



**SIGMA -- A JOINT INITIATIVE OF THE OECD AND THE EUROPEAN UNION,
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FINANCIAL MANAGEMENT AND CONTROL OF PUBLIC AGENCIES

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THE SIGMA PROGRAMME

SIGMA — Support for Improvement in Governance and Management in Central and Eastern European Countries — is a joint initiative of the OECD and the European Union. The initiative supports public administration reform efforts in thirteen countries in transition, and is principally financed by the European Union's Phare Programme.

The Organisation for Economic Co-operation and Development is an intergovernmental organisation of 30 democracies with advanced market economies. Its Centre for Co-operation with Non-Members channels the Organisation's advice and assistance over a wide range of economic issues to reforming countries in Central and Eastern Europe and the former Soviet Union. Phare provides grant financing to support its partner countries in Central and Eastern Europe to the stage where they are ready to assume the obligations of membership of the European Union.

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- assist beneficiary countries in their search for good governance to improve administrative efficiency and promote adherence of public sector staff to democratic values, ethics and respect of the rule of law;
- help build up indigenous capacities at the central governmental level to face the challenges of internationalisation and of European Union integration plans; and
- support initiatives of the European Union and other donors to assist beneficiary countries in public administration reform and contribute to co-ordination of donor activities.

Throughout its work, the initiative places a high priority on facilitating co-operation among governments. This practice includes providing logistical support to the formation of networks of public administration practitioners in Central and Eastern Europe, and between these practitioners and their counterparts in other democracies.

SIGMA works in five technical areas: Public Administration Development Strategies; Policy-Making, Co-ordination and Regulation; Budgeting and Resource Allocation; Public Service Management; and Audit and Financial Control. In addition, an Information Services Unit disseminates published and on-line materials on public management topics.

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FOREWORD

All Member States of the EU and countries from Central and Eastern Europe use agencies of various shapes and sizes as part of their system of public administration. The legal forms vary widely from country to country depending on the legal tradition and the system of administration. Public agencies, if properly designed and managed, provide an opportunity for decentralising public administration, achieving greater transparency in government operations, and improving the efficiency and effectiveness with which government services are delivered to end users. Agencies can thus be used for economically and socially beneficial reasons, and indeed are sometimes employed as a stepping stone to more radical options, e.g. the privatisation of government services. However, agencies can also be misused for purposes that contravene the tenets of good governance and sound financial management. They can be a source of inefficiency, unregulated and covert expenditures, political favouritism and corruption.

This paper originated in a request from the Ministry of Finance of the Czech Republic for SIGMA advice in developing new legal provisions for the financial management of public agencies. However, this subject cannot be addressed without avoiding the broader context. This paper has expanded well beyond the scope of the original mandate. It highlights the practice and experience of five EU Member States with very different legal systems and administrative structures. It focuses on issues relating to the financial management of public agencies but also discusses, in less detail, other issues concerning legal structures and governance. No single good practice "model" exists in this complex field. International best practice is still evolving. Moreover, we recommend a cautious approach by countries that are tempted to transpose elements of the agency models applied in countries such as New Zealand, Sweden and the United Kingdom. Would-be reformers should consider whether the legal and administrative structures are comparable, and the necessary systems of regulation, control and open reporting are in place and can be enforced.

Whilst avoiding simplistic solutions, the paper includes recommendations that policy makers in Central and Eastern Europe should take into account before embarking on major reforms in this area.

Larry O'Toole was the manager of the project and wrote the introductory Chapters, under the direction of Richard Allen, SIGMA. Authors of the country Chapters were Daniel Tommasi (France), Peter Van der Knapp (Netherlands), Nuno Vittorino (Portugal), Åke Hjalmarsson (Sweden) and Colin Talbot (United Kingdom).

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EXECUTIVE SUMMARY

Nearly all countries have long used public agencies (PAs) as a form of organisation in specific areas of public administration and services. During the past decade or two, EU countries, and developed countries generally, have created new agencies at an accelerated pace. The governments of transitional countries in central and eastern Europe (CEEC) inherited many agencies from the previous regime and have created more of them to implement new tasks and to speed up the modernisation of public administration.

This paper is aimed at illuminating the special dilemmas that arise in connection with budgeting and financial control for public agencies. The more fundamental questions of whether governments should use the agency form of organisation and, if so, for what tasks and in what configuration, are *not* addressed here. The paper should be of use to transitional and developing countries everywhere and, indeed, to developed countries experiencing problems with public agencies or considering reforms in this area. However it is intended primarily for the transitional countries in the central and eastern European region that are preparing for accession to the EU. Chapter 1 describes the scope of the paper, relates the public agency question to that of EU accession, and presents a summary of the country Chapters.

The paper is based upon a survey of five western European countries, selected to reflect a diversity of traditions and approaches to public administration and management. Sweden has a place because of the long-standing Nordic tradition of using public agencies, the United Kingdom as a representative of the radical 'New Public Management' school of thought with a strong emphasis on using the market, France as a centralist yet modernising system which has moved more slowly to open its public sector to market forces, the Netherlands as employing a balance of approaches, and Portugal as a newly modernising country with a strong centralist tradition. In Chapters 3 through 7, the reports of country experts describe their systems of laws, institutions and practices governing creation and control of public agencies, together with the motives and concerns which shape the systems.

Chapter 2 is an essay on the design of a financial management and control framework for PAs, and it draws both on the experiences of the five countries and on the generally accepted principles of expenditure management to offer suggested approaches to key design issues. A brief summary of international experiences identifies the motives that led some countries to use the agency organisational form since early in the 20th century; while agencies have long been the general purpose implementation vehicles in Sweden and France, they were used sparingly in other countries for special purposes such as utilities, regulatory missions and for bringing outside expertise into the policy process. Since the 1980s there has been an explosion of interest in the agency model in many countries, driven largely by the pressures to restrain spending and make service to citizens more responsive.

Clearly there are many actual and potential advantages in the use of agencies (greater efficiency and effectiveness, closer relations with clients, higher quality service). At the same time, observers are troubled by numerous actual and potential problems and by the fact that claims about the advantages are not yet backed up with credible evaluations. Indeed there is substantial debate among academics and practitioners about the extent to which countries have achieved the expected benefits from agency creation and also about the collateral damage they may be causing. Concerns about reduced political accountability are prevalent in some countries and have even led to some backtracking.

In short, the creation of agencies cannot be regarded as a 'magic bullet' to cure administrative ills. The fact that there are many claimed advantages as well as many potential pitfalls underlines the need for transitional countries to analyse their administrative problems with care and examine all options before deciding on the architecture of an agency management regime. The question should not be 'where can we

use agencies?’ but rather the broader and more fundamental question ‘what are the problems with the present arrangements and how can they best be resolved?’ Such analysis might reveal that problems could be overcome by a more straightforward, less risky, type of administrative reform. Should it be concluded after all that some functions must be independently organised, the review of options should include the many organisational models used in western European countries to set functions outside of the standard hierarchical ministry; these include central offices, commissions, interministerial committees, and advisory boards in addition to the public agency in all of its varied forms.

Against this background of international experiences and uncertainties, the paper goes on to identify the specific financial management and control risks inherent in the public agency type of organisation. The very freedom of action which is the hallmark of agencies opens the door to a new set of risks; public money and public assets being used for purposes not intended by government and parliament; public borrowing increased beyond approved limits; new opportunities for corruption being created; citizens rights compromised without proper redress, and; accountability arrangements such as transparency, financial reporting and audit being neglected. Additional risks which are country specific cannot be catalogued but two common problems are pointed out; if there are insufficient trained people or inadequate information systems, it will be impossible to implement high quality controls; and if the central bodies of an administration themselves do not have effective budgeting and control practices there is little hope of enforcing higher standards for subordinated agencies.

Chapter 2 includes recommended approaches that countries in transition should consider in designing and implementing a financial management and control framework for public agencies. These recommendations are listed below. They are not presented as a comprehensive architecture for an agency management regime, nor as ‘best practices’, because international experience does not yet justify a claim of ‘best’. However, the suggested approaches are believed to represent sound and appropriate practice for any country contemplating reforms.

1. Choosing and Classifying Agency Models

Suggested approaches:

- Reformers should not import a foreign model of public agencies but seek to analyse the specific objectives, risks, and management incentives that are most important in their own country.
- The experience in developed countries demonstrates that a meaningful classification of agencies is essential if a reform initiative is to move beyond the typical cycle of trial and error changes.
- It would be sound practice to classify agency groupings according to their degree of autonomy, making appropriate minor adjustments by means of the laws establishing individual agencies. However, classifications based on other criteria are acceptable if they reflect special problems or concerns of the country. Sometimes a shortage of administrative skills would dictate the use of an imperfect but simple classification with few but very clear distinctions, as Portugal has done.

2. Choosing the Appropriate Degree of Autonomy

Suggested approach: Carefully defined objectives and the analysis of operating methods provide a basis for prescribing the nature and degree of autonomy needed by an agency to effectively perform its tasks. Matching autonomy with accountability mechanisms is critical to agency design. To ensure discipline in the use and design of agencies, an appropriate decision process for approving the creation of agencies must be spelled out in legislation.

3. Legal Status

Suggested approach: The logical starting point is to provide private law status for large commercially orientated agencies and public law status for all others. Beyond that, the rules for creating separate legal personality must be determined by each country on the basis of its particular legal and administrative environment. An over-riding consideration, however, is to ensure, either in general administrative laws or in the agency founding laws, that separated agencies are not so independent as to be able to defy the government on matters of legitimate concern. Individuals or posts in line ministries and/or finance ministries should be clearly identified as the legitimate channels for government supervisory actions.

4. Real Property Assets

Suggested approach: Agency use of real property assets should be supervised to the extent necessary to ensure it is strictly confined to the agency mandate. Large commercially oriented agencies should be permitted to own and manage real property without government intervention except through the shareholder approval of business plan and/or investment budgets. Decisions by other agencies to change the use of land or to dispose of it should be subject to review and approval by government authorities. In the special case of agencies which buy and sell land as part of their primary mandate, their founding law should exempt them from detailed government supervision while establishing strict conditions and processes to ensure that all property transactions fall strictly within their mandate.

5. Borrowing

Suggested approach: Agency borrowing should be subject to government oversight proportionate to the degree of responsibility assumed by the state for repayment of the debt. For large commercially oriented agencies where the government does not explicitly guarantee debts, the supervision arrangements should be limited to the shareholder role and/or designed so as to minimise perceptions of an implicit guarantee. For ailing commercial agencies and for all other agencies, because governments can scarcely avoid responsibility for their debts, the prior approval by the finance ministry should be required for all agency borrowing from outside lenders. Both agency debt to government and agency debts guaranteed by government should be fully disclosed in state budget documents, and reserves for potential losses should be set aside in annual appropriations.

6. Agency Revenue Policies

Suggested approach: Agency revenue policies should be reviewed by government in the context of the annual budget or in a separate structured process. It is sound practice for governments to limit their revenue policy interventions with commercial agencies to cases with monopoly or taxing powers. For other agencies it would be sound practice to establish full cost recovery as the baseline rule; exceptions proposed by agencies would require policy approval by government.

7. Cash Programmes Administered on behalf of Government

Suggested approach: Budgets for cash programmes delivered by an agency should be maintained in an account totally separate from the administrative budget to avoid, and to be seen publicly to avoid, possible "leakage" of programme funds into enhanced salaries, office accommodations or other amenities.

8. Earmarked Contributions

Suggested approach: Earmarked contributions to agencies should be accompanied always by written conditions concerning their purposes and management. These arrangements lie outside the purview of the general regime of agency management and control. However the ministry of finance in this regard should regulate the practices of donor ministries.

9. Budget Review and Control for Agencies Financed by their own Revenues and Operating Close to Commercial Markets

Suggested approach: Budget review and control methods for agencies financed by their own revenues and operating too close to commercial markets should be modelled on those of private law corporations, with special review and control features added to the model only for specific areas of genuine risk. The requirement and standards for management control and external audit should be defined in laws or regulations.

10. Budget Review and Control for Agencies Significantly Dependent on State Budget Support to their Operations

- (a) Budgeting gross expenditures vs. net government contribution?

Suggested approach: All agency budget approvals should be based on an analysis of gross expenditures, not merely the state budget contribution, and the same information should be included in budget documents for parliament. The control total for execution should be the net budget contribution for commercial agencies, and the gross expenditures for all others. In the latter case, the control could be made more flexible when management techniques are improved.

- (b) The budget formulation process; maintaining government budgeting standards while catering to agency autonomy

Suggested approach: Most countries should maintain a traditional input-oriented budget review in sufficient detail to ensure the government knows and approves how agencies spend public money. The normal review standards (such as government priority, economy, efficiency, effectiveness, etc) should be applied. The use of performance management techniques, as in (e) below, should be encouraged to strengthen the review process. Respect for agency autonomy should be demonstrated through simplified procedures. As far as possible the parent ministries should conduct the budget review. Operating within basic parameters set by the Finance Ministry, they have the flexibility to tailor the information requirements and process to the characteristics of individual agencies.

(c) Oversight of staffing and personnel costs

Suggested approach: Government oversight of staffing and personnel costs in agencies should be proportionate to the importance of these items in the agency budget. While, in principle, agency effectiveness might be enhanced by relaxing restrictions on staffing and compensation, it is only prudent for most countries to analyse personnel cost budgets in some detail where they are a major cost factor. If some agencies have authority to create civil servants by their hiring decisions, supervision and audit similar to the provisions of the civil service law may be necessary to avoid corrupt behaviour or the appearance of it.

(d) Control during budget execution

Suggested approach: These non commercial agencies should remain in the Treasury system and be subject to audit by the supreme audit institution unless exceptions can be justified on their individual merits. While ex ante control methods may be necessary in the immediate term, it should be a priority to introduce management control practices to standards specified by the finance ministry and work to improve them to the point where third party interventions can safely be eliminated.

(e) Performance management practices; relationship to budgeting and control

Suggested approach: Countries in transition should emphasise input oriented budgeting and control processes while promoting performance management techniques to make those processes more effective, not to replace them. Systematically designed and implemented, management control, cost accounting and internal audit are the practices most likely to yield early results. As the reforms take effect both budgets formulation and control should become more effective and the possibility opens to further streamline the procedures of agency supervision.

11. Selling Private Goods in Competition with the Private Sector

Suggested approach: Public agencies should normally be barred from selling products or services which are private goods readily available from private sector suppliers; in circumstances where they do so, the control rules should be designed to ensure the sale price is not subsidised and, as in the Netherlands, to require that the commercial activity be fully segregated in organisational and accounting terms and eventually privatised.

12. Accounting and Reporting

Suggested approach: Accounting and reporting by commercial agencies should match the highest private sector standards. Financial activities of non-commercial agencies should be reported publicly and fully consolidated in government financial reports. Their accounting and reporting standards should be the same as the rest of government which, in turn, should be brought into conformity with internationally accepted standards.

CHAPTER 1. FINANCIAL MANAGEMENT AND CONTROL OF PUBLIC AGENCIES

Chapters 1 and 2 were written by Mr. Larry O'Toole, a SIGMA consultant, drawing on previous work by Professor Sue Richards of the University of Birmingham whose contribution is gratefully acknowledged

1. Introduction

Nearly all countries have long used public agencies (PAs) as a form of organisation in specific areas of public administration and services. During the past decade or two, EU countries, and developed countries generally, have created new agencies at an accelerated pace, driven by both political and managerial pressures. The governments of transitional countries in Central and Eastern Europe (CEEC) inherited many agencies from the previous regime and have created more of them to implement new tasks and to speed up the modernisation of public administration.

This volume is aimed at illuminating the special dilemmas that arise in connection with budgeting and financial control for public agencies. The more fundamental questions of whether governments should use the agency form of organisation and, if so, for what tasks and in what configuration, are not addressed here. Clearly there are many actual and potential advantages driving the creation of agencies in many countries, just as there are numerous actual and potential problems troubling observers. This publication addresses one important area of potential problems that agencies, created expressly to enjoy freedom and autonomy in pursuit of their missions, can also use that freedom in ways which pervert the financial objectives of government and parliament. Financial authorities in government need to build an architecture of financial management and control to ensure that the advantages of agencies can be achieved without threatening fiscal discipline and allocative efficiency.

1.1. Scope and Audience

This publication should be of use to transitional and developing countries everywhere and, indeed, to developed countries experiencing problems with public agencies or considering reforms in this area. However it is intended primarily for the transitional countries in the central and east European region that are preparing for accession to the EU.

The project is based upon a survey of five western European countries. The present Chapter explains the background to the study, its scope, and summarises the country Chapters. Chapter 2 is an essay on the design of a financial management and control framework for PAs, and it draws both on the experiences of the five countries and on the generally accepted principles of expenditure management to offer suggested approaches to key design issues. Chapters 3-7 contain the country reports which describe their rules, institutions and practices for the creation and governance of public agencies.

The countries in the survey have been selected to reflect a diversity of traditions and approaches to public administration and management. Sweden has a place because of the long-standing Nordic tradition of using public agencies, the United Kingdom as a representative of the radical 'New Public Management'¹ school of thought with a strong emphasis on using the market, France as a centralist yet modernising system which has moved more slowly to open its public sector to market forces, the Netherlands as employing a balance of approaches and Portugal as a newly modernising country with a strong centralist tradition.

The authors of country reports were asked to identify first the ‘horizontal’, or general, structures and rules that apply across the government administration, describing classes of agency. Particular ‘vertical’ sectors — universities, hospitals and cultural institutions — are of special interest to some CEE countries and the reports make reference to them. However the balance of the effort is devoted to the description and analysis of horizontal classes.

Public agencies may be located at any level of government — central, regional or local. The emphasis is different in each of the survey countries depending on the division of responsibility between government levels. However, for the purposes of this project, the authors were asked to focus mainly on agencies at central government level.

It is hard to define "public agency" precisely in a way that makes sense in countries with varied legal traditions and administrative cultures. For the purposes of this project, the following list of characteristics provided a working description:

- The organisation operates with some degree of autonomy from political direction by a minister or other political leader
- The strategic direction of the body is established in a founding law, charter or contract which may be supplemented, to the extent permitted in rules, by the instructions of a minister or other political leader
- The organisation manages its budget autonomously, but within a framework of rules set by the government
- Financing comes from some combination of own source revenues, earmarked contributions, and operating and/or investment subsidies from the state budget
- The assets of the body are publicly owned and may not be used for private benefit
- The nature and degree of public accountability are defined by law and tradition.

While this approach is less than fully satisfactory when attempting international comparisons, it does offer a pragmatic way forward. As even a cursory review of international experience reveals, the term public agency, when used by a national government, really carries whatever meaning that government wishes to give to it.

This volume does not analyse as a special class the state owned enterprises (SOEs) those corporate entities to which government relates primarily as sole shareholder. However, in many countries, there is a ‘grey area’ resulting from recent or proposed changes in the legal status of enterprises. Enterprises in public agency form are incorporated as public law companies; commercial agencies and public law companies are subjected to private law jurisdiction, in whole or in part; company ownership is partly transferred to the private sector or designated for privatisation in the future; enterprises remaining in public agency form are encouraged to adopt private sector management and financial practices. Because of this state of flux, most country reports include information about SOEs and some of the observations in Chapter 2 on commercial agencies may be applicable as well to state owned enterprises.

Finally, some other exclusion should be noted. Central banks and supreme audit institutions are not included in this survey because of their special characterⁱⁱ. Social security agencies or extra-budgetary funds loom large in most European countries but their structures are often conditioned by the social philosophies underlying the programmes and by the participation of social partners in their governance.

Because of these complexities, social security agencies are not analysed as a separate class in this survey. And neither are regulatory agencies singled out for special attention as a group; the reports make clear that the countries have agencies in various categories vested with regulatory powers but it would require another specialised study to compare the organisation of regulatory functions, as such, across national borders.

1.2. *Implications of EU Accession*

CEE countries are correct to evaluate all administrative reforms in the light of accession requirements. It should be noted that there are no specific EC rules on the use of agencies or on agency governance, except for the important financial control regime imposed on any entity involved in the management of EU funds. (Those rules are not examined here but a full explanation can be found in the SIGMA publication *Managing Government Expenditures in Transitional Countries*).

At the same time, EU membership does exert important indirect influences on the development of the public sector. No country aspiring to membership should define the status of its agencies and the rules for their management without carefully considering the implications of such features of EU membership as the following; the definition of the public sector that conforms with Eurostat criteria derives in turn from the definitions of the deficit and public debt enshrined in the Maastricht and Amsterdam Treaties; the definition of the protected public sector is affected by decisions of the European Court of Justice on reserved employment; internal market rules determine which public services must be exposed to competition, and; EC competition authorities make decisions affecting the status and governance of certain communications services such as post offices.

CEE governments designing agency reforms are well advised to seek the counsel of legal and financial experts who are well versed in the detailed requirements of EU standards.

2. *Summary of Country Reports*

2.1. *France-Chapter 3*

The administrative context in France is characterised, on the one hand, by the broad network of controls maintained by the Finance Ministry and, on the other, by the cadre of public officials who through long professional training and internship master the arts of governance. The administrative law system itself and the strong horizontal networks forged through common training and experiences among senior public officials have proven very adaptable during the managerial revolution of recent years.

The long-standing French practice is to use legal entities separate from the hierarchical ministries to perform most government tasks; the exceptions are the 'royal prerogative' functions of defence, police, justice and foreign affairs. The public sector includes a variety of legal forms of organisation but the author of the French report has concentrated attention on the *établissement public* (EP) as the most typical model of public agency and the one most relevant for this survey. Because it is only one of several French organisational models, this summary follows the example of the country report by retaining the term *établissement public* (EP). Two principal types are distinguished. 'Administrative' EPs are the most numerous. 'Industrial and commercial' EPs enjoy a wider degree of autonomy, designed originally to allow competitive efficiency; but the designation has been extended also to certain favoured organisations with purely administrative functions, apparently to enhance management flexibility. (Certain 'professional' EPs, not discussed at length, are business and professional associations, essentially managed and financed

by their private sector members.) EPs of both types are found especially useful when an activity requires co-operation between the state and a profession such as in agriculture or health care.

A parliamentary statute is required to create a category of EPs, a category being a set of EPs under the same administrative authority and with similar objects. After a category has been created by statute, individual EPs can be created by government decree. There are now some two hundred categories. Each EP is a public law legal entity; in principle, 'industrial and commercial' agencies' activities fall under private law, those of other EPs under public law. However, there appears to be a wide spectrum of possible combinations of legal attributes.

Within broad parameters specified in the category legislation (relationship with supervisory authorities, makeup of the board of directors), the founding decree for each EP specifies a tailored array of powers, privileges and supervisory procedures considered appropriate for the individual case. It appears that France, compared to other countries, custom designs more of the agency powers and governance arrangements. By tailoring such factors as the substantive decision-making process, the management of assets, the personnel selection and compensation process, and the budget formulation and execution rules, it tries to produce an agency uniquely adapted for each specific task. Even the applicable legal jurisdiction can be nuanced; some industrial and commercial EPs may have certain of their functions brought under public law jurisdiction, while some public law agencies may be subjected to private laws and tribunals for certain purposes. The combined effect of this fine-tuning can produce some agencies with nearly as much autonomy as a public enterprise and it can produce others nearly as tightly supervised as a division within a ministry.

While privatisation in France has speeded up in recent years, it is important to note the special case of the large commercially oriented EPs. About twenty public enterprises of the central government remain in the form of EP. Some of them are very large such as the electricity company and the railway companies. (France Telecom has been transformed into a private law corporation and partially privatised.) Like all industrial and commercial EPs, enterprises of this type are in private law jurisdiction, at least for employment, industrial relations and most third party disputes. However they are seldom completely in one jurisdiction or the other. The heads of very large enterprises in this group are appointed directly by the Council of Ministers and their power and influence often is equivalent to that of the ministry to which they are nominally subordinate. Thus, while they are formally classed with other industrial and commercial EPs, these enterprises enjoy a degree of practical independence that is unique.

By comparison, most other EPs find their powers heavily circumscribed by the general governance culture and by a pervasive framework of government supervision as adapted and inscribed in founding decrees. Generally, supervisory authorities on agency boards of directors wield most of the power; the line ministry and Finance Ministry directors represent respectively the technical and financial supervisory roles and usually meet with agency officials ahead of directors meetings to settle all contentious issues. The senior officials of the agency are usually chosen from the professional cadres of experts mentioned earlier.

2.2. *Netherlands-Chapter 4*

In describing the governance structure, the author of the Chapter on the Netherlands quotes the term 'decentralised unitary state', a description which nicely encapsulates the balance which characterises the administrative style. The state is decentralised territorially to municipalities and provinces, and functionally through the transfer of public authority to a large number of Autonomous Governing Bodies (AGBs) which are responsible for executing a specialised function, a long tradition in the Netherlands aimed at accessing special expertise or knowledge and bringing it into the governing process. Some of these functional bodies have local offices or outlets, which give them a sub-national presence. Integration

between territorial and functional bodies at sub-national level takes the form of voluntary association or partnerships, where several agencies work together to achieve common goals such as economic regeneration. Introduced more recently, the new 'state agency model' is designed to provide management flexibility while preserving greater political accountability than does an AGB.

Autonomous Governing Bodies are a category of agency which are legally separate from government departments. They are of three kinds; (1) agencies which bring experts into the decision-making process; (2) agencies required exercising judgement on the basis of general guidelines but independent of the minister; (3) agencies designed to facilitate the participation of interests and independent experts. The term 'autonomous' in AGB means that these bodies are not in a direct hierarchical relationship with ministers. Most AGBs are public law bodies, founded by a specific act of parliament. There is no single blueprint for governance or decision-making because of the wide variety of their tasks. Instead these are decided on a case by case basis. The sector minister decides the task, goals, products and services and client group of the AGB. Public law AGBs that are financed by their own revenues manage their budgets independently of their sector ministry. Those public law AGBs which are financed primarily by grant will have their budgets prepared by the sector ministry. Non-state AGBs (i.e. those exercising public functions as one element of a private association) will usually finance their public tasks by means of charges.

While the AGB is a traditional and successful model, the increasing number of such agencies can be seen as detracting from democratic accountability. For this reason a new category of agency has been devised which places the management under more direct political direction. The new form, called 'state agencies', was devised to undertake operations which needed accountability via the democratic process, but with a regime which allowed more managerial freedom and responsibility, output oriented steering, and accrual accounting. The sector minister, together with the Minister of Finance, may choose to make part of the department a state agency and they are empowered to do so by the Government Account Act (1994).

Sometimes these agencies undertake work of a commercial nature as a side activity, but such activities must be under a clearly separate accounting and control regime so that the side activities do not create unfair competition and, when deemed appropriate, can be disposed of to the private sector.

The state agency remains under the control of the minister, but through a 'steering' relationship laid down in the founding statute and elaborated through steering protocols. In these specific arrangements for each agency the extent of managerial discretion and responsibility is itemised, but they are never given 100 per cent autonomy in the setting of prices and tolls, since these decisions need to be taken in the light of the total burden on society of such charges. A framework of agreement is laid down specifying the regime for budget surpluses, and the agency is able to keep and redirect some of the gains from efficiency savings, thus providing further incentives for improvement. Performance management is a key principle. Services cannot become agencies unless and until they have an output oriented planning and control system, and this provides the basis for reporting to the sector ministry. The Netherlands Court of Audit undertakes the audit, as it does with other state organisations.

Finally it is necessary to mention the evolution, during the past two decades, in the status of commercially oriented public agencies. During the 1980s in particular a large number of state-owned enterprises were 'privatised' by being given the form of a limited liability company (NV) and made subject to Dutch company law. In some cases 100 per cent of the shares were sold, in other cases government kept 100 per cent shareholding or a partial holding. Both of the latter cases were considered as a transitional step to full privatisation. Where government primarily relates to these companies as a regulator, these cases are outside the scope of this report. Where, however, it relates to them as an owner, the main practices are described in the country Chapter.

2.3. *Portugal-Chapter 5*

Portugal is a unitary state with regional self-government implemented, as yet, only for the Portuguese islands. Local self-government exists at the municipal level with slightly different arrangements for the two major cities. Post-revolutionary Portugal is on a fast track to modernisation, particularly following its membership of the European Union and, more recently, of the European Monetary Union. The administrative culture, however, still retains visible and strong traditions from the past of an autocratic, centralised state. Following entry to the European Union in 1986, Portugal adopted more liberal economic policies, encouraging a trend towards the privatisation of publicly owned companies, and the use of business-like techniques and methods in those organisations that remained in the public sector.

The state participates as a shareholder in a number of private companies which are run under private company law. Many companies were nationalised following the 1974 revolution, but a large number have now been privatised, particularly since Portugal's entry to the European Union. There are currently five 'public' companies in Portugal, which carry out such major functions as running the railways and the Lisbon underground, managing the airports and printing the currency. They are separate legal entities and pursue profit goals, but their boards of directors are appointed by the Council of Ministers and they are subject to inspection by the General Inspectorate of Finance.

The most numerous public agencies in Portugal fall into two groups, depending on which classification they have been awarded in the public accounting reform of 1990 — 'administrative autonomy' or 'administrative and financial autonomy'. The 1990 reform was a broad effort aimed at decentralising financial control in a variety of ways.

The status of administrative autonomy was designed to apply to services which do not generate significant amounts of revenue. Where they previously required ex-ante approval from the Ministry of Finance, the operating expenses of these agencies may now be incurred if they are in accordance with the law, are within the budget and correctly classified, and undertaken according to the principles of economy, efficiency and effectiveness. Financial management is conducted by an administrative council of three members who have the sole authority over financial matters. Budgets, cash management and investment planning are all handled as integral features of the wider state.

The status of administrative and financial autonomy is exceptional, not the general rule. In theory it is available only to agencies generating revenues greater than two-thirds of expenditures and it must be specifically declared in each case. This higher status gives greater flexibility to use their internal budget to achieve results. Agencies which have been given administrative and financial autonomy take responsibility for controlling their operations according to the general principles of financial management; this is ensured through internal control, with the agency management having responsibility for ensuring their systems are capable of achieving this. Like all state bodies they are subject to audit by the Court of Audit.

2.4. *United Kingdom-Chapter 6*

The United Kingdom has steadily implemented the New Public Management principles and ideas since the early 1980s. The main targets initially were to reduce aggregate totals of expenditure and to increase the accountability of public servants and public services, but the same powerful thrust was applied to privatisation. Publicly owned enterprises were privatised — first those in competitive markets, then the 'natural monopoly' cases, with new regulatory institutions to protect the 'consumer' interest. The final stage emphasised contracting out and entrusted public/private partnerships with access to or ownership of other public assets. Only a few special cases of public enterprise remain, notably the Post Office and the British Broadcasting Corporation.

Like the Netherlands, the United Kingdom has a long tradition of the representation of interests through its policy and service process. The tradition has been implemented, in numerous and diverse roles, through a category of agency termed the non-departmental public body (NDPB), an entity which, according to the Cabinet Office, 'has a role in the process of national government, but is not a government department¹ or part of one and which accordingly operates to a greater or lesser extent at arms' length from ministers'. NDPBs with an executive function generally have an independent statutory basis and employ their own staff. They operate under a financial regime which allows them to operate their own budgets but their 'parent' department exercises supervision through agreeing the corporate and business plan. This relationship was characteristically diverse historically, but since the 1980s HM Treasuryⁱⁱⁱ has forced some common standards in the management and control of NDPBs. The country report describes in some detail the governance and control scheme for NDPBs using the museums as the example.

Another autonomous agency model emerged in the early 1990s as part of the reform of the National Health Service (NHS). In keeping with the government's market oriented ideology, an 'internal market' was created by separating the purchaser and provider roles. NHS hospitals and other health care providers became semi-autonomous 'trusts', established under statute as separate legal entities within the NHS. The trusts earn their own income through contracts with general practitioners and the local Department of Health, control their own assets within limits required by the necessity to make a set return on capital, and maintain private-sector style accounting and reporting. The present government has made some changes to the internal market rules, including removing the requirement that the purchaser/provider relationship must be 'competitive'.

A notable feature of the United Kingdom system is the existence of an over-arching complex of standards that apply to individuals and entities within the public sector, including those with separate legal personality. The system includes rules issued by HM Treasury for accounting, reporting, audit etc., and a Standing Committee on Standards in Public Life which promulgates governance standards and codes of conduct for board members and officers. In addition, agencies in all classes are subject to audit by the National Audit Office. An important result, as the country report demonstrates, is that management control rules and procedures are formally codified in great detail for each and every agency. The systematic formulation and monitoring of management controls clearly distinguishes the United Kingdom from other countries in the survey.

The 1980s saw the introduction of the Executive Agency model, widely known and discussed internationally as the 'Next Steps Agency'. Continuing its determined search for improvements in efficiency and effectiveness, the United Kingdom government began to move to the form of executive agency for most operational services within government. Not being a constitution-based system, this decision was an executive action not requiring parliamentary sanction. Since that time more and more of services have been treated in this way, so there are now 140 executive agencies, employing 81 per cent of all civil servants. These agencies remain integral parts of the ministry, the chief executive reporting to the permanent secretary as well as to the minister, but they have substantial flexibility in budget and personnel management and separate accounting and reporting arrangements.

Each proposal to create a new executive agency is compared to other options (i.e. retaining the activity within the department, contracting out to the private sector, or full privatisation). This is called the 'prior options review' procedure and it must be completed before the decision to establish the agency is confirmed. If executive agency status is confirmed, a policy and resources framework is drawn up setting out what delegated powers are to be held by the agency. The key element in the management structure is the chief executive, with much emphasis laid on the role of that individual's performance in guiding the

1. A United Kingdom department is equivalent, for practical purposes, to a ministry elsewhere.

agency towards performance improvements. The chief executives of larger agencies are designated as Accounting Officer, the same role played by the top civil servant (Permanent Secretary) of a department. Unlike the agencies in other countries surveyed, the Accounting Officers may be held directly accountable to Parliament for their stewardship of public money.

Due to the broad discretionary powers held by the state in the absence of a written constitution, the autonomy of executive agencies has no statutory basis and rests on a self-denying ordinance on the part of ministers, thus inviting a spectrum of interpretations. It has not proven possible to clearly separate "policy" from "executive" responsibilities as envisaged in the design of the system, nor to define an exact boundary between the policy role of the minister and that of the agency chief executive. Because of these continuing ambiguities there is reported to be some disillusion with the utility of this particular model in achieving the performance improvements required.

2.5. *Sweden-Chapter 7*

As a nation which has employed public agencies for over 300 years, Sweden was a natural choice for inclusion in this survey. The author of the Chapter on Sweden characterises it as having 'a large public sector but a small central government'. Part of this is explained by the significance of municipal and county government in Sweden, which are autonomous levels of government and which respectively provide the major part of personal public services. The characterisation is also explained by the structure of central government where a tiny core consisting of less than 4 000 staff in the Government Offices is responsible for setting the overall framework of control for public agencies, involving laws and ordinances, and setting objectives and targets, preparing and monitoring the budget, but is not operationally involved in implementing the approved policies.

The dominant agency model in Sweden is an ancient administrative form that predates the modern era. Some 300 of these agencies, employing about 200 000 staff, are charged with all implementation tasks. They have considerable scope for determining the organisation and delivery methods for the service they are providing, although the government sets out the broad framework. There is no single professionalised cadre of civil servants who have a monopoly of certain positions in government, and the freedom of information law ensures transparency of government activities. In another uniquely Swedish feature, the agency is legally accountable not to the sector minister but to the whole Cabinet, an arrangement undoubtedly favouring autonomous behaviour.

Agencies are established under a general statute that sets out the broad framework of powers and responsibilities, and then each agency has its specific ordinance concerning tasks, management structure, organisation and means of public appeal and redress. Agencies remain part of the state, but also have a degree of separation like a subsidiary company. They can manage land and property in trust and dispose of it (under certain value thresholds). Loans are taken out only with the National Debt Office, up to an aggregate amount agreed in parliament and allocated as credit limits by government.

Most agencies are financed from a combination of budget appropriations and user fees. Budgetary control concentrates on the former with the latter largely left to the agency and its marketing policies, providing it roughly breaks even. Reporting is focused on results, with an 'objectives and results dialogue' instituted between agency and ministry, with the Government Offices providing technical advice. Government sets overall goals and targets for agencies, and control is very output oriented with very little input control. Agency directors general have a great deal of autonomy about how to achieve the targets and results with the budgets they are given.

The National Audit Office audits for regularity, efficiency and effectiveness. The forty largest agencies also have been instructed recently to establish their own internal audit function.

Sweden uses the joint-stock company model for state undertakings of a commercial nature. These companies are rarely dependent on direct subsidy from the state, and most of them, like the state gambling companies, a couple of real estate companies and the State Power Company, are profitable and return revenue to the state, but are held in this form in order to allow control over their activities through ownership, full or partial. These bodies are subject to company law in the same way as other private companies. They can raise funds in the market and incur debt. Where an earmarked subsidy is received from government it will be on the basis of specific conditions agreed at the time. Government supervision is exercised through the lawful methods appropriate to a shareholder.

Finally, there is another organisational model which expresses the strongly mutualist nature of Swedish political culture. The Unemployment Societies are public law entities with ancient roots as friendly societies but the benefits are now financed entirely through the state. The Social Insurance Societies are formally independent of the state. There are 20 of them, each covering the territory of a county. They are responsible for administering benefits — the structure and level of which is decided by the state. The costs of the benefits and 90 per cent of the costs of administration are paid for by the state.

ENDNOTES

- i. New Public Management designates a philosophy of public administration reform that has gained significant currency over the past decade, notably in countries of Anglo-Saxon tradition such as Australia, New Zealand, United Kingdom and Canada. It emphasises the introduction of private sector management methods and the application or simulation of competitive market behaviour. Typical reforms include such features as clearly defined outputs and goals, resource allocation linked to measured performance, greater flexibility in hiring and compensation, cost-cutting and labour discipline, and breaking up monolithic ministries into decentralised units or agencies centred on well-defined products or tasks. Both the effectiveness of the reforms in countries where they have been implemented and their suitability for transition countries remain subject to debate among academics as well as practitioners. For more information, see SIGMA publication, *Managing Government Expenditures in Transitional Countries*.
- ii. Information on one important aspect of central bank governance will be found in SIGMA Paper No. 24, *Central Bank Audit Practices*.
- iii. Her Majesty's Treasury, H.M. Treasury, or simply the Treasury, is the name used for the Finance Ministry of the United Kingdom.

CHAPTER 2. DESIGNING THE FINANCIAL MANAGEMENT AND CONTROL FRAMEWORK FOR PUBLIC AGENCIES — SUGGESTED APPROACHES

1. Introduction

The country reports illustrate the broad array of species to be found within the genus public agency. The arrangements for financial management and control^{iv} exhibit an equally rich variety, and it would be difficult to demonstrate a generally accepted^v international pattern. It is clear, nonetheless, that certain rules and practices are more likely than others to bring successful outcomes in transitional countries seeking to stabilise and modernise their management regime for public agencies. Identifying such sound practices is the task of this Chapter.

The Chapter focuses on certain aspects of the public agencies system which are especially relevant for financial management and control. In doing so it draws on the experience described in the five country reports and on principles of expenditure management which are generally accepted by practitioners and in the international budgeting literature. This publication does not purport to offer a detailed analysis of the advantages and disadvantages of the agency model as such, and when to use it; the brief summary of international experience (and unanswered questions) included at Section 2.2 is intended only as background to the discussion of the main risk factors for financial management and control.

Section 2.2 identifies the motives that led some countries to use the agency organisational form since early in the 20th century; while agencies have long been the general purpose implementation vehicles in Sweden and France, they were used sparingly in other countries for special purposes such as utilities, regulatory missions and for bringing outside expertise into the policy process. Since the 1980s there has been an explosion of interest in the agency model in many countries, driven largely by the pressures to restrain spending and make service to citizens more responsive.

Clearly there are many actual and potential advantages in the use of agencies (greater efficiency and effectiveness, closer relations with clients, higher quality service). At the same time, observers are troubled by numerous actual and potential problems and by the fact that claims about the advantages are not yet backed up with credible evaluations. Indeed there is substantial debate among academics and practitioners about the extent to which countries have achieved the expected benefits from agency creation and also about the collateral damage they may be causing. Concerns about reduced political accountability are prevalent in some countries and have even led to some backtracking.

In short the creation of agencies cannot be regarded as a ‘magic bullet’ to cure administrative ills. The fact that there are many claimed advantages as well as many potential pitfalls underlines the need for transitional countries to analyse their administrative problems with care and examine all solution options before deciding on the architecture of an agency management regime. The question should *not* be ‘where can we use agencies?’ but rather the broader and more fundamental question ‘what are the problems with the present arrangements and how can they best be resolved?’ Such analysis might reveal that problems could be overcome by a more straightforward, less risky, type of administrative reform. Should it be concluded after all that some functions must be independently organised, the review of options should include the many organisational models used in western European countries to set functions outside of the

standard hierarchical ministry; these include central offices, commissions, inter-ministerial committees, and advisory boards in addition to the public agency in all of its varied forms.

Against this background of international experiences and uncertainties, Section 2.3 goes on to identify the specific financial management and control risks inherent in the public agency type of organisation. The very freedom of action which is the hallmark of agencies opens the door to a new set of risks; public money and public assets being used for purposes not intended by government and parliament; public debts incurred beyond approved limits; new opportunities for corruption being created; citizens rights compromised without proper redress, and; accountability arrangements such as transparency, financial reporting and audit being neglected. Additional risks which are country specific cannot be catalogued but two common problems are pointed out; if there are insufficient trained people or inadequate information systems, it will be impossible to implement high quality controls; and if the central bodies of an administration themselves do not have effective budgeting and control practices there is little hope of enforcing higher standards for subordinated agencies.

Section 2.4 describes selected elements of the financial management and control framework, which should be implemented to counter the identified risks. They are not presented as a comprehensive architecture for an agency management regime, nor as 'best practices', because international experience does not yet justify a claim of 'best'. For each of these key elements, suggested approaches – intended to represent sound and appropriate practice for any country contemplating reforms – are set out in detail in Section 2.4.

2. The Uses of Agencies in Government Organisation

In considering a reform of the general regime for agency management in a country, or indeed when considering the creation of a specific new entity, perhaps the most basic question to be asked is "why use the agency form of organisation?" No general answer to that question is attempted here. The five country reports illustrate many of the excellent motives for which countries establish agencies; they range from improving commercial effectiveness, to insulating sensitive decisions from politics, to increasing economy and efficiency, to permitting experts and affected citizens to be drawn into decision-making. At the same time the reports describe, or hint at, some of the bad reasons for establishing agencies (or agencies with too much power); these include avoiding political accountability, evading government financial and personnel rules, sequestering a stream of public revenues for the exclusive benefit of one group, permitting behind-the-scenes political tampering with decisions, and permitting favouritism rather than merit to determine the award of contracts or other benefits.

Some countries have a very long history of using agencies, in some form, as the preferred vehicle for programme implementation, Sweden and France being examples in this survey. Even in countries where they were not a general-purpose solution, certain agency forms have been used since early last century for tasks that were considered unsuited to the rule-bound central administration itself. Some public services delivered in commercial fashion, such as utilities, needed to be freed from civil service staffing regulations, rigid spending compartments, borrowing limits, and restrictions on the use of revenue. Some important regulatory/inspection tasks were considered so sensitive that they should be placed out of reach of partisan political favouritism. Some areas of policy analysis were considered so complex or divisive that mechanisms were needed to bring outside sectoral expertise and interest groups into the process. For most of the century, some countries created agencies for such reasons yet they represented a relatively small proportion of their public administrations.

Since the 1980s, there has been an explosion of interest in agencies in many countries and the concept of "contracting" with the minister has come to the fore as a new mechanism for direction and control. This explosion results from a new set of motivations added to the traditional ones just mentioned and it has been

furthered by academics, consultants and international financial institutions. The driving forces for most governments have been the need to reduce spending, on the one hand, while, on the other hand, strengthening their own legitimacy by improving the quality and responsiveness of public service delivery. The agency model offers the advantage of separating implementation tasks from policy-making. By confining specific operational tasks within a separate entity, it is expected that responsibilities and performance targets can be specified more clearly, leading in turn to a more accountable management and more motivated staff. The predicted results include higher efficiency, economy in the use of resources, closer customer relations and higher quality of service. Distancing the agency from political oversight is emphasised, but for a reason different from the dangers of favouritism mentioned in the previous paragraph; the argument is that ministers are prone to excessive interference and 'micro-management' of operations they directly control. Their directions, being ad hoc, opportunistic and tactical, are claimed to seriously undermine management efforts strategically to build efficient, responsive organisations and systems over time. Thus arm's length agencies provide a model for eliminating this handicap. These, in brief, are the advantages sought by governments in multiplying the number and forms of agencies in their administrations.

