting the expectations underlying the new mode of appropriation. The authority will be contained in an Appropriation Act.

Periods of appropriation

There are three possible lengths of time for which Parliament can make appropriations. They are:

- Annual: Most appropriations are made on an annual basis and this is likely to continue to be the most common period;
- Multi-year: These appropriations will be possible for periods of up to five years. It is anticipated that Parliament will give its authority to incur costs or fund a further investment in resources for periods in excess of one year in specific circumstances. One example might be capital projects where Parliament would consider the total project cost, which may span many years. Although a multi-year appropriation would give authority for the total project, it would not preclude Parliament from monitoring progress over the project's life; and
- Permanent: These appropriations are traditionally agreed to by Parliament for special reasons. One is the constitutional desirability of preserving a measure of independence from Government control, for example payment of salaries of the Judiciary, the Ombudsmen and the Controller and Auditor-General. Another reason is for expenditure having a priority charge on the public revenue, for example debt servicing.

However, in recent years the principle of permanent appropriation has been extended to permit certain government departments engaged in trading activities to incur costs without annual appropriation by Parliament. Such an appropriation is made in the Public Finance Act. Departments allowed to operate under this authority will have to provide outputs to parties other than Ministers, in the open market in competition with other potential suppliers. The permanent appropriation given allows the department to incur costs up to the amount of trading revenue estimated at the beginning of the year. Use of this authority is subject to approval by the Minister of Finance.

Q. How do the various types of appropriation fit together?

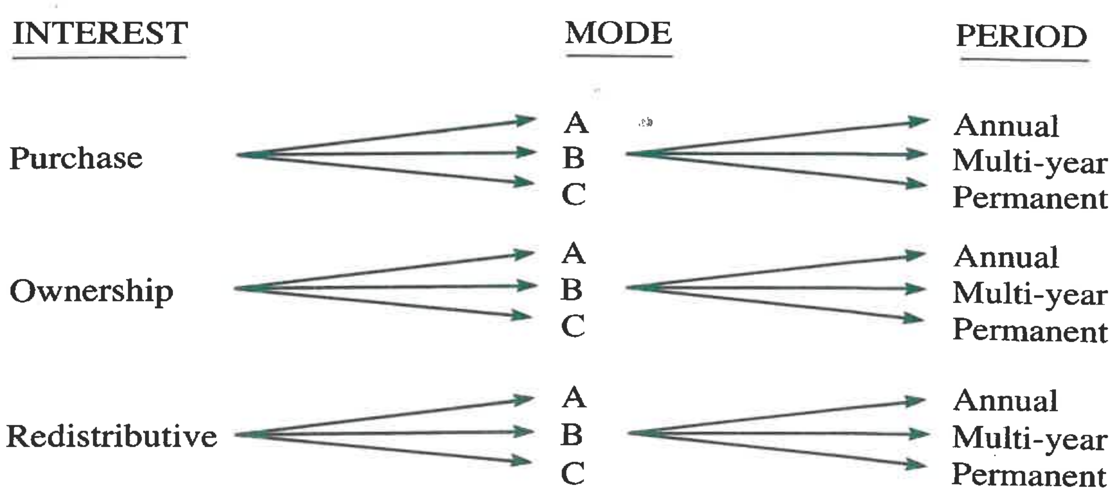
Parliament gives authority for the Government to exercise all three interests, in any of three modes of appropriation and for any of three time periods.

A Minister could receive appropriation for a department for each of Parliament's interests in Mode A, B and C. Then, for example, a department which is the subject of Mode B appropriation could receive that appropriation for one of the time periods: annual, multi-year (up to five years) or permanent (see diagram below).

The Estimates will reflect the actual information for the appropriations to each Minister.

Diagram 2

POSSIBLE APPROPRIATIONS



The Estimates

The information needed for Parliament to appropriate in the manner described above is to be included in a significantly revised Estimates document. These Estimates (Estimates of Annual Appropriations and Departmental Budgets of the Government of New Zealand) will reflect information, by Vote, of the interests, the modes, and the time periods for which Parliament is being asked to make appropriations.

