

# THE ROLE OF BUDGETS IN LOCAL GOVERNMENT: PROBLEM OR SOLUTION?

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## ABSTRACT

*This paper considers criticism of the practice of budgeting in local government, and proposals for both a standardised budgeting model and standardised financial reporting. The paper examines whether standardised models are appropriate, particularly in the context of ambiguous outcomes, criticism of accrual accounting in the public sector, and a focus on the implementation of a flexible best value regime. In light of the criticism that accrual accounting and other private sector practices are not necessarily appropriate for the public sector, this paper questions whether the conclusions of a 2001 report that budgeting practices are exceedingly poor are justified.*

## Introduction

In 2001 the Institute of Chartered Accountants of Australia (ICAA) undertook a survey of local government budgets. Budgets are an essential element of a council's financial management and control system. The ICAA concluded that the quality and content of Victorian council budgets is variable but generally poor. In 2003, the ICAA issued a set of guidelines and a model budget to guide Victorian local governments in their preparation of budgets, in an attempt to overcome the weaknesses that it perceives to still exist in local government budget preparation and financial management. The remainder of this paper looks at the reforms which have been imposed on Victorian local government, the responses to those reforms, and issues which may explain why it is perceived that budget reform has not been fully accepted.

## Reforms

Victorian local governments have experienced significant reform and change since the early 1990s. In 1991, the Municipal Accounting Regulations were updated. In 1992/1993 AAS 27 *Financial Reporting by Local Governments* became operative. In 1992 and 1993, in reports published by the Office for Local Government using annual report data (among other data sources), local governments were 'benchmarked' across a number of categories which used annual report data, much of which was not really comparable. In 1994/5, following a round of compulsory amalgamations resulting in fewer but larger councils (210 to 78), rates were both cut (by about 10%) and capped by the State. These changes were followed by the introduction of compulsory competitive tendering (CCT). The State government introduced compulsory benchmarking. Other reforms included the requirement for all local governments to produce corporate plans, and to prepare annual reports for their ratepayers. There was a background of change in State and Federal government sectors, with privatisation and corporatisation. Following another change of State government in 1998, Best Value was mandated in place of CCT. Best Value essentially requires that services be delivered to clear standards of both cost (similar to CCT) and quality (as determined by community consultation).

Throughout this period consultants were employed to instruct, develop new systems and processes and generally guide local governments through the changes. Many of the new, larger councils hired accountants and managers with private sector expertise. Nonetheless, in 2001, after 10 years, some local governments still could not prepare useful budgets. However, other research suggests there has been substantial change in

some aspects of management practices in Victorian local government. Kloot and Martin [8]&[9] demonstrate that modern management practices have been adopted and there are high levels of accountability to the community experienced by managers in local government.

### **Financial reporting and management changes**

Financial reporting has been the focus of much of the NPM reform in Australia. The adoption of accrual accounting has been seen as a panacea to increase transparency and accountability within the public sector. However, there has been substantial disquiet over the wholesale introduction of accrual accounting into the public sector [1]&[5]. It is argued that the public sector is not the same as the private sector. It has public interest responsibilities and community service obligations which are by their nature loss making. They are thus not amenable to private sector reporting practices which are focused on profits. There is also some evidence that a lack of rigour in defining community interest outcomes, combined with a propensity to insert cash figures into accrual accounts, renders the reports doubtful as appropriate tools for management purposes [3]&[4]. Financial management, as opposed to financial reporting, is not necessarily enhanced by accounting reform. Standardised reporting also mitigates the development of financial (and other) management practices specific to the circumstances of individual councils. Collecting and analysing 'comparative' data across councils may be intended to communicate best practice [2] but it may also distort the position of councils with different socio-economic and geographic environments.

Following the financial stringency imposed by the State government, the functions of control and coordination should have assumed greater importance. However, fiscal stress does not necessarily lead to change in entrenched management practices [12]. Van Helden [12] suggests that the application of NPM at State level should encourage the implementation of modern budgetary practices, as the expertise and philosophy flow from the centre to the councils. Certainly, the State government has implemented NPM and strong central control over departmental budgets through the State Department of Treasury and Finance and a number of financial reforms designed to strengthen financial management and to some extent centralise it. Lapsley [10] suggests that there is little evidence of substantive change in public sector reform but there is a preponderance of rhetoric which may or may not take hold. Practices essentially stay the same behind a cosmetic show of change [11]. Taken at face value, the ICAA findings provide a grim picture of local government budgetary practices, but is the explanation that the situation is not as bad as described in its reports? Is there a problem with the *perceptions* of budgeting practices in local government, and not so much with the *actual* practices themselves?

The measurability of outcomes in local government is still questionable. Performance indicators may be available for some or many activities, but others require social indicators [11] and these are much less amenable to measurement. Even the objectives of some activities may not be easily definable. Where outputs are non-measurable, non-routine, ill-defined or ambiguous, non-cybernetic models of control are necessary [11].

The ICAA's criticisms of budgets include that they do not convey important messages to stakeholders. Firstly, budgets do convey important messages about operating decisions to managers and staff. Second, there are other ways to convey messages to external stakeholders, e.g. the local community. Best Value is seen as on-prescriptive and flexible; encouraging a culture of local responsibility; focusing on local employment options, particularly in rural and regional areas; and a management tool consistent with best

practice, continuous improvement and allows for alignment with corporate strategy. The process of community consultation in itself conveys many messages to the local community.

The thrust of the Best Value is on local responsibility and accountability. Councils are performing satisfactorily across a number of best value dimensions, including costs and by implication budgeting. The ICAA comments that budgets have a short-term focus in many local governments. Is a long-term focus for an annual budget realistic? *Financial Management* (CIMA) has suggested that setting long-term budgets can be harmful for organisations, as budgets reduce an organisation's flexibility and ability to respond to rapid changes in its environment.

### Concluding comments

This paper questions whether the conclusions of the ICAA (2001) report are justified. Practices which may appear to be wrong, may in fact be appropriate for specific local conditions circumstances. There may be good reasons for councils to adopt different modes of budgeting. There is a need to balance efficiency and effectiveness outcomes to achieve best value for local communities, and this may not be achieved by prescriptive, private sector practices. Where private sector practices themselves are the subject of debate in the professional and academic literature, it would appear to be somewhat precipitous to insist on their wholesale adoption in local government at this time.

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