On the other hand, governments contemplating a programme of agency creation are advised to be cautious: the creation of agencies cannot be regarded as a 'magic bullet', a general-purpose formula for success in modernising a public administration. Indeed there is substantial debate among academics and practitioners about the extent to which countries have achieved the expected benefits from agency creation and also about the collateral damage they may be causing. It must be noted that very little rigorous evaluation has been done in the countries where agency creation has been most vigorous. Moreover, concerns about reduced political accountability and oversight are common and have led some countries actually to reduce the autonomy of agencies or to disband some of them. Some governments also have been politically injured in the effort to distance themselves from agency operations, whether this was done with the admirable intention of reducing 'interference' or for the less admirable motive of avoiding responsibility. They have found that the electorate would not exonerate the government of responsibility for problems just because it had written a contract or otherwise put an operation at arm's length. Indeed, governments could get the worst of both worlds when they have given up the levers of control over agencies while still being held politically responsible by the citizens for failures of policy, deficiencies in service or loss of financial control. Observers point out that some countries have created agencies only to avoid fundamental political, institutional or management reforms (such as decentralisation or civil service reform), or hard policy choices (such as downsizing or deregulation). Others have observed that the apparent success of new agencies in some countries, and the absence of problems, may be due to the disciplinary traditions of a long-established civil service, which could have done its job within almost any organisational architecture.

One further factor needs to be added. An effective system for the control of public expenditure rests on the existence of a culture of the public interest. The countries where agencies are widely used without any disastrous consequences have had the advantage of building on such a culture. While the private interests — especially their future career prospects — of politicians, officials and public managers are all affected by the financial control apparatus, if they feel an obligation within the culture to act in the wider public interest there will be a much greater chance of the necessary trade-offs within public expenditure being made appropriately. A culture of the public interest is a precious property which should not be taken for granted. It must be sustained and developed and the conditions for its enhancement to be created. To the extent that public interest culture is weak or absent, laws and controls must be more stringent in order to compensate.

A good deal of caution is indicated also when deciding on the legal status, mandate and powers that should be accorded to a particular agency because it has been found that an identical design model can produce vastly different consequences when applied to agencies with different types of tasks. One key factor is scale; if the task requires that an agency be very large, it is likely, on the one hand, to succumb to the same

bureaucratic tendencies as any other organisation of similar size yet, on the other hand, it may prove powerful enough, financially and politically, to disdain the control efforts of a supervising ministry. An agency tasked with some aspect of sectoral policy development can, if operated too autonomously, become ‘captured’ by client groups to the detriment of broader national interests^v. Or an agency granted too much discretion in marketing fee-based services might start to value its revenues and internal organisational perquisites more highly than its public service responsibilities.

The fact that there are many claimed advantages as well as many potential pitfalls underlines the need for transitional countries to analyse their administrative problems with care and examine all solution options before deciding on the architecture of an agency management regime. Pressure for agency creation from external aid donors or the private sector should not be allowed to drive the decisions. The question should not be ‘where can we use agencies?’ but rather the broader and more fundamental question ‘what are the problems with the present arrangements and how can they best be resolved?’ Such analysis might reveal that problems could be overcome by a more straightforward, less risky, type of administrative reform. Should it be concluded after all that some functions must be independently organised, the review of options should include the many organisational models used in western European countries to set functions outside of the standard hierarchical ministry; these include central offices, commissions, inter-ministerial committees, and advisory boards in addition to the public agency in all of its varied forms.

3. Principal Risks

An appropriate regime of financial management and control must take account of the issues and risks, which are inherent in the public agency model itself plus those which are specific to one country at one point in time. Note that political risk, risks to policy coherence and the like, are not considered in this section which deals only with factors affecting financial management and control.

Among the risks inherent in the public agency model itself, it is suggested that the foremost are that:

- Agencies might allocate public money for purposes different from those intended by government and parliament
- Agencies might convert public assets to uses different from those intended by government and parliament
- Agencies might, directly or indirectly, increase public borrowing beyond limits approved by government and parliament
- Agencies might engage in corrupt practices for the unjust enrichment of ministers, employees or favoured friends, or make it more difficult to enforce existing anti -corruption rules
- Agencies might serve as vehicles for the circumvention of financial and administrative rules by parent ministries or other parties
- Agency finances might not be appropriately consolidated in government financial reports
- Accountability arrangements such as transparency, performance reporting, financial reporting, control and audit might be weak or absent
- Citizens’ rights to appeal and redress against agency decisions might be compromised

- The executive government might not retain adequate powers to impose remedies or sanctions when public agencies fail to fulfil their responsibilities.

(Note that the "intentions" of government and parliament mentioned above, as well as other standards, may be expressed in many ways such as laws, charters, performance contracts, administrative policies etc; they do not necessarily have to be enforced by line-item budgeting or detailed controls during budget execution).

The second category, the country-specific concerns, cannot, by their nature, be enumerated. However it is important to note two risky conditions which, if they exist in a particular country, must be fully factored into any agency reform strategy:

- there may not be sufficient trained people, adequate information systems or sufficient money available to carry out the control and governance designs embodied in legislation; even if legislation incorporates the kind of safeguards suggested below, an inability to implement them invites failure
- the central bodies of government should themselves have an effective set of rules and practices for budgeting, financial management, internal control and audit, and the system should be transparent and accountable. Thus, any public agency regime would represent a derogation from, a weakened version of, the controls applicable to the rest of government. Obviously, if this assumption is not accurate in a particular country, the standards advocated below may be higher than those existing in the rest of the government and thus render them almost impossible to implement in subordinated agencies.

None of the risks identified above can be eliminated by a single technique. To mitigate any particular risk, two or three, sometimes all, of the framework elements discussed below must be in place. Reformers facing this lengthy agenda can take comfort, however, from the fact that each and every approach suggested below can be predicted to have some positive benefit in reducing exposure to financial management risks.

4. Selected Elements of the Financial Management and Control Framework: Suggested Approaches

What follows is not presented as a comprehensive architecture for public sector agencies; neither is it claimed to represent 'best practices' in any absolute sense because the general literature provides no evidence of acceptance of a unique standard model; however it is believed that the approaches suggested below can be taken, at minimum, to represent 'sound' practices for governments seeking to reap the advantages of the agency model while minimising the risks.

Not discussed here are the informal controls which are vital components of good governance in all democratic states; the media, the organised interest groups of civil society, and the culture of the public interest within the administration. However, the emphasis on transparency throughout this discussion is an indispensable factor in nurturing the sense of accountability, which gives meaning to the informal controls.

4.1. *Choosing and Classifying Agency Models*

The variation among the five countries in the survey has been noted repeatedly. And there is ample anecdotal evidence that similar variability would be found throughout the developed countries. The

agencies themselves vary greatly in status and other attributes from country to country. Moreover the overall schemes of agency governance, including financial management, differ dramatically. A key insight for would-be reformers is that all these systems work reasonably well, notwithstanding their differences. Clearly there is no one agency management model that can be considered 'right' for all countries.

Sweden, at central government level, relies on a single agency model that serves for all sectors and functions. Most of Portugal's agencies have autonomy only in the administrative and financial management areas expected to contribute to efficiency improvements. Within very broad general rules, French central government agencies tend to have powers and supervisory arrangements which are individually tailored to the specific tasks and circumstances at hand. The United Kingdom has many legally separated public entities with a wide range of roles and enjoying broad (and sometimes ambiguous) degrees of management and financial autonomy; but it also has the well known Executive Agencies inside the administration and operating under contract to ministers. The Netherlands' traditional agencies have substantial autonomous powers tailored on a case by case basis as in France; but concerns about loss of political accountability led the Netherlands to define a new 'state agency' model which provides extra financial management flexibility while retaining ministerial direction.

It is also worth noting that no country seems content to let its public agency system remain static for long. The story is one of constant tinkering and improvement. Even Sweden's agencies, the most ancient and stable model, seem to have evolved through numerous incremental changes; recent examples are results-based budgeting and the introduction of the formal results dialogue; the legislation on internal auditing; and the termination of the use foundations within the public sector. Transitional countries too should monitor any new arrangements and anticipate the need for regular amendments and fine-tuning based on experience.

Suggested approach: Reformers should not import a foreign model but seek to analyse the specific objectives, risks, and management incentives that are most important in their own country.

A strong inference can be drawn from these country reports that an analysis of public agencies will be most effective if it begins with a classification of existing agencies into groups based on similarity of attributes. While this may seem a truism, it is striking to note that three, at least, of these countries seem to have made such a classification only during recent reforms. Historically, in these and other OECD countries, the tendency was to establish individual agencies as the need arose, each with powers and attributes designed to respond to needs as perceived at that moment, and probably not immune to the "fashions" in public administration theory which change every few seasons. Later, when reforms needed to be undertaken because of emerging problems or in an effort to streamline the system, each government has made an effort retrospectively to divide agencies into groups and create common management rules for the agencies in each group.

Netherlands has defined its agency classes more rigorously during the last decade, while allowing for phased implementation and permitting certain special cases to continue with exemption from new rules. United Kingdom appears to have defined classes in a gradual, pragmatic process over the past decade, also permitting exceptions and ambiguities to persist, and allowing time for gradual adjustments. Portugal included its codification of public agency rules within a much broader amendment of the government budget and accounting rules, though it appears that the agency classification mainly clarified a system that existed already in practice. In Sweden and France, incremental changes in rules and procedures have been made without the necessity to re-classify the agency groupings.

Suggested approach: The experience in developed countries demonstrates that a meaningful classification of agencies is essential if a reform initiative is to move beyond the typical cycle of trial and error changes.

The criteria to be used for classifying agencies may be chosen according to national priorities and concerns. Portugal's key criterion is the proportion of the budget covered by own revenues, a choice that probably reflects an over-riding preoccupation with the broad budgeting and control reforms underway, and of which agency reform represents a minor part. United Kingdom reforms reflect strong ideological preferences for privatisation of public services or the introduction of "market-like" mechanisms to spur efficiency, and this influence can be seen in the agency classification which is emerging. The Netherlands has defined three classes using as a criterion the objectives or "vocation" of an agency, whether commercial operations, policy decisions or administrative efficiency.

Other bases for classification might be considered depending on the priority concerns in a particular country. For example, a grouping could be made of agencies where the sole objective is to isolate their decisions from political interference, say in making grants in support of scientific research projects, or in purchasing and displaying works of art in a national museum. It could be envisioned that such a group might remain subject to most normal government rules of financial management and control while being endowed with strong safeguards against political influence on their substantive decisions (project selection exclusively by peer reviews, a merit-based appointments process for executives, lengthy fixed term tenure for professional staff). Yet another classification could be sector-based, something like France's 200 categories. In fact nearly all countries provide sector-specific regimes for agencies in the social security, health and education fields.

However, a highly practical and understandable classification could be constructed based on the degree of autonomy granted. A graduated series of three or four levels of autonomy might be identified and defined in terms of legal personality status, policy role (if any), budget formulation process, budget execution modalities, asset management and borrowing powers, and relationship with supervisory ministries. Then all agencies, regardless of sector or vocation, would be fitted into the resulting groups. In this approach, it is still possible to tailor the autonomy of a specific agency to some degree. Most readily, this could be done in the agency's founding statute, decree or charter, by eliminating or reducing one or more of the powers defined for the class as a whole.

Suggested approach: It would be sound practice to classify agency groupings according to their degree of autonomy, making appropriate minor adjustments by means of the laws establishing individual agencies. However, classifications based on other criteria are acceptable if they reflect special problems or concerns of the country. Sometimes a shortage of administrative skills would dictate the use of an imperfect but simple classification with few but very clear distinctions, as Portugal has done.

4.2. *Choosing the Appropriate Degree of Autonomy*

The five country reports reveal how governments have gradually come to focus on what might be called "task-related" autonomy. Historically, the often haphazard process of establishing agencies produced numerous organisations whose powers were poorly matched with their real needs; some agencies with straightforward programme delivery tasks enjoying much more financial or policy authority than necessary; other agencies placed in a straitjacket of supervision which undermined the effectiveness or efficiency of their work.

In defining the nature and limits of agency autonomy, the sound practice is clearly found in the example of recent reforms by those governments which seek precise answers to the questions: What are the objectives and tasks of the agency? What powers are essential to meet the objectives and accomplish the tasks? Can those powers be granted within a framework which provides acceptable controls over public money and acceptable public accountability? Each of the dimensions of autonomy should be assessed such as the legal/constitutional, policymaking, financial, personnel, performance etc.

Where efficiency and profitability are at stake in a commercial undertaking, it may be best to duplicate as closely as possible the attributes of a private sector company, reserving to government the right to appoint the directors and chief executive, and supervisory powers only over matters of essential public interest (such as monopoly prices or the use of subsidies from the budget).

Where direct political accountability needs to be maintained for delivery of essential government services, the relaxation of financial and administrative rules may be all that is necessary to permit gains in efficiency.

Where it is necessary for an agency to exercise public powers and/or policy discretion to meet its objectives, a further analysis should answer the question, 'how much discretion?' Netherlands, for example, distinguishes agencies with full decision-making autonomy within their legislated mandate from those, which have authority to decide individual cases, but only within a policy framework approved by the sector minister. Another method of constraining autonomy is to prescribe a decision-making process (e.g. peer review) in legislation or by ministerial order while barring government interference in specific cases.

Needless to say, any grant of autonomy for policy decisions should be accompanied by appropriate safeguards including transparency, performance reporting, due process and provision for appeals. For agencies with policy autonomy, governments often maintain accountability through the simple device of appointing directors and chief executives "at pleasure", meaning they are subject to dismissal for misbehaviour. However this powerful device should be used sparingly — only for specific well-justified cases — because it is open to misuse as a vehicle for political influence. The contrasting device, tenured appointments for fixed terms, is used to reinforce immunity from political influence for directors and chief executives of agencies with particularly sensitive roles such as news media, administrative tribunals or support to the arts.

Decisions to create agencies with policy autonomy seem fraught with concerns about the loss of accountability, concerns which are entirely justified in the context of democratic administration. In the four countries with agencies of this kind, central authorities systematically review each proposal, and parliamentary authority of some kind is normally required for the creation of such entities. In United Kingdom and Netherlands, parliament is asked for, or given an opportunity for, specific legislation for each case. In Sweden and France, individual bodies can be created by government decree, but only within a framework previously approved by parliament. While parliaments are likely to be interested in various details of the cases brought to them, it seems a safe inference that placing significant policy decisions out of reach of political oversight is the common denominator in their concerns.

Although mentioned explicitly only in the French and Portuguese papers, the absence of such task-related analyses in the past could account for much of the misuse, or the confused implementation, of the public agency model. Typical of the experience in many countries, the Portuguese Chapter states that agency status frequently was sought and granted for no reason other than to evade government budgeting and/or staffing rules. The French Chapter describes the wide autonomy designed for the needs of industrial/commercial agencies, but points out that the same status can also be given to certain organisations whose function is purely administrative; and it reports the unease of the Finance Ministry that the continuing creation of new PAs erodes financial controls without producing much evidence of improvements in effectiveness or efficiency. Though not always mentioned explicitly in the country Chapters, partisan political bargaining (seeking enhanced powers for agencies popular with one party or one minister) can be assumed to affect all countries (though Sweden may be an exception because agencies are both ubiquitous and uniform); this is an entirely predictable side-effect when autonomous powers are awarded without analysis of the real needs, and it can be counted upon to create problems sooner or later.

Finally, because of the critical importance of decisions on agency autonomy, there must be a strong and clear decision-making process leading to the creation of any agency. The country reports describe the structured screening procedures used in these five countries as well as the levels of legal approval needed to establish an agency in each of the different classes. The process itself and the level of required authorisation are matters for each country to choose; the important thing is that agency creation decisions be made in a systematic way and that they be disciplined by legislative action at the appropriate levels.

Suggested approach: Carefully defined objectives and the analysis of operating methods provide a basis for prescribing the nature and degree of autonomy needed by an agency to effectively perform its tasks. Matching autonomy with accountability mechanisms is critical to agency design. To ensure discipline in the use and design of agencies, an appropriate decision process for approving the creation of agencies must be spelled out in legislation.

4.3. *Legal Status*

Knowing it to be a particular concern in a number of CEEC, SIGMA asked the authors of country papers to describe the legal status of public agencies and the rules, if any, by which specific agencies are assigned their status. A review of the country reports makes it evident that practices in this regard are unique to each nation and offer no general pattern. The one exception, perhaps, is the widespread appearance of the private law company as the model used for large organisations operating in the commercial marketplace. In France, the industrial and commercial agencies are placed under private law for most purposes and recently some are being converted to corporations and partially or completely privatised.

In France and Portugal all agencies seem to be separate legal entities while all of Sweden's agencies remain within the state. Most non-commercial agencies are under public law but exceptions persist. In the Netherlands and United Kingdom, the rules specify different status for different classes of agency but numerous exceptions are also permitted. The most probable reason for this is that many factors affect decisions on legal status, among which the factor of financial management and control is but one of many. The constitutional and legal framework, the scope of administrative laws, parliamentary practices and administrative culture are likely to be other key determinants.

At the same time, it is important to note that the governments retain the authority to adapt the legal models, where necessary, through administrative means. French and Portuguese agencies, in spite of their status, are accessible to various forms of administrative and financial influence by the sector minister and/or finance ministry. Some United Kingdom agencies formed under company law seem to be treated, in practice, as vehicles for delivery of predetermined programmes and fully subordinated to the line minister. And most countries have some 'revolving account' mechanism which permits an agency operating within a ministry to be given enough financial flexibility to mimic important aspects of corporate behaviour. It might be concluded that, if such adaptive mechanisms did not exist, these countries might have been forced to choose different legal forms.

In all cases, agencies must be clearly informed of the channels through which the government's legitimate supervision will be exercised. In France, an official of the parent ministry may be legally designated as 'commissioner' for a given agency; other countries may simply identify the supervisory roles on organisation charts. The important thing is to eliminate any ambiguity that could tempt unauthorised officials or politicians to attempt to influence agency decisions.

Suggested approach: The logical starting point case is to provide private law status for larger commercially-oriented agencies and public law status for type of agency. Beyond that, the rules for creating separate legal personality must be determined by each country on the basis of its particular legal

and administrative environment. An over-riding consideration, however, is to ensure, either in general administrative laws or in the agency founding laws, that separated agencies are not so independent as to be able to defy the government on matters of legitimate concern (cf. the French agencies which refused government instructions to move their headquarters out of Paris as a regional development initiative). Individuals or posts in line ministries and/or finance ministries should be clearly identified as the legitimate channels for government supervisory actions.

4.4. *Real Property Assets*

The principal risks related to real property in the hands of autonomous agencies are; that public land might be alienated from the national patrimony, inadequately maintained, or used in a manner which degrades the environment, or; that land is bought, sold or used in a manner that unjustly benefits specific persons rather than the public interest. While the same risks are present to some extent for all real property owned by the state, the political accountability of ministers to parliament is an ultimate safeguard which may be weak or absent in the case of a highly autonomous agency.

Real property use by agencies is likely to fall into one of three situations. The first is that of many commercial agencies, where a primary motive for creating them is to set aside certain capital assets in the hope that investment and exploitation can be managed more effectively outside government. In the second situation, probably the majority of agencies use real property only as an administrative support to their main mandate. The third case is represented by certain agencies whose main objectives can be achieved only through buying, developing and selling real property (e.g. when establishing and operating an industrial park for regional development purposes). While, in the second case, government should maintain direct influence over decisions on use and disposal of real property, the other situations call for a more general form of supervision by way of the investment budget or special rules.

In large commercially-oriented agencies real property, like other capital assets, normally should be owned directly and should not be micro-managed by government. However the government, before approving the business plan and/or investment budget, should scrutinise carefully the provisions affecting real property. In some countries, public goods laws may create additional general protection for certain types of lands.

For other (usually public law) agencies, the practices vary among the five survey countries with regard to the registration of title to real property in the name of the agency. However none of these countries grants more than a limited set of ownership rights to non-commercial agencies. Even where the agency is permitted to register title in its own name and/or to include property value among its balance sheet assets, it typically faces restrictions on its right to buy or sell land and on its use of the proceeds of sales which do occur. More commonly, land title is held in the name of the state, the sector minister or in trust therefor, so that decisions follow the general government process for such transactions.

Suggested approach: Agency use of real property assets should be supervised to the extent necessary to ensure it is strictly confined to the agency mandate. Large commercially oriented agencies should be permitted to own and manage real property without government intervention except through the shareholder approval of business plan and/or investment budgets. Decisions by other agencies to change the use of land or to dispose of it should be subject to review and approval by government authorities. In the special case of agencies which buy and sell land as part of their primary mandate, their founding law should exempt them from detailed government supervision while establishing strict conditions and processes to ensure that all property transactions fall strictly within their mandate.

4.5. *Borrowing*

The objective here is to ensure that autonomous agencies do not make borrowing decisions which create public debt beyond the limits envisioned in the government's fiscal plan or exceeding the borrowing authority approved by parliament.

Open market borrowing by commercially oriented agencies is common in the five survey countries, within the limits of the business plan approved by the government in its role as shareholder. This is clearly desirable because it supports the goal of subjecting such agencies to all the disciplines of the marketplace. For the most part, government does not explicitly guarantee the debts but, among lenders, there is sometimes a perception or expectation of an implicit guarantee. Incorporating such agencies under private law, as recommended above, could have the added benefit of reducing such expectations. However it is not at all uncommon for government owned corporations to pile up operating losses, to struggle with improvident investments, and/or suffer from poor management generally. Since debts in these circumstances are almost certain to become budget liabilities, it is imperative that governments retain the authority, when necessary, to impose direct controls on all aspects of borrowing and debt management.

Similar borrowing by agencies with policy autonomy seems to be permitted in some form by all countries. However, in these cases, government retains control, either by restricting the agency to borrowing from the Treasury (or equivalent), or by requiring prior government approval of loans from market lenders. It is acknowledged everywhere that debts of agencies of this type to outside lenders carry a government guarantee, implicit if not explicit. While it is apparently difficult to confirm, the country reports indicate that some lenders extend preferential interest rates to agencies because of the guarantee.

Practices vary with regard to recording agency debts in the government accounts. Some countries do so but many do not. It is not clear from the country reports how government financial exposure under agency debt guarantees is handled in the state budget. Reserves for potential losses may be provided in some countries but, if so, they are not always identified separately from other reserves. Unquestionably the best practice in government budgeting is to report all potential liabilities and to make systematic provision for losses in annual appropriations. However, the issue for PAs is entangled in many countries with continuing debates about the much wider universe of government contingent liabilities and how they should be accounted for and reported in the budget.

Suggested approach: Agency borrowing should be subject to government oversight proportionate to the degree of responsibility assumed by the state for repayment of the debt. For large commercially oriented agencies where the government does not explicitly guarantee debts, the supervision arrangements should be limited to the shareholder role and/or designed so as to minimise perceptions of an implicit guarantee. For ailing commercial agencies and for all other agencies, because governments can scarcely avoid responsibility for their debts, the prior approval by the finance ministry should be required for all agency borrowing from outside lenders. Both agency debt to government and agency debts guaranteed by government should be fully disclosed in state budget documents, and reserves for potential losses should be set aside in annual appropriations.

4.6. *Agency Revenue Policies*

Revenue policy refers to decisions on the controllable factors that directly affect agency revenue, including pricing, delivery channels discounts, cross-subsidies among products or regions, abatements for specific clients etc. Government oversight of revenue policies is often integrated with the annual budgeting process, especially when revenue is proportionately small, but there is no reason why it could not be a separate exercise if so desired (e.g. where a complete fee schedule for hospital services is issued by a separate

authority). The important thing is that a structured process be established within which there are clearly defined roles for the agency, the line ministry and/or the Finance Ministry.

For commercially oriented agencies, an integral feature of the model is that revenue policies should be determined as far as possible by market forces. Where real market forces exist, sufficient supervision is provided when government, as owner or shareholder, approves the business plan, the investment budget and the borrowing plan developed by agency management. However, when revenue is derived from a monopoly or a form of tax, or when there is a permanent price subsidy to specific clients, market forces do not provide adequate discipline. Citizens could be subjected to unnecessarily high prices, such prices could mask wasteful and inefficient management practices, and groups could be favoured with subsidised prices at the whim of managers. It is for these reasons that all country reports indicate a dual approach to revenue policies; market linked revenue factors are left to agency management while, for monopolies and tax-like forms of revenue, the governments participate, or retain the power to intervene, in decisions about prices and level and quality of service. (In France, indeed, it is the parliament itself which must authorise the earmarked taxes which finance certain PAs functioning as professional associations and chambers of commerce). Subsidised prices to select groups should always be transparent and require government approval. These precautions are fully justified to prevent abuse of power and accompanying maladministration in agencies.

Revenue policy issues among non-commercial agencies are as varied as their mandates and revenue types, thus complicating the task of oversight. One approach that could simplify matters is for a government to adopt a straightforward rule of full cost recovery and then consider only the exceptional cases where agencies wish to depart from the baseline. Practices in a number of countries in the survey suggest the following elements of a sound policy framework: prices are to be set to recover the full costs of production, including cost of capital, unless a variation is specifically authorised; prices which cover less than full cost represent a subsidy, the subsidy must be transparent, and it should be authorised in the same manner as any other subsidy; prices yielding a 'profit' over the complete product cycle represent general revenue collected selectively (i.e. only from citizens dealing with the particular agency) and, for that reason, must be approved specifically by government, acting under the authority of a parliamentary statute. Such a policy framework recognises that there are many agency services that should *not* be priced at full cost; legitimate grounds for exception include social and environmental issues and the deterrence of frivolous demand. The point of the policy would be to bring such cases for decision by government policy makers rather than leaving them to agency management alone. (Of course, a broad policy of this type should, from the outset, exempt marginal fee categories such as museum entry fees or employee parking).

The country reports show a common desire to provide the more highly autonomous agencies with maximum freedom in revenue matters: it is suggested that the policy framework described above is consistent with that goal because, provided an agency adheres to the policy, its detailed pricing decisions need not be questioned.

The need for analysis and oversight of revenue policies provides a further reason why agencies with significant own source revenue should be required to have good cost accounting systems. In capital intensive agencies, moreover, accrual accounting is a desirable support to the costing system.

Suggested approach: Agency revenue policies should be reviewed by government in the context of the annual budget or in a separate structured process. It is sound practice for governments to limit their revenue policy interventions with commercial agencies to cases with monopoly or taxing powers. For other agencies it would be sound practice to establish full cost recovery as the baseline rule; exceptions proposed by agencies would require policy approval by government

4.7. *Cash Programmes Administered on behalf of Government*

A common role given to agencies is that of administering a programme of cash benefits to citizens, such as unemployment insurance, research grants, pensions etc. It is important for budget discipline, as well as to maintain public confidence in government integrity, that money voted by parliament for specific public benefits not be converted to other uses. The agency model, created to give greater autonomy to management, could permit programme funds to be converted into higher salaries and amenities for staff and managers, thus reducing the amounts available to the beneficiaries intended by parliament.

A common practice among the countries in this survey is that of keeping the funds for such programmes carefully segregated from the operating budget of the agency. Most countries budget such programmes within the sector ministry itself and they are implemented through a Treasury account separate from the agency's. The other method would be to maintain the programme funds under a separate appropriation or under a separate heading in the agency budget but with management having no powers of *virement* (transfer) between headings.

Suggested approach: Budgets for cash programmes delivered by an agency should be maintained in an account totally separate from the administrative budget to avoid, and to be seen publicly to avoid, possible "leakage" of programme funds into enhanced salaries, office accommodations or other amenities.

4.8. *Earmarked Contributions*

Earmarked (specified purpose) contributions are an important source of revenue for many agencies in all countries. They may originate from the parent ministry, another ministry, another level of government, or a private entity. Any earmarked contribution, by definition, gives the donor the right to specify conditions; and the agency's acceptance of the contribution includes accepting the donor's definition of purposes, methods, targets, accounting and reporting etc. If, in some cases, those conditions are not defined or not properly monitored, the fault lies with the donors, who must take responsibility for ensuring they receive value for the money expended.

Suggested approach: Earmarked contributions to agencies should be accompanied always by written conditions concerning their purposes and management. These arrangements lie outside the purview of the general regime of agency management and control. However the practices of donor ministries in this regard should be regulated by the Ministry of Finance.

4.9. *Budget Review and Control for Agencies Financed by their own Revenues and Operating Close to Commercial Markets*

Agencies close to the market, broadly speaking, are incorporated as private law legal entities in four of the five countries surveyed and the fifth, France, is moving in that direction. Under this model, government supervision is exercised almost exclusively through the shareholder powers defined in civil code laws on corporations and in the founding corporate charter. The inference seems clear; a degree of autonomy closely approaching that of a private sector company can be tolerated because the conditions of the commercial marketplace are relied upon to provide significant financial and operational discipline on the agency.

For agencies of this kind, the government (playing the shareholder role) reviews and approves the agency's business plan, investment budget and, if necessary, borrowing programme. The appropriate techniques are those of business viability analysis, and investment analysis which, together, shed light on all significant factors of agency strategy and operations. Management control standards^{vi} are established either by civil

code company laws or finance ministry regulations. Mandatory external audit of financial statements may be assigned to the supreme audit institution or to private sector auditors depending on the status of each agency. In practice, of course, no public agency participates so completely in the market as to permit the use of this model in its pure form.

It is suggested, however, that countries could design their rules using this baseline model and adding to it the features necessary to cover specific risks or concerns apparent in their various commercial agencies. To avoid complexity, add-on features should be limited to the most essential. Among the numberless possibilities are modifications such as the following:

- agency investment selection could be subjected to the regular process and criteria used within the administration
- as in France, special rules could be applied to personnel management and to control overall wage costs
- public duties laid upon an agency could be segregated in the business plan for special review and reporting
- the public procurement law could be applied or the agency could be required to develop its own procurement rules for government approval
- specified major decisions by an agency could be approved with conditions, or made subject to a second stage government approval
- performance evaluations of specific business operations could be demanded
- real property and borrowing transactions might be subjected to approval as suggested above.

Suggested approach: Budget review and control methods for agencies of this kind should be modelled on those of private law corporations, with special review and control features added to the model only for specific areas of genuine risk. The requirement and standards for management control and external audit should be defined in laws or regulations.

4.10. *Budget Review and Control for Agencies Significantly Dependant on State Budget Support to their Operations*

In these cases it is imperative that the government have sufficient leverage to discharge its own accountability for resource allocation and control. Performance management techniques should be promoted to make the review and control processes more effective.

(a) Budgeting gross expenditures vs. net government contribution?

Where agencies are financed by a combination of state budget contributions and own source revenue, both must be regarded as public money and the government is responsible for ensuring it is allocated and used appropriately. Gross budgeting is the standard approach although net budgeting may be appropriate under certain conditions.

(It should be noted, as a related but separate issue, that the gross revenue and expenditure data should be reported to parliament in budget documents and final account except in the case of true commercial agencies).

In net budgeting, analysis focuses on the state budget contribution which is approved as a cash limit. Implicitly, this approach empowers the agency to formulate its own spending plan to the extent it is financed by own source revenues. During execution, the agency is free to spend any amount required by its operations provided that it is covered by its own revenues and the government contribution is not exceeded. As explained in later paragraphs, the net budget approach is not uncommon for agencies in advanced countries, which have the capacity to supplement it with other forms of oversight and discipline. Unfortunately, the net approach is sometimes mistakenly adopted by poorly prepared countries in the belief that an agency, once created, has some kind of ‘ownership’ rights in its revenues. In such situations, every one of the risks listed in section 2.2 becomes extreme. Where it exists, strenuous efforts may be required to change both the administrative culture and any carelessly worded laws that support this mistaken interpretation of agency autonomy.

In gross budgeting the agency’s total spending plan, including own revenue and the state budget contribution is examined. In addition to the question of the plan’s affordability within fiscal targets, this permits analysis of overall work volumes, cost comparisons, key input costs etc. If a cash limit on gross spending is imposed during budget execution, the control might vary from rigid to highly flexible. A legal limit could be imposed by parliament in the annual budget bill; or the limit might be imposed administratively, with the finance minister and/or the sector minister having authority to approve the spending of surplus revenues when warranted. In either case, when revenues exceed the forecast, any resulting financial surplus is taken into account in establishing the budget for the following year. (Allowing flexibility for the finance ministry to approve carryover of surpluses may be justified in special circumstances such as delays in capital projects).

However, for agencies in commercial activity, budget execution is normally controlled at the level of the net budget contribution; indeed anything else could cripple their efficiency. Control at the net level may be justified also, on a case by case basis, for some of those agencies being given a high degree of autonomy for policy decisions. (The country reports indicate that Sweden, the Netherlands and United Kingdom control budget execution in most agencies at the net contribution level. But, as explained below, this is made possible by performance management techniques in which these three countries are quite advanced, by the culture of the public interest noted in section 2.2 above, and by the comprehensive governance codes and internal control standards under which they operate). For those non-commercial agencies with intangible or poorly defined outputs, it is sound practice to place control limits on total spending. As agencies perfect their performance management techniques it might be possible to move progressively toward more relaxed forms of control limits.

Suggested approach: All agency budget approvals should be based on an analysis of gross expenditures, not merely the state budget contribution, and the same information should be included in budget documents for parliament. The control total for execution should be the net budget contribution for commercial agencies, and the gross expenditures for all others. In the latter case, the control could be made more flexible when management techniques are improved.

- (b) The budget formulation process maintaining government budgeting standards while catering to agency autonomy.

As demonstrated by the country reports, there are a multitude of possible permutations in the rules, processes and roles by which countries strive to meet this challenge. In the process most typical of the five country reports, the budget is prepared by agency managers, examined by the sector ministry and the state

budget contribution is included in the ministry budget for approval by the finance ministry. The state budget contribution is seen by parliament as a line item in the budget of the sector ministry while the detailed agency budget or business plan is included among background papers tabled with the state budget or made public in some other way.

Consistent with their supervisory responsibilities, it is normally the line ministries that undertake most analysis and negotiations with agencies. But each country must determine an appropriate division of roles between finance ministry and line ministry, taking account of the knowledge, skills and capacities available to each. At minimum, however, the finance ministry must be able to regulate the accounting and reporting conventions and management controls standards, to establish the schedule, to have 'participation rights' in problem cases, to set wage and inflation assumptions, and to have final approval on agency borrowing authorities.

The format and content rules for budget proposals should be designed to permit analysis of overall work volumes, allocations by tasks, benefits from investments, service level and quality issues, costs compared to prior years and to similar activity in other agencies, and an examination of the costs of key inputs. Much of this information is the same as that needed by agency management to do its own job effectively; thus if line ministry examiners learn to exploit what is already available they can simplify the paperwork burden on the agency at the same time that their demands provide an incentive for the improvement of internal management reporting. Some or all of the following should be considered:

- the agency should be expected to demonstrate that its activities are strictly within its legal mandate and consistent with stated government priorities
- the agency should document changes in workload and quality of service and their financial impact
- the agency should identify the cost of its core activities separately from those which are discretionary
- the most significant individual inputs such as personnel costs should be analysed and justified
- if agencies are exempt from the public procurement rules they should be expected to define their own specific procedures for approval by the government
- where the investment budget is significant, the agency should define project evaluation and selection criteria acceptable to the government or enforce those used within the government.

Suggested approach: Most countries should maintain a traditional input-oriented budget review in sufficient detail to ensure the government knows and approves how agencies spend public money. The normal review standards (such as government priority, economy, efficiency, effectiveness, etc) should be applied. The use of performance management techniques, as discussed in (e) below, should be encouraged to strengthen the review process. Respect for agency autonomy should be demonstrated through simplified procedures. As far as possible the parent ministries should conduct the budget review. Operating within basic parameters set by the finance ministry, they have the flexibility to tailor the information requirements and process to the characteristics of individual agencies.

(c) Oversight of staffing and personnel costs.

This observation merely amplifies the previous point concerning the need for special attention to high cost inputs in agency budgets. Because personnel costs often loom large, government authorities should have

the authority to scrutinise all factors affecting them, such as headcounts, wage levels and organisation structure. (There may be also a personnel policy issue; if compensation levels in agencies are allowed to drift higher than in other parts of the public sector, it may be difficult to lure competent individuals to traditional ministries.) In Portugal and France the personnel costs budget is strongly influenced from the centre and the personnel management transactions are monitored throughout the budget execution phase. A priori control practices by third parties have been abandoned in the other three countries. However, wage negotiations by the agencies do appear to be monitored formally or informally by ministries of finance in all countries, and the degree of influence or "guidance" they exert should be assumed to be stronger in practice than it formally appears.

A further complication, and risk, arises if employees of an agency have the status of civil servants or enjoy similar benefits such as tenure in their jobs or privileged access to regular civil service posts. Under these conditions, the decision to hire conveys a valuable prize and therefore a temptation to corrupt behaviour. Unless agency management is motivated by clear performance indicators such as unit costs and measured production, they could seek personal benefits for themselves by using staffing decisions for political and bureaucratic patronage instead of as a means for improving performance.

Suggested approach: Government oversight of staffing and personnel costs in agencies should be proportionate to the importance of these items in the agency budget. While, in principle, agency effectiveness might be enhanced by relaxing restrictions on staffing and compensation, it is only prudent for most countries to analyse personnel cost budgets in some detail where they are a major cost factor. If some agencies have authority to create civil servants by their hiring decisions, supervision and audit similar to the provisions of the civil service law may be necessary to avoid corrupt behaviour or the appearance of it.

(d) Control during budget execution.

The country reports indicate that many, but not all, non-commercial agencies are operated within the cash management and payments systems of the Treasury. In the absence of any general pattern, it can only be suggested that non-commercial agencies be kept within the Treasury system unless a particular agency can demonstrate that its operations would be inhibited thereby.

Nearly all such agencies in the surveyed countries are subject to audit by the supreme audit institution, always to financial audit and often to value-for-money audits as well. Exceptions to this rule seem most frequent for universities but they are nevertheless required to appoint professional external auditors of their own choosing and publish their reports.

Most noteworthy in enabling governments to safely confer financial autonomy on agencies is the widespread reliance on management control principles (cf. Endnote #3). (France and Portugal retain ex ante controls but increasingly insist on improved internal controls as well). The basic principle is that agency management and supervisory boards must take responsibility for designing, implementing and enforcing control systems appropriate to their own missions. While this responsibility is defined for some agencies by private law, it seems that most non-commercial agencies are subject to standards promulgated by the ministry of finance and often supplemented by line ministry directives. The standards should also oblige the agency to maintain an effective internal audit facility; normally this would be a separate unit in the larger organisations, an outside contractor or a joint facility for smaller agencies.

The great practical benefits of the management control approach are that; supervising ministries are assured of receiving accurate numbers in budget requests and periodic reports; regularity and legality of transactions is maintained without intrusive third party measures, and; the continued adequacy of the "organisation, policies and procedures" is monitored and reported to managers and supervisors by internal

audit. It is, in short, an approach which combines effectiveness with appropriate respect for agency autonomy.

Suggested approach: Non-commercial agencies should remain in the Treasury system and be subject to audit by the supreme audit institution unless exceptions can be justified on their individual merits. While ex ante control methods may be necessary in the immediate term, it should be a priority to introduce management control practices to standards specified by the finance ministry and work to improve them to the point where third party interventions can safely be eliminated.

(e) Performance management practices; relationship to budgeting and control.

To the extent that budget decisions can be supported with accurate output and cost measures, government supervision of agency finances can be made less detailed. If the outputs and results of agency work can be reliably monitored, there is less need for intrusive input control measures. Indeed, the increased use of the public agency model in many countries reflects a belief that programme outputs of smaller, more focused units can be more easily measured and controlled than in traditional hierarchical administrations. Examples of the trend toward performance management can be found in the country reports for Sweden, Netherlands and United Kingdom where task performance as well as relevant administrative and financial results are the primary focus of attention. Increasingly sophisticated tools for defining, measuring and tracking performance are supplementing or replacing input analyses for budgeting purposes, for reporting to the public and for remuneration of staff. Typically, the founding laws of each agency define the basic parameters of performance but there is also ample space for the sector minister to negotiate targets annually at budget time.

Of the three, Sweden provides the purest model of this approach: After consultation with the agency concerned, the government decides on the general objectives and expected results of the operations, the required reporting procedures, and the financial resources; during execution, all input categories are fungible (including even personnel costs) and the aggregate spending limit is the net contribution from the state budget. Reporting to the minister during implementation and at yearend focuses on performance and outputs rather than inputs. The United Kingdom and, increasingly, the Netherlands also appear to have incorporated elements of this approach, as have other developed countries. (New Zealand is widely considered the world leader in this regard with its 'output budgeting' and contractual relationships between ministers as 'buyers' and agency officials as 'sellers' of public services.) However, few are prepared to abandon completely the use of input-based budgeting and control methods^{vii} and their reluctance is justified, it must be said, by the absence of reliable evaluations of the long term effects of such radical experiments as output budgeting and replacing hierarchy with contracts.

Another popular innovation in developed countries is the practice of subjecting non-commercial agencies to "artificial" market mechanisms with the goal of improving performance and/or compensating for the reduction of direct controls. One example is the revolving fund device which provides a working capital advance rather than an expenditure limit, and enables an agency to increase or decrease spending as dictated by its sales. In other examples, some agencies are permitted to "borrow" from the Treasury on commercial terms for investments which will yield an acceptable return; others are encouraged to sell their products or services at a price which covers the full cost and they are permitted to add back some or all of the increased revenue to the budget. Carefully designed and painstakingly implemented, such market-mimicking devices are being used with substantial success in many countries to improve performance and make financial supervision of agencies more flexible.

It is suggested that countries in transition would benefit from the orderly introduction of performance management practices but that they should not expect or attempt to quickly replace traditional budgeting and control methods. The experience of the advanced countries demonstrates the very demanding

preparations necessary to make performance management succeed. Transitional countries are well advised to adopt the same cautious approach.

The three countries named above place great emphasis on cost accounting, performance reporting and publication of results. Other essential techniques include corporate planning, programme evaluation and performance measurement. Like all countries attempting such reforms, they have spent many years experimenting and perfecting these technical prerequisites of success. All have proceeded by making a series of incremental reforms to already strong administrative institutions. Management control practices, internal audit, and value for money auditing and financial information systems were established and perfected over time. Agencies were encouraged to develop programmatic approaches in their internal management and reporting. The introduction of market-like mechanisms to stimulate efficiency improvement was a gradual development, beginning with straightforward cases. Lengthy periods of experimentation were necessary to develop useable tools for defining, measuring and tracking performance, especially the qualitative factors that are so critical in most public services. (For example, defining a performance framework for an agency that issues driving licenses is inherently less difficult than doing so for an agency charged with helping AIDS victims or one that deals with immigration cases.) Improvements in the concepts and methodology of cost accounting were developed in the private sector but had to be adapted for government use. Although broad implementation of accrual accounting in these countries is a recent phenomenon, it began many years ago with selective^{viii} use of accrual accounting in capital-intensive agencies.

Side by side with technical innovation, the reorientation of an administrative culture from compliance to performance is itself a major human development challenge. In retrospect, it could be concluded that the extended period of technical development in the performance management countries provided both stimulus and the necessary gestation time for the culture and the people to adapt.

Suggested approach: Countries in transition should emphasise input oriented budgeting and control processes while promoting performance management techniques to make those processes more effective, not to replace them. Systematically designed and implemented, management control, cost accounting and internal audit are the practices most likely to yield early results. As the reforms take effect both budget formulation and control should become more effective and the possibility opens to further streamline the procedures of agency supervision.

4.11. *Selling Private Goods in Competition with the Private Sector*

There are two main objections to activities of this kind; the health of the private sector is undermined when it is forced to compete against the powers and resources of the state, and; the goods and services sold in entrepreneurial fashion are likely to enjoy some degree of state budget subsidy which is hidden from view.

