



# *Public money for the public good*

BUILDING TRUST IN THE PUBLIC FINANCES

A POLICY INSIGHT

# Foreword

***‘Public money ought to be touched with the most scrupulous conscientiousness of honour. It is not the produce of riches only, but of the hard earnings of labour and poverty.’***

Thomas Paine

Successful economies deliver sustainable growth and resources to meet the needs of individuals, communities and business. With government activities accounting for nearly half of the global economy, effective public financial management is a crucial, yet all too often overlooked, condition for prosperity.

The role of professional accountants is fundamentally about creating trust. Trust that numbers are correctly stated and that a true and fair account has been produced, showing what money has been raised and how that money has been used. This is equally true in business or in the public sector.

For the government this bond of trust is especially important. The public needs to trust that when the government asks them for taxes, the monies paid over and other public resources will be used for the public good.

Every country has a unique history and faces distinct challenges. While there can never be a single approach to public financial management, there are certain universal principles and factors which underpin the creation of trust anywhere in the world. This publication provides an overview of those factors, both cultural and technical.

To illustrate what can be done, we have included a range of case studies showing how different countries have taken practical steps to build trust in public money. The majority of these are from developing nations: lower GDP is no barrier to effective public financial management.

We hope that this report will contribute to building a world of strong economies, where public finances are transparent and well managed, and where public servants hold themselves to the highest standards.

## INSIGHT

With the public sector making up nearly half of the global economy, effective public financial management is a critical factor in the economic success of each and every country.



*Michael Izza*

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# *Contents*

Foreword	2
Executive summary	6
Trust: the basis for strong economies	8
The foundations of trust	11
Culture and behaviour	12
Professional skills and ethics	14
Robust systems and processes	16
Building trust in practice	19
Insights	28

Economies can't succeed without trust in how public money is managed. Lack of trust discourages business, deters investment and lowers tax yields.

Trust grows out of a commitment to accountability and transparency which together create a culture of rigorous scrutiny.



**THE NETHERLANDS**  
The IntoSAINT integrity audit  
**PAGE 25**

**EUROPEAN COMMISSION**  
The 'Four Eyes' concept  
**PAGE 16**

**AFRICA**  
Improving professional financial skills  
**PAGE 15**

**NIGERIA**  
Transparency over tax liabilities  
**PAGE 24**

**BRAZIL**  
Supreme Audit Institution  
**PAGE 18**

**LIBERIA**  
Defining good financial management  
**PAGE 13**

**BRAZIL**  
Participatory budgeting at local level  
**PAGE 21**

**SOUTH AFRICA**  
Protecting external scrutiny of public administration  
**PAGE 20**

This report describes concepts, structures and methods which have promoted trust on every continent. It is dedicated to all who have devoted their careers to building the public's trust and looking after the public's money.

The case studies from around the world show how countries have taken practical steps to build trust in public money.



**MOLDOVA**  
Analysing public financial data  
**PAGE 23**



**PAKISTAN**  
Harnessing technology to expose corruption  
**PAGE 26**



**UGANDA**  
Keeping tabs on spending  
**PAGE 24**



**SOUTH AFRICA**  
Asserting positive values  
**PAGE 12**



**SINGAPORE**  
Three pillars of anti-corruption  
**PAGE 26**



**TIMOR-LESTE**  
Managing commodity price risk  
**PAGE 27**



**THE PHILIPPINES**  
Citizens' Budget  
**PAGE 21**

# Executive summary

## INTRODUCTION

Effective public financial management is essential for economic success. At its core is the need to build and maintain trust.

Trust grows out of a culture of rigorous independent scrutiny which enables citizens to see that the decisions their leaders take are in the public interest.

## KEY PRINCIPLES

Four principles underpin trust in the public finances:

- **Transparency** – accurate records that show where money is raised and spent.
- **Assurance** – figures and processes are checked by independent experts.
- **Accountability** – decision makers are clearly identified and subject to strict rules and review of performance and outcomes.
- **Objectivity** – policies are based on accurate information and rigorous analysis.

Three functional factors put these principles into practice.

- **Culture and behaviour** – which needs to support the behaviours and values required of good public servants: integrity, selflessness, objectivity. Public money must be managed for the public good.
- **Professional skills and ethics** – high quality public financial management requires highly developed technical skills, continuous learning and strong ethical codes.
- **Robust systems and processes** – which should be supported by comprehensive data collection, analysis, scrutiny and audit.

These principles and factors are vital for an effective system

Strong public financial management requires **transparency** in how resources are raised, managed and used, together with **accountability** to instil confidence and promote continuous improvement.

Strong **governance and controls** will ensure public officials are held accountable for the stewardship of public money, with feedback and sanctions when behaviour falls short of expectations. These also provide assurance that the system is operating as intended.

