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**“New Public Management and Modernization of Administration as a
Challenge for Public Sector Audit”**

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*“New Public Management in the Administration of the Federate State of
Hesse and the role of the Court of Audit of Hesse”*

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Contents

A) New Public Management in Hesse

- I. New Public Management and Modernisation of Administration – comments regarding terminology and philosophy
- II. “New Public Management” in Hesse
- III. Introduction of commercial accounting and target and product-related budget planning as a core area of reform in Hesse
- IV. Challenges of New Public Management in terms of policy

B) New Public Management and the Court of Audit of Hesse

- I. Introduction of New Public Management at the Court of Audit of Hesse
- II. Advisory activity of the Court of Audit of Hesse during the Introduction of New Public Management
 - a. in respect of the Hesse State Parliament
 - b. in respect of the Hesse Ministry of Finance
 - c. for the other ministries
- III. The audit and approval of the opening and closing balance sheets
- IV. Challenges for the Court of Audit of Hesse

A) New Public Management in Hesse

I. New Public Management and Modernisation of Administration – comments regarding terminology and philosophy

In most countries, there is likely to be considerable pressure to rationalise and adapt government budgets. Under discussion are issues such as which tasks the State itself should be responsible for, how it can structure its administration in the most efficient and effective way, etc.

In **Hesse** – as well as elsewhere – the concern that risks could endanger the federate state's long-term financial stability has for years been the principal reason behind **comprehensive administrative reform**. After all, it is an old basic principle that the scarcity of goods is at the root of business administration. Thus, what is happening here is the realisation of a completely normal economic principle.

In addition, the federate state government has decided to adopt drastic measures to achieve annual savings of over EUR 1 billion, based, as it were, on an "immediate measure" within the framework of "Operation Sichere Zukunft" (Operation Secure Future). This corresponds to approximately 5% of the size of the budget. The rise in the weekly working time from 38.5 to 42 hours for civil servants, the target of reducing the workforce by some 10,000 units and the removal of special grants are just some of the highlights. Awareness of the problems of an ageing population has also led to the decision to ruthlessly analyse the federate state's financial situation and to introduce far-reaching measures which will remain effective over the long term, in order to maintain the political opportunities for adjustments to be made and to preserve the necessary room for manoeuvre. Although the measures which have been taken are far from being original, they do, as is shown, become effective quickly.

These traditional elements of administrative reform lie more in the organisational sphere of the executive. They are characterised by the "top down" orientation of decision-making and what amounts to little

more than a cursory look at the current liquidity of the government budget.

What, in contrast, distinguishes New Public Management?

During the 1980s, New Public Management was developed in government policy in the United Kingdom, Australia and New Zealand as a model for the political management of government administration. The model replaces cameralistic “input” orientation with business results orientation – the introduction of “outputs” as a planning category. To this end, New Public Management uses many elements of corporate control, ranging from financial planning and management to industrial organisation models (e.g. decentralisation and the creation of profit centres) and personnel management techniques (e.g. contract management). As far as administration is concerned, this primarily means the delegation of authority to take decisions and, in so doing, the merger of responsibility for materials and finances.

New Public Management is ultimately a “client-supplier relationship”: in the case of the supplier, i.e. the administration headed by the government, the necessary and feasible framework conditions are put in place and orders carried out.

More recently, the focus of New Public Management has been on the aspect of steering public sector finance, and therefore the creation of “output”-oriented budgets, the use of commercial accounting, cost accounting and reporting systems as part of a management control system, as well as the use of agreed performance targets. Another key component is the evaluation of administrative performance, the aim of which is also to make such a systematic analysis the basis of political target setting and at the same time to assess the political results of so-called “outputs” in “outcomes”. This means both considering and evaluating administrative results in connection with the underlying political strategy, through to formulating the strategy and putting it into operation.

One of the most important aspects of New Management for governance in Hesse will be the use of commercial instruments for a transparent system providing information on the erosion of assets and long-term budget risks.

