

3. FINANCIAL MANAGEMENT AND REPORTING

3.1. Introduction

3.1.1. This short section is intended to provide an overview of financial management in the public sector, its role and format. It also considers the need for a financial management information system, and the appropriate format of reports.

3.2. What is financial management in the public sector?

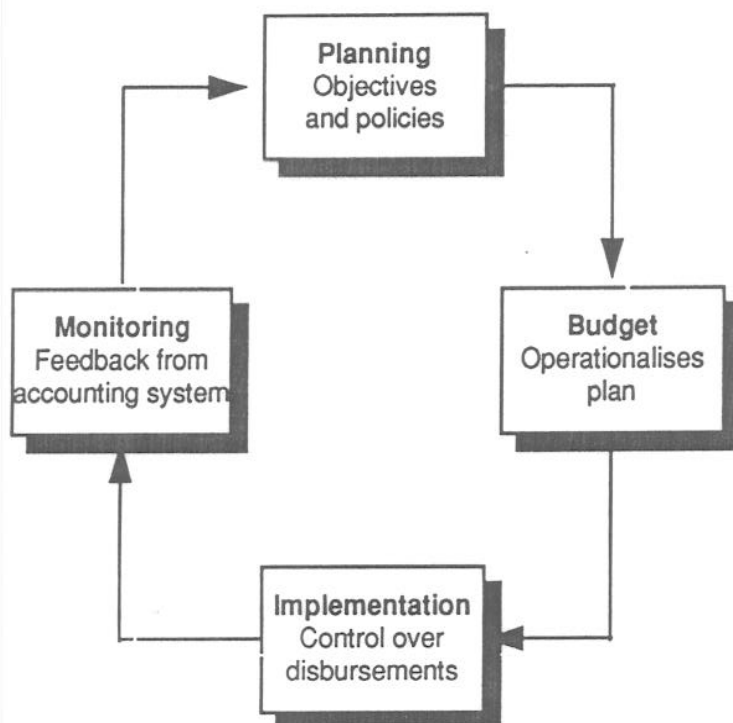
3.2.1. A survey of senior Government officers in Australia in 1983 found that 94% saw financial management as "spending no more no less than their budget allocation". This perception would almost certainly be reflected by government officers in Bangladesh today, in so far as they had any concept of financial management.

3.2.2. The purpose of financial management in the public sector is to deliver for the benefit of the population as a whole the best possible value for money (economy, efficiency and effectiveness) in the mobilisation and allocation of resources and delivery of services, based on policies established by the legislature. This is achieved through an interaction between the planning and budgeting processes, and subsequent implementation management, expenditure monitoring and control, and performance measurement. In effect, a budget is a financial statement of the priorities in a plan. The system of linking resource allocation to planning involves:

- top managers setting priorities, managing resources and reviewing performance;
- all managers being responsible for the resources they consume;
- departmental budgets linked to resources availability;
- in respect of all budgets, output and performance measures to evaluate achievement.

