Constructing a Unified Theory of Contemporary Australian Public Sector Management Reform

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Abstract

The literature on public sector management and accountability has had a great deal to contend with over the last decade or so. This is particularly the case in countries such as Australia which, along with New Zealand and the United Kingdom, have adopted far more radical and wide ranging public sector reforms than many other jurisdictions. Examples of such reforms include, but are not limited to, the introduction of accrual based accounting systems to replace traditional cash based systems, the implementation of budgeting systems focused on outputs and outcomes rather than inputs as well as the fusing of market or quasi market structures into institutions previously shielded from market disciplines. An extensive literature exists on each of the reforms nominated above, as well as other components of the overall reform process. However, the literature is fragmented. Thus, as an example, while reforms to budgetary processes have been analysed through theoretical lenses as diverse as critical management theory, public choice theory or political theory, the literature has been largely unsuccessful in locating and explaining individual reforms within their broader context. Because of the large number of different reform agendas which have been implemented in countries such as Australia over the past decade (and which continue to be implemented at a rapid rate), the literature surrounding these reforms has concentrated on the technical aspects of individual reforms. In order to advance the literature on public sector management reform, it is now necessary to begin the construction of a more unified theory of public management reform. Thus, reforms relating to asset valuation should no longer be viewed and explained only through the lens of accounting measurement theory, budgeting reforms should be explained in terms wider than simply public choice or political theories of budgetary construction, and so on. An alternative perspective on each of these changes to public sector management is to view them not as whole reforms in themselves, but rather, as part of the fabric of public management reform generally. This paper seeks to contribute to the literature by examining some of the linkages which exist between the individual components of public sector management and accountability reform which have been implemented in Australia over the past decade. In doing so it suggests that performance measurement in the public sector needs to be informed by the interconnection effects associated with simultaneous or near simultaneous implementation of multiple reform techniques.

1. Introduction

The past two decades have witnessed considerable changes in the manner and mode of public sector management, and in particular, public sector financial management. This has not been a uniform global experience, with some nations or jurisdictions within nations adopting public sector financial management techniques radically different from traditional methodologies [1]. Australia and the various states and territories which comprise the federation is an example of a country which has chosen a radical rather than conservative or traditional approach to public sector financial management. This paper describes a number of key reforms, and then examines the inter-relationships which exist between these changed management and measurement practices. In doing so, it argues that study of public sector management reform needs to be conducted from a systemic rather than component perspective in order to appreciate the full magnitude of the impact brought about by the introduction of new management techniques. While literature which concentrates on individual components of management reform is vital in developing an in depth understanding of these reforms, the time has come to extend our understanding of the implications and effects of public sector financial management reforms by taking a more systemic view.

2. Key Elements of Reform

The individual fibres in the reform fabric analysed in this paper are:

- Accrual accounting and reporting by public sector agencies,
- The adoption of a purchaser / provider model of government,
- The adoption of accrual output based budgeting systems,
- The adoption of alternative asset valuation and related accounting techniques, and
- The adoption of capital charging regimes.

Accrual accounting is the first reform element analysed in this paper. The earliest of the cluster of reforms listed above, it was implemented with a view to bringing accounting practice in the public sector closer to prevailing private sector practice [2]. The debate surrounding the introduction of this technique to the public sector consisted largely of protagonists arguing that its adoption would make governments more aware of the resources they commanded, and thus more efficient and accountable, while antagonists suggested that there was nothing inherently logical about implementing "for profit" accounting techniques to an essentially "not for profit" sector of the economy. Irrespective, the reality is that traditional cash based accounting has now largely been dispensed with in Australian public sector agencies, meaning that accrual accounting is now the norm rather than the exception.

This has had several effects. Firstly, in the year of adoption, government expenses will have risen to the extent that non-cash and other accrual expenses impacted on the operating statement for the first time. Secondly, Australian public sector financial statements are now largely the same in form as publicly issued private sector general-purpose financial statements. This has been the subject of some criticism, with some authors contending that this is inappropriate since the rationale for and purpose of public sector general purpose financial statements differs or at least ought to differ considerably from those of private sector financial reports and conventions [3]. Thirdly, cosmetic similarities in the form, structure and content of public and private sector financial reports has led in some quarters that there is a high degree of comparability between the reports issued by the two sectors, when empirical evidence suggests that in Australia, this may not be the case [4]. Irrespective of these concerns, as a matter of fact, accrual based accounting and financial reporting is now endemic within the Australian public sector.

The next aspect of change considered in this paper is the adoption of a purchaser / provider model or philosophy of government. The key idea behind this has been described as the suggestion that government should take a steering rather than rowing role in the economy. In this view, there are relatively few functions currently carried out by government agencies which could not be carried out by private sector agencies, leading some to suggest that as an endgame of the application of this model, government would be transformed into "virtual government" – a policy, purchasing and monitoring shell [5]. While the model is conceptually simple, its implementation may be a more difficult matter. This is partly because the purchaser provider model embraces the notion of competitive markets providing pricing stimuli to purchasers at the epicentre of activity.