The financial year has been changed to allow the Estimates to be presented earlier than previously. The last date they may now be presented is 31 July, the end of the first month after the beginning of the financial year. However, given the considerable influence the form of parliamentary appropriation has, it is desirable that the Estimates be in the House prior to the beginning of the financial year, to permit earlier, and thus more effective, appropriation and financial planning. There is nothing to prevent this occurring.

Q. Why are only trading activities given a permanent authority to spend their revenue?

Firstly, in this situation, Parliament's interest is principally as owner of the department rather than as purchaser.

Secondly, only trading activities operate in a competitive environment where they are dealing with customers who, in purchasing their goods or services, are exercising a willing choice.

Trading activities to which this authority applies have to be distinguished from activities where fees and charges are collected. In the latter case there are no competitors. The public may have no choice over using the services, and thus the collection of fees and charges represents the Crown using its taxing powers.

The outputs supplied are therefore considered in the same way as all tax-funded outputs; the purchase is subject to approval by Parliament.

MANAGEMENT

The changes to the appropriation process will strongly affect the management of government departments. This section considers the consequences of the changes for the management of central government departments and Crown agencies.

Q. What changes are likely to flow to management?

One of the most important changes is that Chief Executives and managers within government departments will have a clearer and more relevant idea of what is expected of them. For example, a prerequisite to parliamentary appropriation for "classes of outputs" is that Ministers will have to identify the outcomes the Government is seeking. Then, with their

Chief Executives, they will be in a position to determine the means, the outputs, by which they intend to achieve these outcomes. Responsibilities will be more appropriately allocated. The responsibility of Chief Executives is stated to be "the effective and efficient production of outputs". This includes the responsibility for the effective management of resources. Responsibility for the specification of, and accountability for, outcome rests with Ministers or the Government as a whole. The agreed outputs will form part of a performance agreement between each Chief Executive and his or her Minister, agreements against which the Chief Executive and his or her department's or Crown agency's performance will ultimately be evaluated.

The greater clarity of purpose resulting from these agreements will facilitate improved management planning, including corporate planning and budgeting. Accordingly, it can be expected that all public servants will have a clearer understanding of their roles and responsibilities. As a result of these improvements, public servants can reasonably expect they will be given the resources needed to perform their tasks in a manner appropriate to their responsibilities.

A further feature of the changes is that Chief Executives will, in future, have a greater degree of managerial flexibility as they will have control of:

- **People** – Chief Executives are now employers of their staff and have the ability to deploy those staff in the ways they consider will best contribute to supplying the required outputs;
- **Cash** – The managers of government departments will now be responsible for the control of cash. In the past managers had neither the incentive nor, often, the opportunity to make payments or invoice customers in a way that considered the Government's cash flows. Managers will now manage their own bank accounts and can benefit from their success in effectively managing their payments and revenue;
- **Other resources** – Departments and agencies will have greater flexibility in managing their resources. Within the overall appropriation framework already outlined, managers will be able to buy and sell assets (to the extent that the size of the community's investments in the department is not increased) to produce their outputs;
- **Trading revenue** – Where government departments earn revenue from the sale of goods and services in the open market, Chief Executives may apply that revenue to that activity under permanent appropriation.

This increased managerial flexibility, and the resulting increased responsibilities, will necessitate changes in the management information systems in government departments. Managers will need more information in order to manage their operations effectively, and that information will have to be more timely and of a different nature to that provided in the past. They will constantly require accurate and complete information on such things as assets and liabilities, and income and expenditure. Now that managers are responsible for, among other things, managing their cash, they will need to know more about their debtors, creditors and other commitments. This demand for better information means departments will be installing improved management information systems. To provide more useful financial information, departments will be using accrual accounting.