II. “New Public Management” in Hesse

Hesse’s New Public Management project is called “**Neue Verwaltungssteuerung**” (**New Public Management**). It is **embedded in comprehensive administrative reform** and comprises the following elements which, at the same time, may be characteristic of a comprehensive approach to New Public Management:

- a. Decrease in regulations/deregulation (inter alia, restricting laws to five years/sunset legislation; decrease in regulations, e.g. removal of planning permission for smaller construction projects; reduction in the number of standards, e.g. maximum sizes for school classes and nursery schools, etc.)
- b. Privatisation of administrative duties (e.g. construction of, and, to some extent, also the running of a prison)
- c. Delegation/bundling of administrative duties, doing without administrative authorities
- d. Personnel management (personnel development, personnel placement agencies)
- e. E-government
- f. New Public Management: management of all administrative activities via a product budget as from 2008, replacement of the cameralistic accounting system with commercial accounting, resource management on the basis of cost and performance accounting.

New Public Management represents the core of the reform measures in Hesse. Its introduction creates a high level of staff retention and considerable expense. The state of Hesse expects to spend some EUR 240 million on introducing commercial accounting using SAP R/3 business software modules adapted to administrative requirements. A further amount of EUR 54 million is earmarked for the introduction of the HR module as well as for other areas which are not to be included in the introduction of commercial accounting.

III. Introduction of commercial accounting and target and product-related budget planning as a core area of the reforms in Hesse

Following a period of various model projects on reforming budgeting and accounting within individual ministries, the Hesse state government passed a resolution in the summer of 1998 to make the basic switch from a cameralistic system of accounting to commercial accounting. Double-entry bookkeeping with cost and performance accounting, product management, decentralised budgeting and controlling were to be introduced in all areas of state administration. The project is being supported by all of the political parties in the Hesse state parliament.

In no other federate state is the approach to reform so rigorous and far-reaching. The aim is to convert the entire state budget by the budget year 2008 at the latest. The following year, a decision was taken with regard to the initial structure for the entire introduction project, and in particular a timetable for the individual implementation measures, the establishment of development phases of a multi-level state benchmark model and a multi-structured project management. A decision was also taken to adjust the way in which the standard software SAP R/3 is used.

In conjunction with a firm of management consultants, the development work was carried out in the reference areas of each ministry, and was applied to the other areas of the ministry, including all of the subordinate authorities, as part of the wider introduction. This process has been completed up to the introduction of commercial accounting and the use of cost and performance accounting. 95% of state administration, including the Justice Department and the Court of Audit of Hesse, use commercial accounting with SAP and **the conversion will have been completed by the end of 2004**. The conversion process affects all administrative functions, including personnel administration and real estate management, which was hived off as a separate state enterprise.

The next implementation measures are the **preparation of opening balance sheets and annual accounts at “client” level**. These are

65 administrative areas, in which departments or specialist ministry areas were grouped together in “accounting areas”. In part, some of the 769 state departments are independent “clients”. By 30.06.2004, the first 13 accounting areas had prepared an opening balance sheet at 01.01.2003; some of these had also prepared the first closing balance sheet at 31.12.2003; a further 28 accounting areas are currently preparing the opening balance sheet at 01.01.2004. The individual ministries are drawing up part-group consolidated annual accounts, into which the balance sheets of the clients forming part thereof are consolidated in full. **The Court of Audit of Hesse is responsible for auditing and certifying these part-group consolidated annual accounts.**

The part-group consolidated annual accounts are brought together in the “state” group account. An initial consolidated “**group balance sheet**” should be available in **2007**. It is also likely that their audit and approval will be confirmed by the Court of Audit of Hesse.

If, in accordance with the basic concepts of New Public Management (concepts which are not entirely new, since NPM has, at the latest from Clausewitz onwards, been the basis for military leadership), such management is to be performed on the basis of orders and agreements, the information required by the user for his decisions must be provided by the system.

IV. Challenges of New Public Management in terms of policy

Two “major” questions must be raised here.

1. Does economy, efficiency and effectiveness take precedence over policy as a result of the reform?
2. Does the reform itself fulfil the criteria of economy, efficiency and effectiveness? What are the risks which it harbours?

Asking the first question means answering it.

