SECTION 6: IMPROVING THE MANAGEMENT OF FINANCE

6.1 Restructuring the classification of accounts and organisations

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6.1 Restructuring the classification of accounts and organisations

In accounting systems, the classification of accounts determines the manner in which financial data are identified, accumulated and reported for planning, resource allocation, management control and results evaluation. In government accounting, the development of a classification of accounts is dictated by two requirements:

- the need to provide data in the form required for presentation of the Financial Estimates to the House of Representatives; and

- the need to provide detailed information necessary at ministry/department level for management purposes.

The project endeavoured to define a framework for the government's chart of accounts that would include expenditures, revenues, assets, liabilities and off-set accounts, and that would reflect the recording/reporting requirements for all levels: Public Accounts, Treasury, ministries and departments. The project did not examine the underlying accounting principles, but defined a common framework for classification of government's financial transactions. The objective was to define an operationally simple structure to enable financial transactions to be coded on a consistent basis, at the initial point of information capture, and with the necessary relational information to serve all significant reporting requirements. In parallel with the chart of accounts, an organisational coding structure was developed to record transactions by organisational units at different levels of aggregation i.e. responsibility centre, cost centre, department, ministry, etc.

The context for change

The accounting classifications in use in Malta's public service had been modified to the point where there was no longer an underlying accounting structure that addressed the reporting needs of the operating departments, ministries, Treasury or the House of Representatives. The accounting coding conventions were not well understood, nor applied consistently. The resulting financial records were generally unreliable for management information purposes, in all but their aggregate form. The Government published standard objects of expenditure, but they were not generally applied across all departments.

Financial transactions appeared to be classified or reported as per local departmental requirements and numerous non-standard classifications occurred in the Estimates for 1992 and for previous years. The classification practices appeared to lack an underlying structure with organisational and accounting relationships inter-mixed. The lack of a common expenditure classification system created difficulty when there was a need for government-wide consolidations and comparisons of administrative costs among departments.

Most transfer payments within Malta (programme disbursements to third parties) were reported as discrete *Operational and Maintenance Expense* items. Lack of a clear distinction between payments to third parties and the operational expenses of a department made it difficult to establish a basis for assessing a programme's direct costs and benefits on one hand and the operational efficiency of departments on the other.

There were few consistent classification definitions. The boundaries between major types of expenditures also appeared to depend upon local circumstances. The decision to identify a particular financial transaction as *Operational and Maintenance*, *Special Expenditure*, or *Capital Expenditure* was flexible. The lack of consistency in the classification as between recurrent and capital expenditures severely compromised the comparability of Government's financial statements from one fiscal year to another. There was little consistency in the application of the commonly used *Operational and Maintenance* classifications, e.g. transport-related expenditures.

Standard classification of financial information is indispensable for effective management as well as for economic analysis. The purpose of the project was to identify an appropriate method of classifying financial transactions to ensure consistent and effective financial recording and reporting across organisational units within the Government of Malta, and over time.

Implementing change

The first step following formal approval of the terms of reference of the project by the Ministry of Finance was the establishment of a committee of advisers from the public service to represent the accounting interests of operating departments, the control concerns of the Treasury and Public Accounts/Estimates processes in the Ministry of Finance. Examination of the current information structure was followed by redefinition of the existing accounting conventions/practices in Malta. This redefinition was based on the experiences of other jurisdictions and assistance from the advisory committee.

Since no single classification system can provide for all coding requirements, a multiple classification system with multiple levels of detail within each classification was developed. The effectiveness of this system depended on individual transactions being properly identified. This two-fold classification was linked by an integrated coding system which required each transaction to be identified both by nature and by source, thus facilitating analysis of the financial aspects of government activities.

The first breakdown of accounts is two-fold:

- *Chart of accounts classification* to identify the *nature* of transactions

  The chart of accounts classification provided a breakdown of the transactions of each ministry and department and each cost centre to the level of basic line objects where the operations, processes, services, projects, tasks, etc. were identified. These all identify, at various levels of accumulation, the purposes for which funds were spent to achieve their objectives or the sources of revenues received.

