The subject is about the considerable gains possible through modern management approaches to public finance. Whilst the value-for-money consideration lies at the base of any such approach, the derived fiscal and macro-economic effects can be hugely significant. Yet all too often an appreciation of these potential benefits seems absent from the thinking of Finance Ministers and senior finance officials. How else can we explain why, in most countries, financial management reform is not prioritized to the extent that it should be?

Let me relate a short story to you concerning the Toyota corporation in South Africa, which at the time was Toyota’s only motor vehicle assembly plant outside of Japan. Toyota was developing their JIT system and to make this workable they decided to buy out suppliers of key vehicle components. I was part of a team of accountants and business economists whose job it was to assess potential acquisitions - which in all cases were profitable companies operating in competitive markets. When considering the sellers asking price against our assessment of the business, we were almost always able to advise the board that, simply by employing Toyota’s compelling financial management methods, Toyota would be able to add between 10 to 30 percent to bottom line profit, if the acquisition were made. We were consistently proved correct.

Since moving my attention to the public sector, the question that has taunted my imagination is “If improved financial management systems can add 10 – 30 percent improvement to the financial performance of a successful business in a vibrant private sector industry – what potential would there be the financial performance of government operations and their typically outdated administrations? And further, what could such improved performance across an entire government mean for a country’s bigger macro-economic management picture?” - in terms of:

• decreasing the budget deficit
• reducing the national debt
• improving liquidity through savings and the release of idle working capital.
• opportunities to lower tax rates
• other opportunities for supply-side stimulation
• greater macro-economic stability and thereby an improved fixed investment environment.
• and improved conditions for currency stability.

1 The following is a note to accompany a diagrammatic system flow chart (available as a separate pdf file) used during a presentation by Dr. Gavin Woods to World Bank staff in Washington on 17 January 2002. The occasion was a seminar organized by the Public Expenditure Thematic Group of the World Bank.

2 Dr. Gavin Woods is a Member of Parliament of the Republic of South Africa and chairman of its Public Accounts Committee.
Simple arithmetic, based on 10% of national expenditure, will prove these possibilities - as can the experiences of a number of countries which have undertaken the necessary reforms. The recent history shows that until 12 odd years ago the universal public sector approach was one that tried to look after public monies by way of conformance to an ever-growing array of rules. What began to emerge just over a decade ago however, was that the achievement gap between the ‘competition-driven private sector’ and ‘the control-driven public sector’ had simply become too vast to justify – essentially in terms of the value-for-money question but also in terms of the governance question. Thus began “the quiet revolution”.

The quiet revolution, is the ‘New Public Management’ revolution – concerns public sector thinkers exploring ways in which successful private sector methodologies and experiences can be adapted to good advantage in the public sector. And in particular how the necessary motivational effects of the competitive market can be substantially captured through a performance driven system in which individual initiative seeks to attain predetermined goals. This is fairly central to available NPM literature and to the observations I have made when surveying the reform initiatives undertaken by 12 countries in recent times. Today, I will (somewhat proudly) focus on South Africa and will take you through the reforms that it has committed itself to - in its determination to gain advantages found in the new financial management thinking. There is a strong correlation between the South African reform model and that of a number of other countries.

In 1998 South Africa’s Minister of Finance tabled a bill in parliament that intended a number of changes to the financial management regime of government. A few Members of Parliament however convinced the parliamentary committee on Finance (the relative legislative committee) to voice dissatisfaction at the bill’s reform limitations. The Minister to his credit then withdrew the bill and proposed that a redrafting committee, comprising both members of parliament and government technocrats, be set up to produce a new act through which to govern financial management. This joint committee, which I had the privilege of chairing, took 9 months to produce what today is known as the Public Finance Management Act of 1999 (PFMA). I will now, by way of a system flow chart construct a model of the PFMA.

---

3 The Public Finance Management Act referred to can be viewed in pdf format at the following website address: http://www.parliament.gov.za/acts/1999/ACT1-99.PDF
PART 1.- POLICY OBJECTIVES.
The first point to make is that financial management should not take place in a policy vacuum. It should take its lead from government policy, because policy is after all the basis of the voters mandate. We have to do more than spend money in the vague direction of government expressed policy. There has to be an approach that defines policy objectives and then pursues these objectives through functional planning and systematic management stages.