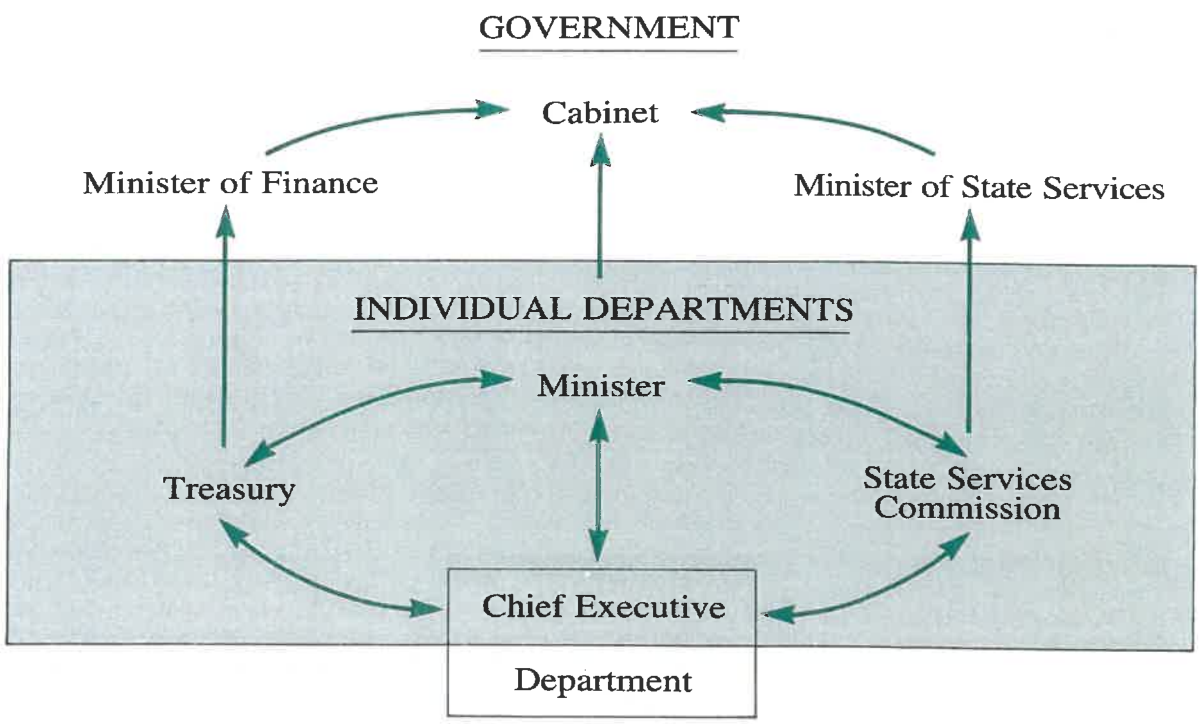
The diagram below highlights the major relationships affecting the management within departments.

The responsibility of, and accountability for, the provision of "classes of outputs" by the department lies with the Chief Executive. The Minister is responsible for obtaining the appropriate outputs to meet the Government's desired outcomes.

In addition, central agencies (Treasury, State Services Commission, Women's Affairs, Environment, and Maori Affairs) are responsible for advising both Chief Executives and Ministers on specific aspects of common concern to central government. They are also able to brief their own Ministers to facilitate the presentation of their ideas in Cabinet. However, the mandates of central agencies are not intended to, nor can they, cut across the responsibilities of the Chief Executive and the Minister, if these changes are to be effective.

Diagram 3

LINES OF RESPONSIBILITY AND ACCOUNTABILITY



Many of the changes outlined, and their consequences, will only come to fruition if the incentives provided to (and by) managers are appropriate. Many of those incentives will flow from the system of appropriation and accountability already described. Others, however, will be determined by the actions of Parliament, Ministers, Chief Executives and the central agencies. One example is the incentives flowing to staff from the way responsibilities are allocated.

Q. What do we mean by "incentives" and how are they going to improve performance?

The setting of performance targets and the new reporting processes will set the criteria for judging the success or failure of Chief Executives and their staff. The judgement of Parliament and the public on actual performance will be crucial to the continuing operations of Chief Executives and their departments. There will therefore be real incentives for departments to perform effectively and to clearly demonstrate that effective performance.

Incentives will also result from the greater flexibility given to managers in managing their operations. In future, managers will have more freedom over how they use their resources. A major disincentive to effective management that existed in the past is eliminated.