  The chart of accounts is a coded listing of accounts which is used to record revenue, recurrent expenditure, capital expenditure and below the line transactions. Each of these account types is divided into categories and these are further divided into standard objects. Each standard object consists of a number of line objects which are the lowest level at which all expenditures are coded and are therefore the building blocks of the standard object and category classification.

- *Organisational classification* to identify *responsibility* for transactions

  The organisational classification ranges from the highest level of managerial responsibility to progressively lower levels of responsibility and thus identifies who is responsible and accountable for spending public funds The organisational classification culminates in a ministry/ departmental vote, which provides the basis for the vote structure by which the House of Representatives appropriates funds.

  At the top of the structure is the ministry/department which is identified in the Estimates by means of a recurrent vote and which is divided into a number of cost centres. A cost centre is defined as a major programme or activity of a ministry/department and it is further divided into responsibility centres. A responsibility centre is a sub-section or division within a major programme or activity where there is a manager who is accountable for a budget.

The adequacy of instructions in a sample department was tested prior to implementation. Information in the 1993 Estimates was structured according to the new Chart of Accounts and organisational codes. In order to accommodate the new information structure modifications to the *Treasury Accounting System* were carried out.

Training sessions on the use of the new Chart of Accounts and organisational codes were attended by approximately 200 departmental accounting officers. The approved accounting conventions were documented in a coding manual and a booklet with explanatory notes. Copies of these documents were distributed to all ministries and departments.

The management reporting format based on the new Chart of Accounts was developed and made available as from February 1993.

The development of a comprehensive recording and reporting structure and its consistent application is a prerequisite for reliable and informative financial reports. The provision of such reports, in turn, is closely related to other projects in the ambit of public service change in Malta. In particular, it supports directly the implementation of business and financial planning in Government, the estimates process and ministerial reviews of expenditure and revenue against approved amounts which take place on a quarterly basis. The codes for recording and reporting transactions according to the new chart of accounts and organisational codes will be used in the *Departmental Accounting System* to be implemented across the public service.

The development of a chart of accounts and the organisational coding was carried out over a period of four months in 1992. These were followed by the preparation of supporting documentation and the preparation and delivery of training seminars for staff from the central agencies and line departments.

6.2 Strengthening internal audit

The *Internal Audit Project* was launched following identification of the need to establish a standardised internal audit function for ministries and departments in support of increased delegation levels and the introduction of decentralised accountability structures.

The context for change

One of the deficiencies identified in the area of financial management and administration is the lack of accountability for overall performance. Moreover, the limited internal auditing conducted by ministries was weak, restricted in scope and thus ineffective. Furthermore, the limited resources of the Department of Audit (i.e. the national audit office) constrain it to concentrate on monetary control while there is virtually no evaluation of the overall performance of ministries.

Concurrent with other change initiatives the need was felt to provide management with a 'monitoring' mechanism that provides effective and objective reports on ongoing infrastructural changes and the management of allocated resources.

Implementing change

The introduction of the internal audit function required a specific project methodology. The methodology pursued consisted of a conventional data gathering phase undertaken mostly through extensive consultation with the major stakeholders in the service. This was followed by a data analysis and assessment phase. The diagnosis resulting from these two phases was instrumental in providing a report to government on the advisability, feasibility and timeframe required for the introduction of internal audit for all government operations.

An implementation strategy based on this report was developed, covering observed internal audit needs as well as organisation structures to support the provision of internal audit across the public service. This strategy was further validated with potential users of internal audit in government by means of a series of extensive consultations, including information seminars. It focused on a strong training programme, an effective central audit policy monitoring unit and the association of auditors with a professional body (Institute of Internal Auditors of the U.K.).

As noted previously the timetable for implementation was set at two to four years. Three key markers in the programme of implementation are:

- the preparation and promulgation of a Government Internal Audit Policy;
- the creation of Ministry Internal Audit Committees;
- the creation of a Central Audit Policy and Monitoring Unit in the Ministry of Finance.

In an effort to build a partnership with the future users of the internal audit function a Steering Committee composed of senior civil servants was constituted to advise on and monitor implementation.