3.2.3. This approach may be summarised in terms of a planning-budgeting-implementing cycle, as illustrated below.

Figure 1: financial management cycle



3.2.4. In fact public sector financial management has three components:

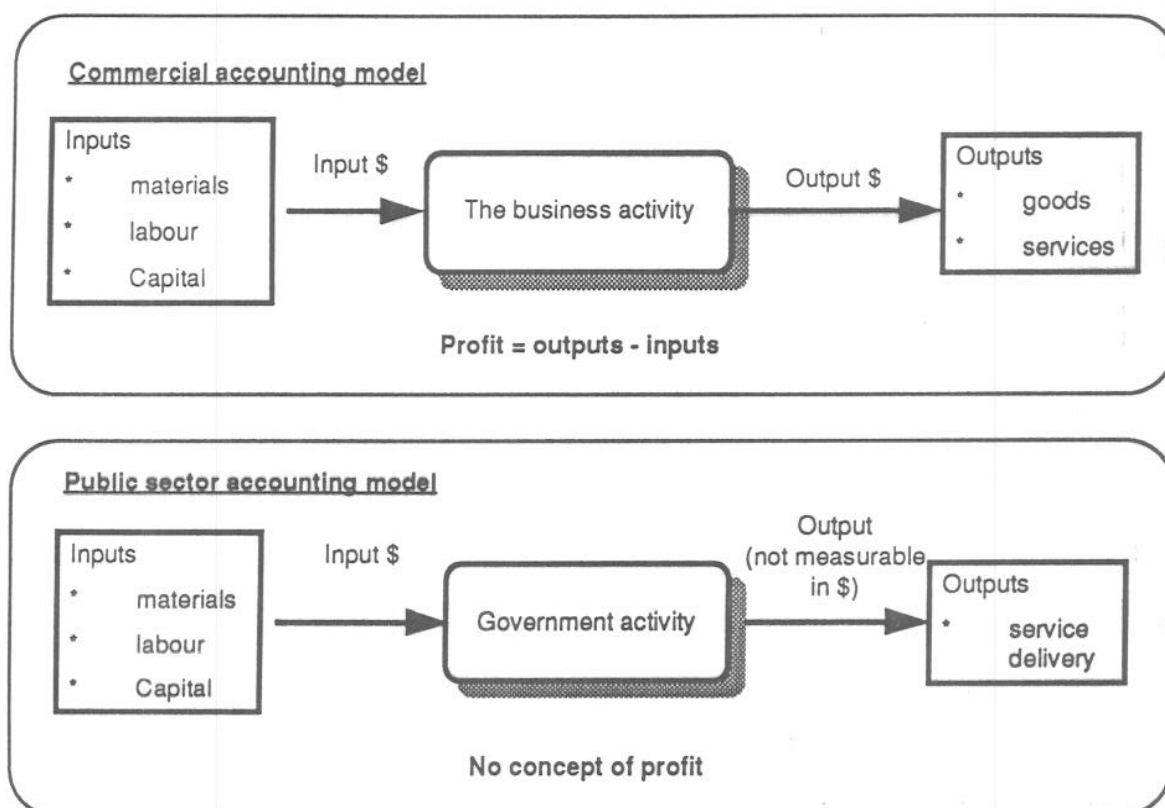
- (i) the resource allocation decisions involved in budgeting;
- (ii) the monitoring and control of the implementation of budget decisions;
- (iii) the feedback, or reporting to management.

3.2.5. These three components are examined further below. Before doing so a general conceptual framework for government financial management is developed.

3.3. Conceptual framework of public sector financial management

3.3.1. In the commercial world, the accounting model, and hence financial management, has become dominant because it provides a complete input-output model of the entity. This contrasts with the situation in the public sector. In the latter money only measures inputs; most outputs are service delivery, and therefore unmonetised. This is illustrated in the diagrams below.

Figure 2: commercial and public sector accounting models



3.3.2. In commercial accounting, the financial model leads to the widely accepted concept of profit, and provides a complete, and simple, input-output model for all commercial activities. This is why the accounting model has become so widely accepted. In the public sector, in contrast, accounting measures only work for inputs, since there are generally no financial outputs. Concepts of profit do not apply, and historically public sector accounting and budgeting has focused on input control. Modern public sector financial control systems typically involve attempts either to monetise outputs (as is happening in the health sector in the UK), or to relate monetary inputs to non-monetary outputs (e.g. cost per patient-day in hospital).

3.3.3. Public sector financial management in essence is the process of using the available resources, measured in money, to achieve optimal service delivery outputs. What are optimal outputs depends on policy objectives, essentially political decisions, and these tend to be formalised in a medium term planning framework.

3.4. Budgeting and resource allocation

3.4.1. As indicated above, budgets are decisions about resource allocations to achieve optimal outputs. Budgets are linked to a planning process, which should provide a medium term framework of policy objectives to be operationalised in the budgets. Yet traditionally budgets have been incremental and based on an annual cycle; incremental because that is the easiest way to estimate expenditure, and annual based because this fits in with Parliamentary and accounting timescales. Both of these approaches have come under increasing pressure in the search for improved allocative efficiency.

3.4.2. The disadvantage of incremental budgeting is that it is essentially backward looking, and that existing expenditure patterns become entrenched. As a result new activities are always an addition, rather than an alternative, to existing expenditure. Also under incremental budgeting, attention is focused on the few activities and expenses which are visible, and the major part simply carries on without debate. Alternatives to incremental budgeting include zero based budgeting and the system known as Planned, Programming and Budgeting Systems (PPBS).