A wide range of **professional skills** are needed to ensure government has the capability to undertake the financial management of large public bodies in a complex stakeholder environment. Clear guidance on **ethics** will help public servants in situations of conflict.

It is vital that robust systems and processes are underpinned by **core accounting disciplines** to ensure financial information is relevant, reliable, comprehensive, complete, understandable and produced on a timely basis.

**Good financial management practice** will include clearly defined responsibilities, segregation of duties, adherence to documented procedures and controls, regular management review, and reconciliation of account balances.

**Independent audit** gives citizens confidence that the numbers presented by government are accurate. Internal audit should have a high degree of operational independence. External audit should have constitutional safeguards that ensure its independence from the executive.

## INSIGHT

Building trust about public money is about putting in place comprehensive mechanisms to demonstrate to citizens it is being spent for the public good.

**Building trust in practice has a strong social dimension.**

It is vital to uphold the **'social contract'**. Citizens must be confident that they are protected by the law and that public institutions and servants will act in accordance with it.

Public institutions with operational **independence** from political control are more likely to be trusted to act in the public interest.

A well informed population is far more likely to be confident about investing for the future. This means both providing appropriate information in ways that are accessible and easy to understand, and **educating citizens** as well as inviting them to participate in decision making.

Effective public financial management requires that decision makers, citizens and other stakeholders, are able to **'follow the money'** to see how taxes were raised, why decisions to spend it were made, how the money was actually spent and what was bought.

Where government plans and activities are measured against expected outputs and outcomes, citizens and other stakeholders will be able to judge the performance of government. This in turn provides the basis for **feedback and continuous improvement** mechanisms.

For the public to believe that public officials will do the right thing, a range of controls to promote **integrity and ethical behaviour** and to tackle **fraud and corruption** are required. Most importantly, the public must believe that individuals will be held responsible for their actions, no matter who they are.

A **climate for investment** is created when investors believe a state is stable, well run and that political and fiscal risks will be managed effectively.

**CONCLUSION**

A world of strong economies depends on trust in the public finances. Public servants spend other people's money and citizens and investors need to have confidence that those funds will be properly and effectively used. Governments have a duty to demonstrate that they deserve that trust.

Chartered accountancy exists because of the need for financial data to have been scrutinised by skilled, independent and objective professionals with a commitment to high ethical standards and the public interest. Their qualifications ensure these professionals can be trusted to declare that a financial statement provides a true and fair reflection of the facts. Accountancy skills are the foundation of rigorous independent scrutiny.

The techniques developed by chartered accountants over many decades build confidence that public finances are being managed for the public good. This in turn provides a key condition for the sustainable economic growth vital to addressing the profound challenges faced by nations in the 21<sup>st</sup> century.

Professional accountancy bodies have a valuable role to play in providing the frameworks and expertise to help government develop effective public financial management. This includes both technical accounting and management know-how and the strong ethical standards expected of professional accountants.

# Trust: the basis for strong economies

## WHY TRUST MATTERS

### A strong economy depends on governments establishing and maintaining trust.

Good government is essential for strong economies. Government tax and regulatory policies create the environment in which the private sector does business. In turn, citizens and businesses can only work within the framework that a state provides.

In almost all cases it is the private sector which generates the wealth that is taxed to provide public services. It is important for citizens to trust that the government will act in their interest, if they are to invest their own private resources and so create economic activity and employment.

People need to know that the government won't change the rules that shape their lives in unnecessary or arbitrary ways. This means reasonably stable legal, financial and institutional frameworks are required to support a strong economy.

Citizens also need to believe that the burden of taxation and benefits of welfare systems are fairly distributed, public procurement decisions are fair and public money is spent to good effect.