It is not just at the specialist levels that the question as to whether certain services can be provided more effectively and more efficiently is omnipresent and that management officials of specialist levels –

just like leading political staff - must allow themselves to be measured on an ongoing basis in terms of the agreed contracts, therefore in terms of services and budgets. - This effect is intentional. -

Even the state parliament, as the “purchaser” of administrative products, which also serve the realisation of political objectives (and therefore must have an “outcome”) will come under completely new kinds of pressures as a result of cost transparency. It is expected that citizens and the media will increasingly question the sense of political decisions, once their cost implications are more accurately known. In future, anyone wanting to have a new road will also have to bear the financial and political risk thereof.

The need to assess the desired political effects and the tools and costs to be employed for this, also makes great demands on the budget legislator. In this respect, the new budgeting system and its control might in themselves represent a challenge for parliament. The information, discussion and learning process in the Financial Controlling and Public Management sub-committee of the state parliament’s budget committee is, in any case, in full swing.

It should also be mentioned here that the type and depth of the current information, which members of parliament will receive, has not yet been finally determined. To this end, and in a similar way to institutions in the American Congress, a state parliament committee has demanded access rights to a database which is to be set up at the state parliament and updated on a monthly basis. This should contain data with the same depth of information as is available to the state government. The Ministry of Finance has put forward a rough outline proposal for a special monthly report to be submitted to the parliament with the following characteristics: management duties, costs and revenue, strategic data, need for action, performance data and financial data.

In order to safeguard the budget legislator’s budgetary interests, it is in any case necessary to provide parliament with the information it needs to maintain its “core competence” – whatever that may mean. The fact that the dividing line between the parliament’s right to set the budget and the entitlement of “producers” to “corporate” freedom in fulfilling contracts may become a “target breaking point” is obvious. Nevertheless, these difficulties do not seem insurmountable.

The second question concerns politics and the general public.

The already-mentioned projected costs of approximately EUR 240 million for the introduction of the SAP-based new accounting system and the additional cost of EUR 54 million for the introduction of the HR module as well as for other areas, which are not included in the introduction of commercial accounting, are resulting in heated discussions as to whether this expenditure is justified.

At the parliament's request, the Court of Audit of Hesse has analysed the costs of introducing SAP as well as its economy, efficiency and effectiveness. In so doing, it has pointed out certain risks arising from the further development of the software, but in particular as a result of the costs of external consultants when there is an insufficient number of own staff available to provide support for the system. No comment has as yet been made on the overall economic efficiency of the project as a whole. To date, there has been no comparable major project.

The "economy, efficiency and effectiveness" cannot be geared solely to whether the costs of converting the accounting system and the introduction of the software will pay for themselves due, for example, to lower personnel and materials costs. There are a number of other benefits which should not necessarily be assessed in monetary terms. However, I do admit that these concepts do not exactly make it any easier to evaluate success.

In the medium and long term, a successful introduction of similar commercially based budget management systems in all of the federate states, the federal government and at all administrative levels, must also be achieved. The reform will be really economically efficient if a comparable data basis is achieved in all administrations and an overall network is developed nationwide. Between the federal government, the federate states and the local authorities, administrations are interconnected in such a way that an isolated solution is no more than a piecemeal solution.

In the long term, what sense is there in precisely calculating the costs that will be incurred by a federate state in constructing a motorway, for instance, but having no clear idea of the costs that will have to be

incurred by the federal government during the planning stage, and possibly beyond?

This process is an arduous one. At federal government/federate state level, following many years of negotiation, an agreement was reached in 2003 that the administrative accounts framework used by Hesse for commercial accounting, which was derived from the industrial accounts framework customarily used within German industry, is to be uniformly adopted by federal government and the federate states. However, it is a prerequisite that they introduce commercial accounting or at least cost and performance accounting on the basis of a broader cameralistic system. The resolution of the finance ministers' conference, expected last year, to replace the cameralistic system with commercial accounting and to provide for a consolidated accounting system for federate states and their sub-divisions, has not yet been passed. In any case, at working level, an understanding was reached to develop a uniform product framework plan at national level for the purposes of cost and performance accounting. Many federate states intend to follow Hesse, but nationwide standardisation is not expected for another 10 to 15 years.

In Hesse too, it remains an ongoing political requirement that local authorities in Hesse adopt the accounting system used throughout the federate state (compatibility of figures/cost-effectiveness of introducing similar systems). The Court of Audit, too, has demanded, without success so far, that Hesse's universities adopt the accounting system used throughout the state, including the software. However, here the point at issue is more the introduction of a standardised system and not the question as to whether a system will be introduced at all!