The potential benefits of incentives will only come provided organisations and individuals are treated fairly. We are aware of cynicism about the extent that departments will be allowed to benefit from improved performance. If the required improvements to performance are to occur, good performance at both organisational and individual levels must be fairly recognised and rewarded. Poor performance must be similarly identified and remedied.

The effectiveness of these incentives – rewards and sanctions – will be determined by:

- Parliament in its examination of departments' and agencies' activities;
- Ministers in their negotiations of performance agreements with Chief Executives about output requirements;
- Chief Executives in their relationships with their staff; and
- Treasury and the State Services Commission in their dealings with Ministers, departments and agencies.

Without fairness in the application of both rewards and sanctions, the potential for improvements in public sector management will not be realised.

REPORTS

The amount, nature and timing of the information provided by both the Crown and its departments and agencies is radically different under the Public Finance Act 1989. The changes are designed to provide Parliament, and the public, with better information on the way in which the Government and its departments and agencies perform.

From the Crown as a whole, statements are required that show the full size of its activities: what is owned; and what is owed, invested and committed. The Crown will also be required to show the full extent of its activity by reporting total operating costs, revenues and cash flows. Actual figures for the previous year, or budgeted figures where relevant, will also be provided for purposes of comparison. The audited reports on the Crown's activities will be presented six-monthly.

These reports replace the quarterly and annual statements of the Public Accounts. The new form of reporting will significantly enhance the ability to consider and evaluate the operations of the Government as a whole. The changes to the reporting by departments and agencies will provide better information in a consistent framework which can be consolidated for the whole central government sector.

The information from departments will also allow better assessment of their performance. This information will include details of:

- What departments set out to do: their objectives, classes of outputs to be produced, and financial and other targets; and
- How well departments performed: statements of performance for the period being reported (comparing actual output performance against previously set targets), cash received and applied, operating costs and revenues and financial position – assets employed, liabilities, commitments and contingent liabilities.

Departmental reports, too, will be audited and presented at six-monthly intervals.

Q. Why is six-monthly reporting needed from Government and its departments and agencies?

Six-monthly reporting will permit both Parliament and the Government to monitor departmental performance regularly. The presentation of two reports a year will provide reasonably up-to-date information to facilitate the consideration of the Estimates, and ultimately, the Appropriation Act before the new financial year.

There has been a trend to six-monthly reporting by a number of companies in the private sector, and the Crown is now similarly adjusting its reporting practices to provide more timely information.

The reporting requirements represent a significant improvement to the way the Government reports its performance. There are, however, matters pertaining to these reports that have yet to be resolved.

Two matters yet to be resolved were identified in the Finance and Expenditure Committee's report on the Public Finance Bill. There is uncertainty about what constitutes a Crown agency and about the method to be used to consolidate the financial statements of State-Owned Enterprises with those of the Crown. While I am yet to form an opinion on what organisations would fall within the definition of a Crown agency, I do hold an opinion on the method of consolidating State-Owned Enterprises into the Crown's financial statements.

The objective of consolidation is to reflect the full size of the Crown (what is owned, what is owed, invested and committed) and the full extent of its activities (operating costs, revenues and cash flows) in a single set of statements. There are two distinct methods of consolidation. One is to aggregate all assets, liabilities, equity, revenues and expenditure. The other is to include only the equity portion of each enterprise. The use of the latter method would imply that the public money invested in State-Owned Enterprises is only for short-term gain. I disagree that this is what the Crown's consolidated statements should reflect. The former is the method that should be used.

Further improvements are possible in reporting outcomes. The changes, while requiring departments to report their actual performance by reporting outputs produced against targets, do not require Ministers to report their progress in meeting the outcomes to which the outputs contribute. I believe there is a need for such reporting. The commentary on the Budget provided by the Minister of Finance is an example of the kind of statement that I think all Ministers should provide.

Similarly, there is no requirement in the Public Finance Act for the Government as a whole to report progress in meeting its overall objectives. Such a report would be helpful in adding understanding to the reports of the Crown. These are matters which, I believe, should be considered further.