On the whole, there is limited reference to this kind of activity in the country reports. United Kingdom specifically bans competition with the private sector and HM Treasury actively enforces the rule. In Netherlands, when an agency sells products or services in commercial markets as an incidental sideline to its main tasks it comes under additional rules designed to protect the private sector from unfair competition. Their main feature is that the agency must totally segregate its commercial from its non-commercial activities; separate organisations, cost accounting and financial reports are demanded for this purpose. It is government policy that the commercial activities should ultimately be sold to the private sector.

Suggested approach: Public agencies should normally be barred from selling products or services which are private goods readily available from private sector suppliers; in circumstances where they do so, the

control rules should be designed to ensure the sale price is not subsidised and, as in the Netherlands, to require that the commercial activity be fully segregated in organisational and accounting terms and eventually privatised.

4.12. Accounting and Reporting

It scarcely needs to be said that accounting and reporting by commercial agencies should conform to the highest private sector standards and that, in some cases, governments should impose even higher standards in order to safeguard the principles of transparency in public finance.

It will be noted that the accounting and reporting rules for non-commercial agencies described in the five country reports are as varied as other features of the agency systems; in some cases, the rules vary also among different agencies within one country. It is likely that the reasons for the variations are themselves varied. Agencies have been created at different times and under different circumstances and, when new rules are later introduced, it is often necessary to 'grandfather' some existing situations. Also, the conventions of government accounting and reporting have evolved over the years and, in recent decades, have been further moulded under the pressure of globalised investment and financial markets. It is not surprising that practices in the demimonde of public agencies have failed, as yet, to settle down into a common, stable pattern.

Countries embarking on a fundamental reform of the public agency system are perhaps in a better position to implement 'standard' rules than are the five countries surveyed where reforms tend to be incremental rather than fundamental. In doing so, the best course would be to adopt in full the internationally accepted standards for accounting and reporting as recommended by the IMF and the EU, even if full implementation must be phased in over a period of years. The basic requirement is stated in the SIGMA publication *Managing Government Expenditures in Transitional Countries*; "All funds and accounts of all entities of the government must be consolidated. To make this consolidation possible, the chart of accounts of government entities and the economic and functional classification of their budget must fit a common framework determined at the central level. Good financial reporting is required for accountability." The detailed specifications and available alternatives are described fully in the same publication.

The need for transparency in connection with contingent liabilities was noted earlier. The state budget should disclose all contingent liabilities arising from government guarantees of agency debt and set up reserves for forecast losses. Any broad reform of agency governance should be seen as an opportunity to fully implement in this sector the principles of fiscal transparency advocated by the IMF^{ix}.

Suggested approach: Accounting and reporting by commercial agencies should match the highest private sector standards. Financial activities of non-commercial agencies should be reported publicly and fully consolidated in government financial reports. Their accounting and reporting standards should be the same as the rest of government which, in turn, should be brought into conformity with internationally accepted standards.

ENDNOTES

- iv. Control, controls: the term has two meanings relevant to management and administration. In the first and broadest sense; it refers to all the laws, policies, traditions, processes, procedures, practices and other instruments used by (in this case) the State, to ensure the work of the administration is done in accordance with the will of parliament and government. Specific structures and self-regulating mechanisms are set up which prevent errors and which promptly detect any errors which occur. This publication uses "control" in this sense.

The second meaning is related to investigation. In this sense, control means to check, to scrutinise or to confirm information. In its pre-eminent meaning, this use of control is equal to control, an activity carried out by a person who is not doing the work or responsible for getting the work done. The publication uses the word "audit" for this meaning.
- v. An interesting example of this phenomenon can be found in 'Cases in the Agricultural Administration (Denmark)' by Rolf Elm-Larsen; SIGMA Papers No. 4, Management Control in Modern Government Administration: Some Comparative Practices. In brief, audits revealed that EU subsidies administered by the Danish Intervention Agency had resulted in large overpayments to Danish farmers. Because the eligibility criteria used were not consistent with the EU rules, Denmark was required to amend its Budget and reimburse the EU for the illegal overpayments. It was found that the Intervention Agency was heavily influenced by agricultural interest groups to define eligibility criteria, inspection and payment arrangements to maximise the amount of payments rather than to achieve the EU goals of market stabilisation.
- vi. Management control (also called internal control) can be briefly defined as the organisation, policies and procedures used to help ensure that government programmes achieve their intended results; that the resources used to deliver those programmes are consistent with the stated aims and objectives of the organisations concerned; that programmes are protected from waste, fraud and mismanagement; and that reliable and timely information is obtained, maintained, reported and used for decision-making. (For an extended discussion of management control see SIGMA Papers, No.4, Management Control in Modern Government Administration: Some Comparative Practices).
- vii. As an OECD study notes, "inputs are still important as a budgetary guideline; the link between performance and the budget is indirect and often inferential rather than direct and automatic; and budgetary pressure moves the use of performance indicators more to the ex-post evaluation". (In Search of Results: Performance Management Practices; as quoted in SIGMA publication Managing Government Expenditures in Transitional Countries).
- viii. Selective use is advised also for the countries in transition because they have higher financial management priorities than the complex and onerous task of introducing full-scale accrual accounting. OECD Occasional Paper 93-178, *Accounting for What?* states that; ".full cash and full accrual accounting should properly be viewed as end points on a spectrum of possible accounting bases... And it may be that accrual accounting is more useful in certain activities than in others e.g. in contracting out, market testing or in activities where significant capital assets are involved".
- ix. *Code of Good Practices on Fiscal Transparency — Declaration on Principles*: International Monetary Fund, Washington, D.C., April 1998.

CHAPTER 3. COUNTRY REPORT FRANCE

By Ms. Simone Touchon and Mr. Daniel Tommasi

This Chapter presents in Part I an overview of the various types of public organisations that benefit from some autonomy in management, although to various extents. These include legal entities (such as the various types of *établissement public* (EP), the public corporations, and certain private law organisations) and a few entities not legally separate from the State such as the "*services à compétence nationale*" and the independent commissions responsible for economic regulation and protection of citizen rights. Part II of this Chapter focuses on the *établissement public*, which is by far the most frequent form of autonomous organisation.

PART I. AN OVERVIEW

1. The *Établissement Public* (EP)

1.1. The Basic Types of the EP

The French government has long used the EP to perform most of its tasks, with the exception of those duties which have traditionally been considered a "royal prerogative" and encompass defence, police, justice and foreign affairs.

The Court of Cassation clearly defined what was meant by an EP as early as 1856. The definition is based on five criteria:

- the agency must be a separate legal entity from the entity which created it
- it must be a public law entity, even in the case of an EP operating under the private law system and engaged in manufacturing and distribution
- it must have a specific object, which justifies its existence (any business not within the scope of an EP's object is unlawful)
- it must be autonomous from an administrative and financial standpoint, have separate governing bodies and its own budget

- it must be under the supervisory authority of the national government or a regional or local government.

The above attributes have primarily been interpreted by administrative judges' precedents rather than enacted into statutes or issued as regulations. The "creation" of EPs by case administrative law has marked their entire history, as they expanded along with the very notion of public service (understood as the services of national economic and social interest).

Although there is no official list of EPs it is estimated that some 1 100 have been created by the central government (national EPs) and more than 50 000 by local authorities. Some are unique, mostly the national EPs, such as the National Employment Agency (*Agence Nationale Pour l'Emploi*), the National Library (*Bibliothèque Nationale*), the Seashore Conservation Agency (*Conservatoire du littoral*), the National Consumer Institute (*Institut National de la Consommation*), etc. In most instances, however, they belong to a group of agencies with similar objects. There are more than 200 such categories of national EPs alone.

Local EPs are under the authority of municipalities (8 000 school administrations, 30 000 municipal social service offices, 2 000 hospitals, etc.), counties (*départements*) (middle-level schools, fire departments, etc.) or regions (secondary schools). Decentralisation measures have caused the number of local agencies to increase. A 1983 law, for instance, transformed 7 000 formerly national middle-level and secondary schools into local EPs. In some sectors, such as the secondary education sector, the creation and the management of EPs are tightly regulated and controlled by the central government. The schools are local EPs, but teachers are employees of the central government. Actually, the French school system is centralised. In the same way, the central government exerts a tightening control on the local hospitals. Conversely, for providing other services, the local authorities can decide themselves among different kinds of institutional arrangements: direct management by the local administration (*régie directe*); unit with financial autonomy (*régie dotée de l'autonomie financière*); industrial and commercial EP legally independent from the local government authority (*régie personnalisée*); semi-public Local Company and; concession or lease contracts with private companies (these last arrangements being the most frequent for water supply).

An EP is primarily a convenient administrative instrument for the provision of government services, as it enables a specific activity to be handled separately from the others. It makes cost recovery easier, whereas the State's budget does not allow revenue to be earmarked for specific expenditures. It provides a way to guarantee the traditional independence of higher education. It also became a widely used instrument for consultations in public administration, meaning the participation in management decision-making of those concerned by a sector, with private sector representatives holding seats on the governing bodies. It makes possible to adapt organisations and resources to a specific task, while providing administrative flexibility through their complex blend of private and public law. Thus, some entities are named industrial and commercial EPs only to allow them to enjoy the extra flexibility available to this category of EP, especially in the remuneration and recruitment of personnel.

The definition EP applies to a spectrum of entities; the administrative EP is the most common form of EP and is very close to the system of government administration; the industrial and commercial EP enjoy somewhat greater autonomy and were designed to operate as commercial companies; and finally, the professional EPs are managed by the private sector. There are no pre-existing criteria to determine whether a given activity is to be performed by a government administrative division or an EP, although there is a political consensus which says that those tasks which are a "royal" prerogative must be handled directly by the central government. At times certain assignments which were entrusted to an EP revert back to the central government, as in the case of testing for drivers' licenses, for instance. The law creating each category of EP, that is, which are applicable to each group of tasks, provide in a very pragmatic way for what is considered the most efficient type of organisation, authority, resources and obligations.

Part II of this paper will discuss in detail the financial management and control of the most common forms of national EPs.

1.2. *Special Types of Établissement Public*

Besides the most common forms of EPs, there are various special types of EPs and some other special arrangements. Many of these arrangements are aimed at both increasing flexibility in management and developing partnership between different public entities or between public entities and the private sector.

Participation of the Private Sector in the Management of EPs

The boards of directors of agricultural product councils, which has regulatory and study functions, include a majority of representatives from the sectors concerned, with government representatives in the minority, along with those of employees and consumers. The participation of the private sector in the board of directors of the EPs that regulate private activities, and the managerial autonomy of these EPs, has the advantage of ensuring private sector needs and concerns that will be better taken into account than by an administrative department. However, this has also drawbacks. Sometimes the EP and the private sector become excessively interdependent. The private representatives can have excessive influence on the EP policy². Interdependency can lead to mismanagement when money is involved³.

The professional chambers, such as the Chambers of Commerce, the Guild Chamber, or the Chambers of Agriculture, are legally public agencies, but are managed by representatives elected by the private sector. (There are about 200 professional chambers that are public agencies). Their sphere of activity can be large. They are consulted when governmental regulations concerning their sectors are prepared, and have some regulatory powers also. They have administrative activities such as keeping the commercial register. The Chambers of Commerce manage a number of ports and airports and many business schools. The revenues of these agencies come often from an earmarked tax, which has to be approved by Parliament. They are audited by the Court of Accounts and are subject to some government controls to verify regularity of their acts. Generally, the comments in this report do not concern these professional chambers.

The GIP

Central government and local authorities can set up joint EPs, either with each other or with private-sector entities. These are known as public-interest groups, GIP (*Groupeement d'Intérêt Public*). Having recently come into existence (early 1980's), GIPs provide an answer to the growing need for concerted action by several public entities in a specific area (e.g. AIDS research), for joint access to resources (such as a computerised university management system or a common telecommunications system for research agencies and universities), or for projects undertaken with the private sector (e.g. an environmental project that involves the central government, the regional government and the polluting industries together). The Regional Hospital Agencies which supervise the hospitals in regions are joint GIPs of the State and the Social Security agencies.

2. Situation met in the National Agricultural Development Agency, according to the 1999 Public Report of the Court of Accounts.

3. Thus in March 2000, the Court of Accounts noted in a report sent to the Executive and the Parliament: "a confused organisation" of the hunting and "irregular and useless" expenditure of funds involving both the National Office for Hunting (which is an EP) and private organisations. The National Office for Hunting was also financing the salaries of seven officers from its supervisory line ministry.

An EP can be part of a GIP which is itself an EP. The law governing its activities (public or private law), and its management and accounting rules depends on both the nature of its activities (as for the EPs) and on the degree of participation of private persons in the GIP. To participate in a GIP, an EP must have the same field of activities as the GIP. Law defines categories of GIP, in the same manner as the EPs. Many GIPs have been created or are in the process of being created.

In addition, industrial and commercial EPs, cultural and scientific EPs (mainly Universities) and scientific and technological EPs (research centres) are authorised to hold an interest in subsidiaries and economic interest groups (GIE)⁴, for the purpose of carrying out business activities. The GIE are private law entities.

The EPCI

Local authorities can join together to create a special type of EP as a vehicle for inter-municipal co-operation, the *Établissements Public de Coopération Intercommunale* (EPCI). There are about 20 000 EPCI or similar arrangements. An EPCI can create and/use various forms of organisation to deliver services. Some EPCIs are set up to carry out a specific activity (e.g. supervising water supply concessions); other EPCIs have missions in several areas, in contrast to the national EP which have a unique mission. The EPCI is a hybrid institutional arrangement, which is, in certain respects, similar to the national EP, and by other aspects similar to a governmental authority.

Other Special Types of EP

The social security central administration and some pension and social assistance funds are EPs. Given the two-party management of the social security, the "board of directors" of the social security administration is composed of representative of the employers, employees, and qualified persons. However, in recent years, the State has begun to exert an increased control over the social security system.

The *Caisse des Dépôts et Consignations* is an EP of special nature. It is a financial institution of a very significant size, which, among other things, centralises funds from the regulated saving institutions. In certain respects, it is similar to an investment bank. It is also an important instrument of public policy for local economic and social development, in areas such as urban policy, planning, social housing, management of local public services, transport, tourism, and environment. It intervenes in many ways: investor, banker (notably in the fields of social housing), service provider (e.g. it owns most "private" companies that manage toll road concessions), engineer, and consultant. Its financial management system is very specific and is not discussed in the present report.

2. Public Entreprises

About 20 public enterprises are legally EPs. Some of them are large enterprises, such as the electricity company (EDF, *Electricité de France*), and the railways companies (SNCF, *Société Nationale des Chemins Français*, and RFF, *réseau Ferré de France*) and the French post. Some public enterprises are submitted to the government accounting regulations discussed below (mainly the seaports, the river port agencies, and the Paris airports agency).

The other public enterprises are semi-public companies and limited companies governed by the private law, fully or partially owned by the State, the EPs, or other public authorities. There are currently about

4. The Economic Interest Group is a legal arrangement to carry out business activities used also by the private sector (it groups private corporations or individual enterprises).

100 public enterprises of which the State owns directly more than 50 per cent of shares or that are EPs. These enterprises have hundreds of subsidiaries. All the subsidiaries of the EPs are private law corporations. Depending on the degree of direct ownership of the State, these enterprises can be subject to special regulations concerning the appointment of managers and State's representatives in the board of directors, the participation of employees' representatives in the board of directors, and the audits from the Court of Accounts and the State Control (see below).

The public enterprises sector is evolving. Its size has dramatically decreased from 1985. The great majority of corporations fully owned by the State have been partially or fully privatised. In the past the administrative divisions of the government directly managed a number of economic activities. Their budget was included in the State budget, either as special trade account or as "annexed budget". It was submitted to the State's budget management regulations with certain special dispensations. Because such arrangements are not appropriate to carry out economic activities, most of these administrative divisions have been transformed into either EPs (e.g. the post office, in 1990), or into private law corporations (e.g., the National Printing Office, in 1993). The telecom company that was also managed as an administrative division became in 1990 an EP, and since then it has been corporatised and partially privatised. Only a very few industrial or commercial units, such as the military shipyards, are not yet legal entities.

Large public enterprises in EP form have many private law subsidiaries to carry out properly a number of business activities. However, there is a growing concern that within the context of increased competition and openness of markets, these enterprises need themselves to be transformed into corporations, in order to give them greater flexibility and to allow them to develop alliances with other companies in better conditions. This will also ensure that corporate governance norms will be better enforced. Thus, concerning the largest EPs a recent report to the government notes: "the functioning of the board of directors of these enterprises is not very satisfactory, with respect to corporate governance norms. The representatives of the State in the governing body face difficulties in reconciling their board director's responsibility with their dependence to the State, and the public interests of the different line ministries"⁵.

3. Other Institutional Arrangements

3.1. The Independent Administrative Authorities

Many bodies provide independent advice to the government on regulatory and policy issues. These include several EPs, such as the food security agency (*agence française de sécurité sanitaire des aliments*) which has a general mission of risk assessment, but has no direct regulation powers except in the field of veterinary drugs, certain ministerial divisions or inter-ministerial committees, such as the authority for nuclear security (*autorité de sécurité nucléaire*), some private law organisations, and numerous committees, high councils and commissions. Some of these commissions are called "Independent Administrative Authority" (*Autorité Administrative Indépendante* -AAI). Note that AAI is a descriptive name for these entities; it is not a legal definition. The AAIs are not supervised by a minister and are generally empowered to issue regulations in their sphere of competence.

The notion of AAI has been first used in the statute that created the National Commission for Informatics and Freedom (*Commission Nationale de l'Informatique et des Libertés*) in 1978. Since then, a number of existing or newly created commissions were referred to as AAIs. Currently, about twenty commissions are

5. Commissariat au Plan; *Services publics en réseau*. Rapport Bergougnoux, La Documentation française, Paris 2000.

deemed to be an AAI, in a few cases because such provision is included in the statutes that creates them, in the other cases according to the juridical doctrine. In a few AAIs one single high ranking person is entitled to exercise the authority (e.g. the Ombudsman), but most AAI are collegial commissions of six to fifteen and so members. Generally, the staff of the AAIs vary from about thirty to two hundred persons.

Generally, the missions of the AAIs lie in such areas as the regulation of economic and financial activities, the protection of the consumer, the regulation of broadcasting and information, the control of political transparency, and the protection of citizens' rights against abuses of powers by the State. The creation of an AAI is often aimed at ensuring that regulations will take proper account of citizen and property rights, independently of political pressures and economic lobbies.

Examples of AAI include: the Securities and Exchange Commission (*Commission des Opérations de Bourse*), the Competition Council (*Conseil de la Concurrence*), the regulatory commissions in the telecom and electricity sectors, the authority of control of airport noise pollution (*Autorité de contrôle des nuisances sonores aéroportuaires*), the Broadcasting High Council (*Conseil Supérieur de l'Audiovisuel*), the National Commission for Informatics and Freedom (*Commission Nationale de l'Informatique et des Libertés*), the National Commission of Financing of elections and political life (*Commission Nationale des Comptes de Campagne et des Financements Politiques*), the Commission for Access to Administrative Documents (*Commission d'Accès aux Documents Administratifs*), the Commission for the control of phone-tapping (*Commission Nationale de contrôle des Interceptions de Sécurité*), and the Ombudsman office.

Depending on the sector, similar missions may be assigned to different types of organisations, an AAI, a ministerial committee or an EP. For example, the university evaluation council is by law an AAI, while other public policy evaluation councils are not deemed to be AAI, and the agency for evaluating and accrediting the public and private hospitals is an EP.

Generally, an AAI presents the following features:

- Its mission consists of the regulation of "sensitive" sectors and/or the protection of civil and economic rights
- It is a public body, but unlike to the EP it is not a legal person separate from the State
- A statute voted by Parliament generally creates it
- It is not subject to any supervisory authority. Its members are independent from both the executive and the Parliament
- It exercises certain powers, which vary from a mere "influence power" to regulatory powers, depending on its mission. A number of AAIs have capacity to refer to the courts. An AAI such as the Broadcasting High Council is responsible for appointing the Presidents of the television and radio state-owned companies. Some AAIs have by law sanction powers. These AAI sanction themselves, independently of the ministerial authorities. However, the AAI is not a judicial institution. Therefore, the Constitutional Council and the case law have strictly delimited these repressive powers, and made sure, among other things, that the sanction procedures of the AAIs enforce the defence rights
- It is an administrative organisation and as such it is controlled by the administrative courts. In most cases administrative decisions and sanctions made by an AAI are appealed to the *Conseil d'État*, which is the highest administrative court. (The *Conseil d'État* judges also on

appeal the decisions of private law professional commissions, such as the Stock Market Council, *Conseil des Bourses de Valeurs*). In few other cases, the sanctions of an AAI are appealed to the judicial courts. Thus, the Court of Appeal of Paris judges the sanctions of the Securities and Exchange Commission on appeal. Appeals against the sentence of the Court of Appeal can be submitted to the Court of Cassation

- It has financial autonomy. However, its financial autonomy is limited by the fact that the budget of the AAIs is included in the budget of the ministries, or in the budget of the Prime Minister, and is reviewed in the same process as the other components of the State's budget. (The Securities and Exchange Commission is an exception; it is financed by earmarked taxes through an extra-budgetary fund). Most AAI are not submitted to the a priori financial control of the Ministry of Finance discussed below, but they are subject to government accounting regulations and to audit by the Court of Accounts.

The independence of the AAI is ensured by some special guarantees, such as the mode of appointment of its members and their status. The members of the AAI are *de facto* (and sometimes by law) irremovable during their mandate. Rules for appointing them are defined in the statute that creates the AAI and vary from one AAI to another. Sometimes the President of the Republic and the Presidents of the two chambers of Parliament appoint them. In other cases, they are appointed by the highest control institutions (e.g. the Court of Accounts or the *Conseil d'État*), and/or by private professional bodies. Some AAIs include members *ex officio* (e.g. the General Director of a specified Department).

Because of their specialised role and status, AAIs are not public agencies within the meaning of this survey and they will not be discussed further in this paper.

3.2. *The service à compétence nationale*

EPs have brought about a certain degree of decentralisation of government services that has been productive; their increased number and diversity, however, has caused the concept to be watered down somewhat. France continues to create EPs on a regular basis but questions are being raised about the need to tighten the control exercised by national or local authorities over them. The Ministry of Finance has an ambiguous attitude toward the proliferation of EPs. It often undertakes to create them, in order to fulfil its administrative responsibilities, but it also considers them to generate additional public spending and to set up a screen with respect to its financial supervision.

Actually, management autonomy does not always require the creation of separate legal entities. Therefore, the government has created in 1997 a new type of government organisation "Division with nation-wide jurisdiction" (*Services à caractère national — SCN*), which can provide an alternative to the continued creation of EPs. In contrast to the EP, these units are not separate legal entities. Organisations that could come under this category rather than have the status of EP include national museums, training centres, national archives, etc. For the moment, only a few SCN have been created. Concerning the museums at least, first results from this experience seem poor. The Court of Accounts reported⁶: "this form of delegation offered a few limited advantages, but did not modify the complexity of the management of these units, which lack the administrative means for performing their new responsibilities". The military shipyards are still managed by an administrative division, the Directorate of Shipyards (*Direction de la*

6. *Les musées nationaux et les collections nationales d'oeuvres d'art*; Cour des Comptes, February 1997.

Construction Navale — DCN). The DCN has been recently transformed into a SCN, but the Parliament's defence committee noted that this transformation will not loosen sufficiently its "statutory shackles"⁷.

3.3. *Other Entities*

Besides the EP and the state owned corporation, the government, and especially the local authorities, creates and uses a few other organisational models to provide public services.

The Semi-Public Local Companies

The Semi-Public Local Company (SPLC) is a private law company. Local governments can use SPLC for managing urban development or construction projects, and a number of other activities, such as management of urban transport, sport facilities, or congress centres. There are about 1 200 SPLC. The creation of a SPLC by local authorities is subject to certain conditions. The respective degree of participation of the public and the private sector in the SPLC are regulated, but actually often the "private" partner is a subsidiary of the *Caisse des Dépôts et Consignations*, which is itself an EP. The SPLC should not compete unfairly with the private sector, therefore generally purely commercial activities are forbidden. The activities of the SPLC must fall within the sphere of responsibility of the authority that creates it. The local governments cannot delegate to the SPLC missions such as police missions. The State regional representative (the Prefect), as well as a private person, can refer to the administrative courts, if they think that the SPLC is illegal or infringe on their property rights. The SPLC may have subsidiaries. They are fully subject to private sector accounting regulations. The regional chambers of the Court of Accounts audit them, but not frequently (about every 15 years). The Prefect is informed on their accounts, and may refer to regional chambers of Court of Accounts, if necessary. The SPLC is an efficient and effective instrument for managing local projects and services. However, sometimes the local authority's controls on the SPLC are weak, or in other cases the financial relationships between the SPLC and the supervisory local authority lack transparency.

The Non-Governmental Organisations (NGOs)

The government sometimes uses NGOs to implement public policies. This is often an effective form of partnership with the citizens groups. There are also many "quasi-administrative" NGOs created and fully financed by government bodies, especially by the local governments, but sometimes also by some line ministries (about 68 quasi-administrative NGO for the Ministry of Culture⁸). As shown by the reports of the Court of Accounts, a number of these NGOs are set up only to overcome government expenditure management and accounting rules. Such organisational arrangements are forbidden. However, as noted by the 1999 report of the *Conseil d'État*: "If the numerous administrative circulars that prohibited NGOs did not achieve results, it is because these NGOs meet some needs. Preventing such drift in government expenditure management calls for modernising the government's administration methods and making the budgetary regulations more flexible". According to this report a modernised and "low-fat" form of GIP and EP should be considered to eliminate the need of creating NGOs.

7. *Avis de la commission de la défense nationale sur le projet de loi de finances pour 2000*; Assemblée nationale.

8. *Rapport Public 1999*; Cour des Comptes.

PART II: THE *ÉTABLISSEMENT PUBLIC*

1. The Institutional Framework

1.1. *The Main Classes of Établissement Public*

Public agencies are considered legal entities. As such, they make decisions for which they are held accountable; they have their own assets, including real and personal property; they have a budget that is separate from that of the entity which created them; and they may take legal action, including against the government.

The main class to which they belong determines, in principle, whether the public law or the private law applies to the EP activities. A distinction is made between administrative EPs, which are governed by the public law, and industrial and commercial EPs for which private law is applicable.

For a number of EPs the designations "administrative" or "industrial and commercial" are not used. These are "economic public agencies", "public hospitals", "public service operator", etc. Nevertheless, the conceptual difference between "administrative" and "industrial and commercial" EP serves always, as reference to determine which law system should be applied.

Administrative EPs

Administrative EPs account for the overwhelming majority of the EPs. There are about 1 000 national administrative EPs. There are generally subject to budgeting and accounting regulations similar to those applied to the State's budget.

Their employees are covered by the public law (except some special cases such as employees of social security administration, which are covered by private law and a collective labour agreement). Some of them are authorised by delegation to have police powers (e.g. the national park agencies); to levy taxes (e.g. the watershed financial agencies), or have pre-emptive rights for certain property transactions (e.g. the seashore conservation agency). Legal disputes with administrative EPs, concerning for example procurement or personnel issues, are examined by the administrative courts.

In the early 1980s, two sectors were granted a higher degree of management autonomy than most other administrative EPs, but did not cease to be considered basically administrative EPs:

- Scientific, cultural and professional *EPs*. There are about one hundred such agencies (80 universities, the Collège de France, the French School in Rome, the Natural History Museum, the Paris Observatory, etc.). They enjoy greater autonomy, are not subject to prior financial controls and their budgets may be automatically implemented; likewise, they are entitled to a certain degree of self-management through the election of their own governing bodies
- Scientific and technological EPs. This is a type of EP, created by a 1982 Act, which includes some ten research organisations, with elected public officials on their board of directors. Their budgeting and financial system has been made more flexible. Apart from this, they are not very different from other administrative public agencies.

Industrial and Commercial EPs

The number of national industrial and commercial EPs is relatively small (about 80), although several of them are very large entities. This group includes, among others, the twenty or so public enterprises mentioned earlier, the Paris Opera, the agricultural product offices, which perform both administrative and regulation functions, the French Foreign Trade Centre, which is responsible for export promotion, the Space Agency, etc.

In principle, their employees are covered by labour laws and disputes involving them are subject to the jurisdiction of industrial tribunals, as for private enterprises. Generally, the other disputes concerning the relationships of these EPs with third parties are also in the competence of the same courts as private persons. Many of these EPs benefit, however, from some public power privileges (e.g. for recovering their debts, see below).

Their accounts are kept according to the general accounting plan, which defines the core chart of accounts and the general accounting principles for all industrial and commercial activities. Most of them are submitted to government accounting regulations, but not to the prior financial control (see below). They have more flexibility in management than administrative EPs.

There is an increasing number of "industrial and commercial public agencies" that have administrative activities only. These EPs have been classified as "industrial and commercial" EPs for the sole purpose of giving them more managerial autonomy. This is made possible by the decree on accounting regulations of 1962⁹, which stipulates that: "Public agencies are named of 'administrative nature' or 'of industrial and commercial nature', according to the object of their activity or the needs for their management.

However, as regards management autonomy, differences between the two classes of EPs are diminishing. Administrative public agencies have been taking advantage of modernisation measures by the central government, whereby more emphasis is placed on accountability and prior controls are being progressively transformed into ex-post audits. Conversely, most industrial, and commercial EPs are still subject to government accounting regulations.

1.2. Legal Issues

As regards the law system, there is no single standard that makes it possible to ascertain whether an EP is either an administrative or an industrial and commercial EP. The 1962 decree on public accounting is somewhat flexible, but the administrative courts have a more stringent approach.

Whenever the EP is created by a decree rather than a statute, which is generally the case, courts will look beyond it to ascertain which body of law applies. They will look at a group of factors, so that for an EP to be recognised as industrial and commercial, it must resemble a private-sector corporation in respect of its object, its financing and its operating principles.

In the case of the French Foreign Trade Centre, the court found that its employees were covered by public law (as in an administrative EP), even though the founding decree stated that it was an industrial and commercial EP.

9. Décret n° 62-1587 du 29 décembre 1962 portant règlement général sur la comptabilité publique (Journal Officiel du 30 décembre 1962).

On the other hand, the Parliament passed in 1986 a law to transform the inter-professional agency for cereal into an "industrial and commercial public EP", despite the fact that according to the case law this agency should be an administrative EP. Statutes being imperative for the administrative judge, this agency is henceforth treated as an "industrial and commercial public" EP.

1.3. *The Creation of an Établissement Public*

Since the adoption of the Constitution of the Fifth Republic in 1958, statutes create "categories" of EPs and set the rules that govern them.

A "category" is a set of EPs under the same administrative authority and with similar objects. For each category the statute establishes the basic rules applying to the organisation and operation of agencies (their terms of reference, relationship with the supervisory authority, nature of resources, categories of representatives on their board of directors and their respective weight). There are a few rules that are common to all EPs. There are some 200 categories of national EPs. Similar rules apply in the case of local EPs.

If a category is already in existence, other national agencies of the same kind can be created by governmental decree. The draft decree is often submitted to the Conseil d'État, which is the highest administrative court, to get its opinion on legal issues. The decrees are always signed by the Ministry of Finance, as well as by the Ministry of Civil Service whenever the agency intends to employ civil servants. While the technical supervisory authority (usually the line ministry) for the EP drafts the actual decree, the Ministry of Finance plays an important role. It makes sure that conditions exist which will enable the agency to balance its budget and closely monitors the creation of posts. It sees to it that the rules limiting increases in personnel or even planned staff cutbacks are not circumvented through the creation of public agencies.

The legal text that creates the EPs consists, generally, of about twenty articles and states with a fair degree of precision the object of the agency, its goals, scope of activity, methods (subsidies, action programmes, joint projects, etc.), as well as its internal organisation (general guidelines, regional division if applicable, etc.). The agency itself does not have the ability to define its missions. Instead, it is the supervisory authorities that draft the founding legal text and adapt it to their needs. A survey of 174 national EPs carried out in 1997 demonstrated that, on the whole, their actual policies were very close to the guidelines contained in the legal texts. There are therefore few cases of "agency drift".

1.4. *The Organisation of Authority in the Établissements Publics*

The "Board of Directors"

EPs have governing and management bodies that have different degrees of authority. The governing body is often referred to as the "board of directors." In those administrative EPs that have the least autonomy, representatives of the supervisory authority hold the majority of the seats, with the Ministry of Finance represented in virtually all of them. At industrial and commercial EPs, 80 per cent of the government representatives are directors and deputy directors of the government department with authority over them, the other 20 per cent coming from the ranks of senior professionals of the State's corps, or civil servants. The board of directors include elected employee representatives in the scientific and technological, and in all industrial and commercial EPs, pursuant to the 1983 Act on the Democratisation of the Public Sector. In many EPs, the board also includes representatives appointed by consumer organisations, as well as experts in the sector, chosen by the supervisory authority. The "board of directors" may at times not include government representatives, or the government may even have no say in the appointment of its members;

this is true of scholarly associations (*Institut de France*, the French "Academies", etc.) and major university and research agencies. No remuneration is paid to members of the boards of administrators of either administrative or industrial and commercial Eps.

The Management of the EP

The EP management has often more genuine authority than its governing body, which appoints the agency's president or chief executive only under exceptional circumstances. There is a kind of correspondence between agencies of a given size and the administrative levels of central government ministries.

The heads of large EPs often enjoy the same status as those of government general directorates and as such are appointed by the Council of Ministers. Individuals who are not civil servants can be appointed at the head of these agencies. A decree establishes the list of EPs whose president and/or director is appointed by the Council of Ministers. The others are appointed by ministerial or inter-ministerial decree (whenever several ministries share authority over them). The Ministry of Finance is always consulted regarding the selection of appointees.

In practice, heads of public agencies come from the central administration of the relevant ministry and are most often senior public servants (Corps of Mines, Corps of Forestry, Hospital directors, etc.). The senior branches of the civil service at the *Conseil d'État*, and at the Court of Accounts (*Cour des comptes*) supply a large number of non-specialised directors of agencies. For large EPs, the financial director is appointed by ministerial order.

Senior executives of many EPs come from the same pool as those of government agencies and civil servants often move back and forth between the two, through "secondment" arrangements. The situation enables civil servants to earn the higher remuneration available in an EP, while at the same time holding on to the benefits that go with civil service tenure. This protection of benefits has led to some abuses, because the practice of "secondment" was extended to many corporations controlled by the State (including for example the commercial banks before their privatisation). A civil service career can be interrupted for up to six years, after which a civil servant must choose between returning to his original department or resigning. After a number of cases where this limitation was ignored, more attention is now being paid to compliance with these rules.

The Supervisory Authorities

All EPs have two supervisory authorities (*tutelle*): (i) the technical supervisory authority, and (ii) the financial supervisory authority, that is the Ministry of Finance.

The policy of an EP is proposed by its director and voted on by the board of directors; it is examined on a regular basis with the supervisory authorities, generally in conjunction with the budget application and the review of the annual report. In theory, the head of an EP is solely responsible for its policy. But for a large majority of EPs, their complete dependency on state budget financing forces close consultation with supervisory authorities. EPs heads do not have a free hand in all areas. The agency initiates and proposes, but the supervisory authority has veto power and the authority to limit overall activities within the boundaries defined in the legal texts. For example, the head of an administrative EP does not have the authority to produce goods and services for sale in order to finance expenditures without express agreement and, in all likelihood, an amendment to the founding decree. Public enterprises can sometimes

face similar constraints. Thus, the electricity company EDF is not yet allowed to extend its activities to the whole utilities' sector¹⁰.

The powers of the supervisory authorities include generally the prior approval of the most important acts: budgetary decisions, borrowing, acquisitions or transfer of interest, or certain remuneration of managers and personnel. In budgetary matters they have the additional power of substitution, which is used under exceptional circumstances. This includes the right to impose a budget in the event of delay or excessive deficit, or to include in the budget a compulsory expenditure (e.g. an unpaid debt), and eventually to order its payment. This power of substitution is specified by category of EP, but there are also general principles stipulated by law, such as the power of ordering expenditures imposed by court decisions. This power of substitution can be exerted for all administrative EPs, including the universities.

However the supervisory authority is not a line authority and the courts have seen to it that this principle is respected. There is no supervisory authority except as defined in regulations, and its power does not extend beyond the regulations. Thus a supervisory authority cannot exert a power of substitution not legally authorised.

Concerning the technical supervisory authority, arrangements are often straightforward: the line ministry responsible for the sector is the supervisory authority. However some EPs have several technical supervisory authorities. In the case of large agencies, the technical supervisory authority is made more formal and assigned to a line ministry official named "commissioner" (for example, the head of the ministry's directorate responsible for the agency's economic sector might be named commissioner). The "commissioner" is consulted on major projects and strategy guidelines, and he is member of the "board of administrators", in an advisory capacity.

The financial supervisory authority is powerful since it exercises a priori financial control over a majority of administrative EPs. Moreover, often budgets voted by governing bodies are not automatically implemented and must be expressly (or by tacit agreement in the case of scientific and technological agencies) approved by the supervisory authorities. As noted, the supervisory authority exercises less control in the case of universities. Thus the budgets of universities are not subject to the prior approval procedure.

In practice, the role and the degree of intervention of the supervisory authorities depends on the sector and the nature of the EP, and on the circumstances. The survey of 174 national EPs carried out in 1997 showed the relationships between the EPs and their supervisory authorities divides fairly evenly between those described as having full autonomy (36 per cent), those with some autonomy (33 per cent) and those with none (22 per cent). There is no clear correlation between the nature of the relationship and the size of the agencies, their sector or the supervisory authority concerned.

The nature and focus of technical and financial supervision reflect the balance of power existing between the EP and the central government departments, as well as the prevailing political climate. In the event of a crisis, especially if it affects public opinion (such as AIDS prevention or nuclear safety) the supervisory authorities can go so far as the issuing of directives, either in writing or orally. Under normal circumstances, the supervisory authorities communicate by means of circular letters addressed to several EPs. Every year, the Budget Directorate of the Ministry of Finance issues a budgetary circular and the directorates of line ministries issue many circulars covering policy objectives, administrative procedures

10. This regulation is aimed at protecting private utilities operating, for example, in the water sector, from unfair competition of the electricity monopoly. But, it will be a handicap for EDF in the context of the opening of the electricity market.

and reporting methods. Supervision is often episodic; day-to-day operations proceed in the absence of effective performance monitoring; yet a specific event or issue can sometimes stimulate a highly interventionist response by supervisors. The nature of the *tutelle* depends also on the institutional arrangements. Thus the Court of Accounts noted that the technical supervisory authority "is particularly weak in the excessively frequent situations where supervision is shared among several line ministries, or two different directorates of the same line ministry that do not get on together"¹¹. As noted earlier, in some agencies the private sector may play a more important role in defining the agency than the supervisory authority.

In order to reduce to a minimum possible conflicts between the technical and financial supervisory authorities, meetings are convened prior to those of the board of directors of large EPs, bringing together only the supervisory authorities and EP management, with the object of laying the groundwork for main decisions to be taken. As a result, board meetings are often limited to the role of a rubber-stamp, reducing the effective participation of employees, users or experts.

Concerning the public enterprises, the relationships with the supervisory authority are also complex. As early as 1967, the report Nora stressed the need of granting them autonomy in management. Nevertheless, since this date there were many examples of excessive interventionism, and of confused or contradictory objectives assigned to the enterprise. Conversely, however, an enterprise such as EDF developed sophisticated pricing and planning instruments, which also increased its power in negotiations with its supervisory authorities. As noted by the former director of EDF, M. Boiteux: "We would have continuously the government on our back if we not had been able to produce a coherent instrument, to which a scientific aura was attributed, and which cut off all complaints, whatever their origin"¹².

In the past, in some industrial sectors, the technical supervisory authority played a key role. The supervisory authority co-ordinated the development of an industrial sector, involving often an EP research centre, an EP national operator, and nationalised or private industries¹³. The monopoly powers of the national operator and the use of preferences in public procurement policy helped to promote national champions. But changes in technology, openness of the markets, and privatisation of industries make this kind of arrangement no longer relevant. The role of the technical supervision is diminished proportionately, while large public enterprises have more human resources capacity for planning and strategy formulation than is available to a line ministry for directing a whole sector.

2. Assets and Liabilities

2.1. Real Property

Since EPs are legal entities they also hold title to their assets and/or have "assigned" assets belonging to the government or a local authority, the value of which appears on their financial statements. As in the case of the State itself the real property of an EP, whether it holds title to it or only uses it, is classified as either public property or private property. Public property is governed by the special provisions of the State Property Code (*Code du Domaine Public*) making such assets inalienable and exempt from execution or

11. *Rapport Public 1999*; Cour des Comptes.

12. M. Boiteux quoted in M. Wiervorka and S. Trinh; *Le modèle EDF*. La Découverte, Paris.1989.

13. See, for example, E. Cohen; *Le colbertisme high tech. Économie des Telecom et des grands projets*. Hachette, Paris 1982.

attachment. Private property requires the approval of the State Property Department (*Service des Domaines*) of the Ministry of Finance and of the national, regional or local commission on property transactions, for major acquisitions, leases and construction. The State Property Department must be consulted to establish the purchase or sale value of property and the financial controller must ensure that there is no major discrepancy between that appraisal and the actual price paid or collected.

The State can transfer its private property to an EP; something that is generally done as an initial endowment at the time the agency is created. It can also "assign" state property, meaning make it available without title passing. An assigned building must be returned to the State Property Department when an EP ceases to occupy it, and if it is sold, as may happen under special circumstances, all revenue from the sale must be turned over to the State's budget.

An EP may acquire its own property. Real estate holdings may be very substantial when this is part of the EP's assignment, such as for those in charge of land use, urban development, the Seashore Conservation Agency and the Forestry Agency. An EP acquires or disposes of assets by decision of its board of directors, subject to the usual oversight, in particular that of its financial supervisor.

As a legal entity governed by public law, it may be authorised to expropriate. The improvements it makes are governed by specific rules, such as the requirement that a prior investigation be conducted to ascertain that the work is in the public interest, and to measure its impact on the environment.

An EP may also acquire property on behalf of the state or local authorities. The Ministry of Finance frequently intervenes with national EPs, by means of its financial controller, to propose this course of action, so that property thus acquired become government property and any revenue from its subsequent sale reverts to the government, on the grounds that the purchase was financed with government subsidies. This method has certain drawbacks. For one, the inventory of government real property is not properly kept up to date and the legal status of many items of property is confused, a matter which comes up only at the time they are put up for sale. For another, EPs have no incentive to generate revenues from real property transactions, since they would not have control over the proceeds; all revenue from sales of assigned property must be turned over to the government, or it is deducted from the annual grant transferred by the State to the EP.

Most administrative EPs do not depreciate their real property or restate its balance-sheet value. The inclusion in government accounts of the value of property assigned to EPs, or the inclusion of their property in consolidated government accounts is neither correctly done nor updated. The Ministry of Finance first looked into this matter in 1996-1997, as part of a review of the proprietary accounts, including the accounting procedures for physical assets.

Insofar as the appropriation of revenue from the sale of State's real property is concerned, government agencies themselves are not particularly interested in generating savings in this area, since revenue from such sales would go to the general budget. The Ministry of Finance had to change its practices some years ago, when the government decided to relocate certain agencies outside Paris, for reasons of regional development. A compensation fund was created, to which ministries and public agencies had access, in order to allocate revenue from the sale of buildings in the Paris area to the creation of new facilities. The system was not very efficient, as the ministries and EPs, which had land available for sale, were not those which were being relocated. At the time, the *Conseil d'État* ruled that the government could not decide to force an EP to relocate its principal offices whenever the legal text that creates the EP in question did not contain a provision to that effect, which is generally the case. Several EPs successfully sued the government on this point.

Within the context of liberalisation of the European market, the arrangements for infrastructure property of network industries have been recently clarified and reorganised. The electricity transport infrastructure now belongs to EDF, which was previously only the concessionaire. The ownership of railways infrastructure has been clarified with the creation of an EP for infrastructure management (RFF) separate from the railways operator (SNCF).

2.2. Debt

In general, the legal texts for both administrative and industrial and commercial EPs provide that they may borrow funds, by decision of their board of directors and with the express consent of their financial supervisory authority. In practice, the extent of borrowing by EPs varies a great deal. It is relatively frequent among local EPs, since local authorities accept this as a regular method of financing their own budgets as well as those of their EPs. Very few national administrative EPs make use of the borrowing power. However, the universities borrow funds and generally, regional authorities grant universities investment subsidies to repay their debts.