PART 2. - STRATEGIC PLANNING.
The modern annual strategic planning exercise is used to convert policy intentions into a tangible plan (service delivery plan) upon which the budget and its management are established. The exercise is to work out how a particular operation should pursue its policy goals through defining its essential purpose, its sought after outcomes and outputs, the programmes it needs to undertake, the performance levels it should achieve and the resources necessary to achieve all this. Capital expenditure projects are also identified. This planning, which covers a three year term, is revised annually - with a more detailed emphasis on the initial year.

PART 3. - MEDIUM-TERM EXPENDITURE FRAMEWORK (MTEF)
This is the three-year budget – which as already indicated is informed by the Strategic Planning exercise. The long practiced one year budgeting horizon gave rise to many short-sighted planning decisions which have been costly and ineffective – not only in terms of erratic and inefficient service delivery but also in terms of co-coordinating the objectives of operational and capital spending. The three-year projection also assists planners to plan the required performance goals into a more useful time frame. The interdependent strategic planning and medium-term budgeting stages play the primary role in the prioritization and allocation of resources.

PART 4.- THE ANNUAL BUDGET – ITS CONSTRUCTION AND DEVELOPMENT
The annual budget cycle produces the MTEF some 4 months before the new fiscal year and the annual budget 1 month before the new year. The 3-month gap is used for developing the detail and fine-tuning the budget for the following year (year 1 of the MTEF). Performance budgeting considerations are extensively incorporated in the construction of the annual budget.

PART 5. - THE COSTING BASIS
The costing exercise, which begins at the strategic planning stage and continues through the annual budget stage, is fundamental to the effectiveness of the performance budget. It is therefore surprising that its importance is understated in some reforming countries. While there are methods of costing which can serve the purpose, this seems to be an area where more development is required if we are to achieving costing systems which have particular relevance to public sector operations. The basic accommodation of activity related direct and indirect costs together with an absorption of apportioned overheads needs to be taken further. The advantages of the emerging ABC (activity based costing)
techniques hold strong possibilities but would involve a rethink of aspects of the overall accounting system.

I cannot over emphasize the integrity that sound costing brings to the budget and to the results that it ultimately reports on. The issue of inputs, outputs and performance indicators is also worth pausing on here. These, which represent both the necessary financial and non-financial performance measurements and which have important uses for those who manage and those who exercise oversight, are only of value if they emanate from an appropriate costing system.

PART 6. - THE CURRENT BUDGET – ITS INTRODUCTION
The annual budget comes into effect on the 1st of March each year. It is produced in a format that meets the extensive management reporting requirements of the PFMA that I will elaborate on shortly. Its construction also allows for the devolution of responsibilities down to line managers who, through cost centers, will have their own budgets and performance goals to manage by. In the interests of accountability and transparency the National Treasury issues a useful range of documents which set out the assumptions, the trends and other workings upon which the budget is established – as well as performance criteria and objectives per each operation. These publications include:
An overall review of the whole budget
The detailed estimates of national expenditure
A policy statement upon which the budget is based
Details of how the nationally collected revenues will be distributed across all three tiers of government

PART 7. - THE CURRENT BUDGET – ITS REFINEMENT
The quality and relevance of the categories of monies, which are processed through the management accounting system, must also be emphasized. This is achieved through the move from fairly simple bookkeeping to sophisticated financial and management accounting.

The budget, which lays the base for this, is not only structured in terms of management’s reporting requirements, but also conforms to best practice financial reporting standards through the adoption of the IMF/GDS accounts classification. There is also the imminent establishment of the Accounting Standards Board which promises much through the range of Generally Recognised Accounting Practices (GRAP) it is required to produce - the most important of which will be the conversion to an accrual based system within the next year. We are mindful of the problems most countries have experienced in this regard.