4. IMPLICATIONS OF THE CHANGES

Q. Are the changes going to deliver what we want from central government?

For various reasons, few people are ever certain what they want from the Government. What follows are my views on what the various groups affected by the changes can reasonably expect from the Government and, in turn, what their contribution must be if the changes are to be successful. The expectations and implications for each participant are not mutually exclusive. The benefits of the changes will be achieved only if each participant (including the central agencies) fully and fairly plays its part in the new environment.

The Community: Expectations and Implications

It is reasonable to expect that Government (including its departments) will "do the right things" for the community, for the best price, and that it will do them effectively, efficiently and equitably. Further, it can be expected that resources will be allocated to the areas of greatest need, and that the Government and its employees will be responsive to the community's needs.

The way the Government responds to the public is intended to change. Departments and agencies will think more clearly about what it is their customers want from them. Government departments will, in future, be driven by customer need more than has been the case in the past. Departments are being freed from excessive centralised control and the changes will make it clearer to everyone what the departments and agencies do. How much the public is paying for the goods and services that we get from Government, and how well it is protecting the assets that the public has paid for over the years, will be clearly stated. The changes also make it clearer why specific outputs have been chosen, how much they cost, and how effectively and efficiently they have been provided.

Like any other legislative changes, these will be effective only if they are used by the community. They provide the means for everyone to judge how well their political representatives, and the public service for which the representatives are responsible, are performing. Everyone will have access to better information and thus the means to better express their wishes to those in charge of the public purse.

These changes should permit members of the community to contribute more to decision-making than previously. Members of community organisations need to understand the framework within which central government will be working if their contribution is to be effective. I urge everyone to use the opportunities afforded by the changes to scrutinise performance and require greater accountability from those responsible for public resources.

Parliament: Expectations and Implications

Parliament requires that the Government does only what is consistent with Parliament's authority. Parliament needs complete, accurate and reliable information on what, and how well, the Government is performing if it is to monitor the Government and exercise its traditional control over the Executive.

Until now, Parliament's ability to influence the Government's policies has been limited by the extent and nature of the information available to it. Information that has been available has not always been easily understandable and has not properly recognised Parliament's dual owner/purchaser interests. The changes will provide Parliament and its select committees with clearer and more relevant information about the Government.

Members of Parliament will thus be better able to judge the effectiveness of the objectives and performance of departments and how well their outputs contribute to the Government's intended outcomes. They will be better able to scrutinise government policies. They will have the opportunity to question Ministers on their chosen outcomes and Chief Executives on the outputs to be produced to meet those outcomes. Parliament will thus have the ability to hold the Executive more accountable for its actions than has been the case in the past.

The changes will, however, only fulfil their promise if Parliament takes advantage of the opportunities offered to it. The House's Finance and Expenditure Committee, in its report on the Public Finance Bill, recognised the need for Parliament to examine its own procedures to allow for more focused and timely select committee consideration, and parliamentary debate, of the Estimates. These are matters of some significance which need to be addressed.

The changes will not necessarily make life easier for Members of Parliament. They will certainly be receiving more timely and relevant information and in greater quantities. If members are to take the opportunity to exercise rigorous control of the Executive, they will probably spend more, rather than less, time reading departmental reports. I recognise that members have constraints on their time and resources. This raises questions about the nature and extent of support available to Members of Parliament. This is an area of need the House itself could review.

The Government: Expectations and Implications

The Government can reasonably expect its departments to be responsive to its needs and to do what it requires in an effective, efficient, economical and equitable manner. It can also expect that departments will be responsive to their communities and, in carrying out the Goverment's directions, will take the community's needs into consideration.

The changes will provide the Government with a clearer framework within which to make decisions. The distinction between outcomes and outputs provides Ministers with a clearer focus for their attention than has formerly been possible. The reports will also provide the Government with information about the outputs of departments. While the new framework is likely to alter decision-making, most of the changes will result from clearer roles and responsibilities and the availability of better information.

Ministers: Expectations and Implications

Ministers can reasonably expect their departments to be managed effectively, efficiently, economically and equitably in accordance with their directions. They can also reasonably expect that Chief Executives are responsive to their needs as Ministers.