The close financial supervision of administrative national EPs by the government enables it to do all the borrowing itself and to finance EPs entirely through budget appropriations. National administrative EPs in fact have no real financial autonomy. They do not generate revenues to repay a loan. They depreciate their assets in accordance with purely accounting principles, with no consideration to the financing of capital projects. They commonly use lease financing to acquire computer equipment, but this is done in order to finance it through the annual State's subsidy.

Major public enterprises use debt financing under conditions, which are narrowly defined by the financial supervisory authority and reviewed by the Prime Minister's Office. These major industrial and commercial EPs borrow from French and foreign banks, or more often on capital markets by issuing negotiable bonds guaranteed by the government. The yields on those bonds are close to that on government bonds, the difference never exceeding half a point, creditworthiness of these enterprises being generally well rated. EDF and GDF (*Gaz de France*) issue bonds which are not guaranteed by the government and which have similar yields.

For the past twenty years or so, EPs have no longer been allowed to borrow from the government. Prior to that time, the Economic and Social Development Fund was a Special Treasury Fund extending interest-free or interest-bearing loans, the cost of which (the shortfall in yields and defaults on loans) was included every year in the government budget. Likewise, the government is no longer involved in extending low-interest loans, which were previously available to farmers, small and medium-size firms and for exports. European Commission regulatory measures on competition have provided a strong incentive to put an end to all of those financial practices by public agencies with commercial activities.

The debt of major EPs does not appear in the government Budget Act, but is shown in national accounts under a specific heading.

2.3. Other Assets and Liabilities

Public agencies subject to government accounting rules (EP with "public accountant") benefit from a number of privileges. Their assets are non-seizable and their claims are settled without a commercial court having to issue a ruling. Their debts are proscribed after four years (but, this limit may be extended for certain creditors by decision of the board of directors and with the approval of the Budget Directorate of the Ministry of Finance).

Some twenty years ago, before the use of computers became widespread, the government and its EPs were known for the long time it took for them to settle their bills, which were commonly left unpaid for more than three months. EPs now settle their debts promptly. The monitoring of payment delays following the receipt of invoices provides some of the main administrative criteria used by EPs, which conduct operational audits.

A circular from the Public Accounting Directorate calls for EPs to pay interest on overdue suppliers' invoices, which remain unsettled for 45 days. They may be in arrears only where there is a payment crisis, which happens every now and then at various EPs.

The common rule applicable to EPs subject to government accounting regulations is the fact that their cash reserves are part of the government Treasury, so that they are not permitted to invest surplus cash balances in securities. Their cash account must show a positive balance at all times. No interest is paid to administrative EPs, but in some cases industrial and commercial EPs earn interest on their cash deposits. By special exemption, universities are allowed to invest the portion of their cash balances which they generate themselves.

Rules governing this issue have tended to become more flexible recently and the Ministry of Finance is more likely to allow EPs, even administrative ones, to invest short-term cash surpluses, on condition that investments be in government securities for one year or less. Hospitals are free to invest their surplus cash balances, as are of course industrial and commercial EPs that do not have an assigned "public accountant."

Public agencies engaging in applied research may own intellectual property rights. Here, the government's guidelines have changed several times and these assets are probably not handled in the best manner. This is so because the main motivation of EPs is to provide public services and to promote technological progress in the economic sector for which they are responsible. They have many contacts with private firms which they allow to file patents in their own names for discoveries arising out of joint research. Patents filed in the name of an EP are often in areas where the EP could not find a French or foreign company to work with. Filing and renewing patents causes EPs to incur expenses without automatically generating revenue. Intellectual property therefore costs more than it brings in. The share to which individual researchers are entitled amounts to 25 per cent of fees earned, with a ceiling set at the equivalent of one year's salary, which tends to reinforce their tendency to allow firms which finance their research laboratories to own the patents. The policy in recent years has been to let a number of inactive patents lapse and to introduce the practice of evenly sharing fees paid on active patents.

3. Budget Control and Audit

3.1. Budget Control and Accounting: General Principles

Budget Execution Control

The budget execution system for EPs is generally more flexible than for the State budget. However, for most EPs, the State budget execution procedures serve as reference. In the French budgetary system, these procedures are organised as follows:

- The authorising officer (*ordonnateur*) is responsible for budget implementation. The line minister (or for EPs the head of the EP) is the authorising officer. The authorising officer, or actually his delegates, commits (*engage*), that is issues contracts and orders, verifies deliveries, invoices and claims (*liquide*), and issues the payment orders (*ordonne*)

- The financial controller, who is an officer from the MOF posted within line ministries, makes a prior control on the commitment and the other decisions that have a fiscal impact, such as recruitment. The financial controller verifies that there is an appropriation available and the commitment fits the purpose of the appropriation. This is only a regularity control. Its precise nature depends on the economic nature of the expenditure, its amount and the nature of the entity (e.g. depending on whether it is a central division, or a "deconcentrated" division, or an administrative EP)
- An officer known as "public accountant" controls the payment orders issued by the authorising officer. The "public accountant" is responsible to verify the regularity of the payment orders; he issues the payment through the Treasury Single Account (or the EP's account at the Treasury) and keeps the books. As discussed below the "public accountant" has special status and duties.

For management control, in most major private and government organisations of a significant size, a principle of separation of duties is applied. This ensures that the same person cannot make orders, verify deliveries and make payment. In the French system this rule has been institutionalised. The "public accountant" does not report to the "authorising officer". He is empowered to reject any irregular payment orders issued by the authorising officer.

Thus, the principle of the separation between the authorising officer and the "public accountant" is a fundamental principle of the French system. It is applied both for expenditure and revenue (i.e. revenue assessment is separated from revenue collection).

The "public accountant" is responsible for channelling all transactions through the Treasury's accounts and for accounting. He is generally a staff member of the General Directorate of Public Accounting, which is the accounting and administrative arm of the Treasury, but not always. Frequently in agencies under the authority of the ministries of education or agriculture the "public accountant" is an accountant officer of the line ministry. But, the General Directorate of Public Accounting to which he remains functionally responsible must always approve his appointment

The "public accountant" has special duties. He is personally responsible, on his own money, for compliance and administrative errors. He is controlled by the General Directorate of Public Accounting, usually in the person of the Treasury's regional chief accountant (*Trésorier Payeur Général*). He must prepare the annual accounts, and he is accountable to the Court of Accounts, which audits the annual accounts.

Because of the separation principle, the authorising officer is not authorised to hold bank accounts or cash. The Court of Accounts can punish authorising officers that evade this rule, for example through the channel of an NGO. In exceptional circumstances the authorising officer can force the "public accountant, through a "requisition order", to authorise a payment order that the accountant had previously rejected. When this occurs the requisition order is reported to the Court of Accounts by the Ministry of Finance and accountability shifts from the "public accountant" to the authorising officer.

The authorising officer is also accountable for financial management. The authorising officer must certify the accounts prepared by the Ministry of Finance officials.

Accounting

The 1962 decree on government accounting serves as a strict framework defining the duties of the "public accountants", the authorising officers and the presentation of the government accounts, including the EPs.

It stipulates also that the government accounting methods must be derived from the "general accounting plan". As noted, the "general accounting plan" defines the core chart of accounts and the general accounting principles for all business activities. It comes into force by a decree of the ministry of finance prepared after consultation with experts and the accounting profession.

Actually, government accounting differs still from private sector accounting. For example the central government and many administrative national EP do not account for the physical assets and their depreciation properly. But, the recent amendments to accounting methods tends to bring government accounting rules closer to those of the private sector. The 1999 general account of the State shows progress in this direction. Often, the burdensome procedures required to implement changes decided by the Public Accounting Directorate of the Ministry of Finance hinder the revision of regulations. For instance, the 1989 circular on computerisation failed to resolve all issues, and neither the government nor those public agencies with "public accountant" can accept payment by credit card (this is about to change).

3.2. The "Public Accountant" Arrangement in *Établissements Publics*

A "public accountant" is assigned to most EPs. However, whereas in the government there is generally a complete, physical separation between the spending administrative unit and the "public accountant", who works at the Treasury's office, the "public accountant" of the EP works physically in the agency. In many EPs she/he works there permanently. In some small EPs an officer of the Treasury, fills the public accountant role while still keeping his position with the Treasury.

A "public accountant" is also assigned to local governments and the Chambers of Agriculture (but not to the other professional public agencies). But, transactions of these entities are not submitted to prior financial control. In fact, these entities enjoy a high degree of financial autonomy although the Court of Accounts audits them in the usual way.

Because they involve a close control by the ministry of finance and do not fit well the management of business activities, the State's budget execution and accounting control procedures have been eliminated for a dozen EPs that are the largest public enterprises.

Sometimes, the principle of separation discussed above is altered. Thus, in some public enterprises, the "public accountant" is also the financial director of the EP, and as financial director reports to the head of the EP and authorises expenditures. Such cases are problematic, as noted by the Court of Accounts in a report on the Port authorities: "the principle of separation between the authorising and the accounting functions is distorted. The director is the immediate superior of the accountant, who will have difficulty to reject a payment order prepared by its own financial services or according to the directive given by himself as financial director. The actual existence of a public accountant poses a problem". For those public enterprises, the Court of Accounts recommended either to eliminate the "public accountant" arrangement or to transform these EPs into state corporations, and submit them to the private sector accounting standards and audits¹⁴.

It is believed that a number of managers find advantages in the "public accountant" system, because it releases them from responsibilities for cash management and accounting. However the separation between the authorising officer and the "public accountant" has the disadvantage of focusing attention on general accounting procedures, and weakening the role of the budget. It has also slowed down the introduction of

14. *La politique portuaire française*; Cour des Comptes.

costing procedures, it separates management from accounting, and it weakens managers' awareness of budget performance.

3.3. Ministry of Finance Financial Controls and Audit

Most administrative, and some small industrial and commercial agencies, are submitted to the financial control, the nature of which is evolving progressively. Other agencies are submitted to "the economic and financial control of State".

The Financial Control in Administrative Agencies

Generally, the financial controller makes prior controls on the commitments and decisions that have a fiscal impact. The financial controller works closely with the EP administrators; he has consultative status on the board of directors. He performs regularity control only, and ensures that directives from the Budget Directorate, either written or oral, are complied with. He controls mainly decisions on personnel (e.g. recruitment), foreign travel expenses, investment, subsidies and transfers, and other expenditures above a certain amount (which is sometimes negotiated with the manager). The Universities and few other administrative EPs are not submitted to the prior financial control. Among the changes that have taken place over the past ten years is a streamlining of authorisations. For example, financial controllers approve all of the estimated personnel expenditures at the start of the year and do not have to approve every promotion, although they still must approve recruitment.

In the regions, the Chief Regional Accountant often performs the function of financial control. Discussions have been taking place concerning changes in financial control with a view to lessening prior controls and increasing their role as advisors and promoters of management audits.

The State Control of Industrial and Commercial Agencies

The "economic and financial control of State" is commonly named "State control". The State control performed by officers from the ministry of finance covers the EPs that are not submitted to the financial control, State controlled corporations, and any other entity which draws most of its revenue from public funds. It covers about 600 entities. This control is performed either by a State controller or, for large entities, by a control mission.

The nature of such controls varies from one agency to the other. Sometimes it consists of a prior control for decisions with significant financial impact. Most frequently it consists of an audit (ex-post). For the public enterprises of a significant size the State Control is similar to a process audit.

State controllers have consultative seats on the board of directors. They issue annual assessment reports containing their opinion of the effectiveness of an EP's policies. The reports are sent to the Ministry of Finance; they are not confidential, but are not widely disseminated either, as it is not mandatory that they be forwarded either to the agency audited or to its supervisory authority.

Financial Inspections

The Ministry of Finance has also a staff of high ranked inspectors (*Inspection Générale des Finances*), with the authority to examine and investigate all matter connected with "public funds". The Ministry of Finance sets its annual programme. Primarily these inspectors audit the "public accountants", but their work is also aimed at assessing the performance of the agency. Such inspections are fairly effective and often bring about results, but they are not very frequent in the EPs.

3.4. Internal Audit

The largest EPs, without "public accountants", use internal auditing procedures which they set up at their own discretion. Within most other agencies, there are no systematic internal financial controls. This can be in a large part explained by the fact that financial and accounting controls are seen as being a matter for the Ministry of Finance and agency managers feel no responsibility for them.

Nevertheless, all technical ministries also employ staffs of inspectors and auditors, with jurisdiction including subordinate EPs. Their reports are for limited circulation and their effectiveness depends on the willingness of ministries to make use of them. Sometimes, they are of limited effectiveness because of unqualified staff (most are civil servants who can no longer find active positions). However, in other cases these inspections have proved to be effective.

3.5. Supreme Audit Institution

The Court of Accounts (*Cour des Comptes*) is the Supreme Audit Institution. The Court of Accounts and its regional courts have a very broad auditing authority. It examines all of the end-of-year accounts of the central and local governments, and it audits public accountants. It performs audits at the premises of EPs and other State controlled entities, at various intervals (every 3 to 10 years, depending on the size of the entity) covering the entire period since the previous examination. It is an adversary proceeding, and the management of the audited entity is expected respond to the observations made by the Office. The final report, forwarded to the head of the entity and to its supervisory authorities often contains specific requests for reforms. The Court of Accounts examines the effect of its suggestions at its next audit and recommendations are most generally complied with. Whenever necessary, it can transform itself into a financial compliance court. The Court of Accounts also conducts evaluations and issues reports on many subjects, on request or at its own initiative. Its annual report is public and is eagerly awaited by the press and the public. It summarises the Court's principal observations and recommendations.

4. Budget Formulation and Implementation

4.1. Budget Presentation

The Budget Structure

The budget appropriations of administrative EPs are cash spending limits. The budgets of industrial and commercial EPs are considered to be "estimates of revenues and expenditures". These estimates are in principle only evaluations, since they depend on the agency's own revenue. However, there are limits on personnel and investment expenditures, which diminishes flexibility in budget execution. The budget includes authorisations for committing multi-year investment projects, which are named "programme authorisation" or "commitment appropriation". These authorise commitments only, not payments.

Generally, the budget consists of two sections, one for operations and the other for capital expenditures. They can offset each other or in combination with working capital funds. These two sections are divided into "Chapters" and "articles". The budget classification follows the accounting plan, which classifies accounts by economic category. There are, however, a few inconsistencies that pose practical problems. For example, the standard for distinguishing operating expenses from investment expenditures is not the same in budgetary terms (threshold of FRF 300 000) as in accounting practices (threshold FRF 5 000).

Both the structure of the budget classification, which is governed by the accounting plan and the nature of budget execution controls put the focus on inputs instead of results, and make budget management cumbersome in the EPs with public accountants. An attempt at improving the budget presentation has been made in the case of research agencies, which have a budget broken down into three sections, one for personnel expenditures, another for general operating expenses and a third for research operations. Appropriations of the third section can be used to finance purchases of capital goods or small equipment as well as operations and some expenses for employees on contract, such as the remuneration of temporary employees hired to conduct research jointly with private-sector firms. This fundability makes it possible to grant research facilities "block-appropriations" that provides them with a high degree of administrative flexibility. At the same time, this practice has the side effect of mixing together expenditures of different economic nature. The third section of the budget, which regroups three-quarters of total expenditures, is not monitored properly according to chart of accounts, and is somewhat a black box.

Some agencies when discussing their draft budget with their supervisory authorities present their outlays under various formats, including analytical tables showing their expenditure programme by tasks or purposes. The latter are 'snapshot' presentations provided for informational purposes. But because the budget is voted, monitored and controlled according to the presentation stipulated by law or decree, these analytical works have no impact on budget implementation.

4.2. Personnel Expenditures

Personnel Budgeting

The personnel expenses are generally closely monitored and controlled by the supervisory authority, while at the same time the applicable procedures differ between administrative and industrial and commercial EPs.

The budget of an administrative EP includes an attached schedule of budgeted personnel positions which describes all of the permanent positions by trade, skill level and seniority in terms of the equivalent civil service jobs. An average grade-related point value is assigned to each of the levels and, when the number of posts is multiplied by the value of these points as indicated by the budget supervisory authority and based on a system which applies to all of the civil service, can be used to compute the corresponding budget appropriation. Any changes in the value of grade-related points results from the government's compensation policy and the EP has no say in the matter. The filling of budgeted positions by actual employees requires the approval of the financial controller. This is done whether the EP conducts its own competitive recruitment tests or decides to fill a job with a civil servant already in the employ of the government. The vacant budgeted job must be at a level corresponding to the qualifications of the individual appointed to it.

This control procedure has contributed substantially to the development of administrative planning for personnel, so as to anticipate retirements, deaths and the termination of assignments, which result in vacancies, as well as to plan career advancement based on seniority and skills. The discussion of administrative policies on personnel and careers is an important part of all budget negotiations, as it is often necessary to adapt the structure of budgeted jobs to the needs of the agency.

For the past twenty years or so, changes have generally been initiated from above. This is due to a combination of two factors. One is the demographic problem resulting from the glut in end-of-career civil servants who joined the service in the 1960s and will retire only 5 to 10 years from now, combined with the decline in the number of new civil servants hired annually (for twenty years, policies have been

implemented aimed at stabilising or reducing the ranks of civil servants). The other is the continuing rise in the qualifications of civil servants, as computers gradually replace those in unskilled jobs.

Administrative EPs also receive appropriations for personnel not in budgeted jobs, for the purpose of engaging contract employees for limited periods (three years, with one possible extension of the same duration). The recruitment of these persons is closely monitored by the financial controllers, whose prior approval is required, and contract employees account for only a small minority of total staff (less than 10 per cent). Limits on payroll expenses are included in appropriations, and the Budget Directorate gives directives concerning the increase in the personnel budget at the time of the initial circular calling for the drafting of budget applications.

The budgets of most industrial and commercial EPs do not include a schedule of budgeted positions. Yet they have only slightly more latitude than their administrative counterparts, because personnel expenditure objectives are established by the supervisory authorities. They must justify any departure from the stated objectives. In general, the Budget Directorate is involved in specific aspects of personnel administration, even in the case of major industrial and commercial EPs, whereas it often lacks the technical wherewithal for estimating the value of large capital projects and their sliding cost.

Remuneration of Managers

The heads of administrative EPs have no autonomy in matters of remuneration and those of industrial and commercial ones have very little. As far as the remuneration of the director himself is concerned, the budgets of administrative EPs generally contain a specific provision for it, since all permanent positions are identified by category in the budget and the director is the only person in his category. The amounts in question are discussed with the supervisory authorities at the time the EP is created and then on an annual basis when its budget is examined. The Budget Directorate of the Ministry of Finance plays a key role at that time. A kind of pecking order has developed among EPs, based on the salary of their director. This has occurred principally within families of EPs such as museums, research councils, etc. The "budgeted" remuneration represents the actual salary only in the rare cases when it represents a pay raise deemed sufficient by its recipient. Remuneration can significantly exceed the amount provided for in the budget, to take into account where the director came from, his previous salary and the complex nature of the assignment. A letter then fixes the actual remuneration from the Budget Directorate. The Budget Directorate has an up-to-date comparative chart of the remuneration paid to heads of administrative and industrial and commercial EPs. Pay is generally higher at industrial and commercial agencies, although the size of an EP plays a more decisive role than its type.

The director has no authority over the remuneration paid to his immediate subordinates. The Budget Directorate of the ministry of finance has gradually required all sectors to limit to 15 per cent the pay increases granted to civil servants being assigned to an EP; this is intended to reduce problems at the time they return to their original agencies.

In administrative EP, whenever the employee concerned is an employee under contract, not an incumbent civil servant, the salary range is closely scrutinised by the financial controller, who compares it with the remuneration paid to civil servants. Any difference requires the written approval of the Budget Directorate. In theory also, the director of an EP can adjust the amounts of salary bonuses, as elsewhere in the civil service, but in practice this is seldom done except to penalise employees for professional misconduct. The important role played by the Budget Directorate in respect of pay scales is explained by the contagious effect on other EPs of any remuneration that is not clearly related to the qualifications of the individual or the demands of the position in question.

4.3. *Budget Formulation and Approval*

The timetable for the budgeting procedure is very strict and is the same for national EPs as for the government. The process starts with an annual budget circular sent out on or about April 15; it is followed by two budget conferences bringing together the Budget Directorate and the ministry with technical supervisory authority. EPs, even major ones, are today more rarely present at the conferences, as the ministries with technical supervisory authority wish to assert their role and limit the authority of the Budget Directorate. There are frequent preparatory meetings involving the Budget Directorate and the EP, however. Appropriations for subsidies to an EP are examined at the same time as those of the ministry with supervisory authority over it and are part of that ministry's own budget.

The circular provides guidelines for the drafting of the budget, by way of rates of increase in total payroll, operating expenses and capital expenditures. It also contains directives regarding horizontal reforms, such as job cutback objectives; percentage of total payroll to be set aside for continued training, changes in tax regulations or budgeting practices.

The initial budget conference concerns continuation measures and the impact of new measures implemented the previous year. It serves to identify those issues which need to be resolved. The second conference, in June, examines new positive and negative measures and reviews the EP's budget in detail, including its revenue forecasts and pricing policy. The EP has also by now forwarded to its two supervisory authorities a large application file for budget subsidies, containing data that often spans ten years. The review uses the previous year's accounts as a reference and examines differences. Consideration is given to unused EP budget appropriations and bills outstanding. Whenever a contract with the EP exists, it serves as the main reference for the budgetary discussions. Important issues are resolved by the Prime Minister's office between the end of June and the Fourteenth of July.

The budget subsidies for EPs are communicated to them by telephone between 14 July and 15 August. They comprise four amounts: one for staff expenditures, one for additional employees, one for operations and one for capital projects. Whenever real property transactions are budgeted, the subsidy is also earmarked, for even though they are part of the same budget unit as other capital expenditures, the two are not fungible.

The EPs then start their own internal budgeting procedure, which is generally completed by 15 October. The technical supervisory authority sends a written notice to the agencies during the month of October, which may contain a number of details and be adapted to individual EPs. It states the fee-setting objective, any changes in structures (mergers of EPs, creation of subsidiaries, etc.), and includes policy directives regarding priority areas etc. This is the time when the main projects of an EP are finalised. The preparation of the supervisory authority's letter shows sometimes the balance of power between the technical supervisory authority and the EP: the main EPs submit their own written notices to the Minister for signature. The notifications sent to major EPs are communicated to the Budget Directorate prior to being signed.

The budget of an EP is then presented to its board of directors, which votes on it before the end of October. Then for the large majority of EP, the budget must be approved by a joint decision of the two supervisory authorities (as noted earlier, there are exceptions).

The internal apportioning of budget appropriations to the agency's divisions takes place in the period from 15 October to 15 December. It is not officially communicated to the supervisory authorities and does not require approval.

The parliament is given information about the budgets of EPs only by means of the subsidies included in the State's budget. It is not provided with the budgets of individual EPs. However, the reporters of the Parliament's committees are free to obtain all necessary information either from the Ministry of the Budget or from technical ministries, or else directly from an EP. They frequently do so and the parliament may, at its discretion, modify the budget subsidies for public agencies.

Expenditures for hospitals do not come out of the government budget. But recently, Parliament has begun to control their aggregate spending. For the past four years the Parliament passes an annual Social Security Finance Bill. This budget includes an aggregate target for the hospital expenditures that will be financed by the health insurance. The Ministry of Health apportions these expenditure estimates for hospitals among the regions taking account of various indicators. The Regional Health Agencies divide these envelopes among the public hospitals in the region. That timetable is inadequate, as the law has until now been implemented only at the end of December, while hospitals need earlier decisions to prepare properly their budgets.

The budget of EPs must be approved before the first of January of each year, as no spending can occur in advance of approval. In the event that an administrative EP fails to secure approval by that date, the financial controller puts in place monthly commitment and cash limits corresponding to one-twelfth of the previous year's budget.

From 1996, the investment and borrowing policy of the largest industrial and commercial EPs, the motorways companies and the regional airports (which are private law corporations) are reviewed and decided during the second quarter by an inter-ministerial committee chaired by the Minister of Finance (The "Committee of Investment of Economic and Social interest" — CIES). The Treasury Department of the MOF assures the secretariat of the CIES. The competitive context and the EU directives will probably lead to the amendment of some aspects of this procedure¹⁵.

4.4. Appropriation Management Rules

State's budget subsidies are transferred to EPs according to a schedule whereby 50 per cent is remitted on or about 15 January, 25 per cent between July and September and another 25 per cent between October and December. Remittances are frequently late. EPs are required to keep a working fund equal to one month's operating budget.

Most EPs are not authorised to make transfers between sections and between personnel and non-personnel expenditures. EPs with prior financial control need approval from the financial controller to make transfer among articles. The board of directors and the supervisory authorities must approve budget revisions, as it is the case for the initial budget.

For EPs with a "public accountant" year-end carry over of surpluses is regulated. After the end of the fiscal year EPs have a complementary period of two months in which to spend their budget, provided that the expenditures were committed prior to the end of the year. Only 10 per cent of non-payroll operating appropriations which remain unused at the end of the complementary period may be carried over, which considerably restricts this practice. Payroll appropriations can be carried over only if the control officer grants an express exemption to that effect, which can occur for instance if the implementation of a statutory reform has been delayed. Capital appropriations can be carried over in full only if they are

15. See Commissariat au Plan; *Services publics en réseau*. Rapport Bergougnoux, La Documentation française, Paris 2000.

authorised by a "programme authorisation /commitment appropriation". Unused appropriations which cannot be carried over are transferred to a reserve fund, from which the financial supervisory authority periodically deducts any amount in excess of the operating budget for one month, reducing the annual State's subsidy by the same amount. This procedure has unintended effects in that it leads to an increase in inventories at the end of the year, but EPs frequently manage to negotiate the allocation of these reserves for special activities.

4.5. Special Issues

Pricing Policy

Most fees are still set by ministerial decisions. Universities are an exception since their boards of directors are free to set registration fees, although the relative weight of revenues from such fees in their budgets is very small. Hospital charges are decided entirely by the supervisory authorities, notably because about 90 per cent of the hospital revenues come from reimbursements of users' charges from the social security fund.

Pricing policy issues are often decided at the same time as the State budget's subsidy to the EP, in close co-ordination with the review of revenue forecasts. Revenue is seldom underestimated but it may be overestimated because of excess optimism or wilfulness, and the two supervisory authorities are jointly responsible for the figure ultimately agreed. There is no mechanism designed to encourage EPs and their supervisory authorities to produce conservative forecasts. Adjustments required as a result of excessive revenue expectations or for other reasons are implemented during the year in the event of a serious crisis, but most often in the following year's budget.

For EPs with limited revenues, the funds thus generated have long been overlooked by the EPs themselves which allocated them to various operating expenses as well as by the supervisory authorities; indeed they frequently did not appear as an item in the initial budget but led to revisions as they were collected. Budget restrictions in recent years have eliminated such practices.

Many EPs, especially in the applied research sector, do not have full costs pricing policies. They charge too little. Prices often reflect only variable costs and exclude personnel expenditures. Private-sector firms sometimes complain that scientific and technological EPs generate unfair competition (in the creation of plant varieties, for example).

For the largest public enterprises, those having a medium term contract with the State, often called a "contract plan", the pricing policy is reviewed within the context of the existing contract, which includes generally price targets. The authority exercised by the Budget Directorate and the Treasury Directorate are determining factors. But, the increasingly competitive environment is limiting the degree of freedom of decision-makers.

Public Procurement

Administrative EPs must comply with the same procurement rules as the government. Some industrial and commercial EPs are required to do so by their founding law while others undertake to do so voluntarily. The rules are fairly burdensome, as they seek to achieve several objectives at once, including promoting free competition, obtaining the lowest prices and preventing misappropriations and covert commissions. Invitations to bid are issued by announcements in the press and the best bid is selected under the supervision of the control officer. In the case of purchases in excess of FRF 300 000, including taxes, EPs must in addition secure the opinion of a procurement commission, whose object is to bring rational methods to public procurement while preventing certain suppliers from monopolising markets.

For a long time, suppliers could not be freely selected and were chosen by an EP specialised in procurement, which negotiated nation-wide quality and price conditions with suppliers. In the end, everyone objected to the system, as it was very time-consuming and failed to guarantee low prices. Local suppliers or wholesalers often offered much more substantial rebates than the discounts obtained through centralised procurement at the national level. For the past few years, agencies have no longer had to channel their purchases through the centralised procurement agency, although the latter still exists and publishes the terms and conditions obtained at the national level for the benefit of all public procurement officers.

Rules governing public procurement still cause some problems, in particular concerning the purchasing of computer equipment. EPs are often dependent on a supplier who sold a system developed for their specific needs and find it difficult to comply with competitive bidding rules. The rationalisation of the computer market by the procurement commission is often viewed as inadequate and ineffective.

The system also has certain undesired effects, as it can cause an order to be artificially divided up into several orders of less than FRF 300 000 each, so as to bypass prior consultations with the commission and freely choose a supplier, which may not be the one with the lowest bid. Compliance with the regulations is ensured by the financial controller, in EP submitted to prior financial control, and by the "public accountant".

Taxes and Employer's Social Contribution

Increased attention to tax and employers contribution over the past ten years has necessitated a substantial rise in government's direct subsidies to EPs, while at the same time improving the government's costing procedures, by bringing budget appropriations more in line with the actual cost of operating public agencies.

Since the adoption of the European Directive on VAT, the system has been extended to all EPs whenever 10 per cent or more of their revenue is subject to VAT. Their operating subsidies are increased by the VAT rate. VAT collected is generally far in excess of the deductible amounts. This artificially increases operating subsidies, but the budgets of many administrative EPs voted on and implemented still do not include the VAT, which is handled entirely by the "public accountant", not by the authorising officer.

Employer social security and similar contributions are roughly the same as in the private sector for health insurance, occupational accidents and family allowances. On the other hand, employer contributions for old-age pensions increased to 33 per cent from 6 per cent over a period of 5 years (from 1987 to 1992). The 6 per cent rate had remained unchanged for a long time, while the actual cost of pension benefits paid by the government represented a huge item in the budget of the Ministry of Finance. That item has now been eliminated and expenses are charged to the budgets of each ministry, and included in the State's subsidies to the EPs, applying a realistic rate of 33 per cent.

4.6. Relationship of an *Établissement Public's* Budget to the State's Budget

Only the State's subsidies to EPs are included in the State's budget. The subsidies to the largest EPs are in a special section for operating subsidies, including personnel expenses (under Title IV, a special heading of the government budget for operating subsidies) and a section for investment subsidies (under title VI). Subsidies to other EPs (training centres, vocational schools, museums, etc.) appear in a single section, sometimes under a specific item within that section.

Transfers for social and economic assistance programs are in a specific section, also part of Title IV of the State's budget that is completely separate from operating subsidies. These transfers are not included in the budget of EPs responsible for their administration and are granted during the course of the year.

The situation is different whenever public subsidies are interdepartmental and/or are paid out by several regional or local authorities. This is typically the case for Research, Scientific and Technical EPs. These EPs get their basic resources from the budget of the Ministry of Research, but receive also receive earmarked subsidies, which they secure through competitive bidding with private research firms, or from contract with various ministries or regions and other local authorities. These earmarked public subsidies are treated as revenue by the EPs concerned and are an integral part of their budgets.

Revenue generated by EPs and the corresponding expenses do not appear in the budget of their supervisory authority. For personnel positions, only the "budgetary posts" (civil servant positions authorised by the budget) are shown in the State's budget, not the "non-budgetary posts". Conversely, some EP expenditures may not be included in their own budgets but appear in that of their supervisory authority. This holds true in the case of EPs whose staff continues to be employed and compensated by the government, as in that of universities. In addition, it is common for personnel to be temporarily transferred to and from the central or local government and an EP, without this being shown in the budget. For certain EPs, therefore, their budget is an inadequate indication of the resources they use and does not facilitate the practice of cost accounting.

4.7. *Performance Management*

Current Weaknesses

Current budgetary and accounting tools, and control procedures are well suited to verify regularity of the use of resources, but are inadequate to assess performance, or to support properly policy decision making. Past experiments, in the 1970s, in programme budgeting has long been abandoned. Attention to resources clearly outweighs attention to results.

Although there is a dramatic decline in planning over the past fifteen years, France continues to prepare plans, national schemes and mapping (school map, university map, health-care map, motorway, railway or harbour programme, regional development chart, etc.), general principles acts (e.g. for agriculture) and sometimes multi-year programme laws (research, armed forces). These plans and acts sometimes include specific targets, such as; the certificate of secondary education to be obtained by 80 per cent of students; the 3 per cent of GDP to be set aside for public and private research; the regions and regional urban areas to be opened up; energy self-sufficiency; and the reduction of post-neonatal mortality. Some of these targets were more or less achieved. Yet the critical path from the objectives discussed by parliament and the results expected of each participant is not clearly laid out; plans often merely provide for the means to be used, but do not provide operating methods.

Linkages between the budget and these general programmes are often weak for a variety of reasons including the annual nature of the budget and the absence of proper instruments to ensure them. The budget includes "commitment appropriations" for multi-year investment programmes but these are frequently sequestered or cancelled. Instruments such as contract plans or programme laws cannot

contribute effectively in improving government expenditure management without a modicum of predictability¹⁶.

The use of performance indicators is still not very widespread, and even less so the practice of cost accounting. Institutional separation of accounting from agency management provides little incentive to develop new tools. Hampered by the priority which the accounting officer puts on general accounting, agencies are faced today with an inadequate information system. The primary — and often only — computerised management system found in EPs is that used for the accounting of revenue and expenditures. This implies insufficient review of budget performance, problems in identifying programmes, insufficient monitoring of assets and uses of assets, and insufficient assessment of costs, because in many EPs neither depreciation nor personnel expenditures financed by the State budget are not accounted for. When done, the computerised processing of results still has gaps in it and is frequently done independently of financial management, with parallel entries. Because the supervisory authorities frequently ask EPs to produce accurate statements regarding specific priorities, they create special budget codes to help them monitor the relevant operations. This makes budgets harder to read and accounting software often cannot reconcile expenses with codes without being entirely reprogrammed.

Current discussions of these issues recognise the need to help EPs develop methods for quantifying their objectives and for assembling an information system that would enable their performance to be monitored.

Instruments being developed

The atomic energy commission (CEA) has practised for five years management by objectives and used a very effective costing procedure, requiring much involvement on the part of the agency's officers (the financing of projects is revised on a weekly basis).

For the other agencies, with management by objectives difficult to implement, current discussions concerning the adapting of budgeting structures to practical administrative considerations have focused on the notion of a "budget by tasks" with fungible resources, except in the case of payroll expenses. This has been tried out in some government agencies as part of multi-year service contracts (local branch offices of the Ministry of Public Works, for instance). But while such experimenting would be significantly easier to conduct in EPs than in the departments, no practical application has yet been developed.

The hospitals have started over the past few years using analytical codes for medical procedures, developed at the national level, enabling them to be ranked on the basis of their efficiency. The system is based on a time-tested code system for fees charged for medical procedures, already used in connection with social security medical insurance. Even though it has been in use for three years, the system cannot be used to produce indicators for the allocation of resources. In 1999, for instance, because of the further development of specific codes for complex diagnoses (with several diseases), the ranking of hospitals has changed radically. However, progress in the medical review of their performance has recently resulted in the general press publishing the "league-table" of hospitals, ranked in order of efficiency, with statistics on mortality from various types of diseases correlated to cost. In the case of universities, there are certain performance indicators, such as the percentage of students who graduate or the time graduates take to find a job, which are often published in the press and have an impact on student enrolment. However, the allocation of university resources for teaching and research has more to do with their position on the map than with objectives.

16. A review of government expenditure management made by the press noted that managers are disappointed by experiences such as the "responsibility centres" launched in 1990. The contractualisation that was at the core of the reform was swept out by budgetary adjustments. (Rafaele Rivaïs. *Le Monde* 24 to 27 June 1998).

The largest public enterprises have been using three to five year contracts, often named "contract plan", for the past 30 years. Such contracts are a way of overcoming the problem of annual budgets, short-term decision making and clarify their relationship with the State. Initially focused on prices, investment and personnel policy, these contracts developed into agreements on objectives incorporating quality and results targets. They define public service obligations, such as obligation to service the entire territory and to ensure continuity of the services. They clarify financial relationships between the State and the enterprise (for example they state the level of the "dividend" for the profitable enterprises). The negotiation of the contract plan always takes place at the highest government level, with several arbitration sessions at the office of the Prime Minister.

The 1997 survey mentioned earlier showed that two-thirds of the 174 largest national EPs examined still lack any type of reliable long-term agreements with their financial supervisory authority, regardless of what they are called. The remaining third were party to contracts that were closer to declarations of intent than to genuine programs of objectives and resources.

The need to generalise the use of contracts by EPs has been clearly stated by the government. Several types of contracts are being developed, which represent various levels of expectations.

"Target contracts" has been prepared to a still limited extent in the case of research agencies. Very recently, the practice was introduced in public television. It was also applied to universities some time ago. The 1996 by-law on the reform of the hospitals stipulates that targets contracts should be generalised to all the hospitals (including private hospitals that have an agreement with the Social Security Fund). There are aimed at being a tool for restructuring the health sector. For the public hospitals, they should define the strategic objectives of the agency and the criteria for financing the hospital over a multi-year period.

The "management charter" has become increasingly popular as a way of introducing management control factors in EPs for which it is still difficult to set quantifiable objectives and performance indicators. The Louvre Museum has a management chart which includes the programming over several years of certain resources to be used. Objectives are not absent but are often expressed in qualitative terms, with few performance indicators (number of visitors, number of new purchases, number of joint international projects, etc.). The instrument is more a monitoring tool than a means of setting objectives.

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CHAPTER 4. COUNTRY REPORT THE NETHERLANDS

By Mr. Peter Van der Knaap

1. Introduction

The public agencies included in this study are those autonomous and semi-autonomous bodies on a national, regional or local level that are not part of government ministries but do provide public services. Giving a brief overview of the financial management and control of Netherlands public agencies that fall under this broad definition is not easy. Over the last few decades a wide variety of autonomous and semi-autonomous bodies have been developing within and on the fringes of the three traditional layers of Dutch public administration, i.e. State-level, provincial level and local or municipal level. In 1995 this trend led the Netherlands Court of Audit to publish its annual report under the title "Autonomous administrative authorities and ministerial accountability" where it suggested that there has been "a wild or uncontrolled growth" of autonomous bodies in the Netherlands.

In spite of this complexity, some distinct common structures and rules can be identified that apply across the Dutch government. By taking the degrees of autonomy and the legal status of agencies as distinguishing features, a useful classification can be identified.

In this country report, the system of financing and control of government agencies in the Netherlands is described using three categories:

- companies corporatised under private law (*geprivatiseerde ondernemingen*), with government exercising control through 100 per cent ownership of company shares
- autonomous governing bodies (*zelfstandige bestuursorganen*)
- state agencies (*agentschappen*).

This provides a methodical way to describe the financial management and control of the most typical agency forms and may help to explain the rationale, development, and current practices of agencies in the Netherlands. In addition to the three horizontal, or common, agency forms, the financial management and control of three specific "vertical" agency forms will be described in brief: hospitals, universities, and museums.

2. Agencies in the Netherlands: Historical Origins and Rationales

Over the last 15 to 20 years, successive governments established many forms of agencies and much attention has been given to the development, competencies, and, especially, the organisation and financial management of such agencies. Although this activity might appear haphazard at first sight, a snapshot of the historical origins and the differences in legal status and financial management and control systems of government agencies will clarify the picture.

2.1. *The 1980s — Reducing the Size of the State: Corporatisation for the Purpose of Privatisation*

In 1981 a first list of potential activities that could be privatised was published. The 1982 centre right coalition agreement made *privatisation* — alongside deregulation — official government policy. The main driving force behind privatisation was a mixture of budgetary pressures and the demand for "more market and less government". It was adopted as an ideological doctrine that the provision of all goods and services that could not be considered to be part of government's public task should be privatised. Together with attempts to trim the national budget, simplify legal procedures, and decentralise public tasks from the state level to lower levels of government, privatisation was seen as a way to accomplish the centre right government ideal of "small is beautiful" (Roberts, 1997:98).

Early privatisation in the Netherlands aimed at a strategic reduction of the role of government and a shift between the borders of the public and the private domain (Van de Ven, 1997:6). The early 1980s privatisation initiative had three main goals (Ministry of Finance, 1983, in: Haffner & Berden, 1998:59):

- to achieve budgetary savings [by bringing the supply of publicly-produced goods more in line with demand and by improving productive efficiency]
- to accomplish efficiencies in public management [by restructuring the public sector and reducing its size]
- to reinforce the private sector [by giving private enterprises more opportunities to develop].

Under the first and second Lubbers administration in the 1980s, much privatisation took place. Sectors in which government services were corporatised included public transport, post, telecommunications, energy and water, health care and pension funds. In addition, four genuine State companies were privatised: the State Printing & Publishing Office (SDU privatised in 1988), the Dutch Postal & Telecommunications Service (in 1989), the State Port Authority IJmuiden (in 1989), and the Royal Mint (in 1994). Only some minority State participation still exists today.

2.2. *The 1990s — Improving State Effectiveness and Efficiency (Part I): New Guidelines for Autonomous Governing Bodies*

The Kingdom of the Netherlands can be characterised as a decentralised unitary state. The provinces and municipalities constitute the territorial dimension of decentralisation. Together with the State (*Rijksoverheid*) they constitute the institutions of general government. Functional devolution — rather than decentralisation — describes the transfer of public authority to *autonomous governing bodies*: agencies that are specialised in executing distinctive functions. An autonomous governing body (AGB) is fully part of government, but has no direct hierarchical dependence from a minister.

The "Water Boards" (*waterschappen*) are a special feature in Dutch public administration. Their origins date back to the Middle Ages and they were well established long before the Kingdom of the Netherlands was formed in 1813. But it is not only for historical reasons that the Water Boards still have their own place in the Dutch Constitution alongside the Constitutional backbone formed by State, Provinces and local authorities. Water-management was and still is most essential in the Low Countries and it is as efficient as ever to organise this special branch of public administration in accordance with its own geographic logic.

The Netherlands has a long tradition of functional devolution. The first AGB's appeared in the early 19th century (e.g. the Chapter for the Civil Orders). In contrast to corporatisation for the purpose of privatisation, functional devolution is not aimed primarily to incite efficiency by exposing public activities

to market forces. Neither does it aim to reinforce the private sector or to decrease the size of the State as a main objective. The traditional and still predominant aim of functional devolution is to better equip government to perform distinctive functions in specialised fields. The 190 AGBs perform tasks like control, examination, research, funding, registration, or administration of justice. They can be found in the fields of art, social security, traffic control, education, public housing, state pensions, and include numerous control and inspection bodies in such fields as insurance, transport and broadcasting (Van de Ven 1997:7-8). Examples of AGBs are the Administration for Indonesian Pensions, the Netherlands Institute of Chartered Public Accountants (NIVRA), the Central Fund for Public Housing, and the Chamber for Fresh Water Fishing.

Initially, there was a perfect Babel on how to label the various forms of agencies. Only in 1989 a formal distinction was made between corporatisation for the purpose of privatisation and corporatisation for the purpose of functional devolution. The first was reserved to the transfer of the provision of goods and services to the private sector altogether. Corporatisation as functional devolution was limited to the process of incorporating branches of government that would continue to deliver public services, into separate legal entities. Most of these entities are under public law. A few, however, were created under private law. The latter are now regarded as anomalies and will be corrected if possible (if the legal status allows it, if the benefits exceeds the costs etceteras). In addition, there are a number of cases where functional devolution has involved delegating public authority to the existing private law entities as explained later.

In 1988, the Advisory Committee for Home Affairs published its study of functional devolution. The Council stressed the importance of ministerial accountability for the AGB's and argued for a well motivated and, hence, careful use of functional devolution. It called upon the Minister for Home Affairs to develop a frame of reference to assess new AGB's. In 1989, when the Social Democrats (PvdA) replaced the Liberal Party (VVD) in the third Lubbers Government, the ideological attitude towards privatisation changed. It was argued that the ongoing process of public sector reform was intended mainly to increase the effectiveness and efficiency of government.

In 1991, a white paper "Functional government; why and how?" was published by the Netherlands Council of Ministers. The document not only reflected on the place of functional devolution within the public domain, but also described the motives and conditions that, in the past, had been applied to the creation of new autonomous governing bodies.