PART 8. - THE ACCOUNTING SYSTEM
As is common practice the accounting system is established to mirror the budget format – in order that actual spending can be compared to what was budgeted. As I will demonstrate in a minute the PFMA’s demands in this regard are fairly extensive and sophisticated. A feature of the financial statements is the introduction of a full balance sheet that will take on valuable meaning with the introduction of accrual-based
accounting. This in turn will allow for the nationally consolidated balance sheet that is of interest to the international investor community.

The encapsulation of the above management accounting facility in a sound computerised system will do much to avoid poor records which inevitably make for poor information management – which in turn can be a fundamental impediment to all aspects of public sector reform.

**PART 9. - THE SUB-SYSTEMS**

Feeding into the management accounting systems are the personnel system and the procurement system. These two systems, which account for all expenditure, are to be decentralized to fall under the individual operations. A new procurement act that provides a framework of best practices is to be enacted later this year. The stock and the fixed asset inventory listings will be given values on an item-by-item basis and will conform to accrual based principals.

Here too the Accounting Standards Board through its Generally Recognised Accounting Practices will provide the lead. The PFMA has also instructed all government operations to introduce good working capital practices. When considering the private sector experience in this regard, the potential for improved management of cash, debtors, stock and creditors promises to release substantial sums of cash that the National Treasury could for example use to minimize its debt servicing costs. This too has positive macro-economic implications.

**PART 10. - REPORTING**

The PFMA must be amongst the worlds leading pieces of financial management legislation in the sphere of reporting requirements – both from the corporate governance and the operational management points of view. The reports portray the extent of the new accountability arrangements - from the statistical facts to the performance achieved to the shortcomings of the operation. It is clearly the attributes of the performance budgeting and the management accounting systems that allow for this extensive range of reports. The Annual Report has special significance with regard public accountability. The monthly reports are in the main to keep managements on course to achieve its predetermined performance targets by giving it the opportunity to institute corrective actions where problems begin to show.

**CROSS REFERENCING ASSURANCE**

The final column is intended to test the viability of the overall PFMA model I have presented. All aspects of the model are cross-questioned against the various role players and key issues listed in that column. This is perhaps the most interesting part of my presentation as it examines both the theoretical and practical qualities of the entire model. My full presentation of the model includes a separate page for each of the 23 listed factors – where the accommodation of each role or each issue is indicated on the actual model accompanied by a detailed explanation. To make brief reference to a few of these:
Accounting Officers – The important areas of the “administrative accountability” and associated responsibilities.

CFO’s - The responsibilities for the accuracy and integrity of the accounting and budgeting systems and the timeous production of information.

Line Managers - The new levels of responsibility that has been delegated downwards. In some cases these would be full programmes and in others particular activities and the cost centers these fall into. Line Managers actively respond to the monthly reported issues of economy and efficiency. They would also be subjected to disciplinary action under the PFMA should they be responsible for unacceptable instances of expenditure (i.e. unauthorised expenditure, irregular expenditure, fruitless/wasteful expenditure).

Auditor General - With the enhanced internal audit facility the Auditor General as the external auditor will increasingly move his point of departure towards a balance sheet based audit.

Internal Audit - The Internal Audit function is seen as crucial resource to management and could be important to the success of the new systems. Besides assess risks, ensuring that the necessary controls are in place and checking on the functionality of the systems the internal audit should be adding value by undertaking exercises that seek to find new opportunities and discover performance shortcomings etc. – in support of management. The internal audit, while reporting to an independent Audit Committee will prioritise the work proposed by management.

Executive - Members of cabinet have a “political accountability” which relieves them of responsibility for the day to day running of the operations that fall under them. They will in the main rely on quarterly and annual reports regarding the fulfillment of policy objectives.

Treasury - The National Treasury is no longer the ‘big brother’, as the underlying philosophy of the PFMA is to ‘let managers manage’. The Treasury’s responsibilities are essentially to establish standards and best practices which all operations should adhere to. Treasury may be called upon to intervene should a particular operation become so dysfunctional as to pose a risk to the states assets.

Training - As has been the experience of other countries undertaking similar reforms, success more than anything else, depends on the availability of the right human capacity. This calls for urgent education initiatives that cover everything from strategic planning, performance budgeting to accrual accounting. It includes computer input clerks, line managers and all other levels of management.