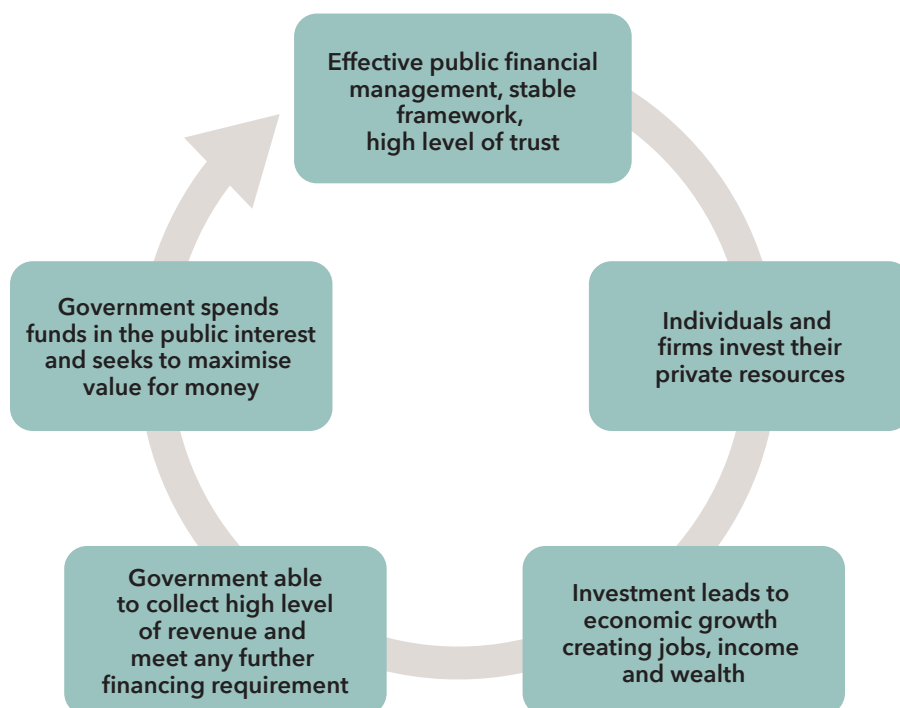
The nature and frequency of changes to taxes and regulation and the efficiency of public spending are vital indicators of the degree of certainty citizens can have about the rules that govern them.

A high degree of predictability leads to investment and enterprise. Figure 1 shows how trust creates a virtuous circle.

### INSIGHT

The policy choices of the state create the context in which the private sector economy operates.

Figure 1: Virtuous circle of trust





**INSIGHT**

Where states fail to instil trust in their citizens the impact on the economy can be profound and long-lasting.

Where the public finances are not managed effectively, because money is either wasted or channelled illegitimately towards personal or political goals, the inevitable result will be an erosion of trust among citizens and damage to the economy. The consequences of a loss of trust in the state can take several forms:

- high levels of aggressive tax avoidance and evasion;
- capital fleeing offshore; or
- the loss of a country's credit standing, leading to the state only being able to borrow at expensive rates of interest.

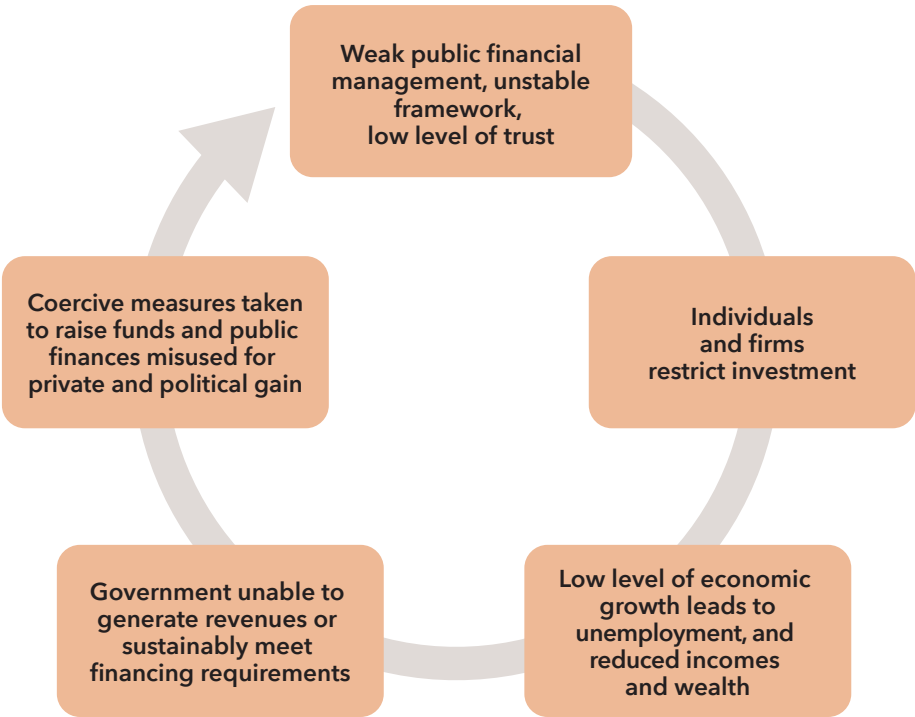
All of these factors can lead to the state finding it difficult to fund its activities, resulting in a breakdown in public services.

States that are unable to raise funds through legitimate activities sometimes resort to desperate measures: demanding bribes to access services, seizing private property or excessive creation of money leading to hyper-inflation.

Such quick-fixes only push an economy, and indeed society itself, further downhill.

Figure 2 shows how a lack of trust impacts economic performance through a vicious circle of mistrust.

Figure 2: Vicious circle of mistrust



## TRUST: THE KEY TO MEETING NEW CHALLENGES

Without trust in the public finances no country will be able to deal effectively with the economic, social and environmental issues shaping the 21<sup>st</sup> century. Figure 2 shows how a lack of trust impacts economic performance.