The implementation strategy focused on three critical ingredients:

- Government should proceed with gradual introduction of internal audit in major ministries. The inherent complexities in the implementation of this initiative coupled with the lack of knowledge of the subject matter dictated a prudent and gradual approach. The introduction is to be phased over a period of two to four years.
- Government should proceed according to an implementation blueprint.
- In order to ensure successful implementation, all partners to the implementation plan must provide an active and fully committed role in their particular area of responsibility. The collective and public endorsement of the introduction of the internal audit function was the first step in recognising the importance of the function.

The framework for the introduction of internal audit was endorsed and the implementation plan launched in April 1991.

The Internal Audit Blueprint and Implementation Plan has since been updated and includes a separate report on the achievements of the programme to date and several recommendations for enhancing the sustainability of the internal audit function in the long-term.

To date, the audit results can be measured by the increasing request for their services, and the growing confidence of management in their new function. Progress has been incremental but positive: for example, audit reports have been instrumental in the re-evaluation of, and changes to, procedures that strengthen financial control over revenue disbursements from social programmes.

Complementing these steps is a public information awareness communications strategy, the development of linkages with the local professional Institutes of

Management and Accounting and the formation of a Malta Chapter of the Institute of Internal Auditors.

Important items in the implementation strategy have been realised.

The first year of the training programme was completed on schedule, and in mid-July 1993 the first teams of internal auditors were deployed in four ministries.

By September of the same year, the Ministry of Finance had established a Central Audit Policy Unit, and the Ministry and MSU had drafted Audit Standards.

There is ongoing review, by permanent secretaries and the MSU, of the work of functioning Ministry Internal Audit Units, against their respective Long-Term Audit Plans.

The basic training programme, devised and co-ordinated by the Management Systems Unit and the Staff Development Organisation, comprised the following:

- selection of an international training organisation (Institute of Internal Auditors) to conduct formal classroom training in three modules amounting to ten weeks over a period of nine months;

- recruitment of respected senior audit practitioners from the Government of Canada to provide practical training through pilot audits within ministries;

- It was decided that it would be cost effective to hold the training in Malta as this allows trainees to apply their new skills in pilot audits across the Service. This approach is, over a period of time, invaluable in the general education of the audit client community vis à vis the public and the Service.

The Internal Audit function requires time to mature as part of and in concert with the new management culture that is being fostered under the change programme. In the short-term its success can be measured by the degree of confidence that one hopes is forthcoming from the organisation and people it serves.

6.3 Improving procurement and tendering systems

A major policy objective of the Government of Malta is to ensure that the public procurement process is executed in a transparent, expeditious and cost effective manner, leading to best value for money purchases. Following recommendations made by the Operations Review, the Government established as one of its priorities the review of procurement and tendering policy and procedures.

During 1993, the *Procurement and Tendering Project* was initiated. The project consisted of two phases:

- the first phase reviewed recent reports and studies on the subject, with a view to obtaining government approval for fast-track implementation of particular recommendations;

- the second phase of the project involves the development of a comprehensive manual which will serve as a sole source of reference on the subject of government procurement and tendering.

The context for change

Stakeholders of the public procurement process, including constituted bodies, have raised concerns about the length of contract adjudication procedures, the prevalence of contract awards on the basis of price differentials and the scarcity of expertise among members of adjudicating bodies. While some aspects of transparency of the process have been improved (e.g. tender bids are now opened in public), there is still a lack of clarity about roles and responsibilities of the official adjudication boards and about evaluation criteria.

Several of the issues raised by contractors related to tender documentation, and included lack of differentiation in the forms to be used for a specific type of tender (i.e. supplies, works, services). Concerns were also voiced about the length of the period between publication of a call for tenders and the deadline for submission of bids, as well as the uneven distribution of calls for tenders during a year. Other minor concerns related to access to tender documents, the lack of standardised document presentation or uniform terminology.

The recommended increase in delegated authority for ministers, permanent secretaries and heads of departments as regards procurement by tender is in line with Government's policy of decentralisation of responsibility and is intended to expedite the tendering process. Greater delegation of authority giving ministers, permanent secretaries and heads of departments more freedom to manage the resources they have been entrusted with, implies increased accountability for performance and decisions.

Other recommended changes support the delegation of authority to departments. For example, availability of a comprehensive procurement and tendering manual is necessary for decentralisation of procurement authority, as well as the change of the function of the Director of Contracts from pre-audit to post-audit.