3.4.3. PPBS is a comprehensive approach to planning and budgeting. It involves an exercise of planning in which the various activities of government are seen as "programmes". Each programme has related benefits and costs. Also most programmes have alternative ways of achieving the same ends, which can also be costed. Benefits need to be defined in normative terms, though not necessarily monetised. The resource allocation then takes place within an integrated planning and budgeting framework, in which rational resource allocation decisions can be made. PPBS has a number of advantages:

- provides information on Government objectives
- cuts across conventional Ministry/Division structures to bring together related activities
- identifies overlapping programmes
- concentrates on the long term
- provides information on the impact of programmes on objectives
- provides a rational framework for resource allocation

3.4.4. Despite these advantages, PPBS has very great practical problems, and attempts to implement it have met with only limited success because of two major difficulties. The first problem is defining output in a way which allows comparison between alternatives on anything other than a subjective basis. For example in education, programme objectives may be an increase in primary education participation, and an increase in specific technical skills. There is no objective way in which these alternatives can be evaluated; they are simply policy options. A second, related, problem is that many government activities are an essential part of Government, and any attempt to specify outputs merely states what will happen. For example, catching criminals is an output of police activity, but can hardly be seen as an alternative to anything else.

3.4.5. For these reasons, despite initial enthusiasm, PPBS as a complete solution to planning and programming has not met with great success. However, if seen as an approach rather than a complete solution, programme budgeting has much merit for the reasons given above. Certainly in an attempt to move from traditional incremental budgeting concepts of programme alternatives, costs and benefits provide a valuable overview of government activities.

3.4.6. Zero based budgeting is another approach to moving away from incremental budgeting. In its purest form it assumes that there is no past pattern of expenditure, i.e. zero based. The activities and objectives of government are identified, and turned into a series of "decision packages". Each decision package is a programme under the control of one manager, with well defined and measurable impacts and objectives. These are then categorised, ranked and evaluated so as to lead the Government to a decision about which packages to implement, and the costs associated with each.

3.4.7. The problems with applying zero based budgeting in its purest form are, as with PPBS, largely practical. It requires very considerable time and effort, and at the end many of the programmes are those which are anyway already in place, and about which there is little choice. There are practical problems of identifying decision packages, and related costs. The result is that though many organisations claim to use zero based budgeting, it is often more a statement of general intent than a complete application of the approach.

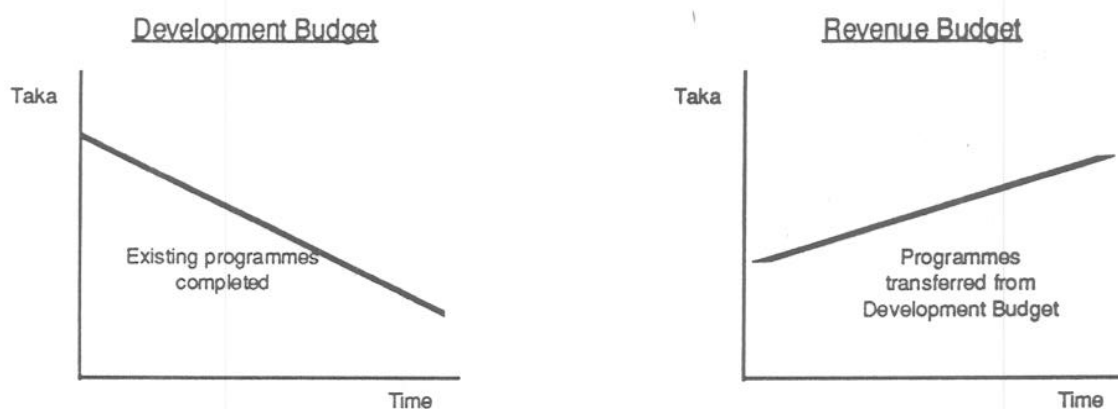
3.4.8. Although both PPBS and zero-based budgeting are rarely used as complete solutions, the ideas derived from them have gained wide acceptance and provide important tools in the budget process:

- **programme** concepts are now of great importance in budgets, identifying broad policy objectives;
- **zero based** approaches emphasise the discretionary nature of all expenditure, and the need to look forward rather than backwards in budget preparation.