To meet their expectations, Ministers will now be able to require Chief Executives to identify clearly what their department is providing to the community. Ministers also have an obligation to communicate to Chief Executives what it is that the Government is seeking to achieve in the area in which the departments operate.

Ministers will now negotiate performance agreements and output specifications with their Chief Executives. Having negotiated and come to agreement with Chief Executives, Ministers will have an obligation to maintain oversight of departments and take remedial action if agreed objectives are not being met.

The Public Finance Act does not require Ministers to report the results against their stated outcomes and outputs (an omission that I believe should be remedied). However, Ministers can still expect to be more informed, and thus receive more rigorous questioning of their objectives and stewardship of public resources. Ministerial performance will be enhanced by the knowledge that Parliament is closely monitoring their departments and holding them accountable.

The changes will also provide Ministers with better information for negotiating with their colleagues over the allocation of resources within the Government's budget. In turn, however, Ministers can expect that their proposals will be subject to closer and more informed scrutiny by their colleagues. This should contribute to more informed ministerial debate over the setting of priorities and the allocation of resources.

The changes will provide Ministers with better information for use in their negotiations with Chief Executives. When negotiating and monitoring Chief Executives' performance agreements, Ministers may, however, feel less certain about the neutrality of the departmental advice and support they receive. In these circumstances, Ministers may need to consider other sources of advice and assistance.

Departments: Expectations and Implications

Departments have the reasonable expectation that the Government will give them clear directions and provide the resources needed to provide the required outputs. It is my view that staff hope to gain a good understanding of how the departments' outputs are intended to meet the Government's outcomes from these directions. I believe they also expect to be able to perform their duties in a way that meets the needs of individual members of the community in a relevant and timely manner.

The changes are creating an environment in which there is less potential for departments to do things "because they have always done them". Chief Executives have to formally define and agree with Ministers what it is that their departments will do and why, and how much Ministers and Parliament are prepared to pay. That in turn requires a clear definition of the philosophy and strategic objectives underlying those agreements.

Like Chief Executives in the private sector, those in the public service will have control over inputs. Because of the political environment, parliamentary control, and the presence of a principal buyer (who is also the owner of the department), comparisons of management in government departments with private sector management are invalid. Public service managers do, however, have advantages that their commercial counterparts do not enjoy. Unlike managing directors in the private sector, public service Chief Executives will have, within the framework of annual appropriations, confirmed "sales budgets" and assured funding at the beginning of each year. Management in the public service is neither easier nor more difficult than that in the private sector; it is just different.

Central Agencies: Expectations and Implications

Central agencies can expect their role to change. The day-to-day control appropriately practised by the Treasury and the State Services Commission in the past is no longer appropriate. Central agencies do have a continuing role in central government management, and it is imperative that the way their role is exercised is congruent with the responsibility and accountability of each Chief Executive.

Chief Executives can be expected to demand greater autonomy from the central agencies because they are now directly responsible and accountable for their department's performance. Intervention by the central agencies which is inconsistent with this will jeopardise the expected benefits of the changes.

I am aware that already some Chief Executives are questioning the changes because of their recent experience with central agencies. Care will be needed in the future if central agencies want to provide real encouragement to Chief Executives and departments to implement these changes.

Summary

Changes to central government management will result in changes in the relationships among the above groups of people. Broadly, the nature of the communication among them has been illustrated in diagrams 1 and 3 on pages 6 and 15.

5. CONCLUSION AND RECOMMENDATION

New legislation is but the first step to significantly changing central government management. The success of the changes depends upon people having a clear understanding of what they are working towards. This, in turn, relies on those involved actively participating in implementing this shared vision.

During the implementation of these changes over the next two years and beyond, many people may be surprised to be affected by them. Some may be frustrated by how difficult it is to effect change in accordance with their original intentions.

I recommend that you keep clearly in mind what you are working towards. The active participation of all is needed if there is to be effective change in central government management so that it enhances the social, economic and cultural well-being of all people living in New Zealand, now and in the future.

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