The study identified four types of situations, which, historically, had motivated functional devolution:

- Cases where it is considered essential that partisan politics not influence the decisions. One example is the Council for the Elections, which decides who can take part in the elections, who can stand for office under what party-name, and ultimately determines the winning candidates in the elections. Another example is the Commissioners for the Media, who decide on the division of the national broadcasting- and television networks. In such cases it is clearly preferable that a committee of independent authoritative persons make the decisions and not party politicians
- Cases where the decisions require professional qualifications. (e.g. the Committee for the registration of medicines and the Patent Office)
- Organisations for the administration of specific projects within well defined interest groups. (e.g. compulsory social insurance that are jointly administered by employers and employees. Originally this was done in the private domain, but since the 1930's it has been progressively regulated by Statute Law and made compulsory. However the legislation respected the organisational arrangements which had existed previously)

- Latterly (since approximately 1980), where a need was felt for a new tool of management; the establishment of autonomous bodies for functional devolution was often motivated by a desire to improve the efficiency and effectiveness of the organisations themselves by converting them from their former status as departments of a ministry.

Today the fourth rationale is considered improper: if there is a managerial problem, the 'solution' should not be devolution, but decentralisation of managerial competencies of the kind that can be established in a government agency which remains under full control of a minister. This model does not affect political accountability, as do the autonomous bodies.

Despite the rather clear principles of the "Functional government" white paper, the debate continued on what many perceived as the erosion of the primacy of politics. In fact, restoration of the primacy of politics and ministerial accountability became one of the key objectives of the 1994 left-right "purple coalition" (Roberts 1997:103). Things were expedited by the Court of Auditors special report on the "uncontrolled growth" of new AGBs that was published that same year. Following the Auditors' criticisms, the ministries of Home Affairs and Finance launched a national review of AGBs based on a government position paper with new guidelines for the establishment of new AGBs. The position paper addressed the imbalance between formal political (ministerial) accountability on the one side, and the inadequate arrangements for holding AGBs accountable on the other, through a set of rules concerning:

- the preference for public law status for new AGBs
- the procedures of financial and operational accountability of AGBs.

2.3. *The 1990s — Improving State Effectiveness and Efficiency (Part II): The Introduction of State Agencies*

In the report "Accountable Autonomy" (1994), the principles of "Functional government: why and how?" were transformed into a broader framework. Taking the division between policy-making and policy-implementation and the overall ambition to improve performance as starting points, the Sint Commission suggested the systematic approach to agencies that is applied throughout this Chapter. Three main categories were distinguished: companies corporatised for purposes of privatisation, autonomous governing bodies, and a new agency form: the state agencies (*agentschappen*). The Sint Commission meant to offer an encompassing normative framework: depending on the desired degree of autonomy and accountability, one of the three forms should be chosen.

The introduction of the state agency model signifies the rise of the managerial efficiency rationale. The Sint Commission signalled the tendency to use external corporatisation (private law corporations and AGBs) as an escape-route from the tight financial regime of the Government Account Act (Maeijer, 1997:4). Therefore, the state agency form was introduced in order to cut off this path to corporations or AGBs (which were deemed undesirable because they created far-reaching autonomy where the goal is merely to change financial management methods).

The foremost objective in the creation of the state agency model was to increase the efficiency of policy implementation through the introduction of more managerial freedoms and responsibility, output oriented steering, and accrual accounting. Through the use of business-like contracts between principals and agents or annual performance plans, state agencies are given autonomy in the way they administer their tasks. They can best be understood as a form of "internal corporatisation": state agencies remain fully part of the ministries and operate within the boundaries of the jurisdiction of ministerial accountability. Their

autonomy consists of a special financial management regime that allows for more managerial freedoms, as enacted in the 6th amendment of the Government Account Act.

In 1994 the first four state agencies were launched: the Immigration Office, the Defence Computer Service, Senter, and the Office for Control of Plant-diseases. Today 19 state agencies exist, accounting for f 3,5 billion (Euro 1.6 billion) or nearly 2 per cent of central government expenditure. Annex 3 gives a survey of current state agencies in the Netherlands. In 1998 the state agency model was evaluated. The overall findings were positive: the state agency model is a good instrument to attain output-oriented management and has resulted in substantial efficiency gains. The basic principles of the state agency model, more managerial freedoms and responsibility, output oriented steering, and accrual accounting, will become available for other policy implementation services.

3. The Netherlands: A Horizontal Profile with Vertical Elements

The conclusion is that the Netherlands employs a predominantly horizontal system for government agencies, which is to say that the same basic models are used in most sectors of government. There are three categories or archetypes of "agencies": (1) private law companies on a path to full privatisation (with government exercising control through ownership), (2) autonomous governing bodies, and (3) state agencies. For each of these categories, this Chapter will describe:

- the legal status and main governance arrangements (concerning decision-making, the definition of tasks, the level of prices etc.)
- the main features of the balance sheet (ownership of property and buildings, debt and assets management)
- budget management
- regulations concerning performance management, internal control and external auditing.

3.1. Companies Corporatised under Private Law (where government exercises control through ownership)

Where corporatisation takes the form of a limited liability company ("NV" or *naamloze vennootschap*) the change can apply to both situations in which government is 100 per cent shareholder, has a minority block of shares, or no shares at all (compare Van Rossum 1997:84). There are in fact three sorts of companies in this category:

- companies in which the government (gradually) intends to reduce or already has been reducing its control by selling its shares: Royal Mail, Royal Mint, DSM-Chemicals (former State-Mining Comp.) and KLM
- companies in which (for the time being) the government intends to keep full control through 100 per cent ownership of company shares: the Dutch National Bank
- non-profit institutions and foundations subsidised by government or with (quasi-) legal status: charities, museums and other cultural institutions and pension-schemes for public servants.

Privatised companies where government's role is primarily that of regulator, however, go beyond the scope of this survey. The focus here is on those private law corporatisations where government exercises control through ownership (100 per cent shareholder). This compartment incorporates the most important government ventures in the Netherlands, including the Netherlands Railways NV, the Bank of Netherlands Municipalities NV, Schiphol Amsterdam Airport NV, and the Co-operating Electricity Producing Companies NV. As can be concluded from this list, Dutch government is inclined to use the limited liability form to establish its commercial activities as separate entities.

Typical for privatisation in the Netherlands is the "two-phase launch" of companies being privatised. In the first phase government is the only shareholder and supervising body of the private law corporation and uses its powers as a shareholder to control the company (Snaijer 1995:54). In the second phase, which may actually embody several sub-phases, government sells its shares and assumes the role of regulator. This is considered to be the crowning piece of the privatisation process. The two-phase launch allows for gradual shifts from the public to the private sector (Roberts, 1997:105): during the transition-period, government does maintain control through (partial) ownership. Most government-owned private law companies in the Netherlands, however, are still in the first phase (and therefore, within the scope of this Chapter).

In addition to the limited liability company a second form, the foundation (*stichting*), is applied. This holds especially in case the privatised company in question is meant to operate as a not-for-profit organisation (Van de Ven 1997:6). As there is no formal State ownership, foundations are not covered in this survey.

A. *Legal Framework and Main Governance Arrangements*

Creation

Like all agencies, government services that may be subject to privatisation are examined beforehand by the so-called Corporatisation Assistance Team (*Begeleidingsteam Verzelfstandigingen*). This team, made up of civil servants from the Ministries of Finance and Internal Affairs, investigates the motives for privatisation, the conditions under which the changeover will take place and whether or not it meets the requirements of the government position paper. On the basis of its findings the team gives advice to the Council of Ministers.

Upon the initiative of the sector minister, the Council of Ministers adopts the proposal to privatise a government service or State Company. Ultimately, however, it is Parliament that should authorise the decision. In the sixth amendment of the Government Accounts Act (1995), the so-called "proposal procedure" was introduced. According to this procedure, the sector Minister must notify Parliament on each proposal to found, co-found or indeed have found a company according to private (company) law. After this, if one fifth of Members of Parliament wishes to do so, Parliament may for a period of 30 days demand more information from the sector Minister. If Parliament does not do so, the creation of the new company can go ahead. If Parliament does require more information, a second period of 14 days begins at the time this information is given. During this period, either the First or the Second Chamber of Parliament may declare by majority that an authorisation by law is required (Article 29, Government Account Act; see also Van Rossum 1997:86).

In this way, Parliament is given sufficient opportunity to judge whether or not there is need for political review of the activities of the company. At the same time, the procedure removes the requirement for all private law corporatisations to be authorised by law which was seen as an unduly heavy and time consuming process. Still, when a large enterprise is at stake, it is deemed appropriate that the Council of Ministers does opt for a special authorisation by law. This especially holds true for projects with far-reaching consequences for the State or the civil servants concerned, or when the activity is a former State monopoly.

Decision-making

A private law company is, by definition, no longer part of the State or local government. Where profit-making activities are concerned its principal legal form is the limited liability Company *Naamloze Vennootschap* or NV. A limited liability company is subject to Dutch company law (2nd Book of Civil Law). If government opts to use the limited liability company (NV) form to incorporate the provision of a certain task, the stipulations of the Civil Law apply. These stipulations regulate the constitution and structure of any private law company. As a consequence, the government can influence the decisions of the company only through mechanisms defined in the Civil Code.

A limited liability company is founded by an individual or legal entity that signs the articles of incorporation (the *statuten*) before a public notary. The articles contain at least the following:

- the company's official name
- the registered address
- the company's objectives
- the authorised, issued, and paid-in capital by number and nominal value in shares in guilders (including the number and nominal value of shares taken by government as the company's founder)
- rules concerning the transfer of shares
- the powers of the managing director(s)
- provisions regarding supervisory boards (if appropriate)
- information on the financial year-end and rules concerning annual accounts, internal control and audit
- rules for general meetings of shareholders and shareholders' voting rights
- provisions for the appropriations of profits or treatment of losses
- dissolution procedures
- detailed information on all pre-incorporation agreements that the company will be required to assume (e.g. the right of government as founder to capital other than in cash, such as intellectual property).

Changing the objectives of the company requires a change of the articles of incorporation. A draft of the changes in the articles by any private law company must be sent to the Ministry of Justice to obtain a "declaration of no objection".

The Netherlands Civil Code allows for the adaptation of a specific form of company management. In any case, the centres of authority, as laid down in the articles of incorporation, will include:

- the general assembly of shareholders (*Algemeen Bestuur*)
- one or more managing directors, assembled in the board of managing directors (*Raad van Bestuur*)
- one or more supervisory directors assembled in the board of supervisory directors (*Raad van Commissarissen*).

The issue of government influence on the company — concerning for instance the tasks, objectives, products and services, client group — must be understood in the light of the notion of the "interest of the corporation". The Netherlands Civil Code orders managing and supervisory board members to put the interests of the corporation in the first place. As a result, conflicts may arise between the interest of the company and the public interest (as guarded by the sector minister — Schreuder 1994:428). Where the State is the only or major shareholder, however, it is considered to have an adequate legal mechanism under the Civil Code to restore this balance. The Ministry of Finance is usually consulted on the drafting of articles of incorporation affecting shareholder rights on financial issues.

If stronger safeguards are considered necessary, it is possible to establish a "company of general interest" (*te algemene nutte*), a device which limits the degree to which the company may seek to maximise profits. On the other hand, the Civil Code does not allow for a stipulation that the company *acts* purely in the public interest.

Where the articles give the shareholders assembly many competencies, the government, as a 100 per cent shareholder, has much influence on the affairs of the company by adopting management board decisions or by issuing general instructions. There is, however, a legal obligation for the shareholders not to forsake the company's interests. Where the articles give greater powers to the management board, the company will be administered in a much more autonomous way (Snaijer 1995:57). If it is deemed necessary to give the government still greater control possibilities, Parliament can be asked for legislative authority permitting the government to issue instructions to the management board.

The members of the board of managing directors and the board of supervisory directors are appointed by the general assembly of shareholders. It follows that if the State holds 100 per cent or a majority of shares, it can directly appoint both centres of authority. In addition, it can influence the way the board of managing directors does execute its duties (for instance with regard to setting tariffs, formulating business and investments plans et cetera). Thus, if the articles of incorporation are appropriately designed, it is possible for the State as shareholder — in the person of the sector minister — to influence the composition, the procedures and the decisions of the board. Under the Dutch Civil Code, the State as shareholder is entitled to appoint members of the board of supervisory directors including the chief executive officer in a direct manner (Schreuder 1994:429).

B. *Balance Sheet Main Features*

Ownership of Property and Buildings (land)

As a legal entity under private law, a company can register land title in its own name and by its own decision. In addition, it can dispose of land (by sale or long term lease) by its own decision and may retain the proceeds of land disposal. If deemed necessary, additional specifications can be regulated in a law authorised by Parliament. The general public goods law does not apply to private law companies. The sector ministers responsible for the company, however, can be held politically responsible for using his shareholder powers to ensure a sound financial management of that company, including the way it manages its assets.

As stated, the articles of incorporation specify the authorised, issued, and paid-in capital by number and nominal value in shares. At least 20 per cent of the authorised capital must be issued on formation and at least 10 per cent must be paid at that time. The minimum paid-in capital of an "NV" must be 100 000 Dutch guilders. Any change in the authorised capital of the company requires an amendment of the articles of incorporation. All contributions to capital other than in cash (intellectual property, good will) must be independently valued.

Dutch companies are not legally required to set up reserves. It is customary, however, to maintain reserves voluntarily. In addition reserve requirements and other specifications concerning the management or assets may be inserted in the articles of incorporation.

Debt

As a legal entity under private law, a corporation can borrow from banks in the market or issue fixed-interest rate notes or debentures (*obligaties*). As a principle, the authority to borrow money and to approve the quantum, form and terms of the borrowing is vested in the agency management. Here again, however, the government as shareholder retains adequate influence.

Liability for debt is regulated in the Netherlands Civil Code. If the State holds 100 per cent of shares, the Civil Code stipulates that it is liable for debts. In addition it is specified that influence on the policies and practices of the company entails responsibility for the financial situation. Although there is no empirical research available or formal arrangements, this government guarantee does play a role in getting preferential interest rates at the market.

A private law corporation's debt is not recorded in the annual Budget bill or the Financial Account. However any earmarked or lump-sum contributions to the company or payments for services rendered will be found in the annual Budget bill and the Financial Account. In addition the Budget provides a reserve for possible losses under government guarantees of corporate debts; it is calculated at 0.1 per cent of the total liabilities.

Specific Assets and Liability

The regime for the disposal of other important assets such as intellectual property must be specified in the founding legislation, if considered necessary.

C. Budget

The private law corporation's budget is determined by the board of managing directors but needs to be approved by the general assembly of shareholders. No specific part of this budget must be submitted for approval to government directly. Nevertheless, through its role as shareholder and through its appointments of managing or supervisory directors the State can control all the constituent elements of the company's operational and investment budget. There are no special arrangements in case the company receives contributions from both central and local governments: if deemed necessary, these aspects could be addressed in the founding law.

These companies are not included within the government Treasury system for cash and payment management. Public procurement (acquisition, purchase) laws do not apply. Ministries that use such companies to deliver a program of government payments — such as subsidies — will keep this benefit programme budget separate from the agency's operational budget as a line item in the ministerial Budget bill.

Due to the legal status of the company under the Civil Code, no special regime applies if the agency is funded from its own revenues. Decision-making authorities for key revenue issues such as the levels of toll or earmarked taxes, prices charged for products or services rendered, the level of service and quality, and the definition of client groups belongs to the domain of the board of managing directors and the general assembly of shareholders unless otherwise specified in the founding law. In its financial contribution, the State will take into account the company's own revenues.

Depending on the specific nature of the public task performed by the company, its budget may be partly financed by a grant (lump sum) or by a payment for services rendered under a contract. The State may pay contributions with specific conditions attached: the Dutch Railways, for instance, are obliged to keep certain lines open in spite of their unprofitable nature. The founding law or the articles of incorporation may specify the utilisation of possible financial surpluses at year-end. However the government as shareholder has, in all cases, the authority necessary to pay dividends or retire debt etc when year-end surpluses appear.

D. Performance Management, Internal Control and External Auditing

Performance

Performance targets, of a sort, may be defined for the private law company in three ways: (1) the founding law, (2) the articles of incorporation, and/or (3) obligations undertaken in contracts with a sector minister or as conditions accepted in return for budget contributions. As a result, the definition of the performance target may be part of the budget process when the target is tied to a financial contribution. Where there is a contract-like agreement, performance reports may be required to be produced for the sector minister. In his turn, he may use these reports to inform the Minister of Finance and/or Parliament. In addition, the Dutch Civil Code requires companies to publish an annual report. Remedies and/or sanctions relative to performance may be regulated in either the founding law, the articles of incorporation, and for contracts and contributions, in the agreements themselves.

Internal control

As a legal entity under private law, a corporation is subject to Netherlands Company Law under the Civil Code. As a consequence, a mandatory framework of internal control does apply. Government standards for internal control do not apply directly. As the Dutch Court of Audit (see below) may audit the company, there is an indirect effect.

External Audit

In the Netherlands, the domain of control by the Supreme Audit Institution — the nature and purpose of Budget funding determine the Netherlands Court of Audit. Where the funding is of a more structural nature and aims at financing the public task of a private law company, the Court of Audit must be able to inspect the regularity and efficiency of the entire financial management of the company. This would be the case where government provides a substantial part of the operating budget or guarantees to replenish budget deficits.

Article 59 of the Government Account Act specifies that this possibility strictly pertains to companies where the State holds 100 per cent of company shares or a dominant majority. If government holds a minority or small majority of shares, the Court's auditing competence is restricted to funds flowing from the Budget. In any case, the Court is expected to use the results of internal control and other external audits as much as possible as a starting point for its research. Upon the request of the sector minister, the company must provide the Court of Audit with all material deemed necessary for the audit investigation. The Court has the right to enforce inspections on the spot.

All audit reports of the Court of Auditors are directed to Parliament. Before that, the sector minister has the right to read and respond to the Court's findings.

3.2 *Autonomous Governing Bodies*

Autonomous governing bodies (AGBs) are anything but new. As described in paragraph 2, the Netherlands has a long tradition of transferring public authority to AGBs that are specialised in executing distinctive functions. The primary aim of the creation of an AGB is to better equip government to perform distinctive functions in specialised fields. In order to improve the way AGBs contribute to this aim, the Kok government introduced new guidelines in a 1996 Government position paper. These guidelines can be taken to represent current policy towards AGBs in the Netherlands and the following paragraphs are based upon them.

A. *Legal Framework and Main Governance Arrangements*

Creation

An AGB is a legal entity according to public law, established by a specific law (Van de Ven 1997). The "proposal procedure" is not available in the case of AGBs for the reasons described in paragraph 60. Sector ministers considering the creation of a new AGB are required to consult with the ministers of the Interior and Finance at an early stage. In addition, the Court of Audit should be consulted. Like all proposals to create agencies, the so-called "Corporatisation Assistance Team" examines the proposals for new AGBs. As is the case with privatisation, this team investigates the motives for the creation of the AGB, the conditions under which the creation would take place and the judicial requirements. On the basis of its findings the team gives advice to the Council of Ministers.

In line with the reports on "Functional government" and "Accountable Autonomy" it was formally established by the 1994 Kok government that an AGB should only be established if there is a need for:

- societal participation, and/or
- independent judgements
- standard application of rules or regulations on mass entities.

When the need for a new AGB has been established, it should be created in accordance with the following general principles:

- the creation of an AGB should supplement the main structure and institutions of general government (an AGB should "add value")
- the case for the creation of a new AGB should include a documented comparison of the advantages and disadvantages of functional devolution
- functional devolution/the creation of an AGB must not cause incorrigible obstructions to the institutions of general government
- functional devolution/the creation of an AGB is only appropriate when the political significance of the task is such that a reduced level of ministerial accountability is acceptable

- a new AGB should meet the requirements of democratic, lawful, and efficient governance.

According to the 1996 guidelines new AGBs should normally have a judicial status under public law. In exceptional cases, public authority can be assigned to existing organisations with a private law status if the organisation concerned is considered to be pre-eminently fit to execute a public task. Inspectorates and certification or examination organisations are good examples of services requiring technical expertise, which could make it legitimate, under explicit conditions, to delegate public authority. However, the State should normally not create new private law entities for the purpose of transferring public authority.

The preference for a public law status is well founded. The most distinguishing quality of government is the faculty to exercise "public authority", that is: the unilateral capability to alter the legal status of other societal entities. This capability is regulated by the principles of democracy and the constitutional state, which is the basis for public law. As a result, the organisations constituted according to public law automatically accommodate the underlying principles of public authority and the notions of democracy and the constitutional state (Peters 1997:6). And this is the fundamental difference between private (company) law organisations and public law organisations: public law does not apply to the organisational design of activities that do not exercise public authority.

AGBs perform public tasks only within a constitutional basis under public (administrative) law. The establishment of a new AGB requires a specific constitutional act of law, or founding law, which specifies:

- the reason why the AGB's task is considered to be the responsibility of the government
- the reason why the task is not decentralised to provinces or municipalities (as a part of territorial decentralisation)
- why the task is not carried out under full ministerial accountability
- the costs-benefits analysis that underlies the decision to delegate public authority to an AGB
- the co-ordination mechanisms between the AGB and other branches of government (provinces and municipalities).

Since the creation of an AGB does entail a reduction of ministerial accountability, and therefore of parliamentary control (see below), it can be authorised only *by a* constitutional act of law. In this way parliament has the opportunity to judge the purpose and design of the new AGB. In case a series of similar AGBs is envisioned (e.g. a national network of regional branches performing one task), the government may create the individual units within a framework defined in a single constitutional act of law.

As a rule, AGBs do not perform tasks that are not attributed to them by law. Where the task entails a monopoly, the methods of regulation are set out in its founding law (see below for establishing prices in a monopoly). As a principle, law-making authority can be attributed to an AGB only in the field of organisational or technical legislation.

Decision-making

The organisational design, decision making, working methods, and political governance and control of an AGB are designed to fit its tasks and responsibilities. For this reason it is not possible to define a common blueprint for the composition of each individual AGB. In each separate case the division of authorities and responsibilities between the autonomous body and the minister and the internal decision making capabilities and external accountability have to be regulated by the founding law.

In order to improve coherence and transparency, the variety among AGBs was reduced by the new guidelines to three main types:

- expertise type: composed of experts, placed at a sufficient distance from the minister that he can influence neither the AGB's general policies nor its specific decisions or recommendations
- independent-authority type: composed of experienced administrators, where the minister is able to influence the AGB's general policies through the imposition of general guidelines, but is not permitted to interfere with individual judgements
- participation type: composed of representatives of various interest groups and independent experts, where various instruments of ministerial influence can be provided as the specific situation requires (impositions of general guidelines, the approval or annulment of specific decisions).

Depending on their function, AGBs may vary considerably in size. The founding law of larger AGBs defines the structure of the board of directors and the procedures for appointment, re-appointment, suspension, and resignation of its members (including the chief executive officer). These include the size of the board as well as the qualifications its members must meet. Civil servants that are under hierarchical control of a minister closely linked to the AGB's task cannot be a part of the AGB board of directors. This is intended to prevent a sector minister from influencing decision-making in the board through a direct channel. Each AGB must have board regulations, in which rules for meetings, decision-making, and the functioning of board components are laid down. The Board regulations must be authorised by the sector minister.

The relations between an AGB and the ministry for which it works are regulated in the founding law. A sufficient degree of ministerial accountability is assured by the competencies attributed in that law to the minister responsible or the Crown (*Kroon*). It should be remembered, however, that the defining characteristic of an autonomous governing body is the absence of a hierarchical subordination to its sector minister (Minister for the Interior 1996:2). Unlike the creation of State Agencies, functional devolution does entail a reduction in the degree of ministerial accountability. The sector minister's influence is limited to the steering arrangements that are incorporated in the constitutional act of law (Van Rossum 1997:86). For this reason, the sector minister is primarily accountable for the way (s) he has modelled the steering arrangements in the first place and used the possibilities to control the AGB afterwards.

In the founding law it is specified that the sector minister or the Crown must authorise the tariffs and levies proposed by the AGB. This typically applies to situations where there is a *de facto* or judicial monopoly: if the AGB provides its products and services in a competitive market, it is considered to be sufficient that the sector minister or Crown set maximum prices.

It is the sector minister who determines the tasks, goals, products and services, and client group of the AGB. The parliamentary debate and authorisation of these aspects ensures political control. In addition, in the case of private law AGBs, the founding law regulates the authority of the sector minister to approve of the annual and the multi-annual budgets. Depending on the nature of the task of the AGB, the constitutional act of law may furnish the sector minister with the additional power to:

- establish general binding regulations concerning certain subject matters
- establish general binding regulations or policy rules with respect to the execution of the AGB's task

- authorise, suspend, or nullify particular decisions specified in the law
- approve of acts of the board of directors prior to their implementation.

An AGB itself cannot determine which public tasks it should perform or which jobs may be taken up as public tasks. Where the AGB's mandate must be changed, the procedure should follow the creation procedure as closely as possible.

B. *Balance Sheet Main Features*

Ownership of Property and Buildings (land)

The main ground to bestow an AGB with legal personality is the desire to put aside capital assets. However the management may use or alter the capital assets only to the extent necessary to achieve the public task of the AGB.

Acts of a private law nature by all government entities (such as the registration of land title, sales of property, establishing legal entities, entering upon lease-contract) are regulated in the State Decision on Private Law Acts. When similar powers are to be included in the AGB's founding law, they should be defined as they appear in this State Decision. Thus the AGB would not be able to register land title in its own name: it is the sector minister who would do so. The same holds for the disposal of land. As a general rule the public goods law (*Regeling goederenbeheer*) should be applied to AGBs as to all public law entities. However it does not apply to private law AGBs and exceptions may be made for others in exceptional circumstances.

In practice, moreover, decisions on individual AGBs may depart from the general guidelines in other ways. In many cases, the founding law allows an AGB to register land title in its own name and to dispose of land without being bound to the stipulations of the Government Account Act. Such departures should be motivated by the special needs of the agency but they are sometimes subject to normal political negotiations.

Debt

Except when the founding law specifies otherwise, an AGB may borrow money from the banks and/or the market. Unless otherwise specified, the authority to borrow, to approve the quantum, form and terms of the borrowing et cetera are vested in the agency management. The founding law may specify that AGB's debts are guaranteed by the Budget. Otherwise they will be guaranteed under the general provisions of the Netherlands Public Administrative Law (*Algemene Wet Bestuursrecht*). In case of an agency bankruptcy, the Civil Bankruptcy law applies. An AGB's debts are not recorded in the annual Budget bill or the Financial Account. As an entity under public law, the implicit obligation seems to be credible enough to gain preferential interest rates at the market.

Specific Assets and Liability

The regime for the disposal of other important assets such as intellectual property is defined in the founding law, if necessary.

C. *Budget*

The primary function of the AGB's budget is to plan the agency's expenditure and income and to provide the means for financial control after the budget term. The financial control is regulated in the AGB's founding law, following the specifications of Netherlands Public Administrative Law.

An AGB's budgeting may occur in various ways. For a public law AGB, its budget will normally be made up — partly or entirely — by a sector minister's contribution and is included as a line item in the Ministry budget. In those cases, the AGB's full operational budget must be examined and approved by the sector minister and the minister of finance and must be approved by Parliament. The budget may be partly financed as a grant (lump sum), as a "payment for services rendered", or as a combination of the two. Depending on the task of the AGB, additional revenue may be collected as fees or charges from beneficiaries of the AGB's services or products. As a part of the State, government-wide accounting classifications and public procurement laws do apply. Unless there are special motivations to the contrary, the AGB should be included within the government Treasury system for cash and payment management. As a general rule, for agencies that deliver a program of government payments (subsidies, welfare) the benefit programme is budgeted separately from the agency budget.

For a private law AGB, according to the Netherlands Constitution, its way of budgeting must be regulated in the founding law. Most AGBs with a private law status (the specialised services that, because of their special expertise, perform a few public tasks) finance their public task with levies or tariffs. If a private law AGB requires a contribution from the state budget to supplement its revenues, it is provided as a subsidy under the terms of the Public Administrative Law. Where the AGB is partly funded from own revenues related to the execution of a public task, the minister or the Crown must approve the tariffs and levies. When there is a subsidy from the Budget the sector Minister may stipulate the service level and quality and the definition of client groups as part of the conditions attached to the minister's funding.

If the AGB's budget comes entirely from tariffs or levies, the founding law will empower the sector Minister to approve those tariffs and levies. Where an agency receives a budget from both central *and* local governments, the co-ordination mechanisms are regulated in the founding law. Private law AGBs are not included within the government Treasury system and public procurement laws do not apply. As a method to prevent an agency to underestimate its revenues at budget time (in order to get a larger budget appropriation) the founding law includes provisions to prevent "cross-subsidies". In the founding law the State may also bind itself to cover an agency's deficits or specify how financial surpluses at year's end are dealt with.

D. Performance Management, Internal Control and External Auditing

The financial control is regulated in the AGB's constitutional act of law, following the principles and specifications of Netherlands Public Administrative Law.

Performance

Where the AGB is part of the sector Minister's budget, the line item or other financial information must include performance indicators. The exact terms under which this is due to take place is negotiated between the sector Minister and the Minister of Finance.

The degree (for instance, the scope, level of detail and accuracy) to which an annual AGB budget and annual report will include information on performance is also regulated in the founding law. The law also includes regulations concerning a severe neglect of the AGB's task and duties. AGB's fall under the jurisdiction of the Ombudsman.

Internal Control

The founding law requires that an AGB publish a report on its financial management, which needs to be certified by a registered accountant. The financial management report must include an overview of income and expenditure, a financial account, a balance sheet, and an explanation on both pieces. The report will be judged on both its completeness and regularity.

In addition, an AGB's sector Minister can draw up binding rules on the structure of the AGB's budget, its financial management report, and, more specifically, special points of interest for the registered accountant's examination. The standards of the Civil Code apply for internal control.

External Audit

As stated earlier, the domain of control by the Netherlands Court of Audit depends on the nature of funding and its purpose. Where budget funding is of a more structural nature and aims at financing the public task of a private law company, the Netherlands Court of Audit must be able to inspect the regularity and efficiency of that company's financial management. The same rule applies to AGBs. Section 59 of the Netherlands Government Accounts Act specifies that the Court of Audit does have auditing powers with respect to "legal persons performing a function regulated by or pursuant to an Act of Parliament and to that end funded wholly or in part by receipts from levies instituted by or pursuant to an Act of Parliament".

In general, it is expected that the Court would use the results of internal audit and other external audits as much as possible as a starting point for its research. The Court has the right to enforce inspections on the spot. Like all audit reports, reports on the regularity and efficiency of AGB financial management are directed to Parliament. Before that, the sector minister has the right to read and respond to the Court's findings.

3.3 State Agencies

As a judicial form, the state agency owes its existence to the desire to cut off the paths to corporatisation, whether under private or public law, when the goal is only that of managerial efficiency. As a model for merely improving financial management, both privatisation and functional devolution are considered to be too far-reaching. For some politically sensitive public tasks, either of these forms of "external corporatisation" is rejected since they will entail a loss of direct ministerial influence.

Following a period where many new AGBs were created, the state agency form was introduced as a formula to increase the efficiency of policy implementation through the introduction of more managerial freedoms and responsibility, output oriented steering, and accrual accounting. State agencies can best be understood as a form of "internal corporatisation": they remain part of the ministries and operate fully within the boundaries of the jurisdiction of ministerial accountability. Their autonomy is limited to a special financial management regime, enacted in the 6th amendment of the Government Account Act.

A. Legal Framework and Main Government Arrangements

Creation

It is the sector minister, together with the Minister of Finance, who may decide to give a specific part of a ministry the status of state agency. Such a decision must not be implemented until at least 30 days after Parliament has been notified in writing of this intention. If, within this period, a request is made by Parliament to receive further information on the proposed decision, the decision shall not be taken until after that information has been supplied. Like all agencies, the "Corporatisation Assistance Team" examines a part of a ministry that may be subject to become a state agency. As is the case with privatisation and AGBs, the team investigates the motives for granting the state agency status, the conditions under which the creation would take place and the judicial requirements. On the basis of its findings the team gives advice to the Council of Ministers.

In contrast to a private law corporation or an AGB, a state agency remains fully within the sector ministry and continues to operate within the boundaries of ministerial accountability. The role and responsibilities

as well as the budgeting and control arrangements of individual state agencies are written down in the formation statutes for that specific agency. The judicial basis for the state agency model is constituted by the Government Account Act. In fact, the bigger part of the 6th amendment of this Act (1994) is dedicated to the creation of the state agency model. Section 70 states: "If different management rules are desirable for part of a Ministry, Our Minister and Our Minister of Finance may decide to grant that part the status of agency, if the Cabinet so agrees". Sections 71 and 72 lay down the financial management regime, whereas section 73 empowers the Minister of Finance to "lay down further rules relating to agencies in general or one or more agencies in particular".

Until recently, candidate state agencies needed to satisfy three conditions:

- the products and/or services must be measurable in both quantity (volume and costs) and quality
- there must be a unqualified opinion by chartered public accountants warranting the adequacy of the administrative organisation
- there must be a real opportunity for efficiency gains (the unit costs or tariffs must fall in course of time).

Following the evaluation of the state agency model in 1997, these three conditions were modified in 1998. Future state agencies need to:

- describe the administrative organisation and production processes, including the methodology for determining the costs of products and services
- define a systematic measurement framework which will be used subsequently to evaluate the degree to which efficiency has been improved (the primary indicator should be the cost price per rendered product or service)
- be equipped with an output oriented planning & control mechanisms.

A special set of rules will be applied in the near future for any agencies undertaking side-activities in the competitive marketplace. As a result of a study carried out under the recent government project on "Market, Deregulation and Quality of Legislation", it has been accepted as a principle that state agencies operating in commercial markets must have no unfair advantages over competitors. Where they engage in commercial activity as a part of or in addition to their public tasks, they should operate under the same competitive terms as private enterprises operating in those markets. The most far-reaching consequence of the principal of equal competitive conditions is that it forces the agency to segregate public and private activities in legal, organisational, and financial terms. Eventually, this segregation should lead to the disposal of commercial activities.

There are four exceptions to this principle:

- the commercial activities are necessary in order to perform a public duty
- the commercial activities relate to research networks
- the commercial activities are produced making use of a minimum capacity required for the public duty (e.g. a military airfield that is also used for civilian purposes when not required by the military)

- when already a decision has been taken to allow competition for the public services.

Decision-making

As an integral part of a ministry, the sector minister is the final decision-maker for an agency. It is the sector Minister, endorsed by the Council of Ministers and Parliament, who decides on the objectives, tasks, and products and services rendered by the state agency, as well as its client group and agency mandate changes.

The "steering" relationship between the sector minister and the state agency is described in the government's founding decree, which is enacted only after notification to Parliament as described above. The arrangements can be further elaborated in a "steering protocol". These documents specify the topics on which the sector minister and the state agency must enter into management contracts. Typical topics might include decision-making on prices, managerial freedom in disposing of budget surpluses, the way the agency's investment plans or business plans are dealt with, or the agency's quality control systems. The same documents define the decision-making procedures for key revenue issues — like the prices charged for products or services, their service level and quality, and the definition of client groups. Decision-making on the levels of levies or earmarked taxes remain at the sector ministry because they must be harmonised with the total burden of tolls and taxes put upon society by the public sector (the *collectieve lastendruk*).

The appointment of the director or chief executive officer of a state agency is made under the regular State legislation meaning that the appointment requires a decision by the Council of Ministers. The appointment of other high officials, including the chief financial officer, must be approved by the General Secretary of the Governing Council (the most senior civil servant.) of the sector ministry.

B. Balance Sheet Main Features

Ownership of Property and Buildings (land)

Section 71 of the Government Account Act decrees that a state agency's financial management and, hence, its budget and financial statement are based on a system of accrual accounting ("systems of costs and benefits"). An accrual accounting system tracks the accretion of capital resources. The principle is that a state agency's budget should provide a genuine, clear, and systematic representation of the development of an agency's capital assets. One feature of the enlarged managerial autonomy is that a state agency can purchase capital goods independently. It can also dispose of land by sale or long term lease by its own decision and may retain the proceeds of land disposal under the general condition that these proceeds are employed to perform the agency's public task.

A state agency may register land title in its own name "in trust" for the state. Public goods laws and public procurement laws apply in the normal way.

Debt

State agencies may borrow from the Budget only. A state agency maintains a special account with the State Account Office (*Rijkshoofdboekhouding*). of the Ministry of Finance which is separate from the sector ministry's account. To borrow from the State Account Office the agency must first make a proposal and obtain the approval of the Directorate of Financial and Economic Affairs of the sector ministry.

Since the state agencies are part of the State, their debts are guaranteed by the Budget. Loans from the State Account Office carry a fixed interest rate. The agency's debt is recorded in the agency's budget and financial account and, as such, published in the ministry's annual Budget.

Specific Assets and Liability

The regime for the disposal of other important assets such as intellectual property is specified in the specific founding decrees, if necessary.

C. Budget

As an integral part of a sector ministry, a state agency's budget is determined following the regulations of civil service law. In the budget process, agreements are made on the products and services an agency will produce during the budgeted year. The sector minister, together with the minister of Finance and the Council of Ministers approves the agency's budget. It is approved by Parliament.

A state agency's budget is published as a separate Title 3 in a Ministry budget. The agency's budget is accompanied by a short description of the nature and objectives of the agency, as well as its tasks and duties. It also describes the agency's plans for improving efficiency and reports on achievements of the past year. The state agency's budget must be accompanied by relevant performance and output indicators and aggregated information on the quantity and quality of products and/or services rendered. The payments made by the state agency's sector ministry are debited or credited by the ministry to one or more budget sections of the relevant main policy areas. On balance the state agency budget consists of the payments made by the ministry and other parties, minus the state agency's payments to the ministry.

The budget of ministry displays, for each of its state agencies, the total estimated costs, the estimated benefits, the balance of costs and revenues, and the total estimated capital expenditures and receipts (including the settlements between a ministry and its state agency). There are three forms of ministerial payments to state agencies:

- contributions to the costs of operation
- contributions to investments
- payments for delivered services or generated products¹⁷.

As a consequence, the budget may be partly financed in advance as a grant (a lump sum contribution to the agency's operating budget) or as a payment for services rendered. State agencies that deliver a programme that includes payments (subsidies, welfare) maintain a division between the operating and the programme budget. As a rule, they will be administered under separate budget headings.

Following the principle of managerial autonomy, the estimates concerning the staff and equipment of a state agency are included not in the section on "staff and equipment" in the budget of the ministry concerned, but under "costs" in the budget of the state agency. The number of agency staff is published as a specific annex to the ministry's budget. In this way the autonomy and distance of the state agency in its relation to the ministry are expressed. Nevertheless, government-wide accounting classifications are used. Modifications to a state agency's budget need not to be submitted to Parliament during a fiscal year: they are included in the Final Budget Act that closes the fiscal year.

As stated, a state agency has a special account with the Ministry of Finance separate from that of the sector ministry. It is, however, fully embedded within the government Treasury system for cash and payment management as administered by the Ministry of Finance. Payments by an agency that delivers a program of

17. Explanatory Memorandum to Section 71 of the Government Account Act, 1995.

government payments (subsidies, welfare) to recipients are carried out via the sector ministry's government account. In this way the benefit programme is not only budgeted apart from the agency's budget, but is also kept separate during execution. Since state agencies remain fully part of the State, there is an open obligation to cover any state agency debts. Since state agencies operate on the basis of a system of accrual accounting, year's end deficits need not be covered immediately. Moreover, as the system includes a representation of the development of an agency's capital assets, it has inherent incentives to remedy a situation where deficits chronically exceed plans.

In addition to the three forms of ministerial payments (general contributions, investment contributions, and payments for delivered services or generated products), state agency budget sources may include revenues from other ministries or third parties. As an incentive to financial and managerial efficiency, the revenues will not in their entirety be taken away by the sector ministry. In the constitutional decrees or state agency protocol, a framework of agreements is laid down specifying the regime for budget surpluses that stem from efficient management. The agency's expected revenues are taken into account in establishing the general ministry contribution and/or the prices of products.

At year-end, a state agency will have to provide the sector ministry with a full financial account. Any underestimation of agency revenues at budget time (in order to get a larger budget appropriation) will be revealed at that time. The institutional statutes or agency protocol regulate what happens to financial surpluses at year-end. In practice, there often is a combination of routes: a part may go as dividend to the Budget, another part may be used to allow for price reductions, whereas, following the accrual accounting system, the larger part will lead to the accretion of capital resources (which will be used in future year investment budgets).

D. Performance Management, Internal Control and External Auditing

Performance

In order to become a state agency, candidate services need to explain how their future efficiency improvement will be systematically evaluated. The primary indicator used is the cost price per rendered product or service. These products or services must therefore be measurable in both quantitative and qualitative terms. The performance target to be defined by agencies stems from this required improvement of efficiency. In the customary budget cycle, regular performance reports are provided to the sector minister. In addition, state agencies provide the sector minister with a multi-annual overview of planned efficiency targets.

Internal Control

As a new entrance condition, state agencies must be equipped with an output oriented planning & control system. This includes a mandatory framework of internal control by which the agency's management must be able to monitor and guide its production processes. Government standards for internal control are applicable.

External Audit

As a full part of the State, the Netherlands Court of Audit audits state agencies. The Court investigates the regularity and efficiency of the agency's performance and financial management. Like all audit reports, these are directed to Parliament. Before that, the sector minister has the right to read and respond to the Court's findings.

"Accrual accounting services": state agencies après la lettre

It is worth noting that, in addition to state agencies, other implementation services of national ministries may be granted permission to employ the accrual accounting system.

4. Vertical Sectors: Universities, Hospitals and Museums

In addition to the above-described general features of the financial management and control of Netherlands agencies, three sectors merit special attention: hospitals, universities, and museums. Like elsewhere in this report, we concentrate on institutions that, despite their autonomous position, are firmly established in the public domain. It should be kept in mind, however, that there are numerous private museums in the Netherlands and, though at a much smaller scale, private clinics and one private university can be found.

Hospitals

The Netherlands enjoys a high level of health care with a rate of (compulsory) insurance that borders 100 per cent. Total spending of the health care sector amounted to 66.4 billion in 1998 which means 21 per cent of the total net expenditure of national government and the social funds. Key principles of the Dutch systems are: *solidarity* (between the young and the elderly; the healthy and the sick and the wealthy and the poor), accessibility, "payability", and freedom of choice (between institutions, doctors, etc.)¹⁸. The minister of Healthcare is responsible for the preservation of these values. There are 156 hospitals in the Netherlands, most of them being general hospitals (next to academic hospitals). Only about 15 per cent of general hospitals belong to the public sector, the remaining 85 per cent being privately owned and autonomously governed as non-profit entities.

There are four sources of funds in the health sector. The compulsory social health insurance accounts for approximately 70 per cent of the budget. Private and public sources contribute another 12 and 9 per cent respectively. Direct payments make up the balance with around 9 per cent (Central Agency for Health Care Tariffs, 1995). Due to its special responsibility for health care, the State (Ministry of Healthcare) has a strong position in the health sector. Among other things, government intervention includes the publication of an annual health expenditure plan (containing an overall indicative budget) and a close regulation of two compulsory insurance schemes¹⁹. The Minister of Finance supervises the budgetary framework for health care.

Despite several attempts to launch radical reform proposals in recent years, the cornerstones of the system are still the 1982 Health Care Tariffs Law (HCTL) and the Hospital Supply Law. The Hospital Supply Law is a central government planning instrument, regulating which institutions are allowed to provide hospital care and under which conditions. The tariffs law is implemented and monitored by the Central Agency for Health Care Tariffs. The objective of the HCTL is the promotion of a well-balanced system of tariffs, leading to a better overall budget control.

As a result, since 1983, in bilateral negotiations, hospitals and insurance companies determine the hospital budgets taking into account the expected volume of hospital production (intakes, nursing days, operations) and applying the tariffs law guidelines (quantity of beds, doctors, nurses, medical sector incomes, standard costs, et cetera). In this way, the budget — which must be approved of by the Central Agency —

18. Ministry of Public Health, Welfare, and Sports, *Jaaroverzicht Zorg 1997* (1997 Annual Report on Care), 1997.

19. See OECD's Health Policy Studies No. 2, *The reform of health care* (OECD 1992), Chapter 7: "The reform of the health system in the Netherlands".

corresponds to an expected volume of hospital services in various categories and prices per item of service. Once established, the agreed upon budget provides security to the hospitals. In case actual payments to hospitals by the insurance companies and/or the insured deviate from expectation (because of a different volume of hospital production), the resulting surplus or deficit will be eliminated in the subsequent year by price adjustments.