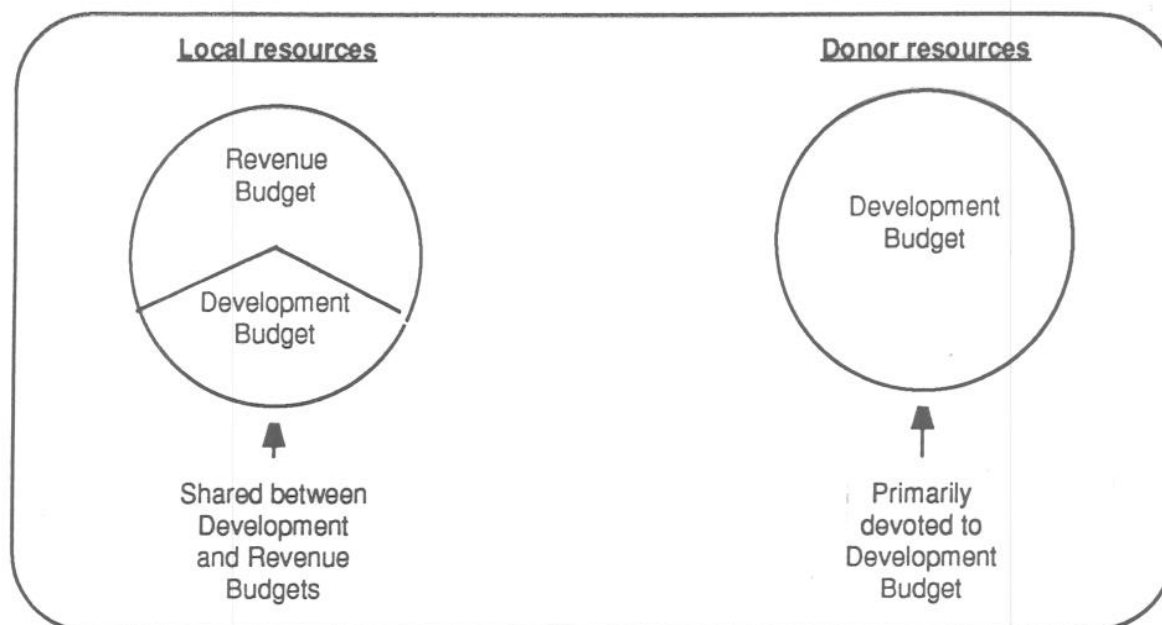
3.4.9. The Development Budget approach in Bangladesh is to some extent an attempt to operationalise these approaches. This recognises that there is a mass of ongoing activities of government, to which the application of the above approaches is difficult. However, there are also a series of development programmes, which can be very much seen in programme and decision package terms. The project proformas, and the evaluation of each programme can be seen as an application of both the above approaches.

3.4.10. The disadvantage of the segregation of the Development and Revenue Budgets is that the latter becomes entrenched and incrementally based, and further as programmes are completed and transferred to the Revenue Budget, the latter will demand ever increasing resources.

Figure 3: transfer from Development to Revenue Budget



3.4.11. Thus the clear result is that the Revenue Budget will always tend to increase as programmes are transferred into it as part of normal recurrent expenditure, without any overall review of the budget in programme terms ever being carried out. A further problem of the segregation of the two budgets is the failure to recognise clearly the resource allocation decisions being made between them.

Figure 4: resource allocation decisions between Revenue and Development Budgets

3.4.12. A further problem with budgets is the annual cycle. There is a real conflict between the need for medium and long term planning, and attempts to fit this into an annual budget cycle. The problem particularly arises when programmes and projects extend over several years. Dividing these into annual slices is, at best, an arbitrary process. Frequently delays in implementation result in unspent funds at the end of the financial year, which will in fact be needed in later years, but are regarded as lapsed under the traditional approach.

3.4.13. Because of these problems, governments have moved towards multi year budget forecasts, as happens in Bangladesh with the Three Year Rolling Investment Programme. The country that has gone furthest with this approach is Australia, which has used budget tools to enforce very tight budgetary constraints. The Australian experience emphasises the need to ensure future year budgets are not simply wish lists, but become real elements integrated into the budget process.

3.5. Expenditure monitoring, control and accounting

3.5.1. In the same way as the processes for preparing budgets need to be integrated, the process of expenditure and control should also be consolidated: to control and monitor the overall progress of the Government Budget. Higher priority is often placed on monitoring development projects, through the establishment of separate monitoring systems, for example the IMED system in the Planning Commission, which is considered to be more reliable than the Government accounts (see Section 7 on accounting, below).