Parliament - Parliaments oversight committees are well served by the new PFMA arrangements. This is particularly true on the appropriateness of services delivered and the value-for-money
achieved in making available those services. Reporting which covers the former perspective will be taking up by the ‘portfolio committees’ (i.e. education, health etc.) and the latter by the Public Accounts Committee. The committees will scrutinize these reports and take up issues of concern with the Accounting Officer and/or relevant Cabinet Minister when necessary.

Crucial Issues - Here too, the issues listed can be cross-referenced to the model in order to show where and how these are fully accommodated within the systems employed. In particular, is the way in which the systems restrict the opportunities for ongoing instances of waste, inefficiency, fraud and corruption. Also important is the strengthening of corporate governance arrangements through clearer roles for all concerned and more useful and reliable information flows.

Law etc. - This section in the column takes up the relevant laws and regulation and audits these against the model to ensure that all critical issues are accommodated.

Implementation - Finally the date linked PFMA implementation plan, which has been imposed on all government operations, is superimposed on the model in order to give perspectives of the state of progress and the logical sequencing of the implementation process.

SOME CONCLUDING COMMENTS

By way of this diagram, I have attempted to illustrate the reform road taken by South Africa, which in many respects is not very different from the road embarked upon by 10 or so other countries I have observed. In general terms the new financial management arrangements represent a radical departure from an input oriented, rules based, compliance dominated environment in which administrators had little discretion or real authority - to a modern best practices, performance-based system in which managers are given unambiguous authority to manage while at the same are given strong accountability obligations.

In the presentation I have hopefully shown how all the necessary systems – planning, recording, management and accountability systems, their functional sequences, their relationships, their processes, their purpose and their inherent dynamics – all integrate into a single comprehensive and coherent picture which makes practical sense and which in its application will serve new levels of the public interest.

The three issues I will now conclude with are firstly implementation difficulties connected to the reforms, secondly bringing the reforms closer to those countries which languish in the old world and thirdly the importance that the development of new reforms remains on-going.

Regarding implementation. There is now sufficient common experience to identify the critical success and failure points along the implementation process. These are first and
 foremost the issue of **human capacity**. All countries undertaking these reforms have been hard pushed to achieve the skills levels necessary to fully effect the new systems. There are also important attitudinal changes that are necessary to make the new systems effective. This, together with aspects of institutional capacity, is a particular problem for South Africa and is likely to impede progress.

Developing the appropriate **performance measures** is another area where, notwithstanding the abundance of good ideas, most countries have struggled to find measures which fully satisfy their needs. As one example, the Government Performance and Results Act (GPRA) in the United States singled this out as a highly problematic area.

**Accrual Accounting** has had mixed implementation results with Australia experiencing particular difficulties. On the other hand New Zealand and Brazil claim to have had a relatively smooth conversion passage. There are the opposing big bang and incremental approaches. Some detailed research on the possibilities and considerations has been undertaken in the UK that is quite informative.

**Costing** as earlier mentioned, generally seems to an Achilles heel with methodological weaknesses tending to undermine reliance on economy and efficiency measurements and reports.

**Management Information Systems**, which must be central to the computerized management accounts configuration, need careful design if these are to produce all the necessary reports in an accurate and meaningful way.

=============

The majority of countries have yet to attempt this new generation of financial management reforms. It is clear that many of these countries would have difficulty coping with the complexity of the South African, United Kingdom or New Zealand arrangements.

I am presently developing a downscaled model that, while incorporating the key reform components, attempts to simplify and even eliminate a number of the less critical aspects with the intention of bringing essential financial management benefits within reach of these countries. This model, which considers a very basic costing arrangement, limiting accrual accounting to the expenditure side, no balance sheet, fewer reports etc. would still represent a significant step forward in the reduction of wasteful and dishonest expenditures.

Finally, regarding the financial management dimension of the New Public Management movement. From the more recent literature on the subject there are a significant number of exciting possibilities that we need to seize upon and develop, in our efforts to bring best private sector principals and practices into the public sector realm. All in the cause of achieving more effective and more accountable governments.
Note:
There are a number of other related issues which time does not permit me to address.