One last point, which must be briefly addressed on the topic of economy, efficiency and effectiveness of the reform, could be entitled "Opportunities and Risks of Transparency" or "Rating and consequently Credit Costs". The presentation of budget risks, especially the disclosure of pension liabilities, might superficially be associated with valuation drawbacks when judging the creditworthiness of the federate state of Hesse. However, this transparency will probably result in corresponding analyses of other public-sector entities requesting capital. Nevertheless, an increase in

the cost of financing on the capital market is bound to represent a risk. This has a good chance of being averted, particularly if the business management calculations highlight any progress made in the budget consolidation.

B) New Public Management and the Court of Audit of Hesse

I. Introduction of the new accounting system in the Court of Audit of Hesse

This year, the Court of Audit of Hesse has itself introduced commercial accounting with SAP R/3 and cost and performance accounting. It has defined four products (external public sector financial control, Federate State Commissioner for Efficiency in Public Administration, supra-local audit of local authorities and specialist and implementation management). The Court of Audit's employees keep time and quantity records. Exempt are members of the decision-making body with a view to safeguarding their judicial independence. Controlling is carried out during the course of the year using monthly reports. Using the report data for 2004 as a basis, next year standard cost accounting will be used for the budget year 2006. To date, the process of introducing New Public Management at the Court of Audit has run smoothly.

II. Advisory activities of the Court of Audit of Hesse during the introduction of New Public Management

From the outset, the Hesse Court of Audit has assisted with the introduction of New Public Management, acting in an advisory capacity for:

a. the Hesse federate state parliament

The budget committee of the Hesse federate state parliament and its Financial Controlling and Public Management sub-committee go to great lengths in dealing with the individual stages involved in implementing the project. Together with the Ministry of Finance, the Court of Audit of Hesse informs

politicians of the approaches and problems, e.g. about valuation and accounting methods, product budgets, etc.

In autumn this year, the Court of Audit of Hesse is expected to issue an experience report in respect of the first audits on the accounts which it is carrying out at two pilot government departments (Ministry of Social Affairs, Ministry of Education). In addition, many of the requests for advice from the state parliament are passed on to the Court of Audit, in the same way as the audit of the introduction of SAP R/3 was returned at a request of the budget committee.

b. the Hesse Ministry of Finance

The advisory activities carried out for the Ministry of Finance are intensive. The Court of Audit of Hesse must be consulted prior to the passing of administrative provisions on state budget regulations. For this reason alone, it is involved in setting standards as part of NPM in Hesse. In this way, the Court of Audit has advised the Ministry of Finance, as the competent department, in particular on matters relating to appropriation and valuation, in opening balance sheets and annual accounts.

The Court of Audit has also commented, among other things, on the issue of whether accounting should, for the time being, be carried out in accordance with the national regulations of the German Commercial Code or in accordance with IAS/IFRS and the corresponding International Public Sector Accounting Standards (IPSAS), where these exist. The Court of Audit believes that the time is not yet ripe to introduce IPSAS.

The development and adaptation of valuation regulations is, to a large extent, the subject of the advisory activities of the Court of Audit of Hesse.

As is so often the case, the devil lies in the detail. In addition there is the fact that it is not always possible to resort to private economy regulations when assessing public sector assets.

Hesse is the most densely forested federate state in Germany. The lion's share of this forest is publicly owned. The forest can therefore be of considerable significance for balancing the

books. In accordance with the different situation of interests in the private and the public sector, there are already different valuation methods (IDW¹ standard/forest valuation calculation guideline), which, in each case, are geared to economic use. As a basic principle, the economic use and/or the embodied use potential are determining factors for the valuation of asset items. However, in view of its “growth properties”, the wood also has an essential ecological and cultural value, a “recreation value”. Such considerations – which are even more obvious in the case of public goods or goods in general use, such as parks or monuments, to which no profitability targets can be assigned – do not, however, prevent accounting and a positive valuation. It is justified to take account of the general concerns of public welfare, which tend to get mixed up with hard-to-measure overall economic effects by undertaking a balance sheet valuation in line with the usual criteria applying to individual businesses. As a rule, in accordance with German commercial law, assets must be valued at cost.