3.5.2. There are significant disadvantages in separate financial monitoring systems based on a distinct data system. The process of expenditure control and monitoring involves the same functions as accounting for expenditures - the recording of expenditures against budgeted allocations. Parallel separate systems for these three functions involves: (i) duplication of work and effort; (ii) the separate systems are unlikely to show similar figures, resulting in confusion; (iii) finally, the data from non-accounting systems is subject to less stringent controls, so lacks the reliability of accounting data (we discuss below why this does not appear to be the case in Bangladesh).

3.5.3. Therefore the objective should be to develop the accounting system so that it is the exclusive database of information on expenditure and income, on which other systems can draw for their specific needs. Also to develop a reporting system which as far as feasible meets the needs for such information.

3.5.4. As well as ensuring that funds are spent as originally intended, another important aspect of expenditure control is cash management: making projections of resource availability during the year and matching the use of funds to resource availability. If cash management is ineffective, the Government will have to resort to short term borrowing, reducing the funds available for development activities. In addition, if there are funds outside the Government's control, there may be a need to borrow funds to meet short term deficits, even though there are large balances in bank accounts outside the Government system.

3.6. Financial reporting

3.6.1. The end point of a system of financial management is a reporting system. Accounting information has no function except to enable managers (i.e. Government officers) to better manage and control the activities of government. In order to serve this function, reporting systems should meet certain requirements.

Table 1: requirements of a reporting system

Related to responsibility span of recipient	<p>A Secretary is responsible for the entire Ministry or Division, and therefore requires information related to that span. In order to make it manageable, the amount of detail will be severely curtailed</p> <p>A project manager only wants information on his own project, but in much more detail</p>
Timely	Data rapidly loses its value if not available promptly. Normally reports are needed within a few days of the end of a period (month, quarter, year). For some purposes, such as cash management, the information is required virtually immediately
Reliable	<p>Unreliable information is useless, and will soon be ignored. On the other hand, precise accuracy is rarely required.</p> <p>These two statements do not conflict. Reports should be reliable at the level of accuracy they claim.</p>
Basis for comparison	Reports should as far as feasible include some yardstick for comparison; most commonly this will be the budget
Clearly presented	Reports should be designed to provide maximum clarity, taking account of the users background. Thus reports to be read by non-accountants should avoid accounting jargon. Also the temptation should be avoided to use the printing speed of computers to produce voluminous print-outs which are rarely read.
Simple	The report should be kept as simple as feasible, with limited volumes of data

3.6.2. In Bangladesh, the limited financial reporting that exists fails to meet most of these requirements. As part of the Phase II project new reporting formats within the above parameters will need to be designed. The initial emphasis should be on simplicity, and avoiding too many reports. A good starting point would be to take the monthly abstract, and to turn this into a useful report to Principal Accounting Officers, by:

- (i) providing budget figures for comparisons;
- (ii) for budget and actual showing figures for current month and cumulative to date;
- (iii) improving the layout and presentation to make the form easier to follow;

- (iv) providing the information by the 15th of the month following the period end;
- (v) ensuring the reliability of the information, but rounding to the nearest Taka 1,000

3.6.3. The same approach could be extended to the range of reports presented to management on their activities. This could then be developed into a Financial Management Information System. In every case, the managers should be consulted on their information needs. Also reports should be reviewed from time to time to ensure that they are being used, and fulfil real needs. A proliferation of reports and returns reduces the effectiveness of the information

3.7. Executive Information Systems

3.7.1. An Executive Information System (EIS) is simply an approach to presenting to senior managers, e.g. Ministers or Secretaries, very summarised and critical information. Typically for a spending Ministry an EIS would include:

- budget and actual expenditure to date, and project to end of financial year
- major areas of over- and under-spend
- performance against key success criteria appropriate to the Division or Ministry (e.g. educational performance, health indicators, and agricultural production)
- a note identifying any other factors or emerging trends that should concern senior management.

3.7.2. The EIS does not contain new information, but extracts the most important indicators and presents them to senior managers in a manner in which they have the time to use the information. Although the concept is simple, in Bangladesh at the present time few Ministries or Divisions have an EIS in place. The development of such reporting formats should be an essential part of the Financial Management Information System.