It is the hospital's management — consisting of a supervisory board and a board of directors — that is responsible for the efficiency of the use of budgetary means. In addition, it is responsible for the maintenance of an appropriate level of health care infrastructure — in both qualitative and quantitative terms. Hospital management must balance the hospital's negotiated budget with its running costs (salaries, social security costs, food costs, and medical equipment): running costs may not exceed the hospital's calculated budget. Despite the guidelines by which the budget is established, the hospital management has considerable flexibility to substitute input items within the budget.

It should be kept in mind, however, that Netherlands hospitals could hardly be described as "whole entities". The interests of its management and of its medical staff are not necessarily the same. In addition, the hospital's budgeting and that of the medical specialists are budgeted in different ways and apart from each other. Whereas hospital management defends the financial management interests, specialists will give priority to medical rationales.

*Universities*²⁰

Besides the privately owned and operated Nijenrode University, there are fourteen universities in the Netherlands. The oldest university in the country, the Leyden University, was founded in 1575. There are three technological, nine "regular" universities, and one agricultural university. The latter falls under the jurisdiction of the Minister of Agriculture.

Netherlands universities have a democratic management structure. An executive board, consisting of a chairperson and the Rector Magnificus, constitutes the head of every university management. The minister of Education nominates the board. Advised by the Deans of the university faculties, the executive board is responsible for the management of the university and for long-term strategy. The university council, whose most important task is to fix the university budget, monitors the board. This council includes academic and non-academic personnel and students.

Netherlands universities have three main sources of income: National government (the Ministry of Education, Culture and Science), the Netherlands Organisation for Scientific Research, and the "market place". In fact, these are literally known as the first, second, and third source of money. The principal financier is the State, which provides up to 64 per cent of the university budget. Income stemming from research funded or subsidised by the Netherlands Organisation for Scientific Research accounts for 10 per cent of university budgets. Activities undertaken for third parties make up a quarter of the university budget. These revenues stem principally from contract research for both private sector companies and branches of government. Over the last ten years, the proportion of revenues coming from the State contribution has been declining.

The national government contribution to the budget is determined yearly. It consists of three different components: a lump sum, a budget to cover the costs of early retirement and unemployment of university

20. Much of the information presented here is taken from the brochure "Universities in the Netherlands" by the Association of Universities in the Netherlands" (VSNU), Utrecht 1996 and the Higher Education and Research Act of 1993.

staff, and a sum for investment in university buildings. In addition, smaller parts of the budget are given for postgraduate teacher courses and universities with teaching hospitals. The lump sum totals are calculated on the basis of a financing formula, in which the costs for education (based on the number of students and the number of degrees awarded), research (based on PhD dissertations and an autonomous part) and the costs of cross-over integration between research and education are incorporated.

In principle, however, Netherlands universities enjoy a rather large autonomy in their financial management and may use these funds in any way they consider to be appropriate. They operate at arms length from the ministry of Education, Culture and Science. Before the 1980s the State was involved right down to the last detail in university education, research, accommodation and personnel policies. Nowadays universities are largely responsible themselves for the management of affairs within the institutions. This includes decisions to register land title, to institute new legal forms, and to manage other assets. This development was formally ratified in the Higher Education and Research Act of 1993. Still, in a number of areas, the State does maintain influence (for instance on the student grants system, the internationalisation of university education and research, and the quality of university education programmes).

The Higher Education and Research Act shifted the State's role in financial management from preventive control *ex ante* to sanctioning control *ex post*. The quality and quantity of university production (graduated students, PhD dissertation, other research output) in relation to the means employed are central to the new relationship between the Ministry of Education, Culture and Science and the universities. The universities have developed management quality plans. External quality assessment complements these systems and aim to ascertain the quality of education and to contribute to quality management. Universities must submit an audited annual report, providing information on both expenditure (including the "cost-sources") and production (numbers of graduated students and PhD dissertations). Revenues from the "third source of money" (contract research) must be included in the budgets and financial accounts presented by the universities to the ministry.

Museums

In the Netherlands, there are over 700 museums, most of which are privately owned and operated. From the 192 publicly owned museums in the Netherlands, 51 are State museums. (Vollebergh 1997).

Beginning in the 1990s the former Netherlands State Museums were transformed into private law entities. The rationale for this operation is to reduce the size of government and to achieve savings. As a form, the limited liability company (the *Naamloze Vennootschap* or NV) was discarded on fiscal grounds. Instead the museums were converted into foundations, of which the Supervisory Boards are appointed and discharged by the minister of Culture. The Supervisory Board appoints the foundation's management (Board of Directors). This is the channel through which ministerial accountability is assured. As foundations, museums are accessible to private sponsors and volunteers. The creation of the new foundations took place using standard regulations, subject to parliamentary approval.

The State of the Netherlands remains the legal owner of the Museum collections. The museums have the collections on loan and they pay rent for the buildings in which they operate (a contract for 30 years with the ministry of Finance's Domain Service). By proxy, the museum's management may obtain objects for the museum (State owned!) collection. In addition, in consultation with the Domain Service, the museum management may decide to sublet parts of its property. The museum budget consists of a state subsidy, supplemented by entrance fee revenues, donations and other sources of income. Despite experiments with output oriented budgets in the early 1990s, the ministry of Culture opted for the subsidy-model: on the basis of annual plans and agreements on measurable achievements (number of visitors, exhibitions, acquisitions), the museum receives a multi-annual lump sum budget. Annual plans and estimates of revenue and expenditure must meet certain requirements by the minister of Culture. Entrepreneurial

museums are not punished: additional revenues will not be deducted from the subsidies. Dutch museums are exempted from value added taxes.

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CHAPTER 5. COUNTRY REPORT PORTUGAL

By Mr. Nuno Vitorino

(We would like to express our thanks for the assistance and comments from Ms. Maria Adelaide Ruano)

1. Introduction

Because of the specific characteristics of the Portuguese political and administrative system, the description of the public agencies system must begin by a brief explanation of the broad constitutional arrangements, as well as some comments on other recent developments.

Following the constitutional background, this paper will present an overall description of administrative organisation, together with a categorisation of public agencies and associated characteristics. We shall also focus, in the context of the presentation of general rules and procedures on financial management and control, the most relevant aspects of public financial administration and the notion and content of different degrees of public entity's autonomy.

To complete the presentation of the characteristics and the rules applicable to public entities, the paper shall include a presentation of the new public accounting plan, including its characteristics, accounts defined and accounting principles considered.

Some references to the rules on procurement of goods, services and public works contracts are discussed, after which a description of main control entities is included.

The special rules for state-owned companies and mixed-ownership companies are also briefly described.

The presentation of this horizontal public agencies system in Portugal concludes with a summary under the headings of legal status, balance sheet main features, and budget and finally, performance management, control and audit.

Finally the differentiated application of this horizontal system in the education, health and culture sectors is briefly summarised.

2. Public Administration in Portugal — An Overview

2.1 Constitutional Background

Although having constitutionally adopted, early this century^x, the democratic organisation of independent legislative, executive and judicial branches of power, Portugal has known — mainly for political and historical reasons — an unusual attribution of legislative competence to Government. Though reduced somewhat after the 1974 revolution, this characteristic remains in place.

According to the present Constitution, the Government not only has the power to approve laws and regulations to implement principles defined in Parliamentary laws but has additional powers to legislate on

matters that "are not reserved" to Parliament and, also, in areas where legislative responsibilities have been delegated by Parliament as provided for in the Constitution^{xi}.

The Constitution specifically identifies the matters in which legislative competence can be delegated by Parliament to the Government; the list includes the following matters with potential effect on the management and control of public agencies:

- definition of property sectors, including the sectors in which private companies and similar entities are not allowed to operate; the latter part of this formulation originates in the revolutionary orientation of the 1974 constitution, is incompatible with current policies, and has no practical effect on private sector activities
- agricultural policy basis and definition of minimum and maximum dimensions of private agricultural exploitation units
- local government statutory rules
- local finance system
- public associations, citizen guarantees and administrative responsibility
- public assets definition and regime
- state-owned companies statute.

It should be noted that the delegation of legislative competence from Parliament to Government is not only a theoretical one; it is practised regularly, namely when the ruling political party has the majority in Parliament.

Depending on the point of view these constitutional arrangements can be argued to produce either a greater flexibility in the public administration, or a reduced flexibility.

The flexibility is greater in the sense that Governments are, generally, more sensible and concerned with social, economic and public opinion movements and pressures than Parliaments — and therefore more likely to adapt the existing rules and regimes to keep pace with changing circumstances.

On the other hand, flexibility is reduced when the government relies excessively on its legislative powers to fix, with legal instruments and procedures, decisions and arrangements that would be better determined by public management tools.

2.2 Broad Administrative Organisation

Portugal's administrative organisation is highly centralised and — largely constructed after the French model.

Until recently the Constitution allowed only two levels of government, the central and the local. Local governments in Portugal are relatively small^{xii} and traditionally have limited powers and resources.

The Constitution of 1976 determined the decentralisation of powers and resources to the municipalities and also provided for the creation of an intermediate level of government — the regional one.

Nevertheless, regions have not yet been created^{xiii}, except for the islands of the Azores and Madeira, which were made autonomous regions.

Many relevant responsibilities have been transferred from the State to municipal governments, together with associated financial resources, however local government is still responsible for the management of less than 10 per cent of State's financial resources.

Within the Portuguese centralised administration there has always been a clear dominance by the Ministry of Finance, mainly with regard to budgetary and treasury management, as well as financial control.

The competence on public personnel global management, which was for same time integrated in a new Ministry for Administrative Reform, is now directed by the Secretary of State for Public Administration and Administrative Modernisation in the Ministry for Reform of the State and Public Administration.

One of the most relevant innovations affecting public agencies was the establishment of an institution separate from the Ministry of Finance to plan and manage the investment budget^{xiv}.

After 1986, with the Portuguese integration in the European Union, a more liberal approach to public policies and management led to important developments such as the privatisation of public owned companies and, in some situations, the adoption of private-sector management rules and procedures for public entities.

2.3 *Categories of Public Agencies*

Within the diverse context of Portuguese public administration it is possible to identify — both with conceptual and operational rationales — four major categories of public entities:

- first, those which are integrated in the structure of Ministries and are clearly subject to supervision and instructions from members of Government
- second, the ones which although operating with some autonomy, dictated either by the nature of their responsibilities or by practical reasons (such as the fact that they have a limited territorial mandate), are still fully integrated within the Government
- the third category is made up of entities, which have their own management body and usually receive separate legal personality. Such organisations remain under the authority of Government by means of indirect instruments. They conduct their activities under the responsibility of their governing bodies, they have their own assets, revenues, budget and personnel and they are responsible for their eventual debts. — However they still receive instructions and orientations on their activities and ways of implementing them, they remain under policy supervision and control from Government and are not allowed to autonomously appoint their managers
- the final category comprises those entities with an almost private statutory and managerial status even if the State participates in their capital and a degree of supervision is undertaken by members of Government.

Because the third one of these categories is the main subject of this study, it is relevant to identify the main reasons which, according to the Portuguese experience, justify not only the creation of such public bodies — or public agencies — but, also, the growth in their numbers.

The positive reasons may be defined as (i) the technical complexity of the functions and responsibilities of such organisations, (ii) the managerial requirements for their effective performance or (iii) the relevance of the impact of their activities either on economic and social terms or on the public opinion; but two other, more negative, motivations can also be identified, (iv) the desire to escape from public accountancy procedures, personnel management discipline and budgetary control and (v) the will to diminish financial and political monitoring and control, namely by the Accounts Court and Parliament.

2.4 Public Financial Administration

An important contribution to the formal clarification of public entity classification was provided as a result of the recent public accounting reform.

The main principles of this reform, which was adopted from 1990^{xv}, are the following:

- expenditures shall no longer be subject to prior authorisation by the Ministry of Finance (thus ensuring, in general terms, an increased autonomy to public services)
- public financial administration shall be carried out under two basic regimes: the general rule which is defined as "administrative autonomy", and an exceptional regime which is defined as "administrative and financial autonomy". With some exceptions and transitional rules, administrative and financial autonomy shall be granted to all public services in which own revenues exceed two thirds of their total expenditures)
- public accounting shall be organised in two systems: the cash accounting system (registry of cash transactions), is to be used by public services with administrative autonomy; the commitments accounting system (registry of assumed obligations), is to be used by those with administrative and financial autonomy
- a new payments system shall be introduced, using bank transfers or the issuance of credit on account orders.

The implementation of these reforms in 1992 saw the introduction of two other major innovations.

The first one defined three criteria for expenditure authorisations by all public bodies (authorisations which were previously, subject to prior approval by the Ministry of Finance), as follows:

- legal conformity, in the sense that expenditures must be made accordingly to the law
- financial regularity, meaning that expenditures must be made accordingly to the budget and must be correctly classified
- economy, efficiency and effectiveness principles, which aim to ensure that they correspond to the maximum value for the minimum cost.

The second of these innovations, which is only addressed to public entities with administrative and financial autonomy, imposed control procedures of three types:

- self control^{xvi} (also called internal control or management control), is to be organised by under the responsibility of their managing boards

- internal audit^{xvii}, conducted by special audit units through systematic audit procedures
- external control, undertaken by Accounts Court^{xviii}.

It must be noted that these provisions do not apply to public entities and organisations with more advanced degrees of autonomy — mainly the state owned companies.

2.5 *Legal and Administrative Characteristics of Agencies*

Administrative Autonomy

Entities classified in this category have the power to practice final administrative acts within their current mandate (i.e. acts which are consistent with their competence and responsibilities, within reasonable amounts and subject to the direction and control powers of their Minister).

This category includes all services whose own revenue amounts to less than two thirds of their expenditures and thus comprises the majority of public services.

Operating characteristics of this regime are the following:

- Financial management is conducted by an administrative council, composed of three members and with exclusive responsibilities in the financial field
- Budget allocations are made in the State budget
- A forecast of cash requirements must be presented monthly to the Ministry of Finance with a request for release of the necessary funds. This request covers both budget transfers and own resources, since own revenues must be deposited in the Treasury. The monthly cash drawdown is limited to a maximum of one twelfth of the annual budget unless a higher amount has been jointly authorised by the line Minister and the Minister of Finance
- The Ministry of Finance, through the General Directorate for the Budget^{xix} (which is represented by its Delegation in each of the Ministries), ensures the co-ordination and centralisation of the system; registering and keeping the accounts of fund demands; budget and treasury transactions and verifying the legality of expenditures
- All own revenues must be transferred for deposit in the Treasury
- Expenditures must be justified to the Accounts Court
- Each public service with administrative autonomy must submit to its line Minister an annual activity plan, comprising goals, objectives, resources and its programme of activities, which is used as a base for its budget proposal.

Administrative and Financial Autonomy

As mentioned earlier this category consists of entities, which have the capacity to raise significant revenues^{xx}.

This higher degree of autonomy must be explicitly declared in the creation acts^{xxi} and usually corresponds to the recognition of separate legal personality. This status empowers such bodies to own property and to contract loans (within the limits and conditions defined by Parliament and after their approval by the Minister of Finance).

The private budgets of these bodies are integrated, as a global sum, in the State budget. Regarding financial management, the most significant distinction from the administrative autonomy level is that these agencies are authorised to determine by themselves the application of their financial resources, both own revenues and budget transfers.

The operating characteristics of the administrative and financial autonomy regime are the following:

- Financial autonomy must be formally recognised in the creation act of the public agency concerned
- Such public entities have their own private budget, which is incorporated in the State budget on global terms; where their own revenues exceed a certain amount^{xxii} they must be individualised in the State budget
- These public entities carry out their own financial management and accounting. They are not subject to individual controls from the General Directorate for the Budget on the legality of expenses; such control is only made on global terms. However the Ministry of Finance must approve all loan operations, prior to their negotiation with financial institutions
- Financial management is undertaken by the Managing Council, which includes representatives from the Accounts Court and General Directorate for the Budget who are non-voting members
- Accounting procedures are performed within the public agency, together with property and treasury management
- Private budget proposals must be submitted to the Ministry of Finance (General Directorate for the Budget)
- Private revenues are transferred and deposited in the Treasury, although autonomously accounted in the private budgets
- Cash resources are made available by means of monthly fund demands requiring authorisation by the General Directorate for the Budget as described earlier
- Any financial surplus at yearend is transferred to the following year's private budget
- The annual financial accounts are issued on the authority of the Managing Council, examined by the General Directorate for the Budget and judged by the Accounts Court.^{xxiii}

2.6 *Public Accounting Official Plan*

The Government approved in September 1997 a Decree-Law on the Public Accounting Official Plan, applicable to all public entities — with the exception of public companies — and subject to exemptions or

specific provisions regarding^{xxiv} Universities, the health sector, Social Security and Local Government. None of the modified provisions for these sectors has yet been published.

Within the context of European Monetary and Economic Union, this legislative act, which will be implemented gradually, aims at the integration of different accounting systems (the budget classification, balance sheet classifications, and economic analysis classification). It is intended to allow the preparation of management tools, the improvement of financial control, the increase of available information and the achievement of a more transparent public management.

Other purposes were to standardise different accounting plans that already existed in some sectors of Portuguese public administration, and to introduce relevant aspects of private sector accounting methods.

The most relevant characteristics of this accounting plan are the following:

- The accounting system no longer serves budgeting purposes exclusively; it will also support the management of property, and economic and financial analysis. Consequently, public entities and control agencies shall have the tools to carry out all modern management tasks including performance evaluation and the evaluation of public policies
- The public accounts will register both financial and budget transactions (double entry accounting). Budget accounting and financial accounting, although separated by means of specific accounts used in each case, are connected through a common information system that uses ten classes of accounts, organised in four groups:

Groups of Accounts	Classes	Accounts
1. Budget Execution Accounts	0	Budget Control Accounts
	1	Cash Assets
	2	Third Parts
2. Balance Sheet Accounts	1	Cash Assets
	2	Third Parts
	3	Stocks
	4	Fixed Assets
	5	Property Assets
3. Results Accounts	8	Results
	6	Costs and Losses
	7	Benefits and Profits
4. Accounts	8	Results
	9	Free — Analytical Accounting

- While the register of financial transactions will use the accrual basis, budget transactions will be accounted for on the cash basis
- Financial reports will include three documents: balance sheet, profit and loss account and budget execution maps (actual expenditures compared to budget, actual revenues compared to budget, and cash flow)

The principles guiding this accounting reform are:

- prudence, meaning that financial plans should reflect a prudent allowance for uncertainty while explicitly ruling out the use of hidden reserves, under estimation of assets and revenues, and over estimation of liabilities and costs;
- continuity, in the sense that administrative entities are assumed to continue operations for the indefinite future;
- historical costs, according to which accounting registers must be based on acquisition or production costs, either in constant or nominal values;
- specialisation, in order to ensure that revenues and expenses are recognised when they occur, independently of the dates they are received or paid. (the legislation uses the term "specialisation" instead of the more common term "accrual accounting")
- consistency, meaning that any modification in accounting definitions from one year to another must be justified in the notes to financial statements, and also, the effects of the modifications must be fully quantified in the annual financial reports
- non compensation of balances, meaning that positive and negative accounts may not be offset in the balance sheet, the profit and loss account or the budget execution accounts
- materiality, meaning that all financial balances must take into account every significant transaction
- The Public Accounting Plan also defines the accounting entity, namely the bodies of public administration, which must prepare and present accounts.

It is expected that this new public accounting plan will provide better conditions to:

- ensure a strategic view in budgetary decision making, (especially using multi-annual budgeting and forecasting future spending pressures
- supply information needed for the effective control of public financial activity
- reinforce the transparency of financial and property transactions and of financial relationships within the public administration
- facilitate the appraisal of relevant national accounting aggregates, as required in the context of European budgetary and financial discipline associated with European Monetary and Economic Union.

Together with these goals and concerns, this system should create conditions for a continuous and integrated budget management, for taking full advantage of information technology, for greater decentralisation of powers, and for holding public managers more accountable^{xxv}.

2.7 *Public Procurement*

Replacing many old and dispersed legislative norms, the Government approved in March 1995 a Decree-Law defining a new regime for the procurement of goods, leased space, construction services and other services. This regime is applicable to all public entities with the exception of state owned companies.

The new rules define the maximum spending authority for the two categories of agencies and the levels of executive power.

- general maximum levels:
 - 10 million escudos (approx. US\$50 000) for managers of public entities with administrative autonomy
 - 20 million escudos for managers of public entities with administrative and financial autonomy
 - 500 million escudos for Ministers
 - 1 000 million escudos for the Prime Minister
 - with no limitations for the Council of Ministers
- regarding expenditures which are included in activity plans duly approved by competent members of Government:
 - 20 million escudos for managers of public entities with administrative autonomy
 - 40 million escudos for managers of public entities with administrative and financial autonomy
- regarding expenditures under multi-annual plans and programmes that have been approved by law:
 - 100 million escudos for managers of public entities with administrative autonomy
 - 200 million escudos (approx. US\$1.0 million) for managers of public entities with administrative and financial autonomy
 - with no limitations for Ministers and the Council of Ministers^{xxvi}.

2.8 *Control Entities*

There are several bodies in the Portuguese system with responsibilities for the control of public finances.

The most relevant of these entities is the Accounts Court under the Constitution, the Accounts Court forms part of the judicial branch of power and is the supreme body for the control of the legality of public expenditures and for the judgement of public accounts. Its specific powers include the examination of the financial accounts of the central, regional (Azores and Madeira), and local governments and those of the social security administration. It also has judicial powers to deal with financial infractions.

In the terms of its specific creation and organisation acts (which are approved by Parliament), the Accounts Court ensures the legality and regularity of public revenues and expenses, examines the soundness of financial management and exercises judicial power with regard to financial infractions. Its power extends to all public entities including state owned companies.

Although the Court has the capacity to intervene in all public entities and in all phases of public financial management, the aspect most relevant (and most unusual among European parliamentary audit institutions) for the purposes of this study is its role in a priori approval of certain types of public expenditures^{xxvii}.

Various laws passed by Parliament or Government prescribes specific transactions or legal instruments, which require a priori approval by the Accounts Court. Specified transactions include lending operations and the appointment of civil servants. In all such cases the action or legal instrument shall not be executed before the emission of a visa or declaration of conformity by the Accounts Court. All public entities must also submit their annual accounts to the Accounts Court for auditing and certification. The Accounts Court is also responsible for the evaluation of internal control systems of public entities, including the review of the legality, economy, efficiency and effectiveness of their financial management.

The second important control body is the General Inspectorate of Finance, within the Ministry of Finance, whose responsibilities include both financial control and technical support. These functions include (i) control of public financial services and treasury, (ii) execution of inspections in all public entities^{xxviii} and public or private companies related to economic, financial and fiscal questions and (iii) implementation of financial audits to public and private companies (with the exception of banks and insurance companies). Its intervention is mainly made through inspections and enquires.

This Inspectorate General also has the power to participate in the legislative process, to make proposals regarding either the fiscal system or initiatives to improve the operations of public companies or other public entities.

As already mentioned, there are internal audit units or inspectorates within some Ministries which complement the activities of the Inspectorate General of Finance by conducting financial and performance audits of public entities which are dependant on their ministry. These units report directly to their respective ministers to ensure independence from audit subjects.

A fourth institution of control has already been mentioned several times in this paper, the General Directorate for the Budget. This General Directorate is the operational, technical and consultative body within the Ministry of Finance responsible for public accounting. In addition to its central office it also has delegations of officials attached to each Ministry^{xxix}. The functions of this General Directorate include the technical preparation of the State budget, monitoring the execution (including modification) of the budget, elaboration of the annual national accounts, and economic and financial analysis of all legislative initiatives.

The responsibilities of the Delegations attached to each Ministry are the following:

- participation in State budget preparation to ensure conformity with laws and regulations and the approval of individual budget projects by the competent authorities
- examination and transmission to the Ministry of Finance of demands for budget modifications
- review and correction of accounting classification of public revenues and expenses

- review and authorisation of payment orders
- execution of financial control on public investments projects
- maintenance of accounting registers
- maintenance of the biographical register of public servants
- preparation of information and data required for the preparation of public accounts
- technical support in financial management to all public entities
- monitoring Portuguese financial participation in projects co-financed by European structural funds, including the examination of their budgetary and legal conformity.

Finally it is worth noting the role of the General Directorate for Public Administration, which is responsible for policy development, audit, co-ordination and technical support service in the field of human resources. The General Directorate falls under the Secretary of State for Administrative Modernisation in the Ministry for Reform of the State and Public Administration.

The goals of the General Directorate are to rationalise public administration structures, promote full employment and socio-professional development of human resources, and thereby to contribute to the improvement of performance and discipline in public management.

2.9 *State Owned Companies*

Portuguese public institutions also include state owned enterprises. Although such entities are created by individual Government decree-laws, their financial management is, in general, conducted on private-sector lines. The three notable distinctions from private sector counterparts are their origin in a State decision, the source of their equity capital (totally or partially) in the State budget, and the principle that they exist to serve the public interest.

After the 1974 revolution, and in accordance with the political orientations of the time, many private companies were nationalised, creating a large public economic sector. The situation has dramatically changed since then; after the 1989 revision of the constitution and Portuguese integration in the EU successive Governments implemented a large privatisation program that is now reaching its last phases.

The remaining state owned companies are active in sectors which are considered to be "strategic"^{xxx}.

Public companies have a separate legal personality; their activity field is defined in their creation statute (approved by the Council of Ministers) and they pursue profit goals.

These companies have two governing bodies: a board of directors and a fiscal commission. The board of directors exercises policy and executive functions, while the fiscal commission supervises management legality and performance, as well as accounting. The General Inspectorate of Finance is responsible for the audit of their accounts.

Members of the board of directors are appointed by the Council of Ministers while the members of the fiscal commission are jointly appointed by the responsible line Minister and the Minister of Finance.

There are other situations where the Portuguese State holds a minority of the share —capital of companies that are ruled by commercial law (and have, accordingly, an almost private sector status). In these situations, all organisational, managerial and control rules and procedures are the ones applicable to private companies, with one significant exception: after their accounts are examined by their specific audit and control bodies, they are also examined by the General Inspectorate of Finance the content of this examination must be taken into account by the representative of Portuguese State in the Annual General Assembly of shareholders where accounts are examined.

3. Summary of General Rules on Financial Management of Public Agencies

The presentation made so far on financial management and control in the Portuguese public sector aims at ensuring not only a background for the understanding of public agencies situation, but also at the description of the prevailing horizontal structures, rules and procedures.

The financial management system in Portugal is, nevertheless, a mixed one — in the sense that the precedence of a general rationale co-exists with a significant number of exceptions or special cases.

Before presenting some of these specific situations for selected sectors, we shall, in the following paragraphs; concentrate on the horizontal system which prevails for most Portuguese public agencies, summarising what was previously discussed with a different systemisation:

3.1 Legal Status

Public agencies are always created in Portugal by a legally binding act, which defines their mandate, managing structure, degree of autonomy, internal organisation, personnel status and financial management rules and procedures. Accordingly, any modification in one of these statutory aspects of agency status must, also, be approved by law.

Although, in some situations, the legal initiative and approval of public agencies' status is undertaken within Parliament, it is more commonly done under the Government competence, involving the Council of Ministers. The primary initiative always belongs to the interested Ministry, which must obtain Ministry of Finance involvement and approval before the submission of a legislative proposal to the Council of Ministers.

The main motivations for the creation of public agencies may be found in the need to improve efficiency in public entities, or to permit less restrictive management procedures and behaviours, or to ensure a closer relationship with citizens or clients; in some situations such justifications are merely used to cloak the real purpose which is to reduce paperwork or to avoid detailed financial, political and parliamentary control.

Public agencies with administrative and financial autonomy usually receive separate legal personality, and are ruled by public law.

The appointment of managing bodies is a responsibility of the supervising minister. For agencies with administrative and financial autonomy the appointments must also have the agreement of the Minister of Finance.

Under the legislation described above, the public agencies in Portugal, which are relevant to this study, are those with the status of administrative and financial autonomy (even if there are minor differentiations regarding their managing powers).

A definition of classes within this category can be made on the basis of three criteria: the nature of their responsibilities, their sectoral activity or their spatial influence. We can find in the first case public agencies with regulatory or executive functions; in the second one, institutions in the education, health, cultural, telecommunications, transports and other sectors; in terms of their territorial competence, they can have either a national influence or a regional one.

Because Portugal remains a centralised country there are no regional public agencies except in Azores and Madeira. On the other hand some agencies of central Government do have a regionally delimited area of activity.

In keeping with the political trend toward decentralisation, including devolution of power to local government accompanied by the transfer of corresponding financial resources, some legal provisions are already applicable to municipalities while other are being prepared. It is worth noting, in the context of this report, that many municipalities have created their own public agencies for the execution of particular functions such as water supply and sewerage, which operate on rules similar to those at central level. This trend demonstrates the continuing search for more effective management methods and for spatial jurisdictions more conducive to efficient operations.

3.2 *Balance Sheet Main Features*

Ownership of real property and buildings is closely related with the attribution of separate legal personality — meaning that when creation acts determine such quality, the public agency may register land titles in the agency name unless there is a clear provision stating otherwise.

With separate legal personality, the decision power on real property and buildings acquisition goes with it, even though, in practice, such decisions are usually made only after consultation or confirmation with the concerned Minister. Identical rules apply to decisions on real property and buildings disposal.

The methods and procedures for property acquisition and disposal must, nevertheless, conform to the Decree-Law on public procurement as explained above.

The rules concerning debt operations are more restrictive than those applicable to fixed assets.

Public agencies have authority, in principle, to execute borrowing operations unless they are forbidden in the creation acts. However such operations are subject to prior approval, as to both quantum and extent of government guarantees, by the concerned line Minister and by the Minister of Finance. In addition all debt operations are also controlled by the Accounts Court.

Once authorised to do so, public agencies may establish borrowing negotiations with any financial institution of their own choosing, including on interest rates and any security and/or government guarantees demanded by the financial institution.

3.3 *Budget*

The budgeting rules for public agencies require the preparation of private budgets (an annual agency budget covering all expenditures, own revenues and state budget contributions) with standard form and content as specified by the Ministry of Finance. The private budget must be approved by both the line Minister and the Minister of Finance.

Financial management supervision and audit of public agencies is, undertaken by the Ministry of Finance (Inspectorate General of Finance and Directorate General for the Budget) and, also, by the Accounts Court. Most line Ministries also have their own control services, as explained earlier, with authority for both financial audit and performance or operational reviews.

Public agencies must prepare annual and, usually, multi-annual plans (which include programmed investments), that are approved by the supervising Minister.

Both annual budgets and multi-annual plans must include the definition of financial targets.

Agency's private budgets are included — as individual line items — in the supervising ministry's Chapter of the State budget, so that they are published and, in principle, controlled by Parliament. However, detailed private budgets are not usually published.

Annual investment plans are a part of their private budgets, as well as staff provisions (number, type, salaries,). However, annual salary negotiations within public agencies follow broad orientations defined by the Ministry of Finance and are subject to political monitoring by the supervising Minister.

Accounting classifications and procedures applicable to public agencies are those defined by the public accounting official plan as explained above, which incorporates many features of private-sector accounting.

In the situations where public agencies deliver goods or provide services, their managing bodies in principle fix the prices or fees. However the supervising minister must be consulted before changes are implemented. In many cases there are laws which give Government the power to define the pricing policy and methodology while leaving its detailed application to the agency.

Private budgets are prepared on a gross basis — in the sense that they determine maximum expenditure, taking into account both transfers from State budget (as grants) and revenues derived from their own activity. Should they wish to spend extra revenue exceeding the amount forecast in their budget, it is necessary to prepare a budget revision for approval by the line minister and Minister of Finance.

Agencies' private budgets must be coherent with State budget provisions — meaning that their preparation can only be finalised after the approval of the State budget in Parliament. In some situations, the Government establishes performance —contracts with public agencies, which define specific multi-annual tasks or operations for agencies to implement and commit the amount of financial contributions to be made from the State budget; such performance-contracts always need the approval of the Ministry of Finance.

As a general rule, year-end financial surpluses originated from own revenues may be incorporated in the following annual private budget. However there are a small of situations where public agencies must transfer such surpluses to the national treasury. Surpluses derived from State budget income must, in any case, be transferred to treasury.

Public agencies' operations are not supposed to produce deficits — and the system of monitoring and control aims to prevent such situations. When they do occur, the agencies' governing bodies have formal responsibility to find remedies. Nevertheless, in specially complex situations the deficit is covered by the State budget.

3.4 *Performance Management, Control and Audit*

The Portuguese situation on public agencies performance targets and corresponding control and audit procedures are, still today, not very positive or encouraging.

Annual reports on activities and financial management must include presentation of performance achievements but the reports are seldom discussed in depth. Moreover, since performance targets and goals are not negotiated and established during the original budgeting process, the effectiveness of the-after-the-fact reporting is obviously questionable.

A similar situation prevails with regard to internal control, where there is a law defining it as the first level of the control system and making it compulsory for all entities.

However the absence of a mandatory framework for internal control, and the lack of general standards, contribute to an under-valorisation of its effective implementation. The same lacunae make monitoring almost impossible.

In contrast, external audit in Portugal is a well-established and effective practice. In addition to the Audit Court, it is vigorously implemented by the Inspectorate General of Finance.

This Inspectorate General, with powers on financial questions as well as on legal compliance ones, undertakes its activities regarding public agencies on a sampling basis or following a report or allegation of wrongdoing. It conducts a programme of annual inspections approved by the Minister of Finance, who also has authority to order special audits.

3.5 *Selected Sectors*

As it happens in many different situations, legislative rules and regulations are applicable to the complex realities of public administration with differentiated degrees of compliance, many times aggravated by the need for transitional mechanisms or by the insufficiency and inadequacy of resources (technical, financial or human).

Such circumstances occur especially when, as in the current Portuguese situation, public financial management rules and procedures are in the midst of a process of fundamental transformation and modernisation.

While it is not feasible to make an exhaustive presentation of such exceptions, we shall briefly discuss below the situations in three sectors: education (universities), health (hospitals) and culture (national theatres, national museums and national libraries).

Universities

The Portuguese Constitution assigns a uniquely high level of financial autonomy to universities^{xxxi} including:

- recognition of separate legal personality and statutory autonomy in the areas of their scientific, pedagogical, administrative, financial and disciplinary activities
- autonomy in making their own laws and orders which, provided they do not conflict with a national law, are only subject to confirmation by the Minister of Education

- autonomy for approval of their internal administrative and financial organisation
- administrative and financial autonomy which exceeds that of other public agencies in the following respects: (i) exemption from prior control by Accounts Court (although their annual accounts must be examined and judged by this Court), (ii) power to dispose of their assets, (iii) authority for free management of annual financial endowments by the State budget, (iv) capacity to modify their private budget and to prepare supplementary private budgets, (v) ability to prepare multi-annual investment programmes, (vi) authority for renting real estate property and buildings justified by their operational needs and (vii) capacity to raise own revenues and make use of them by means of private budgets

Almost simultaneously with the adoption of the new public accounting official plan, Government approved a Decree—Law defining exceptional rules and procedures applicable to universities. The main characteristics of these rules are:

- apart from financial transfers from the State budget, universities are free to collect other revenues, to deposit them in any financial institution and to ensure their management in accordance with their own private budgets
- universities are exempted from the general rule requiring the return of surpluses related to transfers from State budget (in fact, the use of such surpluses is even exempted from approval by the Minister of Education)
- universities are allowed to decide on all types of insurance coverage, provided the cost is covered by their own revenues
- expenses in foreign currency may be directly paid by universities, using the financial institution of their choice
- external audits on university financial management shall be made every two years, using the services of private auditing firms of their choice (the audit reports must be presented to the Ministers of Finance and Education)
- university assets include all real property and buildings acquired or constructed, even if the land is owned by the State
- in the case of disposal of real property or buildings, 50 per cent of the proceeds shall be State revenue, the other half retained by universities for investment purposes.

Hospitals

The Government approved in 1988 general principles regarding the organisation and management of hospitals^{xxxii}, according to which they have, separates legal personality and administrative and financial autonomy.

Hospital management must be organised and performed professionally, in order to ensure the best performance with the minimum cost. To achieve these results, hospitals must prepare annual and multi-annual management plans, which are approved by the Minister of Health.

Their revenues are those transferred by State budget and, also, the ones derived from their activity — namely those from the provision of health care and associated services. The Health Ministry approves prices for health care services.

In general, and taking into account the recent legislation on public financial management described above, hospital management and control do not differ significantly from other public agencies with administrative and financial autonomy.

National Theatres

National Theatres have no specific regime defining exceptions or specificity and thus fall within the general category of public agencies with administrative autonomy.

One exception is the D. Maria National Theatre. It has separate legal personality as well as administrative and financial autonomy. Its managing bodies include a board of directors with three members, (appointed by the Prime Minister following a proposal from the Minister of Culture), a fiscal commission with three members, (one of which is appointed by the Minister of Finance) and a consultative council (which intervenes on cultural and artistic matters).

Its financial management and control follows the horizontal model: multi-annual and annual plans, private budget (prepared in accordance with State budget provisions and transfers) and annual reports and accounts. External audit is made by the Ministry of Finance and Accounts Court.

Nevertheless, special situations occur — the most exceptional of them concerning the S. Carlos National Theatre, which received for some time (from 1980 until recently) the status of a public company.

Its financial management, as well as respective control rules, corresponded during this period to the ones described above: separate legal personality and associated administrative and financial autonomy; activity limited to the promotion and diffusion of artistic culture, namely lyric, musical and, specially, opera; two governing bodies (board of directors and fiscal commission), appointed by Government.

It is interesting to point out some special arrangements were then defined for this National Theatre: the building that this public company uses belonged to the State; its annual accounts were exempted from judgement by Accounts Court; any contracts, acts or operations were also exempted from its prior control (and from registration by Ministry of Finance); personnel management was ruled by private law.

At the same time, special responsibilities were conferred on the sectoral Minister, who approved annual and multi-annual activity and financial plans and programmes, current and investment budgets, annual reports and accounts, loaning operations and associated guarantees, as well as personnel remuneration.

Following these changes the S. Carlos National Theatre is no longer a public company; it is a public agency following the broad organisation and procedures presented above which are very similar to those applying to the D. Maria National Theatre.

National Museums

All Portuguese national museums are, for managerial and control purposes, entities integrated and dependent from the Portuguese Institute of Cultural Assets. That Institute itself is included in the general category of administrative and financial autonomy (with the characteristics, rules and procedures presented above).

As a consequence of this situation, national museums financial management is centralised and co-ordinated by the Institute according to the normal rules for a public agency.

National Libraries

We only have one National Library in Portugal, located in Lisbon, which recently^{xxxiii} received a new statutory definition recognising its cultural relevance and the need for it to adapt to the needs of the present information society.

The Library will have separate legal personality and administrative autonomy under the supervision by the Minister of Culture.

It will be managed by the director (jointly appointed by the Prime Minister and the Minister of Culture, with the remuneration level equivalent to public university headmaster), an administrative council (specially responsible for financial management) and a technical consultative council (composed by the director and all heads of services within the institution, with advisory powers).

Financial management is co-ordinated by means of the annual activity plan (approved by the Minister of Culture), annual budget and annual report. National Library revenues include State budget transfers and other incomes derived from services provided.

In all other respect, the National Library follows the general rules of management and control applicable to the category of administrative autonomy.

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ENDNOTES

- x. Portugal adopted a republican organisation from 1910; the constitutional regime from early last century was a constitutional monarchy.
- xi. There is, in fact, a hierarchy of legislative acts, according to their nature and the competence for their approval. Of course, the Government also has the competence to present legislative proposals to Parliament.
- xii. Portugal has roughly 300 municipalities, with an average population of 30 thousand inhabitants and large imbalances (Lisbon municipality, which is the largest, has some 600 thousand inhabitants). In the level below the municipalities are about 4 000 "Freguesias" (organised after the parishes).
- xiii. The previous Government defined the creation of administrative regions as a priority; nevertheless, since the result of the 1999 referendum was negative, administrative regions will not be installed in the near future.
- xiv. Nevertheless the investment budget is fully integrated in the State budget, being prepared and managed jointly by Ministry of Finance and the Ministry responsible for economic planning.
- xv. This reform is, in fact, a complex legislative process, involving some amendments to the Portuguese Constitution (concerning budget structure and principles and methods of budget management), two Laws approved by Parliament and a Decree-Law approved by Government.
- xvi. Self control being the legal formulation, it is usually called internal control and is conducted within each public entity.
- xvii. Internal control is, again, the expression adopted in the law; however its meaning is that of internal audit as used in other countries, an activity undertaken within each administration by special empowered entities.
- xviii. Which formally belongs to the Judicial Power and is, accordingly, independent from Government.
- xix. General Directorate for the Budget replaced the previous General Directorate for Public Accounting.
- xx. Significant level corresponds to two thirds of total expenses.
- xxi. The creation acts of public entities of all kinds is, in Portugal, always made by means legislation, usually made by Government and, exceptionally, by Parliament. In the decision-making process, the interested Ministry must obtain prior agreement from the Minister of Finance, before submitting the proposal for approval in the Council of Ministers.
- xxii. Actually 10 million escudos (i.e., roughly, US\$50 thousand).

- xxiii. The Accounts Court audit uses sampling procedures; in the case of irregularities, the Court can decide penalties, sanctions or reproaches to Government.
- xxiv. In fact any Ministry may take the initiative to justify special provisions and adaptations to the general provisions of the public accounting plan. The sectors mentioned are those where the need for special provisions is most evident; although the adaptations are under preparation, none has been so far formally adopted.
- xxv. It is important to note that all public administration activities, including financial management, are bound by the new Administrative Procedures Code adopted in 1992. Provisions most relevant to this study include:
- a general regulation of administrative collegial bodies (covering such matters as meetings, deliberations, voting procedures, etc.)
 - the definition of legitimacy regarding "diffused interests"
 - the definition of a general maximum duration for all administrative procedures (three months)
 - regulation of the citizens' rights to administrative information
 - the admission of provisional measures at any phase of administrative procedures
 - the obligation to give hearing to interested citizens before an adverse decision
 - an enlargement of the types and number of situations where tacit approval from administration is automatic
 - the definition of a process for the preparation of regulations
 - a new definition of administrative act
 - the enlargement of the cases where nullity of administrative acts is possible
 - the regulation of administrative final execution acts (in the sense of final administrative decisions, independent from Courts intervention)
 - the definition of a shorter delay for reclamation on administrative acts (15 days instead of 30)
 - the regulation of the hierarchical appeal process
 - the enlargement of possibilities for the use of administrative contracts
 - the re-enforcement of the need to choose suppliers of goods and services by public tender.
- xxvi. Expressed in US dollars these maximum limits are roughly the following:
- a. General maximum levels:
 - US\$50 thousand for managers of public entities with administrative autonomy
 - US\$100 thousand for managers of public entities with administrative and financial autonomy
 - US\$2.5 million for Ministers
 - US\$5.0 million for the Prime Minister
 - with no limitations for the Council of Ministers.
 - b. Regarding expenses included in activity plans duly approved by competent members of Government:
 - US\$100 thousand for managers of public entities with administrative autonomy
 - US\$200 thousand for managers of public entities with administrative and financial autonomy.
 - c. Regarding expenses related to the execution of multi-annual plans and programs that have been approved by law:
 - US\$500 thousand for managers of public entities with administrative autonomy
 - US\$1.0 million for managers of public entities with administrative and financial autonomy
 - with no limitations for Ministers and the Council of Ministers.

- xxvii. It should be noted that there are some exceptions to these powers and procedures; the most relevant limitation is the annual definition in the State budget of a threshold amount below which financial transactions and contracts are exempted from the prior control by Accounts Court.
- xxviii. Including local government.
- xxix. The General Directorate for the Budget has also Delegations attached to the Presidency of Republic and to Parliament.
- xxx. There are actually five state owned companies in Portugal: ANA (airport management), CP (railways operation), IN-CM (currency production and official publications), METROPOLITANO (Lisbon underground) and REFER (railways infrastructures).
- xxxi. We are only referring in these paragraphs to public universities; private universities are managed as private companies.
- xxxii. As it happened with universities, we shall be only concerned with public hospitals.
- xxxiii. In April 1997.