Alternatively, if this – as in the case of state-owned woodland – is not possible, then valuation methods geared towards intrinsic value or productive value are employed. In Hesse, a decision has now been taken in favour of forest valuation geared towards intrinsic value, where separate consideration is given to the land, on the one hand, and the tree growth on it, on the other. In the process, different deductions are made on the intrinsic values calculated by the expert committees. Among other things, the deductions take account of valuation uncertainties resulting from the multiplicative effect of evaluating the entire surface area of the state-owned forest. As far as tree growth is concerned, the age value of the stand is taken into account.

Another example of valuation issues with which the Court of Audit is dealing at present, is the valuation of works of art.

The corresponding valuation method was adopted in the accounting guidelines. This is not just a case of the valuation

¹ Informationsdienst Wissenschaft – an information service on scientific topics

approach for pictures by famous painters, for which there tend to be existing insurance values and/or for which market prices can be calculated without too much trouble. For low-value goods – for example beetle collections – simplified valuation methods are applied.

c. the other ministries

For the other ministries, the Court of Audit of Hesse advises on an indirect basis, by means of its audit procedures accompanying the introduction of NPM. This applies on the one hand to the audits preceding the approval of balance sheets. On the other hand, there are audits which examine and optimise NPM tools, as they are used in individual areas. By way of example, comparative audits on performance and performance benchmarks in certain specialist areas of universities in Hesse or on various New Public Management models in local authorities in Hesse must be mentioned here.

III. The audit and approval of opening and closing balance sheets

As has already been mentioned, approval of the opening and closing balance sheets of the highest state authorities has been legally transferred to the Court of Audit (Article 1 Section 1 clause 3 of the Court of Audit of Hesse Act). Thus, at present, the audit duty covers only the part-group balance sheets of the ministries/departments, in which “client” accounts (subordinate areas) are consolidated. The preparation of a consolidated balance sheet for the federate state of Hesse and the audit thereof by the Court of Audit is the subject of plans.

Approval of the opening and closing balance sheets is preceded by an audit. For this purpose, the Court of Audit may employ chartered accountants from the private sector, in a similar manner to the supra-local audits of local authorities which have already been carried out.

Of course, there are and have been critical voices that maintain that the Court of Audit would interfere too much in administrative procedures, and actively at that.

For the Court of Audit of Hesse – and not just for this court! – issuing certifications (opinions) on accounts is nothing new. Article 144 of the Hesse constitution already provides for the audit and approval of budget accounts to be carried out by the Court of Audit of Hesse. Throughout Germany, courts of audit must certify the figures of the federate states' annual accounts insofar as they are of significance for intra-state adjustment payments.

For us, another determining factor in the assumption of the new duty was also the thought that, if we failed to cover this area, others would step in and we would be excluded from important core issues!

IV. Challenges for the Court of Audit of Hesse

The Court of Audit of Hesse displays a great deal of commitment in accompanying and supporting the New Public Management reforms. It is convinced of the necessity to take all of the necessary measures in order to preserve the federate state's financial stability – the fundamental overhaul of administration and an honest examination of its costs and charges will be of use in this respect. The Court of Audit of Hesse shares the risks incurred by the federate state in this connection, and is faced with the same challenges.

In particular, this means balancing out interests: the interests of the federate state in its financing capacity, and therefore in presenting its income, asset and financial situation in a way which neither worsens its ratings nor forces up its financing costs, on the one hand, and the preservation of its integrity as an independent institution guaranteed under constitutional law, which wants to enjoy credibility in the future too, on the other.

I view the other exchange of roles between auditing of annual accounts and later “conventional” auditing, which is occasionally regarded as a conflict of interests, in the same way as the relationship between auditing and consulting. Both are essential, both require detachment and vigilance.

However, I cannot stop myself from airing one final thought from my small, yet sometimes quite pragmatic lawyer's standpoint. Amid all the euphoria for controlling instruments, cost transparency and such like, we should not forget our common sense: the question of the necessity of the task must come before any perfect administrative action. I do not need to perfect unnecessary tasks. Nonsense remains nonsense, even if I am aware of its cost. But the cost pressures and cost transparency may well make a small contribution towards ensuring that all of us think a little more about the sense!