The value for money trend

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Abstract
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New thinking has expanded the traditional role of public sector auditing

Value for money (VFM) audits have developed in recent years as a move toward expanding the more traditional role of the auditor away from a straightforward examination of the fairness of the financial statements of an organisation.

In Canada and the United States, these expanded forms of audit have been applied to many non-profit organisations; though they are mainly in areas of central and local governments and their agencies. More recently, in Britain, there has been a limited introduction of VFM audits in the public sector, chiefly in local government and the water industry. But they could have wider applications.

The VFM audit encompasses an audit of economy, efficiency and effectiveness of an organisation's operations. The purpose of such an audit is to measure management's performance in the acquisition and allocation of resources for the purposes intended. Such an audit is, therefore, much wider in scope than the conventional audit which examines standards of financial accountability.

When examining the public sector, it is desirable to distinguish between those sectors that generate revenue from the services they provide (eg the nationalised industries) and those that, primarily, do not (eg local authorities, health service, central government departments).

The former, while required to meet a financial target, do so subject to political direction and have, in addition, to cope with non-market impediments such as cash limits, pricing policy and restricted trading activities.

Is it, therefore, right to contrast such industries with their private sector counterparts (where they exist)? Perhaps their performance should be more closely related to the objectives and policies to which they operate.

For those organisations in the latter category, there is no objective of profit or similar target. Their services, which represent the output of each organisation, are vague, abstract and difficult to qualify in monetary terms. There is no simple mathematical relationship between money spent and the value of services received, and thus no analytical method of making decisions as to the areas to which funds should be allocated to increase, the level of service.

The development of a control system as effective as one that can be built around the profit measure, is not possible in such organisations. Cash limits can, of course, apply but, as with nationalised industries, these are more correctly regarded as a constraint on the level of operations rather than a target or objective.

Objectives defined. The three basic objectives of the value for money concept can be defined as:

- **Economy:** 'Acquiring resources of an appropriate quality for the minimum cost'. A lack of economy could occur, for example, when there is overstaffing; or when overqualified staff or over-priced facilities are used.

- **Efficiency:** 'The amount of output per unit of input'. An operation could be said to have increased in efficiency if either fewer inputs were used to produce a given amount of output, or a given level of input resulted in increased output. Inefficiency would be revealed in the performance of work with no useful purpose, or the accumulation of an excess of (or un-needed) materials and supplies.

- **Effectiveness:** 'The relationship between output and the objectives of an organisation'. To evaluate effectiveness we need to establish that approved/desired goals are being achieved. This is not necessarily a straightforward procedure; some goals may not be initially apparent. Once a set of goals has been established we need to examine whether these goals are being accomplished.

Each of these objectives has been ranked in order of comprehensibility and measurability although they are clearly interrelated to one another. To establish economy means to examine the organisation's internal regulations for the creation of standards, objectives, performance measures, etc.,

It may be that independent support for certain of these arrangements can, and should be, sought. Typical areas for the examination of economy would include inspection of national agreements, professional guidelines; O and M reports and technical specifications

Once quality of resources is established, one would need to verify that those were obtained at minimum cost; perhaps more aptly described as 'acceptable' in relation to local conditions of operation.

Efficiency is harder to verify. The definition employed, 'output per unit of input,' may not be very easily quantified. Some Government departments could perhaps provide relevant statistics. For example, the National Health Service has figures for bed occupancy and treatment of certain categories of patients. Other organisations would need to develop appropriate/relevant measures. A local authority's cleansing department could provide figures for dustbin emptied, miles of footpaths and roads swept.

Such guidelines could be nationally agreed to aid comparability between segments or divisions of each organisation. Though desirable, one would need to establish safeguards. To continue our local authority illustration, a distinction would have to be made between the activities of rural and urban authorities.

A useful comparison could perhaps be made between a local authority in Devon and another in the Yorkshire Dales, but neither with the GLC. Output measures need to be relevant, agree and implemented by management (and unions); and capable of measurement. In any comparison cost differences themselves are fairly meaningless. The underlying reasons for such differences are important.

Effectiveness involves an examination of the relationship between the output and the objectives of the organisation. The auditor has the task of deciding whether predetermined goals are being achieved. Effec-
tiveness indicates whether results have been achieved, irrespective of the resources used to achieve those results.

A conflict arises when this objective is related to efficiency. For example, the ratepayer is, on the one hand, concerned with the efficiency of the service he receives. On the other hand he is concerned about the level of contribution he has to make.

As Hepworth states: 'The conflict between efficiency and effectiveness, particularly in sensitive services like education and social services, is extremely difficult to resolve, and is left to individual judgments, which really means the judgment of those most concerned with the development of the service.'

The auditor must determine the reasonableness of these individual judgments. It may be that specialist assistance will need to be sought. This is a particularly novel role for the auditor, in that he is expected to make an apolitical assessment of the deployment of resources, yet that deployment is more than influenced by the political persuasions and personal preferences of those elected individuals who ultimately control the allocation (and perhaps the level) of available funds.