CHAPTER 6. COUNTRY REPORT BRITAIN

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1. Overview of the British System

The United Kingdom consists of four territories — England, Scotland, Wales and Northern Ireland — and strictly speaking ‘Britain’ consists only of the first three. Because of Northern Ireland’s peculiar constitutional and institutional history it is excluded from this analysis, hence the focus in the title on ‘Britain’.

Even within Britain there are now rapidly evolving differences in public administration arrangements as a result of the establishment of the Scottish Parliament and the Welsh Assembly, creating a quasi-federal arrangement. These rapidly changing arrangements mean that what will be analysed in this Chapter is mainly the ‘English’ arrangements, although in some cases these are all British institutional arrangements.

1.1 Public Agencies

Over the past 10-15 years the United Kingdom has had probably one of the largest programs of ‘desegregation’ of public institutions into smaller units of any OECD country. New organisations created (through the break-up of larger structures) include, for example:

- nearly 500 new health service organisations (NHS Trusts) separated out from the NHS structures
- about 45 new Universities (former Polytechnics), 500 plus newly independent further education colleges and 1,200 grant maintained schools, all separated from direct local education authority control
- around 140 central government executive agencies created from (but still within) central government departments.

This list is almost endless. In some areas there has been a decrease in organisational numbers, but even here there has been an increase in share of public expenditure. Non-Departmental Public Bodies (known in the United Kingdom as "quangos") have shrunk in number but increased their share of public spending from £3 billion in 1979 to over £18 billion by 1997.

‘Public Agencies’ in the United Kingdom covers a very wide variety of organisations. These include:

- Ministries — central and regional under the control of the Cabinet or regional governments (Scotland and Wales)
- Executive Agencies – civil service organisations within Ministries

- Non-Departmental Public Bodies (NDPBs) — non-civil service public organisations directly funded and controlled by Ministries
- Public Corporations — mostly central publicly owned organisations in the commercial sector
- Local services — organisations mainly funded centrally but organised locally (e.g. police, probation and fire services)
- The National Health Service — the NHS is in a category of its own. It is neither a Ministry although it now forms part of several ministries — in Westminster for England and in the regional assemblies for Scotland and Wales. Nor does it fall into any of the other categories (e.g. agency, NDPB, public corporation, local services).

Local government also controls or has some input into local public agencies. It provides some funds and has some powers in relation some local services — e.g. police, probation, and fire. It can create its own local agencies (e.g. direct labour organisations) and often has close links with other semi-public bodies (e.g. some museums and galleries). Britain therefore has extremely complex and heterogeneous systems governing the target agencies.

This report focuses on three areas or functions — Higher Education (Universities), Health (Hospitals) and Culture (National Museums, Theatres and Libraries).

An analysis of the status of various bodies in Britain that come under the broad health, higher education and cultural institutions labels shows how diverse and heterogeneous these are in their location and statuses (see Figure 1).

Figure 1. Examples of the Distribution of Cultural, Health and University Functions

Department	Executive Agencies²¹	Executive NDPBs²²	Other and Public Corporations²³	NHS	Higher Education
Education and Employment		HEFC ²⁴ England;			Institutions (135)
Culture, Media and Sport (formerly National Heritage)	Historic Royal Palaces Agency; Royal Parks Agency	Arts Council for England; English Heritage; National Gallery; British Museum; Tate Gallery	BBC; Theatres Trust; Royal Fine Art Commission		700 libraries within HE and FE
Health	Medical Devices Agency; Medicines Control Agency; NHS Estates; NHS Pensions Agency;	English National Board for Nursing; Public Health Laboratory Service Board	Advisory Committee on NHS Drugs; Medicines Commission	NHS Executive; Special Health Authorities (13); Health Authorities (100); NHS Trusts (425)	
Trade and Industry		Research Councils			
Scottish Office	Historic Scotland	Scottish Arts Council; Scottish HEFC; National Galleries; Library; and Museum of Scotland		Health Boards (15); NHS Trusts (47)	Institutions (21)
Welsh Office	Cadw (Welsh Historic Monuments)	Arts Council of Wales; HEFC Wales;		Health Authorities (5); NHS Trusts (29)	Institutions (14)
Local Government	Runs many cultural bodies (e.g. 1 700 Museums, 5 000 Public Libraries, etc) directly and funds more indirectly (e.g. arts bodies). It plays some role in health (mainly environmental health and enforcement of standards in retail food outlets) and a small direct role with Universities.				

In the case of Hospitals and Universities, there are specific rules and controls that apply to these specific organisations, with some small variations between the three British jurisdictions (England, Scotland and

21. Executive Agencies are Civil Service organisations within Government Departments.

22. Non-Departmental Public Bodies are non-Civil Service organisations controlled by, but not part of, a specific Government Department. The general rules governing NDPBs are covered below.

23. Public Corporations are usually publicly owned and/or statutory but again non-Civil Service organisations. They are usually answerable to a Minister, but only within very specific legislative constraints (unlike both Agencies and NDPBs).

24. Higher Education Funding Council.

Wales). These are therefore pre-dominantly sector or 'vertical' arrangements with some regional variations. For Museums (and some other cultural institutions) the arrangements are however 'horizontal' or generic. Most national Museums are what are known as 'Non-Departmental Public Bodies' (NDPBs). There are many such NDPBs covered by a general set of rules, but even here there are some sector specific details that apply to Museums.²⁵

1.2 *Executive Agencies*

Executive Agencies (or 'Next Steps' agencies as they are sometimes known) began to be created in the United Kingdom in 1988, following a report to government called 'Improving Management in Government: The Next Steps'. Since then over three-quarters of United Kingdom civil servants have been transferred to around 140 agencies. Most agencies are staffed by civil servants and fall under civil service rules, but a few include military personnel and other non-civil service staff.

Agencies have no legal existence separate from their parent Department and form part of the department. They produce separate (audited) reports and accounts for their activities, but their accounts are also incorporated into departmental accounts. In terms of 'Accounting Officers' each agency effectively has two – the Permanent Secretary of the parent department and the Chief Executive of the agency itself.

Each agency has a Framework Document which is issued by the Minister concerned and approved by Treasury and Cabinet Office — this lays out the purpose of the agency, the policy framework, the governance arrangements for the agency and its finance regime.

In terms of financial allocations agency budgets are subsumed into departmental budgets for the main process of allocating public funds, although some aspects of the agency budget may be allocated separately, depending on the nature of the agency.

The formal cycle is that agencies contribute to internal Departmental discussions about the level of funding required for the next budget cycle, but that in most cases Departments are the bodies that negotiate with HM Treasury. (There are some exceptions where very large agencies have a direct input to the discussions with Treasury — e.g. the HM Prisons agency. Also agencies with large 'programme' budgets, for example the Social Security Benefits Agency, have some of 'their' funds determined in the formal, parliamentary, budget process. It is only these 'programme' funds which usually appear as such in the Estimates, Agencies themselves do not (mostly) have separate Votes specifically dedicated to them as separate entities but are covered in departmental Votes).

The general rules covering agency finances are set out in a White Paper entitled "The Financing and Accountability of Next Steps Agencies" published by the Treasury in 1989.

There is one major exception to the general pattern — those agencies set up as (or transferred to) "trading fund" agencies under the 1990 Government Trading Act. We will not go into great detail as none of the bodies discussed in this report are 'trading fund' agencies but essentially these are agencies whose finances come from revenues derived from sales of services or statutory licence fees or levies which they collect. Instead of a spending limit, trading funds are controlled by a limit on their working capital. Although they are given much greater discretion over their internal finances there are still tight controls in place — for

25. Because of these complexities it has been decided to simplify matters by looking only at National Museums and exclude Libraries and Theatres.

example proposals to licences or levies cannot be proposed to be varied without Treasury approval and their ability to raise external finance is also closely controlled.

1.3 NDPBs

Non-Departmental Public Bodies (NDPBs or ‘quangos’²⁶) are, as their name suggests firmly outside Departments. They are staffed mostly by non-civil servants (although a few include some civil servants) and therefore not directly subject to civil service rules (e.g. on personnel issues).

NDPBs cover a variety of functions, including advisory bodies, Royal Commissions, tribunals (quasi-legal bodies), and executive (service delivery) organisations. Their legal status varies:

- Advisory bodies are normally set up by administrative (ministerial) action
- Royal Commissions are established by a Royal Warrant issued to the Commissioners
- Tribunals are statutory bodies established by Act of Parliament
- Executive NDPBs are normally established by Act of Parliament or by Royal Charter.

The NDPBs considered in this report are all executive NDPBs — service delivery organisations.

Already existing NDPBs can also become corporations under the terms of the Companies Acts, which provides certain legal and financial advantages. Thus, for example, the BBC is established by Royal Charter as a body corporate but is also registered as a Company under the Companies Acts.

These bodies may also be established through the Companies Acts that allow for share based companies (limited by share ownership) or guarantee (limited by financial guarantees²⁷). These are usually used where very small or time limited bodies are being established which do not justify specific legislation.

In practice nearly all new executive NDPBs have a legal basis, unlike executive agencies, whether it is specific legislation, Royal Warrant or through the Companies Acts. NDPBs usually also do not enjoy Crown Status (and therefore Crown immunities), again unlike executive agencies.

NDPBs may also become recognised as Charities (under the Charities legislation), either by application or they can be treated as Charities by including exemption in their founding legislation. This has many tax advantages, but an NDPB cannot be established through the Charities legislation — it has to be set up first.

In financial terms most executive NDPBs are in a very similar position to executive agencies. They have a parent department that negotiates their budget on their behalf with Treasury and allocates their finances. The controls operated by the Treasury are broadly similar to those for executive agencies, the details are set out in ‘Non-Departmental Public Bodies: A Guide for Departments’ (Cabinet Office and HM Treasury,

26. Technically ‘quangos’ are ‘quasi-autonomous non-governmental organisations’. The United Kingdom’s NDPB’s are not strictly ‘quangos’ under this definition as they are ‘governmental’, but they are generally known as ‘quangos’, even in government publications.

27. Limiting a company by guarantee merely means that the owners (in this case the government) undertakes to meet any debts, up to certain amounts, incurred by the body, unlike a company limited by share ownership where the share-owners liability is limited to their investment.

1992). As with agencies, in practice the degree of control varies with size and importance of executive NDPBs but in all cases there are substantial controls.

Museums are a sub-set of NDPBs and do not greatly differ in legal status, financial arrangements nor management structures from most other executive NDPBs. Variations come mainly from historical accident — Museums are often old institutions and in many cases were originally formed as private or charitable bodies before they came under state ownership. This history produces some small variations but most of these exceptions have gradually eroded over time. In modern times, for example, it is unthinkable that a new state funded museum would be established on anything other than a clear legislative basis.

1.4 Constitution

Part of the reason for the United Kingdom's "messy" arrangements is the absence of a formal (written) constitution and the peculiarity of the Monarchies residual 'powers'. While the latter are in practice exercised solely by the Government of the day, the existence of 'Crown prerogative' and the lack of a constitution means that public institutions often exist on very flimsy constitutional and legal arrangements. To take a simple example — the United Kingdom has created, within the Civil Service, nearly 140 "executive agencies" since 1988. Virtually none of these bodies has any legal standing whatsoever and exist purely at the whim of Ministers, who can create or abolish them at will without reference to Parliament or law.

Despite this apparent constitutional and legal 'weakness' — when compared to other European jurisdictions — the United Kingdom has a very strong set of overall controls on the finance and management of all public bodies. This is a very complex system and we will mention here only a few central arrangements that cover the bodies examined in this Chapter.

1.5 Finance

Finance for all publicly financed bodies come mainly from the annual approval of expenditure by the Houses of Parliament, on a "Finance Bill" proposed by the executive. By tradition, finance bills are hardly ever amended or opposed (except where the Opposition wishes to try and provoke a General Election).

The 'appropriations' agreed in the Finance Bills are scrutinised both before and after agreement by the Committee of Public Accounts, the most powerful standing committee of the House of Commons and by tradition Chaired by an MP from the main opposition Party.

Finance thus approved by Parliament is effectively delegated to Ministries, each of which has a designated 'Accounting Officer' (usually the Permanent Secretary) who can be literally 'held to account' for the proper spending of public money. (This system was extended to Executive Agencies and NDPBs, the Chief Executive of each body also being designated as an Accounting Officer).

The Treasury obviously exercises the real direct controls over the finances of specific public bodies which include a battery of measures including cash-limits, staffing controls, reporting requirements, approvals mechanisms (especially for major and/or capital expenditures) and procedural rules. Treasury also requires detailed reporting on expenditures (often quarterly).

1.6 *Role of HM Treasury*

The United Kingdom's HM Treasury is relatively unusual in being both an economic ministry and a finance ministry. Although some of its macro-economic functions have recently been removed (e.g. transfer of interest rate policy to the Bank of England) it still plays an important role in economic policy, as well as being the guardian of the public finances, including taxation and spending.

In public finances obviously the Treasury's key role is in taxation and total public expenditure decisions. Prior to 1997 their role in agreeing the total public expenditure and determining specific public spending was exercised through the annual Public Expenditure Survey (PES) cycle, a process of dialogue between Treasury and spending departments. This was a fairly typical annual budgeting process, the main difference between the United Kingdom and other advanced democratic countries being that the whole process was conducted in secret and only revealed once all the major decisions had been taken. The public spending plans were then put to Parliament for approval, which conventionally was a routine and mostly uncontested process.

Since election of the Labour Government in 1997 the position has changed considerably with two major separations — firstly Labour has separated capital and current expenditure and, more radically, it has also separated 'Annually Managed Expenditure' (AME) from 'Departmental Expenditure Limits' (DEL). AME and DEL each make up roughly half of all public spending with AME set annually and DEL set for a three-year period through the Comprehensive Spending Review (CSR or SR) process.

(CSR is allegedly a three-year cycle but in practice it has turned out to be a two-year cycle but with three-year plans — the first CSR was in 1998, the second in 2000 and the third is planned for 2002).

Once budgets have been agreed Treasury's role changes to one of monitoring and controlling expenditure. The various guides and codes issued by Treasury — e.g. 'Government Accounting' and 'NDPBs — Guide for Departments' are in effect mandatory, although as with other United Kingdom administrative arrangements they have no clear statutory authority. These regulate the general conduct of public bodies in spending public money and would form part of the basis for audits, both internal and those conducted by the NAO or Audit Commission. (Treasury is always consulted by audit bodies in preparing, carrying out and in reporting on audits).

More detailed 'managerial' control of spending (as opposed to the sort of 'regulatory' control mentioned above) is exercised through a series of reporting mechanisms. Profiles for individual department's spending are set at the start of each year (including allowances for seasonal variations) and monitored throughout the year, allowing corrective action to be taken when necessary. These controls extend to bodies controlled directly by departments (e.g. agencies and NDPBs) and in aggregate to other bodies (e.g. NHS Trusts and police forces). The monitoring periods and levels of detail required by Treasury vary considerably but in all cases monitoring is extensive. In recent years Treasury has tried to move away from very detailed controls towards more strategic monitoring and 'exception' reporting. The whole process (allocation in the budget process and in-year monitoring) is managed by expenditure teams in the Treasury dedicated to specific areas of public spending.

HM Treasury also plays a key role in the establishment of any public body — executive agencies, NDPBs, NHS bodies, etc. In most cases Treasury has to approve the decision to establish new bodies either specifically (as in the case of executive agencies and NDPBs) or by approving the general framework (as in the case of NHS Trusts). In the case of specific approvals HM Treasury will have to agree the decision to establish a new body (e.g. an agency or NDPB) and the governance and financial framework for the organisation. For an executive agency, for example, Treasury will have agreed the Framework Document. In particular, Treasury will ensure that a satisfactory financial regime is established for each new body.

1.7 *Audit*

All public organisations in the United Kingdom are subject to audit for both probity (the proper expenditure of public funds) and value for money.

The Comptroller and Auditor General, head of the National Audit Office, carries out the supreme audit function. These are responsible to and financed directly by Parliament rather than the Executive. The C&AG/NAO are responsible for audit of all central governments Ministries, agencies, NDPBs and public corporations and some other bodies. They audit annual reports and accounts and carry out about 50 value for money studies a year.

In addition there exists the Audit Commission for England and Wales which is in itself an NDPB. The AC has audit responsibility for local government and the health service (although there are areas of overlap with the NAO).

1.8 *Public Appointments and Governance*

Since a number of scandals in the early 1990s and widespread public concern about standards in public life Government has taken a number of measures to ensure high standards.

These include the appointment of the Standing Committee on Standards in Public Life, with a remit to suggest reforms and standards for governance arrangements for public bodies, public appointments, standards for Ministers, MPs and other elected officials and other issues. They established the overarching "Seven Principles of Public Life" which underpin many other rules and procedures now in place.

Government(s) have themselves also issued a wide range of guides and standards including rules for Ministers, MPs, senior civil servants, members of Boards of various public bodies, etc. For example, the "Model Code of Practice for Board Members of Advisory Non-Departmental Public Bodies" which forms the basis for specific codes which every advisory NDPBs had to have in place by 1 January 1999.

1.9 *Inspectorates*

There are also a wide range of statutory 'inspectorates' of one type or another covering a variety of public agencies (schools, universities, prisons, social services, police services, etc). These are usually charged with maintaining professional standards and/or standards of quality in the services covered.

The remainder of this Chapter is divided by 'sector', looking in turn at Museums, Hospitals and Universities in much greater detail.

2. *Museums*

There are about 2 500 museums and galleries in Britain, most of which are run by local authorities or are independent but receive some government support.

There are also a number of 'national*' museums that are directly supported and managed by either the Department for Culture, Media and Sport (DCMS). DCMS funding totalled around £200 million in 1997/8.

(*Some of the DCMS's 17 directly sponsored museums are also not 'national' — e.g. the Geffrye and Horniman Museums or the Museum of London).

Funding to independent and local museums is channelled through an NDPB — the Museums and Galleries Commission, which in 1997/8 totalled £9 million.

In addition, another approximately £200m per year is given to museums and galleries through the Ministry of Defence (for military museums), through the Department for Education and Employment (for university museums) and by the Welsh Assembly and Scottish Parliament.

The ‘national’ museums come under the general category of ‘Non-Departmental Public Bodies’ (NDPBs), for which there are general rules. Each individual museum however has a unique constitutional and legal history and as a result the exact arrangements for each can be very idiosyncratic. In this section we will mainly outline the general rules and give some idea of the exceptions.

2.1. *Legal Status*

Many of the national museums are established by Act of Parliament, although the precise details vary. For example, the British Museum was established by an Act in 1753, subsequently replaced by a new Act in 1963. It is also a registered Charity. The new British Museum Act of 1963 also formally created the Natural History Museum as a separate entity. The Imperial War Museum, as the name suggests, was founded in 1917 to commemorate the First World War and it was incorporated by an Act of Parliament in 1920. The Victoria and Albert Museum, on the other hand, was founded in 1851 but did not become legally "incorporated" until after the passing of the National Heritage Act in 1983.

Other museums do not have their legal basis in an Act of Parliament but have been ‘incorporated’ either as guarantee or limited companies — e.g. the Horniman Public Museum and Public Park Trust is a Charitable Company limited by guarantee.

As legal ‘bodies corporate’ — whether established by Act of Parliament or self-established under company and/or charity laws — these entities are solely responsible for their various property, employment and financial obligations.

One common feature of all these bodies is that, unlike Civil Service organisations, they do not enjoy Crown status and most legislation establishing NDPBs includes a statement to that effect. Given the implications of Crown status, including immunity from criminal prosecution, exemption from many aspects of employment law, etc. this is a major difference between, say civil service executive agencies and executive NDPBs.

Finally, the charitable status that most museums have obtained affects their position vis-à-vis assets. Normally, NDPBs with assets wholly or mainly created by public funding are required to return all or part of the proceeds to general Treasury funds when such assets are sold. Charitable status however means that this is rarely the case in relation to museum assets. This is reinforced by the fact that many artefacts owned by museums were originally donated by private persons or corporations and are therefore in any case not covered by Treasury rules on assets.

2.2. *Governance*

Nearly all the museums are governed by Boards of Trustees established by either Act of Parliament or through their incorporation. In the case of the former, it is usually the responsibility of the relevant Secretary of State to appoint Trustees. For ‘bodies corporate’ the Trustees are usually self-perpetuating, although the Secretary of State may have either formal or informal input into appointments.

New rules introduced recently require that all NDPB's be expected to be open, accountable and effective. All those who serve on the boards of public bodies — or are employed in the public sector — are expected to adhere to the highest personal and professional standards. Public bodies are expected to have in place appropriate codes of conduct for board members. These codes will set out the standards expected from those holding public office and will make provision for handling any conflicts of interest. They will also require registers of interests to be maintained and made publicly available. Similar codes should be in place for staff. (Copies of individual codes should be obtainable direct from the relevant public body).

Most museums' codes will be based on model codes issued by the Cabinet Office and listed below:

- Code of Conduct and Code of Accountability for NHS Board Members
- Guidance on Codes of Practice for Board Members of Public Bodies
- Model Code for Staff of Executive Non-Departmental Public Bodies
- Model Code of Practice for Board Members of Advisory Non-Department Public Bodies

2.3. *Revenue and Balance Sheet*

The degree of public financing of these bodies varies considerably. Traditionally, entrance to the public to the collections was provided free of charge but during the 1980s some museums, led by the V&A began to collect 'voluntary' donations at the door. Museums also collect additional revenue through research grants, commissions, and donations, rental of facilities and sales of other goods and services. (The V&A were also controversial in advertising itself as "a good café with a museum attached").

The bulk of funds however come as grant-in-aid from the 'parent' department, usually in the order of 75 per cent — 95 per cent. They therefore fall outside the generally accepted level (50 per cent) where such public bodies can borrow. However, the statutory position of many museums means that they may have provision built-in for obtaining loans from DCMS, for cash-flow purposes. However, the rules still mean that the Treasury has to be consulted about any loans to be made by departments to museums.

Similarly, Treasury rules lay down guidelines under which fees and charges for services may be levied (the *Fees and Charges Guide*) and any such charges have to be included in the corporate planning process. Any proposal to levy charges that fall outside of the guidelines has to be discussed directly with Treasury. This places fairly strong constraint on service organisations like museums on what they could potentially charge for, for example, entrance fees.

Every museum covered here has to produce a public annual report and accounts conforming to *Government Accounting*. With the introduction of *Resource Accounting*, these balance sheets are reported on an accrual basis.

2.4. *Budget*

The general requirements for budget and financial systems for all NDPBs, including most museums, are set out in 'Non-Departmental Public Bodies: A Guide for Departments'. These include:

- A management accounting system to enable it to monitor and control its expenditure against budget

- Financial management and information systems to enable it to produce annual accounts
- A system of corporate planning leading to the production of an annual corporate plan
- And management measurement systems to ensure that there is continual evaluation of progress towards key targets covering financial performance, quality of service and efficiency
- Systems to ensure best use of resources and value for money.

The details of these arrangements are generally a matter for negotiation between the sponsoring department and the individual museums, although of course there is a degree of commonality in arrangements. Most recently DCMS has taken to negotiating and publishing agreements between the department and its NDPBs, setting out aims and objectives, spending plans and performance targets covering a 3 year period (in line with the new 3 yearly government-wide Spending Review process).

Generally, the detailed contents of annual budgets are also negotiated between the DCMS and the individual museums but the Corporate Plan and/or Annual Operating Plan that this process produces does go to Treasury. In some cases Treasury can also require to see the draft plans and intervene directly in discussions where it deems it necessary.

In paying grant-in-aid to museums, DMCS is covered by the general rules of public expenditure under the 'Vote' system and by governments' accounting principles as set out in *Government Accounting*.

2.5. Performance Management, Control and Audit

Performance

The '*NDPB Guide*' cited above requires all such bodies to set 'output and performance targets and measures which should be incorporated in the overall planning and budgeting process. These documents were not necessarily, or until recently even usually, published however. Until 1996 very little information was published on performance and it is unclear what was actually collected and used internally. Since then however publicly reportable performance targets have been set and results published for a growing range of executive NDPBs. So far this covers only about half of all the nationally funded museums, but this number has grown each year.

Control

Financial and management control for museums has to be exercised by both the DCMS and the Board of Trustees of each museum. DCMS is required to agree a financial memorandum and a management statement with each body, setting out how both external and internal financial and management controls will operate and agreeing on reporting cycles. Generally such bodies are required to report at least quarterly to their parent department, although exact arrangements may vary. The more 'independent' museums may not report in quite as much detail or as frequently as more closely controlled bodies.

Audit

All museums covered here are subject to annual audit by the Comptroller and Auditor General (National Audit Office), on behalf of Parliament. C&AG can also, if he wishes or is requested to do so by Parliament, carry out specific studies or 'value-for-money' audits at any time; for example, the following NAO reports cover aspects of museums' management:

Scotland's National Museums and Galleries: Quality of Service and Safeguarding the Collections
HC 14, Parliamentary Session 1995-96

Department of National Heritage, National Museums and Galleries: Quality of Service to the Public*
HC 841, Parliamentary Session 1992-93

(* Department of National Heritage is the former name of DCMS).

3. Hospitals

3.1. Legal Status

Status

The 1989 government white paper 'Working for Patients' and the subsequent NHS and Community Care Act of 1990 presented proposals for NHS Hospitals and other Health Care Providers to become self-governing NHS Trusts which would be established under statute as separate legal entities within the NHS. This gave Hospitals greater freedoms than they had had at any time previously, however issues of probity, accountability and ministerial responsibilities did in practice limit the powers of Trusts.

As part of the proposals an 'Internal Market' in health care was created with a separation of purchaser and provider roles:

- Purchasers
 - District Health Authorities (DHA's)
 - GP Fundholders — practices permitted to hold their own budgets
 - Private — individuals and insurance companies
- Providers
 - Directly Managed Units — directly managed by DHA's
 - NHS Trusts
 - Private

It was envisaged that Trusts would be the preferred method of providing health care under the NHS and that eventually all DMU's would become NHS Trusts.

In order to obtain NHS Trust status hospitals had to introduce new management structures, (incorporating a board of directors), produce sound business plans and financial forecasts and produce financial accounting systems which would be robust enough to support the contracting system being introduced between Health Care providers and purchasers.

By 1997 virtually all NHS health care providers in the United Kingdom had achieved trusts status.

The granting of Trust status allowed NHS hospitals the freedom to:

- Acquire, own and dispose of assets in order to ensure their most effective use
- Make cases for capital development
- Create their own management structures
- Employ their own staff, determine staffing structures, and set their own terms and conditions of employment
- Treat private patients
- Generate income (subject to it not interfering with other obligations) within the scope of the Health and Medicines Act 1988.

Perhaps however the greatest impact of Trust status on the way in which health care was managed has been the introduction of the financial arrangements under which the trust operated. In particular:

- Trusts earned their own income
- Trusts could borrow funds, (subject to an approved annual financing limit)
- Trusts had the freedom to retain operating surpluses and build up reserves
- Trusts could retain depreciation and any surpluses after meeting financial obligations and could use this money to repay loans, invest or use for capital spending
- Trusts must make a 6 per cent return on their assets and break even
- Trust accounts must be presented in commercial style (in line with the Companies Act).

The election of a Labour government in 1997 heralded further health care reforms, the main effect of which was the abolition of the GP Fund holding status. NHS Trust remained although their numbers were to be reduced by the amalgamation of existing Trusts.

3.2. Governance

NHS Trusts are independent organisations, which have their own board of directors. The board consists of a non-executive chairman (appointed by the Secretary of State), up to five non-executive directors and up to five executive directors, which must include the chief executive and the director of finance.

NHS Trusts are managerially independent of health authorities and have the freedom to manage their own affairs. They are accountable to the Secretary of State for Health (via the NHS Executive). There are four main accountability tools:

- The business planning process — designed to ensure efficient and effective delivery of services and demonstrate the public accountability of NHS Trusts and coherence with purchaser plans. As part of the process Trusts are required to: produce a strategic direction at three yearly intervals, the document to cover the following five years; produce an annual business plan and make publicly available a summary of the plan; provide a rationale for planned capital investments

- The annual accounts — an integrated document comprising three statements: income and expenditure account, balance sheet and cash flow statement, supported by three sections: accounting policies, notes to the income and expenditure account and notes to the balance sheet
- Regional office monitoring — undertaken to ensure that Trusts: have effective business planning processes, are setting objectives in line with their long term strategies and the strategies of their purchasers, have objectives which are realistic, affordable and appropriate
- Annual report — a document reviewing the financial and non-financial performance of the Trust in the previous year.

3.3. *Revenue and Balance Sheet*

Trusts do not receive financial allocations; instead they obtain their income from:

- contracts to provide hospital and community health services for health authorities, GP fund holders and private patients or insurance companies (usually 80 per cent — 90 per cent of a Trust's income)
- extra-contractual referrals (ECR's) — services not covered by contracts
- contracts for training medical and non-medical staff and nurse education services
- income generating schemes e.g. charges to staff, visitors or patients for services such as catering and accommodation.

In pricing their services Trusts have to comply with the following requirements:

- for NHS contracts , prices must equal costs
- costs must include depreciation and a 6 per cent return on the value of the assets employed
- there must be no cross subsidisation between contracts and marginal costs may only be charged where unplanned spare capacity exists
- for contracts with the private sector, the prices charged should be those which the market will bear subject to costs' being covered.

In general financial control within NHS Trusts is more complex than in health authorities and as a consequence Trust boards need to ensure that:

- the Trust publishes a strategic planning document every third year covering the ensuing five-year period
- the Trust publishes a summary business plan by the 31st. March every year outlining its plans for the ensuing financial year, and following the financial consequences through for a further two years

- the Trust's annual income and expenditure budget is realistic and meets the Trust's financial obligations, contingency plans should be drawn up to cover any significant shortfall in income and adequate provision should be made for inflation
- the Trust Board receives a monthly report showing the financial position at the end of the previous month, together with a forecast of the financial year-end position.

Trusts own their assets — land, buildings, and equipment. The value of the net assets (assets less liabilities) having been transferred to the Trust on its establishment is matched by an originating capital debt (owed to the Exchequer) which is made up of two elements:

- interest bearing debt which has defined interest and repayment terms
- public dividend capital, which is a form of long term government finance on which the trust pays dividends to the government.

Trusts are free to dispose of assets; subject only to the reserve powers of the Secretary of State to intervene if, it is deemed that the disposal would be against the public interest.

If the Trust is wound up its assets will revert to ownership of the Secretary of State.

In order to maintain and expand facilities and to obtain working capital Trusts have two potential sources of finance:

- funds generated by the trust itself from depreciation and retained surpluses, or from the sale of assets
- external borrowing from either the Secretary of State or the private sector, (in practice it is unlikely that Trusts will obtain better terms than those available from the Secretary of State). Borrowing is normally in the form of interest bearing loans at fixed or variable interest rates.

Trusts are subject to External Financing Limits (EFL's), that are in effect cash limits on net external financing. External finance is the difference between agreed capital spending by the Trust and internally generated sources. An EFL for a Trust is thus:

- new loans taken out by the Trust; less
- repayments of loans during the year; plus or minus
- net changes in deposits and other holdings of liquid assets.

Trusts are expected to keep within their EFL.

3.4. Budget

It was intended that Trusts should have the greatest possible freedom to run their own affairs but, since they are public bodies, the secretary of State for Health has controls over their exercise of powers. Trusts need to remain and must be able to demonstrate that they can remain, financially stable. They are required to notify the Secretary of State if, at any time, they believe that their long-term viability is at risk.

The Secretary of State has limited range of reserve powers for use on an exceptional basis. These include a reserve power to issue directions to the NHS Trust and to institute inquiries where there is a prime facie case for concern.

3.5. *Performance Management, Control and Audit*

NHS Trusts must operate within a framework of financial control and accountability. As part of the public sector and being responsible for the spending of large amounts of public money it is hardly surprising that the framework of financial control and accountability is much stricter than that operating in commercial organisations.

Chief Executives of NHS Trusts are the designated "accountable officers" of their organisations and as such have overall responsibility for standards of managerial and financial control. In practice, the duties relating to financial control are managed by the Director of Finance who is responsible for establishing and maintaining systems of financial control and for reporting breaches of financial control to the Trust Board.

The Trust board, acting through the Chief Executive and the Director of Finance is required to ensure that the Trust:

- breaks even on its Income and Expenditure account, taking one year with another
- makes a real rate of return of 6 per cent on its assets
- operates within its External Financing Limit set annually by the NHS Executive.

The main elements of a Trusts financial control framework are:

1. Financial Directions —general instructions issued by the Secretary of State through the NHS Executive describing in very broad terms the requirements for financial control in Trusts. They provide the minimal statutory requirements for financial control. Some of the issues covered in the Financial Directions include:

- the need to approve annual budgets
- the need to monitor financial performance
- the need for safeguards on the organisation's resources.

2. Standing Orders —drawn up by the Trust these provide a framework for the overall conduct of business in the organisation. Thus, the standing orders of a Trust will cover a wide range of matters including:

- appointment of vice chairman
- conduct of board business
- arrangements for delegation to officers or other agencies
- tendering and contract arrangements.

Trusts need to review, periodically, their standing orders to ensure that they are kept up to date.

3. Standing Financial Instructions — developed by the Director of Finance and informed by the Financial Directions and the Standing Orders, these describe in broad terms the way in which the organisation will control and manage its financial affairs. They will cover such items as:

- roles of directors and managers in financial control
- powers to recruit and appoint staff
- security of assets
- internal audit arrangements
- delegated spending limits for directors and managers.

Once Standing Financial Instructions have been developed by the Director of Finance they must be approved by the Trust Board prior to their implementation.

4. Financial Procedures — following on from Standing Financial Instructions, the Director of Finance will be responsible for developing and implementing written financial procedures which lay down, in considerable detail, how the content of Standing Financial Instructions are to be applied. They will indicate the various processes and systems to be followed, the records to be kept and the persons who can authorise various transactions. Examples of the types of procedure notes that will be needed include:

- ordering of goods and services
- payments of creditors
- collection of income
- payment of salaries and wages
- stock control
- fixed assets
- budgetary control.

It is the role of internal audit to evaluate the robustness of systems of financial control in the Trust and to monitor compliance.

Audit Arrangements

NHS Trusts are subject to four types of audit:

- Internal Audit
- External Audit - Audit Commission
 - National Audit Office
 - European Court of Auditors

Internal Audit — this may be provided in two main ways:

- by staff directly employed by the Trust
- by means of a contract with an external organisation such as a private firm of accountants, another NHS organisation or some form of NHS internal audit consortium.

NHS internal audit must operate in accordance with the professional standards laid down in the NHS Internal Audit Manual, which sets out the scope and objectives of internal audit as being to review, appraise and report to management on the:

- soundness, adequacy and application of financial and other management controls
- the extent of compliance with established policies, plans and procedures
- the extent to which the organisations assets and interests are accounted for and safeguarded from losses of all kinds arising from:
 - fraud and other legal offences
 - waste, extravagance, insufficient administration, poor value for money
- the suitability and reliability of financial and other management data developed within the organisation.

It is important to note that the internal audit function should not limit itself to the effectiveness of Trust's financial controls but should also review the effectiveness of the organisations non-financial management controls.

External Audit — The Audit Commission

External audit of NHS organisations (including Trusts) is the responsibility of the Audit Commission, who although being a public sector organisation is largely independent of central government. Whereas internal audit is a management tool, external audit is independent of the organisation providing an external view of the organisation. Although the external auditors will provide copies of reports to the organisation their primary function involves reporting to the Secretary of Health on the financial management and performance of the organisation.

In practice this external audit may be undertaken in two ways:

- about 70 per cent of audits are done by the District Audit Service, the operational arm of the Audit Commission
- the remainder is undertaken through firms of private sector auditors contracted by the Audit Commission.

Both types of auditor are required to work to the Audit Commission's Code of Practice.

The main roles of the external auditor are:

- to examine the adequacy of financial control systems and procedures in the organisation and the extent of compliance with those procedures. In doing so the external auditor will wish to rely on the work of the internal auditor in this area
- to examine the annual financial accounts and underlying financial records and systems of the organisations to establish whether or not those accounts give a fair representation of the financial performance and position of the organisation
- to examine the way in which the organisation has used the resources at its disposal to establish the extent to which value for money has been achieved.

External Audit — National Audit Office (NAO)

The head of the NAO — the Comptroller and Auditor General (CAG) has the statutory role, on behalf of Parliament, of auditing the accounts of all Government Departments. The CAG is an officer of Parliament who reports to the Public Accounts Committee, and is independent of the executive arm of Government. Dismissal from post can only be by resolution of both houses of parliament.

The CAG, through the NAO, is responsible for auditing the NHS Appropriation Accounts within the Department of Health and ultimately, for certifying the correctness of those accounts when they are presented to parliament. In discharging these duties, the NAO must be satisfied about the adequacy of the systems of financial control operating in the NHS. In undertaking this task the NAO will rely, to a great extent, on the work of the Audit Commissioners as external auditors in much the same way as the external auditor relies on the work of the internal auditor.

External Audit — European Court of Auditors

When NHS organisations receive funds from the European Commission for specific projects they are required to prepare financial statements and certify that these funds have been spent for the approved purposes. Although not a common event the organisations could be subject to a visit by a member of the European Court of Auditors who will be concerned with verifying the correctness of the financial statement submitted.

4. Universities

4.1. Legal Status

Status

The institutions which make up the current higher education sector in England and Wales have diverse backgrounds and traditions which are reflected in their constitutional arrangements and the structure and powers of their governing bodies. They can, however, be divided into two broad groups: the pre-1992 universities formerly funded by the Universities Funding Council (UFC) or directly funded by the Department for Education (i.e. Open University and Cranfield University); and the post-1992 universities and the colleges formerly funded by the Polytechnics and Colleges Funding Council (PCFC) in England, and by the Welsh Office or Welsh local education authorities in Wales.

The pre-1992 universities are themselves a very diverse group, including such broad categories as the ancient universities of Oxford and Cambridge, the federal University of London, the federal colleges of the University of Wales, the 'civic' universities founded in the late 19th and early 20th centuries, the former university colleges which awarded degrees of the University of London, the group of universities established in the 1960s, and the Colleges of Advanced Technology which achieved university status following the Robbins Report of 1963.

Most of the post-1992 universities are former polytechnics, which until 1988 (or 1992 in Wales) were part of, and funded by local education authorities and awarded degrees validated by the Council for National Academic Awards (CNAA). The Education Reform Act 1988 made them into independent corporations and established the PCFC, which took over responsibility for funding these institutions in England. Subsequently the Further and Higher Education Act 1992 enabled these institutions to award degrees in their own right, and to acquire the title of university.

The colleges of higher education which form part of the higher education sector in England were also funded by the PCFC following the passage of the Education Reform Act 1988. In Wales the colleges continued to be funded by their local education authority until 1992 or, in two cases, 1993. The Welsh Office funded a further voluntary college. Churches provide a number of colleges of higher education.

The colleges can be divided into general colleges offering a range of courses which may be narrower than in the universities, often with the emphasis on business and management, humanities and education, and specialist colleges with more than half their students in one academic subject category, such as music, or art and design. Some of the colleges of higher education have been granted powers to award their own degrees.

The Further and Higher Education Acts 1992 established the Higher Education Funding Councils for England, Wales and Scotland, which took over responsibility for funding all higher education institutions in their respective areas.

Although the institutions in the current higher education sector are diverse in origin, size and organisation, they share the following characteristics of being:

- legally-independent corporate institutions
- bodies having charitable status
- accountable through a governing body which carries ultimate responsibility for all aspects of the institution.

The legal status of particular institutions can, however, take different forms, as described below.

The Pre-1992 Universities (England and Wales)

Most of the pre-1992 universities were established by a royal charter granted through the Privy Council, together with an associated set of statutes. This form of organisation is known as a Chartered Corporation.

A very small number of pre — 1992 universities were, however, established by a specific Act of Parliament, whose operative part is a set of statutes. This form of organisation is known as a Statutory Corporation.

The structure of governance for each university is laid down in the instruments of its incorporation (i.e. the Act or charter and the statutes). The charter and statutes can only be amended by the Privy Council.

The Universities of Oxford and Cambridge have neither an Act of Parliament nor a charter, but do have a body of statutes, changes to the more important of which require the authority of the Privy Council. A further exception is the London School of Economics, which is a Company Limited by Guarantee.

As successive generations of universities obtained their statutes significant variations and differences were introduced.

The Post-1992 Universities and Colleges of Higher Education (England and Wales)

The Education Reform Act 1988 established as Higher Education Corporations (HECs) certain higher education institutions in England previously maintained by, and as part of, local education authorities. The pre-requisites were that they should have more than 350 full-time students on courses of advanced further education, who constituted at least 55 per cent of total enrolments, or which had at least 2 500 full-time equivalent students following such courses. The Act stipulated that any HEC should be conducted in accordance with articles of government to be approved by the Secretary of State. Model articles were prepared by the Department of Education and Science to guide institutions in drawing up their own articles.

The Further and Higher Education Act 1992 extended the provisions of the 1988 Act to Wales. It also amended the earlier legislation and set out the general format for an instrument of government, to be made by each HEC and approved by the Privy Council, governing the membership and constitution of the governing body. The Act also required HECs subsequently to make new articles of government to be approved by the Privy Council.

While most of the former polytechnics are governed by HECs, five (formerly administered by the Inner London Education Authority) are established under the Companies Act as Companies Limited by Guarantee. Such institutions are founded on a memorandum and articles of association, which incorporate the provisions of the instruments and articles of government required in the 1988 and 1992 Acts. The governing body also acts as the board of directors for the company. Other companies limited by guarantee include a small number of general and specialist HE colleges formerly funded by the PCFC.

Some colleges are established as Charitable Trusts under a trust deed or through a scheme made by the Charity Commissioners. They are subject to supervision by the Charity Commissioners and operate under instruments and articles of government approved by the Privy Council.

4.2. Governance

Institutions of higher education are legally independent corporate institutions, which have a common purpose of providing teaching and undertaking research. The council or board of governors is the executive governing body of the institution and carries responsibility for ensuring the effective management of the

institution and for planning its future development. It has ultimate responsibility for all the affairs of the institution.

The Further and Higher Education Act 1992 and the instruments of government state that the board of governors shall consist of not fewer than 12 and not more than 24 members (plus the head of the institution unless he/she chooses otherwise). Of the appointed members:

- up to 13 must be independent members namely persons appearing to the appointing authority to have experience of, and to have shown capacity in, industrial, commercial or employment matters or the practice of any profession, and who are not members of staff or students of the institution or an elected member of a local authority
- up to two may be teachers at the institution, nominated by the academic board, and up to two may be students of the institution, nominated by the students
- at least one and not more than nine shall be co-opted members nominated by the members of the board of governors who are not co-opted members.

The co-opted membership may include members of staff, whether teachers or not, and at least one of the co-opted members must have experience in the provision of education. Elected members of any local authority are excluded from membership of the board of governors, other than as co-opted members.

Subject to the above maxima and minima, the board of governors itself can determine the number of members in each variable category, but must ensure that at least half of all members of the board are independent members.

The constitution and powers of the governing body are laid down in, and limited by, the charter and statutes of the institution in the case of the pre-1992 universities, or in the Education Reform Act 1988 (as amended by the Further and Higher Education Act 1992) together with the instruments and articles of government in the case of the post-1992 universities and colleges. In the case of companies limited by guarantee the memorandum and articles of association incorporate the provisions of the instruments and articles of government. Governing bodies are required to ensure that their institutions do not extend their activities beyond those permitted by these documents.

The main responsibilities of the governing body are as follows:

Proper Conduct of Public Business

Governing bodies are entrusted with funds, both public and private, and therefore have a particular duty to observe the highest standards of corporate governance. This includes ensuring and demonstrating integrity and objectivity in the transaction of their business, and wherever possible following a policy of openness and transparency in the dissemination of their decisions.

Strategic Planning

The governing body has a duty to enable the institution to achieve and develop its primary objectives of teaching and research. This responsibility includes considering and approving the institution's strategic plan which sets the academic aims and objectives of the institution and identifies the financial, physical and staffing strategies necessary to achieve these objectives.

The governing bodies of some institutions have established planning and resources committees to assist in these matters.

Finance

The governing body's financial responsibilities include:

- approving annual operating plans and operating budgets which should reflect the institution's strategic plan
- ensuring the solvency of the institution and safeguarding its assets
- ensuring that funds provided by the Funding Council are used in accordance with the terms and conditions specified in the Funding Council's Financial Memorandum
- receiving and approving the annual accounts
- ensuring the existence and integrity of financial control systems.