To carry out this project and related activities, a project team was established. Officials from central agencies (Ministry of Finance, Treasury and Department of Audit) and line departments which are major purchasers were represented on the team, in addition to Management Systems Unit consultants and an expert on European Union (EU) matters. The team devised a two-phase schedule.

Phase I involved the following two steps:

- review recent reports and studies with a view to obtaining government approval for fast-track implementation of certain recommendations;

- make changes, where warranted, to the *General Financial Regulations* and policies in order to permit these recommendations to be implemented.

Phase II will involve the following discrete steps:

- review current EU tendering policies and procedures, and any procedures current in other jurisdictions which are relevant;

- review the existing legal framework in Malta, recommend necessary changes and a timetable for implementation;

- draft and publish a tendering manual.

At present the procurement and tendering system operating in the public service is two-tier: tenders with an estimated value below a certain ceiling are awarded by departments issuing their own calls for tenders while tenders above those ceilings are adjudicated by the Contracts Committee at the Ministry of Finance. Members of this committee are appointed by the Prime Minister.

In the first phase of the project an analysis of the implications of increasing ceilings for departmental tenders was carried out. Using data available for 1992, the numbers and values of tenders which would be taken over by departments (thus not requiring approval by the Contracts Committee) were estimated for various options for departmental expenditure ceilings. Changes to *Regulations* and policy sufficient to enable these recommendations to be implemented were drafted. The changes, when implemented, will result in at least halving the number of tenders which have to be referred to the Contracts Committee for approval.

The distinctions which already exist as between calls for tenders and direct orders will be perpetuated. While it is being proposed that the departmental tendering ceilings be doubled, there is no ceiling on direct orders which are a ministerial prerogative and subject only to the availability of funds within the approved Estimates of the ministry and to the approval of the Ministry of Finance.

Procurement procedures will be altered in other material respects, e.g. to ensure greater transparency of the whole process.

A number of amendments were suggested after consulting European Union directives on specific topics. Given that Malta aspires to full membership of the European Union, the project team looked at the compatibility of the Government's current tendering procedures with EU tendering regulations. The project team recommended that even though current EU tendering value thresholds above which EU directives are applicable, are quite high by Maltese standards, the Government should endeavour to make its tendering regulations as compatible as possible with EU directives in specific subject areas, while giving due consideration to the structure of the Maltese economy.

The recommendations which emerged from Phase I of the Tendering Process Study included:

- increase the limits which require a bid bond to be posted to Lm25,000 for tenders for supplies and services and to Lm50,000 for tenders for works, i.e. bid bonds would not be required for tenders for supplies and services costing less than Lm25,000 and for tenders for works costing less than Lm50,000;

- identify, in the light of EU regulations, which 'contracting authorities' must comply with the Government's tendering regulations and thus determine what are their respective tendering limits;

- strengthen the Contracts Committee by appointing members for periods of two years and by selecting them on the basis of their skills, experiences and of the contribution which they can make to the Committee's work;

- modify the conditions for blacklisting tenderers so that such conditions are compatible with EU regulations;

- increase the amounts of penalties which may be remitted by heads of departments to Lm250, by the Director of Contracts to Lm1,000, with penalties above Lm1,000 being referred to Ministry of Finance;

- double the tendering ceiling of all contracting authorities which must comply with regulations affecting tendering; this would result in the 'ceiling' being increased from Lm5,000 to Lm10,000 and would result in ministries being able to effect more purchases by tender in significantly less time than is required when the tender is awarded by the Treasury.

During the second phase of the project, work on the procurement and tendering manual will involve examination of Ministry of Finance and Treasury circulars on the subject to ensure that all current provisions are included in the manual, or amended as necessary. Foreign sources, including EU directives, will be used to develop instructions on matters about which the present *Regulations* and circulars are silent. In parallel, terms of reference which clearly define and distinguish roles for all officials in the government procurement process will be written.

Publication of the manual and implementation of its provisions will be preceded by a series of seminars to familiarise officials in charge of procurement and tendering with the manual's provisions.

This project is consistent with the *Financial Delegation and Accountability Initiative*.