Traditionally however, active and liquid and competitive markets for government services such as "prison cells", "environmental audits" or "police patrols" have not existed, nor do they come into existence simply because a government elects to emphasise a particular philosophy of the nature and role of government activity. Thus while the adoption of accrual based financial accounting and reporting theoretically brought accounting practices in the public and private sectors closer together, hopefully resulting in cost data prepared along similar lines, and the purchaser / provider model legitimised large scale government outsourcing, neither of themselves fully facilitated the market or quasi-market conditions needed for the next stage of change.

This lack of open competitive markets meant that a requirement existed for the construction of quasi markets. These quasi markets would require a comprehensive set of cost or price inputs, yet information produced by public sector agencies had traditionally not given rise to detailed data relating to the cost of producing individual goods or services. The adoption of output based budgeting can be interpreted as a solution to this "missing information" problem, since budgets produced along these lines contain estimates of the quantity of "outputs" (goods or services) to be produced by a government, together with the aggregate cost of production, meaning that unit costs ought to be able to be calculated [6]. Using the accrual methodology to support the preparation of budgetary aggregates means that "full" costs of production are taken into account, with the theoretical result that the cost data produced by such a system should be broadly comparable to cost data prepared by potential private sector or other public sector competitive contractors.

The cost data produced by accrual output based budgeting systems is impacted on by the last two financial management changes, namely accounting valuation and related techniques and the use of capital charging. It is not the role of this paper to explore either of these phenomena in depth, but brief comments on both are necessary. While the implementation of accrual based accounting and financial reporting has given rise to an appearance of high comparability between private and public sector financial reports and accounting systems, certain material differences between contemporary public and private sector accounting practice need to be noted.

In particular, the relatively high reliance by private sector agencies on historical cost accounting for the valuation of tangible and intangible non current assets, versus the public sector's high reliance on current cost accounting. This has resulted in public sector balance sheets which are inflated relative to their private sector cousins. It has also resulted in heightened depreciation charges flowing through the operating (profit and loss) statements of public sector agencies when compared against private sector agencies [7].

The effect of these relatively inflated asset valuations is compounded by the introduction, in some jurisdictions, of capital charging regimes. Essentially, these place an additional expense item in the operating statement of each public sector agency, calculated as a cost of capital multiplied by the net asset base of the entity. Thus if an entity had a net asset base of $AUD 100 million, and the relevant cost of capital was assessed as 8% per annum, an expense item of $AUD 8 million in relation to capital costs would be explicitly included in the operating statement. Since this cost now forms part of the explicit (as opposed to implicit) cost base of the entity, it should have a flow on impact on output costs as assessed in the accrual output based budgeting model.

3. Weaving the Fabric

The rationale for this paper is to stimulate debate in relation to the public sector financial management changes referred to above, not on a component basis, but on a systemic basis. To date, there has been relatively little evidence of this approach in the public sector financial management literature. Debates about the introduction of accrual accounting to the public sector have tended to concentrate on the technical features of accrual accounting and the costs and benefits of implementation [8]. Similarly, debate about new modes of budgeting tend to have concentrated on strengths, weaknesses, costs and benefits associated with implementation, as well as normative arguments as to which technique ought to be seen as valid or optimum [9]. Relatively little has been written on the issue of asset valuation in the context of the budget funded public sector, though an extensive literature exists about the same issue in relation to Government Trading Enterprises [10]. Debate on capital charging tends to have concentrated on whether an appropriate cost of capital has been selected as well as on technical aspects of the implementation of capital charging systems [11]. All of this primarily component focused literature has made a valuable contribution to developing understanding of the nature and impact of the types of financial management and philosophical changes discussed in this paper. However, it is arguable that a deeper understanding of each individual item as well as the combined effect of each item can be developed as a result of the adoption of a systemic analysis.

In essence, each of the components discussed above needs to be viewed as a single piece of a larger puzzle. The image resulting from the conflation of those individual puzzles may be far more revealing than that contained on the face of any individual piece. That will only be the case however, if the pieces of the puzzle are in fact systemically related. Artificial forcing together of pieces never meant to be joined will result in a meaningless, or at least highly abstract composite image. However, it is arguable that the pieces of the puzzle discussed in this paper are part of the same overall fabric, rather than coming from disparate sources.

The adoption of accrual accounting, alternative asset valuation techniques and capital charging all fit closely together. Alternative asset valuation, primarily current or deprival cost accounting is made relevant only in the context of a system of accounting which results in the creation of full balance sheets. Cash based accounting did not necessitate the production of full balance sheets (or statements of financial position, if you will), meaning that prior to the adoption of accrual based accounting, detailed consideration of asset valuation methodology was not entirely necessary, at least from an external financial reporting viewpoint.

Having elected to adopt full accrual based accounting and financial reporting however, there was little choice but to confront the issue of asset valuation. The technique most popular within the Australian public sector is current cost / deprival value. The adoption of this type of measurement rule is of vital importance in the entire process of reshaping public sector financial management and hence the apparent cost of producing goods and services within the public sector. As assets are revalued upwards (which is the almost inevitable result of applying current or replacement cost measurements in place of historical cost), depreciation charges increase, as do capital charges.