Estate Management

The governing body is responsible for oversight of the strategic management of the institution's land and buildings. As part of this responsibility it should consider, approve and keep under review an estate strategy which identifies the property and space requirements needed to fulfil the objectives of the institution's strategic plan, and also provides for a planned programme of maintenance.

Charitable Status

All higher education institutions have charitable status under the Charities Acts of 1960 and 1993. In the case of institutions which are exempt or excepted charities under the above Acts, members of the governing body are not, in a legal sense, trustees. However, they must ensure that the property and income of the institution is applied only in support of defined charitable purposes, as set out in the charter or other instruments of governance.

Staffing

The governing body has responsibility for the institution's employment policy. This includes ensuring that pay and conditions of employment are properly determined and implemented.

Students' Union

The Education Act 1994 requires the governing body to take such steps as are reasonably practicable to ensure that the Students' Union operates in a fair and democratic manner and is accountable for its finances.

Health and Safety

Under the Health and Safety at Work Act 1974 the governing body carries ultimate responsibility for the health and safety of employees, students and other individuals whilst on the institution's premises and in other places where they may be affected by its operations. Its duties include ensuring that the institution has a written statement of policy on health and safety and arrangements for the implementation of that policy.

4.3. *Revenue and Balance Sheet*

Higher education institutions attract income from a variety of sources. The relative proportions of income provided by these sources reflect the diversity of institutions' missions and the markets they serve. The main sources of funding are as follows:

Tuition Fees

Fees for the great majority of full-time home undergraduate students are paid from public funds. This payment is made indirectly by the Department for Education through local education authorities. Local education authorities have a statutory duty to meet the fees of home students taking designated full-time courses of higher education, provided they fulfil certain conditions. Since 1999 however students have been required to contribute £1 000 in fees.

Funding Council Grants

The grant from the Funding Councils falls into four main categories:

- funding for teaching
- funding for research
- non-formula funding (or non-mainstream funding in Wales)
- capital funding.

However, funding for teaching and research and some non-formula funding, though allocated under these headings, are all available as a block grant. In other words the institution may distribute the funds internally at their own discretion.

Funding for Teaching

The level of funding for teaching is determined annually by the Funding Councils. The funding method is required to operate sector-wide and to secure stability, promote efficiency and maintain diversity. It is based on a core plus margin approach, under which institutions are guaranteed a very high proportion of core funding from one year to the next, providing that the contracted student numbers agreed with the Funding Councils are delivered. Marginal funding is the route for attracting additional funding for teaching: this is distributed by the Funding Councils according to their priorities at the time.

Funding for Research

The Funding Councils' policy for funding research is to allocate that funding selectively to those institutions, which have demonstrated research quality.

Assessment of the quality of institutions' research output is undertaken by the four Higher Education Funding bodies every three to four years. The assessment is at the level of individual subjects or subject groupings (known as units of assessment). It is based largely on the quality of published research (or equivalent), but also takes into account, as subsidiary indicators, the number of postgraduate research students, funded research studentships, external research income and statement of research plans. Subjects are ranked on an ascending scale of 1-5: subjects awarded a ranking of 5 are judged to be of international standing.

A number of activities, which cannot be funded through the funding formulae for research and teaching, can be allocated non-formula funding. The main targets of non-formula funding are reimbursement of inherited liabilities and funding which recognises the additional costs of operating in London. Non-formula funding is also provided in England to support specialist museums, galleries, collections and libraries, which are available to all researchers within the sector and to provide funding to ensure that certain minority subjects with low student demand is maintained in higher education. Additionally, non-formula funding is also used to support joint activities by all three HE Funding Councils, such as the work of the Joint Information Systems Committee.

Capital Funding

The Funding Councils are no longer the major providers of capital funding, and institutions are increasingly seeking capital finance from commercial sources.

The capital funding which is provided by the Funding Councils contributes to the acquisition or construction of assets, which have a life of more than 12 months. It is divided between:

- Estate Project Funding (in England) which can be used to fund the cost of either the acquisition or construction of an academic building. The HEFCE will typically contribute 25 per cent towards the cost of such projects, with an institution's eligibility for such funding being determined by income level. The HEFCE also provides estate project funding to institutions to contribute to the cost of addressing the backlog of long-term maintenance. Institutions are invited to bid annually for estate project funding against specific criteria determined by the Funding Council
- Formula Capital Funding (in England and Wales) provides all institutions with some capital funding, which contributes to the cost of equipment and estate projects. Formula capital funding is determined by the Councils and is paid on a monthly basis.

Research Grants and Contracts

In addition to Funding Council support for research, institutions also obtain research funding through: grants and contracts from Research Councils; contracts from industrial and commercial firms and government departments; and grants from charities and the EU. Where a contract, as opposed to a grant, is provided an organisation is normally looking for a specific return on its investment.

Funding from the Department of Health

The Departments of Health, through the National Health Service, provide substantial core support both directly and indirectly for teaching and research in medicine, dentistry and other health care subjects. Many clinical medical and dental academic staff employed by universities are funded by the NHS. Indirect support for clinical teaching and research is provided by the NHS to teaching hospitals which are associated with universities to enable them to sustain the facilities and service infrastructure for medical and dental education and research. In recent years the NHS has transferred colleges of health and schools of nursing to higher education, and now commissions non-medical education and training for health care professionals from universities and colleges on a contract basis.

Consultancies and other Services

Institutions are increasingly undertaking consultancies for, and providing other services to, external bodies on a commercial basis. The scope of such consultancies and services is wide, ranging from advice on

business development to the testing of products and goods, and the letting of university accommodation. Many universities and colleges have established separate companies to market their services.

Endowments, Donations and other Sources of Income

Universities and colleges have several other additional sources of income, including:

- income from endowments and from 'foundations' (trusts to raise money for the institution, especially through alumni)
- donations
- sponsorship of posts (including in particular professorial chairs — often in areas of immediate interest to the sponsoring company and sometimes for a fixed term)
- interest earned on cash balances and investments
- income from the exploitation of the results of particular pieces of research or inventions which have commercial applications
- teaching contracts for specific customers (nursing, other professions allied to medicine, further education, initial teacher training)
- income from short courses.

The importance of these other income streams varies from institution to institution: income from invested endowments, for example, tends to be more significant in the older universities and donations tend to be focused on universities with medical schools.

4.4. Budget

Higher Education Funding Councils acting on behalf of the Treasury, place a number of requirements for financial accountability on institutions as a condition for the award of funding. These requirements are set out in a Financial Memorandum issued to each institution. The main provisions are as follows:

- Institutions must ensure that they have a sound system of internal financial management and control
- The governing body is responsible for ensuring that funds from the Funding Council are used only in accordance with: the terms of the Financial Memorandum; the terms of the Further and Higher Education Act 1992, which specifies that Funding Council funds must be spent only on the provision of education and the undertaking of research, or on facilities and activities which are required for these purposes; and any other conditions which the Funding Council may from time to time prescribe
- The governing body must designate a principal officer of the institution who is responsible for satisfying the governing body that the institution is complying fully with the terms relating to the use of Funding Council funds. The governing body invariably designates the head of the institution as the principal officer

- Institutions must keep proper accounting records and submit audited financial statements to the Funding Council by 31 December following the end of the financial year. The financial statements must conform to the Funding Councils' Accounts Direction, which is based on the Statement of Recommended Practice: Accounting in Higher Education Institutions as accepted by the Accounting Standards Board
- Institutions must ensure that the total income for the financial year will be sufficient to cover total expenditure taking one year with another. However, in pursuit of longer-term objectives, institutions may incur a planned deficit, subject to certain conditions specified by the Funding Council
- The annual financial statements must disclose: the total emoluments of the head of the institution; the number of staff paid more than £50 000, listed in bands of £10 000; and any compensation in respect of loss of office paid to the head of the institution or to staff earning more than £50 000.

The Funding Councils also require all institutions to demonstrate longer term planning by submitting their strategic plan and estate strategy. Approval of these plans is a prerequisite for funding.

The Funding Councils also specify procedures to be followed in relation to the use of publicly funded assets as security for borrowing, the levels of unsecured borrowing, and the acquisition and disposal of land and buildings.

4.5. *Performance Management, Control and Audit*

Universities need to ensure that they have a sound system of internal financial management and control. Essential elements of such a control system are:

- effective review by lay members
- managerial control systems which include defining policies, setting objectives and plans, monitoring financial and other performance
- financial and operational control systems and procedures, which include physical safeguards for assets, segregation of duties, authorisation and approval procedures and information systems
- an effective internal audit function.

In formal terms, financial control is usually exercised through a committee system. The governing body usually has responsibility for institutional finances. Many institutions have established a planning and resources committee to consider strategic plans and the allocation of resources to meet such plans. Detailed monitoring of the financial position and financial control systems is normally the responsibility of a finance committee or equivalent.

In practice, officers of the institution exercise day-to-day financial control. Many pre-1992 university institutions also have a lay treasurer (or equivalent), often someone with a significant financial background, who has a constitutional role in presenting financial statements and reports to the governing body. However, the practical responsibility for administering the finances and advising on financial matters

usually falls to a professional full-time employee generally designated as director of finance. That individual must have access whenever he/she deems it appropriate to the head of the institution.

The essential element of financial management is the annual budget. This is an income and expenditure plan, which seeks to identify and quantify the revenue resources available to the institution and to relate expenditure to strategic plans and available income.

In conjunction with the revenue budget, a capital budget should also be prepared prioritising approved building projects and identifying necessary funding sources and strategies to finance such projects.

Once budgets have been approved, it is important that heads of budgetary units are provided with regular financial information to help them manage resources for which they are accountable. Current trends are for a greater devolution of resources to budgetary units and to allow them flexible management and virement within prescribed parameters. However, such devolved budgetary arrangements require sound information systems to support them.

Institutions should have an internal manual of financial procedures and regulations. The manual should set out the role of committees, the responsibilities and limits of authority of senior staff, and details of the financial procedures and rules to be followed in the day-to-day financial transactions. There should also be clear policies on treasury management, investment management, risk management and insurance, debt collection and claiming of grants. These should be periodically reviewed to ensure that they are up-to-date.

Audit Arrangements

While the responsibility for devising, developing and maintaining control systems lies with management, internal audit has a key role in providing a service to the institution and giving assurance on the adequacy and effectiveness of the internal control system. In addition to its role in ensuring probity, the internal audit service should also assist in ensuring value for money.

The Funding Councils require institutions to appoint an audit committee and provide for internal and external audit in accordance with the Audit Codes of Practice published by the HEFCE and HEFCW in 1993.

The audit committee should be a small, authoritative body, which has the necessary financial expertise and the time to examine the institution's financial affairs more rigorously than the governing body as a whole. It should not confine itself to financial systems and details but should be prepared to take an independent stance, examine matters critically and be alert for potential areas of concern (including fraud and malpractice) which it should bring to the attention of the governing body. The audit committee should also be in a position to form an opinion of the institution's arrangements to promote efficiency, economy and effectiveness and to secure value for money in all areas. The committee is responsible for producing an annual report for the governing body.

The Audit Code of Practice specifies that the audit committee shall consist of at least three members of the governing body and that, in order to preserve their independence, members of the audit committee must not have any executive responsibility for the management of the institution. They should not serve on the institution's finance committee or planning and resources committee unless, exceptionally, the institution demonstrates that this is unavoidable for practical or statutory reasons, and obtains special permission from the Funding Council. At least one member of the committee should have a background in finance, accounting or auditing; the committee can co-opt members with particular expertise.

The specific responsibilities of members of the governing body in respect of audit are:

- to appoint the audit committee
- to consider and, where necessary, act on an annual report from the audit committee
- to consider and approve the strategic plan of the internal audit service (unless this is delegated to the audit committee)
- to appoint the external auditors (unless this function is delegated to the audit committee)
- to receive and approve the annual financial statements after they have been audited by the external auditors, and to forward the external auditors' management letter to the Funding Council.

5. National Audit Office

The National Audit Office is responsible for examining the accounts of government departments and certain public bodies, and for reporting on them to Parliament. It is headed by the Comptroller and Auditor General.

The National Audit Office examines the accounts of the Funding Councils in order to ensure that the resources made available to them have been used economically, efficiently and effectively. This examination covers not only the resources required for the running costs of the Funding Councils themselves, but also the use of Funding Council funds by individual institutions.

The Chief Executive of each Funding Council is the Accounting Officer who is answerable for the use of these funds. The Chief Executive of the HEFCE or HEFCW may be summoned to appear before the Public Accounts Committee of the House of Commons to give evidence and answer questions. The Accounting Officer of the Department may accompany the Chief Executive for Education or the Welsh Office as appropriate. The Committee may also summon heads of institutions, as principal office holders, to give evidence.

In order to ensure that institutions are making proper arrangements for financial management and accounting, and are using Funding Council funds in ways which are consistent with the purposes for which they have been allocated, the HEFCE and HEFCW have each established an Audit Service. The Audit Services have the right of access to all records and financial information held by their parent Funding Council and by the individual institutions, which they fund. Over an agreed cycle the Audit Service reviews the financial management systems of the individual institutions, and reports its findings to the Audit Committee of the HEFCE or HEFCW and through the Audit Committee to the Chief Executive. This process involves visits by the Audit Service to the institutions under consideration.

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CHAPTER 7. COUNTRY REPORT SWEDEN

By Mr. Åke Hjalmarsson

1. Large Public Sector — Small Central Government Administration

In the very beginning of the Swedish constitution it is stated that courts of law manage the administration of justice and that the public administration is carried out by central and local government administrative agencies.

The central government administrative operations are carried out in a rather uniform government agency model, although the administrative tasks differ greatly from one another. The central government administrative agencies, the courts, and the Parliament and its agencies together constitute the legal entity the State. In some cases, however, government administrative operations are carried out through organisations, which are not part of the State. For activities of that kind, in most cases civil law legal persons are used, e.g. joint-stock companies, foundations or non-profit associations. Moreover, in a few cases unique models designed for a specific purpose are used.

A characteristic feature of the Swedish public sector is that the local governments carry out by far the greatest part of the production of public services.

In the following section the organisational model of the central government agency is described. Subsequently examples are given of other models, which have been chosen for operations of a public character. Also local government institutions and operations are briefly outlined. As an introduction a short presentation is given of the central government administrative structure.

2. The Central Government Administrative Structure

The Swedish central government administration is under the control of the Government with the exception of a couple of very small agencies that belong to Parliament. In addition, the Central Bank belongs to Parliament but is regarded as a legal entity separate from the State.

The Government Offices support the Government, or rather the Cabinet. The latter is actually in itself a government agency headed by the Prime Minister. The Government Offices consists of the Prime Minister's Office, 10 Ministries and an administrative division. The number of employees in this organisation amounts to 3 700 of which the staff at the Ministry of Foreign Affairs in Stockholm amounts to 1 000. The average Ministry has a staff of only some 200 persons. These small bodies which constitute the Government's staff organisation prepare the Government's proposals to Parliament, for instance the Budget Bill, other bills, laws, and also assists the Government to carry into effect the decisions taken by Parliament. The organisation and working of the Government Offices, which is quite different from that of an ordinary government agency, is laid down in an ordinance decided by the Government.

Some 300 government agencies are subordinate to the Government. Among these are large agencies like the Armed Forces, the National Tax Board and the National Labour Market Board but also very small agencies like the Lottery Inspection and the Public Procurement Board with just a handful of employees.

Among the 300 agencies are those that are almost exclusively financed from State Budget appropriations and those that are more or less completely financed from fees paid by those who make use of their services. The number of employees in the central government agencies totals somewhat more than 200 000²⁸.

The government agencies are subordinate to the Government as a collective body and are not under the direct control of any single minister. But of course every minister is responsible for well-defined political areas and also for designated government agencies within these areas. This responsibility includes making sure that each agency has feasible goals and objectives, has balanced financial resources, a well working management and that it performs its duties in an efficient and effective way. When the responsible minister prepares a Cabinet decision regarding a government agency, he or she consults with other concerned ministries — and always with the Prime Minister's Office and the Budget Department in the Ministry of Finance.

The Government controls the operations of an agency in general terms by setting objectives and targets and monitoring the results as well as by means of the agency's budget and through laws, ordinances and specific decisions. The chief executive of the agency is the director general who makes operational decisions without governmental involvement. Thus, the government agencies have a comparatively autonomous relation to the Government. This means that in Sweden there are no huge ministerial organisations with tens of thousands of employees and extensive operational tasks under the direct command of a minister, corresponding to what can be found in most other European countries.

The public law provisions which shape the Swedish government agency model combine firmness and flexibility in such ways that administrative operations which differ greatly can be carried out in this model without drawback. To a large extent this has made it unnecessary to use other models for central government operations. The system can be regarded as highly horizontal; i.e. one uniform model is used for almost the entire central government administration. Nevertheless, there are occasions when other models have been chosen for different kinds of operations. Illustrative examples will be presented below.

With regard to the circumstances now presented there is good reason to classify the Swedish central government agencies as autonomous or semi-autonomous public agencies. In the next section a description is presented of the characteristic features of the management and control system for the Swedish government agencies.

It should be mentioned at the outset that in Sweden there is neither a comprehensive personnel planning within the central government sector, nor any civil service corps which can be identified by a specific training or professional skills or values — possibly with the exception of legal personnel. It belongs entirely to each government agency to recruit and develop the competencies it needs. The same also remains true for the local governments — possibly with the exception of medical personnel who are knitted together by professional codes and standards.

28. The Swedish population amounts to 9 million and the labour force 4 3 million.

3. Central Government Agencies

3.1. *The Legal Framework*

The central government agency model and the conditions for the administrative operations of the agencies are laid down in a couple of ordinances decided by the Government. It falls within the Government's constitutional rights to decide rules of this executive character. Of fundamental importance is the Government Agency Ordinance (SFS 1995:1322)²⁹ which with minor exceptions applies to all central government agencies. This ordinance contains 35 articles with provisions concerning mainly:

- the authority to represent the State in courts
- the management structure
- the responsibilities of the board and the director general
- how the audit report shall be dealt with
- how matters are to be prepared and decided
- appointments.

The common Government Agency Ordinance is supplemented by a specific ordinance containing an instruction for every single government agency. (See e.g. SFS 1996:148 with instruction for the National Board of Agriculture). In the instructions, which also are decided by the Government, there are provisions concerning mainly:

- the general and specific tasks for the agency
- the applicability of the articles in the Government Agency Ordinance
- the agency's board and management
- the organisation
- how to appeal against agency decisions.

The decision to establish or terminate a government agency is taken by Parliament after a proposal from the Government. Important changes of a government agency's tasks are preceded by information to Parliament. It belongs exclusively to the Government to appoint members of the boards and director generals of the government agencies.

A very important general prerequisite for the administrative operations of the government agencies is that all of them are bound by the Administrative Procedure Act (SFS 1986:223), the Public Procurement Act (SFS 1992:1528), Freedom of the Press Act (SFS 1949:105) and the Official Secrets Act (SFS 1980:100) which are all laws decided by Parliament.

29. Refers to the number in the Swedish Statute Book (SFS).

It is hardly possible to present a simple explanation to why the government agency model has come to dominate the scene. Its origins go centuries back and there has been a gradual evolution over the years. One important circumstance might be found in the fact that Government decisions are collective which has given the Ministry of Finance — or the Ministry of Public Administration when such a ministry has existed — the opportunity to promote a unified administrative structure. If control had been vested in individual ministers a development towards sectional models might have been more likely. It should also be pointed out that on some occasions Government Commissions have examined different questions regarding the governance and control of government agencies. (See e.g. reports from the Government Agency Commission in SOU 1985:40 and 41)³⁰. The resulting Cabinet and Parliament decisions on the different issues have also contributed to the unified evolution.

3.2. *The Annual Report*

The government agencies are parts of the legal entity the State. But they have an economic identity, which is not dissimilar to that of a subsidiary company in a group of companies. Since 1992 each government agency is obliged to present a complete annual report to the Government, containing profit and loss account, a balance sheet, and an account of the results achieved.

In a government agency's balance-sheet are recorded all kinds of materiel, immaterial and financial assets and liabilities and also a residual state capital. An agency can be registered as owner of real estate on behalf of the State. Within defined limits an agency is allowed to buy and sell real estate. Some government agencies which are using or managing large real estate assets, are authorised to sell property that is not needed if the value of the property does not exceed 15 MSEK (1.8m US\$). For other agencies holding minor properties the limit is 5 MSEK (0.6m US\$). There are provisions for how revenues from such sales are to be used.

A government agency's debts consist almost exclusively of state internal loans raised from the National Debt Office in order to finance investments in fixed assets or to cover a temporary or permanent need for working capital. Also the lending that finances most students' higher education is refinanced with internal loans in the National Debt Office by the National Board of Student Aid which is the agency that provides the loans.

On the proposal of the Government Parliament decides each year on the aggregate limits for internal loans to the government agencies. The Government allocates credit limits to each agency. In addition the government agencies have normal credits from suppliers. Only four government agencies with mainly commercial operations are allowed to borrow directly on the market up to limits laid down for each agency³¹. In the end the Government is responsible for these loans.

Parliament can authorise the Government to issue guarantees and the Government can transfer such an authorisation to a government agency. Commitments of this kind are shown in the annual report.

The government agencies' profit and loss statements and balance sheets are annually consolidated to a profit and loss statement and a balance sheet for the legal entity the State, which is presented to Parliament.

30. Refers to the number in the series Government Official Reports (SOU).

31. The Swedish State Railways, the Civil Aviation Administration, The National Maritime Administration, and the National Grid Administration.

3.3. *The Budget Management*

The government agencies are to varying degrees financed from budget appropriations, users' fees and in some cases also public law fees³². Revenue from the sale of property can occur. In addition, some agencies, especially universities and cultural institutions frequently receive donations from persons, companies and foundations.

The size of the budget for a government agency is based on information contained in the annual report and the analysis of the results achieved in different areas and the financial account. Of great importance, of course, is any decision by the Government that operations of some kind are to change in volume, quality or general direction and the estimated financial consequences of such changes. In the annual budget preparation the appropriations are adjusted to a new wage and price level. This adjustment is based on recent official statistics, e.g. concerning changes of wages and productivity in the private service sector.

Budgeting is focused on those parts of the operations that are financed from budget appropriations. As regards government agencies with considerable operations financed from fees, attention is also paid to these parts of the operations. However, no real spending limits are established for these operations and generally the effects of market allocation are accepted. The Government may set targets for service levels, price levels and overall financial results. Usually it belongs to the agencies themselves to decide on the level of fees, provided that the revenues will approximately balance the costs. In general, operations financed from users' fees are expected to break even. Since most investments in fixed assets are financed with internal loans this means that the government agencies must pay interest on the capital employed. The four agencies with commercial operations and a few other agencies, which have equity in the form of state capital, are expected to pay annual dividends to the state budget.

When Parliament has decided on the State Budget including the appropriations the Government commissions the different government agencies to execute the approved operations. This is done by means of an Appropriation and Performance Authorisation Letter handed over from the Government to each agency. This letter contains goals and targets for the operations, expected results, required reports, special assignments and financial authorisations. The methods of control are highly oriented towards the output and the results. The goals or targets are fully individual for each government agency or group of agencies with similar tasks. The targets often contain both quantitative and qualitative aspects, e.g. number of exams passed at different faculties, number of doctor's degrees awarded, number and quality of Army units of different kinds.

Very little if any input control is exercised. This means that there are virtually no directives concerning how expenditures are to be distributed between different cost categories. Only the total amount that can be charged against the appropriation is stated along with limits regarding commitments and internal borrowings.

For investment intensive government agencies Parliament and the Government lay down investment plans. Investments are defined in the accounting rules.

There are no provisions concerning the number of employees or the sums of salaries and wages for the different agencies. It is up to each director general to decide on the number of staff and to negotiate remuneration with the trade unions within the limits imposed by the appropriation. These negotiations are

32. Public law fees are charged for some services, licenses etc. which are compulsory under certain prerequisites. Examples of this kind of fees are the passport fee, the fee for a driver's license the fee for a patent, and the vehicle inspection fee.

to some extent co-ordinated by the Agency for Government Employers. However, neither the Government nor the Ministry of Finance is involved in the negotiations.

The government agencies carry out their accounting according to stipulations to be found in the *Accounting Ordinance* (SFS 1979:1212) and the *Ordinance on Annual Reports* (SFS 1996:882), both decided by the Government. These ordinances contain provisions that for all practical purposes correspond to those that can be found in the *Accounting Act* (SFS 1976:125) and the *Annual Report Act* (SFS 1980:1103) which apply to business companies. The few exemptions concern the financial relations between a government agency and the state budget and the way non financial results are to be reported and analysed. The government agencies apply full accrual accounting although the State budget and its appropriations are on a modified accruals basis. The most important modification is that investment expenditure or expenditures for interest and amortisation of internal investment loans— and not depreciation — are charged against the appropriations and the State budget. The consolidated ex-post State profit and loss statement and balance sheet are on a full accrual basis. The ex-post appropriation statement is on the same modified accrual basis as the approved State budget.

Government agencies have some possibilities to carry over unspent appropriations to the next fiscal year. Actually, there is even a limited possibility to borrow from the next year's appropriation. Since there are virtually no constraints on how money is allocated between different cost categories; there is no need to redistribute money between different items. For cash management the state has a single account system, containing some 5 000 accounts, operated by a state owned giro bank. The government agencies order and receive payments over their accounts in this system.

3.4. Reporting, Control and Audit

The government agencies financed from state budget appropriations report the amounts charged against their appropriations on a monthly basis and the Government Offices perform a monthly follow-up. After six months each government agency presents a financial report for the first half of the year. The report also includes a forecast for the remainder of the fiscal year. At the end of the fiscal year all government agencies present annual reports containing an account of the non-financial or substantive results achieved, profit and loss statement, balance sheet, and appropriation account and cash flow analysis. The Government in turn presents to Parliament on an over-all level, results achieved in the different policy areas.

A very important element in the management and control system is what is called "the objectives and results dialogue". Every year a structured talk is carried out between the responsible minister or secretary of state and the director general who is in charge of a government agency. In this dialogue — a checklist drafted by the Government Offices discusses the results achieved and the expected results. Also different aspects of the situation of the director general are discussed. The complete annual report of every government agency is audited by the National Audit Office (Sweden's supreme audit institution) according to good auditing practices. The audit reports are presented to the Government. The audit of the government agencies is external and it includes financial audit, compliance audit and audit of the non-financial results. The auditors' statement contains a certification whether the annual report gives a true and fair picture of the financial situation and if the accounting has been carried out according to the rules. The NAO also performs effectiveness or "value-for-money" audits.

Important observations made by the auditors, i.e. statements containing qualified opinions, are reported to Parliament by the Government. It has occurred that observations made by the auditors have led to the initiation of administrative discipline and even legal actions. However, the NAO does not have the powers of a court.

In order to strengthen the internal control in government agencies the Government has directed 40 larger agencies to establish their own internal audit units and prescribed the general standards for this (See SFS 1995:686). The internal auditors report to the management board or — if there is no board — to the director general. Further, in the Government Agency Ordinance there is an article that stipulates that the director general is obliged to make sure that the internal control in his or her agency is satisfactory.

4. Other Models

In Sweden there are no other organisational models especially designed to suit specific sectors of central government activities. This holds true even for sectors like universities and cultural institutions where sector models can be found in several European countries. However, it is not unusual for other organisational models like foundations, joint-stock companies and non-profit associations to be utilised for operations of a state or public character. In addition, sometimes it occurs that a unique model of organisation is created for a specific purpose. As mentioned in paragraph 3, the local governments produce by far the greatest part of all-public goods and services directly consumed by the citizens. In the following paragraphs, therefore the organisational model represented by local government will be touched upon and examples will be given of public activities that are performed in organisational models other than the government agency. The respective models are described in relevant respects and reasons stated for choosing the different models are presented.

4.1. Foundations

During the course of the years the Government has taken part in the establishment and utilisation of foundations for operations of a public character. One example is the National Concert Institute the purpose of which is to promote the development of musical life, for instance through complementary musical production. Other examples are the Stockholm Environment Institute, the Institute for Future Studies and the Stockholm International Peace Research Institute. Foundations like these usually lack their own funds of any significance and are dependent on annual contributions from the founders. Earlier the foundation model was rather unregulated and could freely be adapted to the circumstances in the specific case. Foundations were then often used in ventures involving co-operation between the state and some other interested party and financier.

In 1996 a Foundations Act came into force and the institutional model foundation was regulated in detail. The new Foundations Act (SFS 1994:1220) does not recognise new foundations, which for their operations are dependent on annual contributions from the founder or from somebody else. A foundation must possess a capital that is reasonable in relation to the purpose of the foundation. However, existing foundations dependent on current contributions are permitted to continue their activities.

As a result of the new legislation, foundations will not be used in the future by the Government for operations that are dependent on current contributions from the State. (See Reports from a Government Commission in SOU 1994:147 and 1995:93). Further, a number of existing foundations will be reorganised into government agencies, joint-stock companies or non-profit associations. A couple of such reorganisations have already been implemented. Examples of this are the Swedish Institute that informs about Sweden abroad, and the Travelling Exhibitions Service that arranges and produces cultural exhibitions. In both cases the government agency model was chosen. For a considerable time, however, there will remain some foundations that are more or less fully dependent on annual contributions from the state budget.

A foundation is a self-owning civil-law body that is governed by the Foundations Act and the charter of the foundation. The board of a foundation may not take measures that lack support or contradict the

Foundations Act or the charter. This holds true whether the state or somebody else has established the foundation. A foundation has all powers and obligations that belong to legal persons in general, e.g. acquire assets, rights and assume obligations, conclude agreements. After the coming into force of the Foundations Act a foundation is hardly ever a feasible organisational model for co-operation between different parties.

The Government is not allowed to use public funds to establish foundations without the consent of Parliament.

The aim of establishing a foundation is to make sure that resources are put aside and used for a specific purpose during a long time. Independence in relation to e.g. the state is also aimed at. A consequence of the aspiration for independence is quite naturally that it is very difficult for the founder or the board of the foundation to adjust the purpose of a foundation to new circumstances. The assets of a foundation are tied to the purpose and the possibilities for public control are limited.

These characteristics of the foundation model were deliberately used when in Sweden a couple of years ago highly contested wage-earners' funds were liquidated and very considerable funds were distributed to a number of new foundations the purpose of which was to support i.e. scientific research.

At approximately the same time two universities — which earlier were government agencies — were from ideological motives reorganised into foundations. However, these two universities are dependent on grants from the state budget for their operations. The grants are estimated in the same way, as are the appropriations to other universities. It is worth noting that the two foundation universities carry out their operations through joint-stock companies fully owned by the respective foundations.

A foundation of any significance is obliged to keep accounts and to present an annual report according to the rules in the Accounting Act and the Annual Report Act. The accounting, the annual report and the operations are annually to be scrutinised by a chartered or an authorised auditor. A typical consequence of the self-owning character of the foundation is that the auditors' report is presented to the board of the foundation.

The Government contributes annually to a number of foundations established by the state or by others that perform activities of a more or less public character. In these cases Parliament decides on the appropriation concerned and then it is the task of the Government to implement that decision. A rough estimate indicates that the Government annually contributes some 6.5 BSEK (785m US\$) to foundations and similar institutions. The major part goes to support higher education and research, other educational activities, cultural institutions and sport activities.

An annual government contribution to a foundation is usually a financial support to the operations and very rarely includes conditions concerning how the money is to be spent and on what reporting is required. However, in some cases grants are supplied with explicit conditions concerning use and reporting. In these cases the transfer of money can be regarded as payment for services to be rendered.

4.2. *Joint-Stock Companies*

The State owns shares in a number of joint-stock companies. Most of these are not dependent on direct subsidies from the Government; instead they pay considerable dividends to the state budget. Examples of companies of this kind are some gambling companies, some real estate companies, some financial companies, retail trade with alcohol and pharmaceuticals and the Swedish Telecom and the State Power Company. These are commercial enterprises competing in the market and only in a few cases they enjoy a monopoly or a monopoly-like position. These companies will not be commented upon further.

More interesting are some activities of a public character that are carried out in the organisation form of joint-stock companies.

One example is the Swedish Motor Vehicle Inspection Company that carries out tests of all motor vehicles. The state owns 52 per cent of the shares in the company. The remaining shares are owned by professional and industrial organisations and by insurance companies. The operations involve exercise of public authority against the citizens. Parliament has endowed the company with this competence. The operations are financed with fees, the level of which is decided by the Government. The motive stated for the chosen organisational model was to achieve a rational and efficient operation and to facilitate a flexible adjustment of the production capacity. The joint-stock model also made it possible to share the ownership with other interested parties.

Another example is the Samhall Company whose task it is to provide employment to occupationally disabled persons. The operations were earlier carried out in the organisational model foundation but were reorganised into the model joint-stock company some years ago. All shares are owned by the State. The company is, without comparison, the largest single receiver of grants from the state budget. The grant or subsidy corresponds to approximately half the turnover. The remaining part consists of revenues from the sale of goods and services produced. There are conditions attached to the subsidy, e.g. concerning the volume of working hours and the frequency of transition to ordinary employment. There are detailed requirements for reporting. The most important reason stated for reorganising Samhall into a joint-stock company was that the group was considered to receive better opportunities for its operations and that these could become more efficient. The joint-stock company model was also considered advantageous because the distribution of responsibility and authority in such a model is well known to partners and competitors, making their working relationships easier.

A third example is the two royal theatres, the Opera and the Dramatic Theatre, which both are wholly state-owned joint-stock companies. The grants from the state budget to these two institutions amount to roughly 80 per cent of the total revenues. Although the joint-stock company model was not created to satisfy artistic needs, it appears in practice that the clear rules concerning division of authority, accounting etc. are well suited to the requirements for production in cultural institutions. The administration of the operations can be quick and flexible which is important in a competitive business.

Finally, it can be mentioned that recently the Government has proposed to Parliament that a technical research institute shall be established in the form of a joint-stock company. The reasons stated for this model are briefly, that it is well known to the industry and that it enables industry to participate directly in the ownership.

The Government needs the approval of Parliament to establish a joint-stock company. The same holds true if a government agency's operations are to be reorganised into a joint-stock company, regardless if the company is to be owned by the state or a private party.

Joint-stock companies are autonomous legal persons and the rules for their administrative operations are laid down in the Joint-stock Company Act (SFS 1975:1387) and the charter for the company. In addition there might be an agreement or contract between the state and the company. Subsidies can be associated with conditions.

Every state owned company reports to a ministry. As regards companies with a more or less clear commercial purpose the minister's responsibility — within the Government — roughly corresponds to that of an owner. When it comes to companies entrusted to produce public services, in principle, the minister has the same responsibility as for a government agency. However, the formal control over a joint-stock company must be exercised through the institutions of the company — notably the shareholders' meeting.

Accounting and auditing are carried out according to rules in the Joint-stock Company Act, the Accounting Act and the Annual Report Act.

4.3. *Non-Profit Associations*

For some public operations the model non-profit association is used. In contrast to the situation for joint-stock companies and foundations there is no legislation that contains the fundamental provisions for the organisational model non-profit association. As a consequence all vital rules have to be laid down in the charter of the association. However, a rather well established practice exists for how the charter of a non-profit association should be drawn up. In addition to a charter it might be necessary for the founders to enter into a contract concerning key issues such as financial contributions.

A non-profit association is established by a number of persons with the aim of promoting the members' interest in a specific area. The model is especially useful when there are several founding members and new members have to be admitted later on. Since no clearly defined and uniform rules exist for the division of responsibility and accounting the model is unfeasible for business-like operations.

The model non-profit association has been in use for a long time for the Swedish Language Committee. There are 20 members in this association. It is also used for the National Association for Information on Alcohol and Drugs. Members are a number of popular movements. Furthermore, a non-profit association with a considerable number of members appointed by the association runs the Swedish Institute for International Affairs. Recently an existing entity with a somewhat dubious legal status, the Disabled Persons' Institute, was reorganised into a non-profit association. The State, the Federation of Swedish County Councils and the Federation of Swedish Municipalities are establishing this association.

It is rarely the case that the Government has to contribute with considerable funds when a non-profit association is established since the need for equity capital usually is insignificant. However, often it is necessary for the Government and other parties to make multi-annual commitments of future annual grants to the association. Such commitments may only be made with Parliament's approval.

4.4. *Special Models*

Beside the described general organisational models there are also some unique models with their own and often ancient origins.

First there are the Unemployment Societies. These associations are entrusted with the administration of the unemployment insurance. The organisational model is nowadays fully regulated (establishment, governance, members, accounting, auditing etc.) in the Act on Unemployment Societies (SFS 1997:239). The societies are public law entities and their number is approximately 40. The societies, which are closely attached to the trade unions, administer the unemployment insurance in accordance with provisions laid down in the Unemployment Benefit Act. Benefits totalling some 45 BSEK (5.5B US\$) are disbursed. The State finances the entire costs for the benefits. Membership fees cover just the administrative costs for the societies which amount to 750 MSEK (90m US\$). The Labour Market Board supervises the operations. Accounting must be carried out in accordance with the general provisions in the Accounting Act. Auditors are elected by the General Assembly of each Society. At least one of the auditors must be a certified accountant.

Of great importance are also the Social Insurance Societies. These entities are formally independent from the state and are regarded as special public law bodies. There are approximately 20 societies and every society operates regionally in an area that corresponds to that of a County Council. The staff amounts to

some 15 000 persons. In the Social Security Act (SFS 1962:381) there are included provisions concerning this organisational model. The National Social Insurance Board supervises the operations of the societies. Through the NSIB the Government can lay down objectives and monitor results in the social insurance administration. The societies administer benefits according to the Social Security Act, mainly sickness benefits, parenthood benefits and basic state pension benefits. The State finances the entire costs for the benefits — totalling some 300 BSEK (36 B US\$) — and 90 per cent of the administrative costs. The state grant for administrative purposes amounts to 4.3 BSEK (520m US\$). The Insurance Societies are subject to audit performed by the National Audit Office.

It can also be mentioned that the Central Bank, which is an agency that belongs to Parliament, has a unique organisational form that is conclusively regulated in the Central Bank Act (SFS 1988:1385).

4.5. Local Governments

An important feature of the Swedish form of government and public administration is the local self-government.

As mentioned before, the local governments are the predominant producers of public services in Sweden. There are two kinds of local governments, namely almost 290 municipalities and 20 county councils. The municipalities are entrusted to supply child care, primary and secondary education, elderly care and technical services etc. The county councils main task is to provide health care but they often engage in regional and urban transport operations. Most county councils are also involved with regional cultural institutions like theatres and museums.

To some extent, local governments use foundations to carry out parts of their activities. There exist foundations whose task it is to promote cultural purposes, trade and industry, tourism and the environment etc. However, the total volume of these operations is small. Joint-stock companies are often used for business-like operations e.g. transport services, technical services and housing services. The number of persons employed by local government's amounts to approximately 1 000 000³³.

The local government expenditures are financed with local income taxes, users' fees, and grants from the central government. Nowadays, there is a general grant, which is paid at the same capitation rate (SEK per resident) to all municipalities and county councils. The state grants make up approximately 20 per cent of the local governments' total revenues. Furthermore, there is an equalisation system that redistributes resources between local governments.

In the past, Parliament and the Government controlled local government activities by distributing earmarked grants and through extensive regulations. In addition, government agencies supervised the compliance with the rules. This ambition to control has now faded away. Today, Parliament and the Government set objectives for different areas, e.g. childcare, schools, health and medical care. Then it belongs to each local government to use its financial resources, taxes and grants alike, as it sees fit. Control over local government activities and performance is ultimately exercised by the electorate.

Members of the decision-making assemblies of the local governments are elected in general elections. The local governments have the right to levy taxes in order to finance their operations. The local governments are subjected to the Local Government Act (SFS 1991:900) which provides the framework for local democracy, organisation, operations and administration. This law also includes rules regarding budget and

33. The Swedish population amounts to 9 million and the labour force to 4.3 million.

auditing. However the central government does not set formal rules for the establishment of agencies by local government. Accounting in local governments shall be carried out in accordance with provisions in the Act on Local Government Accounting (SFS 1997:614). With some adaptations the rules correspond to generally accepted accounting principles. The assemblies elect auditors that scrutinise all municipal and county council operations. No professional qualifications are prescribed for these auditors.

In this connection there is good reason to draw special attention to the county councils whose main task it is to supply health care. The county councils operate and finance almost all hospitals and district health centres. The county councils also buy medical care supplied by private hospitals and clinics. Approximately 85 per cent of the county councils' total expenditures are destined to the health-care area. After operational revenues, only 15 per cent of the county councils' total expenditures are financed by state grants. The remainder is financed by income taxes decided by each county council. The county councils employ roughly 250 000 persons.

The members of a county council's assembly are elected through general and direct elections every fourth year. The assembly elects from its own ranks an executive board which task it is to co-ordinate the county council's operations. Often, the executive board is directly responsible for the health care area, while there are subordinate committees for other activities like transport and culture. In some county councils there is a committee also for the health care area. Under the direction of the executive board — or the health care committee — the management of hospitals and primary care districts is carried out by a number of usually non-political governing boards.

The production units, e.g. hospitals, form integrated parts of the county councils and their activities and finances are usually closely monitored or managed by the executive board or the health care committee. Thus, the production units do not enjoy a relation of semi-autonomy similar to that of central government agencies. Structural issues, for instance the closing down of a hospital, are always decided on a political level.

On the basis of a proposal from the executive board the county council's assembly decides on the annual budget. Usually this budget is highly aggregated and divided only into a few areas of which health care is predominant. The executive board — or the health care committee if there is one — distributes the resources to different hospitals and primary care districts. Different systems or mechanisms are used in the combined transfer of assignments and funds from the political buyers of health care to the professional management of the producing units.

In some county councils traditional budget allocation with strong incremental character is used, while in others the budget allocation is based on social and demographic variables in different districts. In still other county councils there are more or less sophisticated systems based on expected or achieved output or performance. When a county council buys health care services from private producers there are often contracts based on payment according to performance up to a limit.

The health care institutions and the professional personnel are supervised by a central government agency, namely the National Board of Health and Welfare.

The most important task for the county councils is to supply and finance health care. Although the organisational model is typical for local government in Sweden it can be claimed that it represents a special sector model of organisation used for hospitals and health care in general — in any case it is another model for the production of public services than the model government agency.

5. Some Observations

Sweden belongs to the countries in Europe with the largest public sector and the highest ratio between tax revenues and GDP. Consequently it could be expected that the central government sector also would be very large. That is, however, not the case.

Self-governed municipalities and county councils carry out the predominant part of the production of public services. These local governments levy taxes to finance the large majority of their expenditures. The grants from the state budget — which are of a non-ear marked lump-sum character — make out some 20 per cent of local government revenues. This means that there is a decentralised system based on a close relation between the citizens that use the public services, for instance health care, and the elected local politicians which in the end are responsible for the volume and quality of the services supplied.

It should also be observed that the administration of major welfare systems is entrusted to public-law bodies separate from the legal entity the State. What is aimed at here are the Unemployment Societies and the Social Insurance Societies. Both these organisations, which have their origins in ancient associations, have succeeded in preserving a special democratic character.

Sweden is also a society with many and strong organisations. Outstanding in this respect are of course the different employers' federations and trade unions. Municipalities and county councils also have influential organisations of their own. In addition there are trade and industry organisations with varying strength. The farmers' union is one example of such an organisation; the tenants' association is another example. Further, there are strong organisations for the protection of the environment. All these organisations reflect the opinions of their members and supply their members with information. The existence of such organisations facilitates a mutual exchange of information between important interest groups and the Government.

Circumstances of these kinds — a large autonomous local government sector and strong interest organisations — explain in part why it is possible to have a strong welfare state and a large public sector without a large central government organisation.

The decentralised character of the public sector and activities stands out also in the central government sector. The typical large European ministerial organisation is missing and instead there are small ministries and relatively autonomous government agencies. While virtually no input control, except on a total level, is exercised, governance takes the form of setting objectives and then monitoring output and performance. The organisational model government agency combines firmness and flexibility in such a way that it can be used for almost all kinds of government operations. As a consequence, there has been no urgent need to create other models for different sectors of the central government administration. In those cases when a government agency has been regarded as a less feasible model the choice has usually fallen upon private-law organisational models like joint-stock companies, foundations and non-profit associations.