The auditor has, in effect, to review the operation of each organisation on behalf of the public. He is not only concerned with the presentation of the accounts, but is there to watch over, in more general terms, the financial performance of the organisation, in terms of the cost-effectiveness, or efficiency, of the chosen policies. In this context, the auditor's task is to monitor the performance of both elected officers and management.

A useful principal, applicable across the breadth of the public sector, is provided in the words of the Local Government Audit Code of Practice. 'It is...not the function of the auditor to express his own opinion as to the wisdom of the particular decisions taken by councils in the lawful exercise of their discretion.'

The distinction is that the auditor is not concerned with the policy, but with its effects and whether such effects correspond with the intentions of the policy. This is a monitoring function, an examination of the situation that exists with that which might have been expected.

In a recent report of the Chief Inspector of Audit (for the year to 31 March 1981) he stated, when discussing the nature of an audit: 'It is a function of testing the data or a situation which exists with that which might be expected to exist. If the auditor compares the effects of a policy with the declared intentions, he is not questioning the policy decision, but rather monitoring the results. This enables the auditor to remain independent and, therefore, report unbiassedly to the public.'

In this respect, the auditor often has a thankless task. Electors frequently imagine that auditors can somehow reverse decisions of elected officers. They forget that those elected to office, be they in central or local government, have a mandate which allows them a considerable degree of discretion in implementing policy. Management, to a lesser extent, also exercise discretion on the best way to perform their duties.

Justifying the VFM audit. In recent years there has been much criticism of the standard of financial reporting in certain areas of the public sector and, more generally, on the performance of specific organisations. The Layfield Commission (Cmd 6453) summarised the complaints levelled against local authorities, by members of the public, following the outcry against the unprecedented increases in rate demands in England and Wales in 1974.

This report pointed out that there was no coherent sound system of local finance; a lack of accountability, in that no clear lines of responsibility existed for spending decisions. A coherent system, based on accountability, was called for: one that reflected the roles of both the government and local authorities.

As part of this system it was stated that 'more emphasis in the auditing of local authority accounts should be placed on efficient financial administration and value for money.' Layfield also called for an independent audit service.

At present, nationalised industries account for about half the public sector borrowing requirement (PSBR). They, too, have received complaints from consumers over pricing policy, and from competitors over subsidies. Unions are becoming increasingly concerned with redundancies, and management have to contend with reduced capital investment programmes due to the necessity to reduce the PSBR.

Cmd 7131 states that the government hopes the nationalised industries will develop further the role of their audit committees, or set up comparable arrangements, to look more generally at questions of efficiency and performance within their industry.

Report No 24 of the Post Office Users National Council states: 'Governments set financial targets for the nationalised industries. But customers at present have difficulty in knowing whether they are getting value for money. It is necessary to relate financial requirements, operational performance and quality of service.'

Other examples could be cited. The Corporate Report stated: 'financial reporting must cover a wider range of information than a narrow conventional interpretation of the term 'financial' would allow.' Such reports are expected to 'communicate economic measurements of the reporting entity useful to those having reasonable rights to such information.' The auditor, equally has a duty to ensure that public sector organisations adequately report the effective deployment of their services. Only recently have these problems started to be confronted.

The approach of a VFM audit should be essentially one of 'top-down'. The VFM audit should begin with a preliminary analysis of financial statistics and other performance indicators. Where trends or variations occur, these should be investigated. This would be done via a formalised internal structure, whereby senior management would liaise with the VFM auditors.

It may also be desirable for organisations to have an internal VFM audit team and a VFM audit committee. At the same time there should be a review of the main organisational structure, the key policy objectives, and the major deployment of resources.

For each part of the organisation it is then necessary to identify activities undertaken, and their purpose. An examination should be made of those outputs that are measurable and the costs involved. This information is needed to assess efficiency and effectiveness. The VFM auditor is concerned to see that planned activities have been achieved. He should not be involved in the setting of targets.

There is a strong relationship to recent developments in internal management systems such as programmed planning budgeting and zero-based budgeting. Both techniques, being programme-orientated, relate closely activity to the objectives of an organisation.

The conduct of the VFM audit should be flexible, and obviously depends upon what the initial review reveals. Ultimately the VFM audit becomes a regular and routine audit process. If efficiency and effectiveness targets are based on sound information, the final results should resemble closely those predicted.

Unresolved problems.

As the VFM audit is in its infancy, several problems have yet to be satisfactorily resolved. The audit profession must accept that it has to broaden its horizons and develop techniques that have hitherto been regarded as of academic interest only. If the theory behind work processes changes, then new techniques must accompany the audit.

Specialised assistance may need to be sought, and this may mean that audit teams are no longer composed solely of accountants. The VFM auditor will have to produce a comprehensive report that is not only for the internal consumption of management or elected officials, but is available also to consumer councils and the general public.

Failure to meet these changing needs can only lead to an undermining of the audit profession by critics who will continue to question the value of the conventional audit report for public sector organisations. Auditors must, therefore, ensure that adequate information is provided for those that have a right of access to such information.

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