Accrual output budgeting systems synthesise this data into apparent costs of production, all of which can at least at face value be directly compared with prices offered by potential private sector competitors due to the cosmetically similar accounting practices now in place in both the public and private sectors. The purchaser provider model meanwhile, provides an overarching legitimacy to the notion that public sector goods and services can or perhaps even should be produced by alternative (private sector) entities. Clearly, the pieces of this puzzle are drawn from the same kit, and not at random.

4. Evaluating the Tapestry

If the notion that the five pieces of the puzzle noted above are systemically related to each other is accepted, then the next phase of analysis is to determine the relationship of each item to the other parts of the resulting model. This has been revealed in part above. The purchaser provider model of government produces a demand for price and cost stimulus data. Output based budgeting provides this data. The accounting systems which support output based budgeting need to reflect the full costs, both operating and capital, of resources utilised in the production process. Arguably this drives a demand for accrual based accounting, the adoption of clear asset valuation and recognition policies as well as procedures to reflect the cost of capital utilised by public sector agencies (i.e capital charges).

Cosmetically, the system used to derive public sector product and service costs is similar to systems employed by the private sector for the same purpose. Therefore, the unassailable logic of cost benefit analysis is able to step in and suggest removal or retention of public sector activity on the basis of dollar based cost benefit analysis. But this assumes that the private sector has adopted the same measurement norms as now pervade the public sector. This is demonstrably not the case.

Several studies of the comparative performance of GTEs and their private sector counterparts have concluded that much of the apparent performance gap (and by this the authors were referring predominantly to the cost of service provision and the rate of return earned by the entities studied) was attributable to the fact that while public sector entities were using current cost accounting with resulting impacts on depreciation charges, private sector entities compared against those public entities were not [12].

Stronger still the case of comparing budget sector agencies with their "private sector competitors", since budget sector entities are burdened not only with current or replacement value assets and related depreciation charges, but also capital charges related not to the cash level of capital originally contributed by governments to agencies, but by the current or replacement cost of total assets controlled by those entities.

Whether planned or unplanned, the combined effect of the five model components discussed in this paper may be that there is an upwards bias in estimated public service cost of provision when compared against private sector provision. This bias is not a reflection of relatively lower economic productivity or efficiency within the public sector, which is a matter of considerable contention [13], but rather, of the combined impact of a group of accounting techniques employed by public sector agencies but not, in general, in the private sector.

Thus while the impact of accrual accounting analysed alone might be concluded to be the inclusion of depreciation charges in operating statements where none had previously been counted, or a greater resemblance to private sector reporting, analysed as part of a fabric, the impact takes on a very different shade. The adoption of accrual accounting is no longer characterised merely as a neutral technical process but rather, as an active ingredient in a systematic formula for change whose bounds cannot be mapped fully at a component level.

There are many things we currently do not know about the impact of this collection of changes. We cannot say for certain whether output based budgeting systems will deliver accurate cost data, or whether that data will serve as the ultimate decision for budget decision making. There are political factors at play which as yet are still in their formative period. Politicians used to dealing with cash based reporting may be less familiar with accrual based reporting, or financial reporting inclusive of the impact of capital charges. This current relative information disadvantage relative to the architects of this new system, technocrats in central agencies, may be a long or short lived phenomenon. We cannot even be sure that some of the changes catalogued and described in this paper will be persistent.

Although many of the changes referred to in this paper have been justified on the grounds that they will make the public sector more efficient, by increasing competitive pressure and rooting out gross inefficiency via outsourcing, there is very little empirical evidence to suggest that, taken as a whole, these changes have had a positive net benefit.

Part of the difficulty in making such an assessment is the need to develop robust models of what the outcome of implementing some of these changes ought to be a priori, and measuring success or failure subsequently. Yet performance measurement tends to be at an individual, piecemeal level, whereas what is called for here is a systematic analysis ranging across an entire sector, over the medium to long term. At present therefore, we can only guess at what the combined effect of a range of recent public sector financial management changes has been, and future research in this area needs to take a strongly empirical approach to critically testing rhetorical statements about improvements in efficiency and effectiveness stemming from these changes.

5. Conclusion

Public sector financial management techniques have changed radically in Australia over the past decade. Large clusters of related "reforms" have been implemented simultaneously or near simultaneously in a variety of Australian jurisdictions. Champions of these changes have made claims that the efficiency and effectiveness of the Australian public sector will improve significantly as the result of these initiatives. Unfortunately, there is little available empirical evidence to test these claims. Partly, this lack of evidence can be explained by the component level critique thus far constructed by researchers in this field. This paper submits that a package of changes must be examined in a wholistic manner in order for a full appreciation of the effects of wholesale change to be more richly understood and explained. This approach should advance understanding beyond that currently attained via mainly component level analysis.

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