Two related projects have also been undertaken. The first was a project for the Ministry of the Environment that was referred to as *Standards Rates and Costs*. This was undertaken to assist the quantity survey section of the Building and Engineering Department to produce better budgets for government construction projects and to evaluate tender responses more comprehensively. It became operational at the end of January 1994 and has been operating without problems.

The second was a corporate project called *Stores Management* which is ultimately intended for application in all ministries and departments. It will provide stores data in a uniform format across the public service and thus better stock control. It has been implemented at Inland Revenue, Pollution Control, the General Stores of the Department of Health, and the two main Works Stores. The Armed Forces of Malta has been chosen as the next site for implementation.

6.4 Preparing a financial policy manual

The Ministry of Finance is to prepare and circulate a *Financial Policy Manual* which includes financial policies, the *Financial Administration and Audit Act*, the *General Financial Regulations* made under that Act, and directives on financial planning, including business planning and the annual preparation of expenditure estimates. A section divider is to be included to permit the individual manual holder to keep official circulars of particular interest issued by the Ministry of Finance, the Treasury and the Management and Personnel Office.

Other sections on closely related subjects will be added as they are approved for publication.

This manual will be a comprehensive authority and reference on all matters pertaining to financial management and is intended to be one of the primary support tools for Directors of Corporate Services, Directors of Finance and Administration, finance managers and administrators and all public service managers.

The context for change

This manual is the vehicle which government will use to communicate its corporate financial policies and circulars throughout a decentralised service in order to ensure the requisite uniformity and consistency in delegated financial management.

Since the information required for effective financial administration is scattered over a variety of sources, many of which are dated, there was a demonstrable need to provide one source of clear guidance which serves as a tool for decentralisation of financial accountability.

In addition, many of the scattered sources of information are written in a legal style and format which is not easily readable by most of the users for whom this manual is intended. By contrast, the policies contained in this manual each deal with a separate subject, are organised generically by subject – expenditures/payments/ revenue/receipts and internal control – and are written in a readable style.

Implementing change

The Ministry of Finance must make an unqualified commitment to the principle of decentralisation of financial administration as an essential first step in the process of writing and publishing a *Financial Policy Manual.*

Given that commitment, the preparation of the manual will be undertaken by a drafting committee comprising experienced employees from several ministries and departments, including the Ministry of Finance, which is given clear guidance as to its responsibilities. This may need to be monitored by a senior official of the Ministry of Finance.

It is difficult to prepare a useful *Financial Policy Manual* if the legislation on which it is based is grossly out of date. Thus, the *Financial Administration and Audit Act* and the *General Financial Regulations* must be reviewed to determine their currency and amended where necessary to reflect present circumstances and practices. In sequential terms, the Act should be amended first, and then the Regulations should be amended to reflect the revised Act. These will form the essential basis for the preparation of the *Financial Policy Manual.*

The probable costs of preparing such a manual are a function of its scope and complexity as well as being directly related to the number of copies which are needed for distribution. The time of those directly involved in drafting, reviewing and approving the policies in particular and the other contents in general will need to be included in any calculation of costs. There are also the continuing costs of maintaining the manual to ensure that it is current.

The skills required include an understanding of the broad legislative framework within which the Ministry of Finance operates, the ability to write in a readable, concise and unambiguous style and the ability to perceive how the various policies are interrelated so as to avoid logical inconsistencies among the policies themselves and other parts of the manual.

The key stakeholders whose commitment is essential for success in drafting such a manual are the Permanent Secretary of the Ministry of Finance, senior Finance and Treasury staff and committee members entrusted with responsibility for reviewing and revising proposed contents including policies and finally those charged with the responsibility for the actual drafting of the manual.

The *Financial Policy Manual* constitutes an essential part of the support mechanisms for the *Financial Delegation and Accountability Initiative* which envisages the decentralisation of financial administration throughout government.

The time required to prepare this manual depends on the point of departure. If all the legislation is up to date, the process can be completed much more expeditiously than if the legislation is being amended while the manual is being written. However, the commitment which the Ministry of Finance is prepared to make in terms of human and other necessary resources will clearly have the most significant impact on the length of time required to complete this manual. The management of these resources is also a critical element in determining the amount of time required.