National markets are increasingly open to foreign competition; populations want better services; climate change imposes new burdens; growing numbers of old people need to be supported; and new technologies are changing the nature of work.

The nature of the challenge can vary between high and low income economies as Figure 3 illustrates. Other challenges are global and need a collective response.

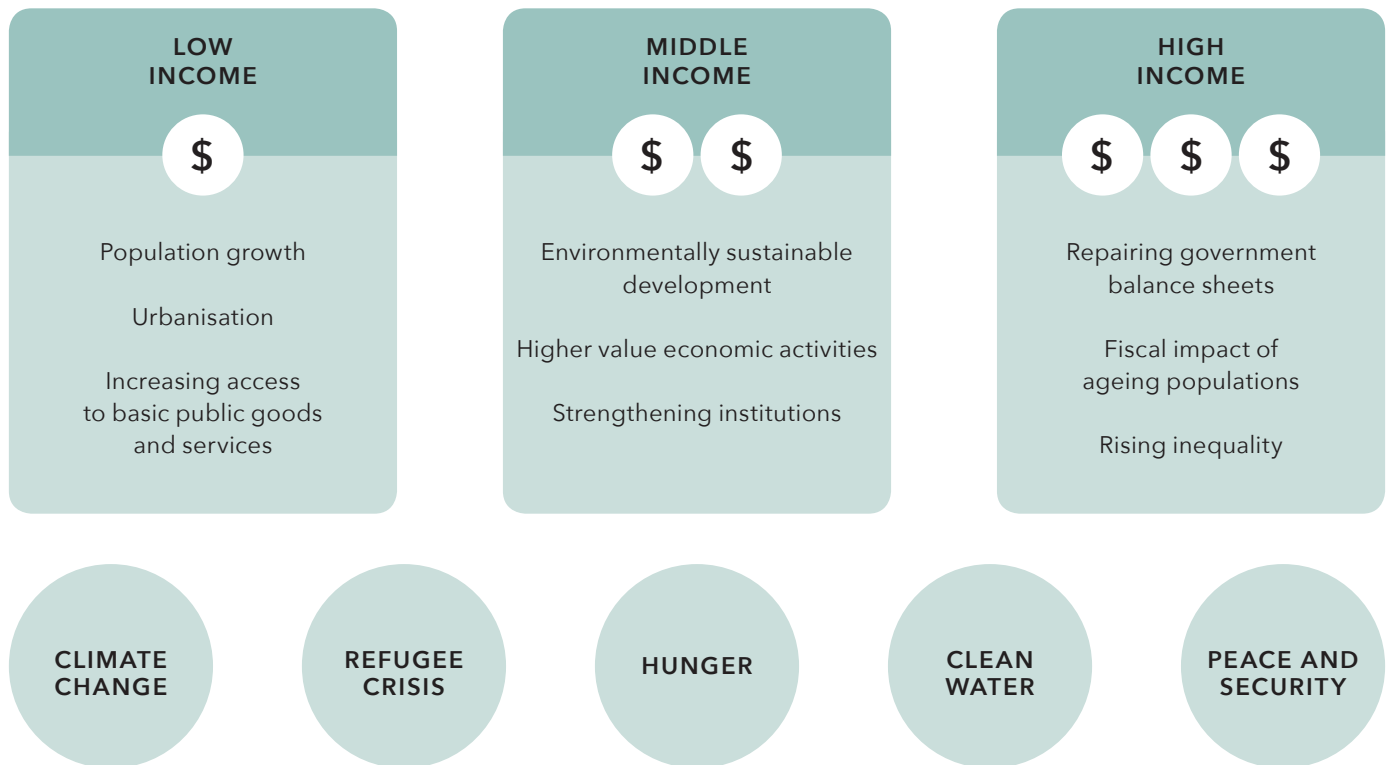
Regardless of the income status of countries, addressing these challenges usually requires wealth to be redistributed from one section of society to another. To be able to do this, governments must work to ensure a high level of social cohesion.

Every group in a country – and ideally every single citizen – needs to know they have a stake in national development and trust government to work for the common good.

### INSIGHT

Strong social cohesion is an essential part of building effective and sustainable public finances.

Figure 3: The challenges facing government



# The foundations of trust

## INSIGHT

A blend of elements is needed to build the foundations of trust. No country will thrive if any one part is neglected, but where they exist or are fought for, strong economies can be built.

### Trust in the public finances flows from rigorous independent scrutiny of how, why and where public money is spent.

Every country's institutional and political framework is a product of its history and constitutional settlement. These frameworks vary widely across the world, but four universal principles underpin trust in government at all times and in all places.

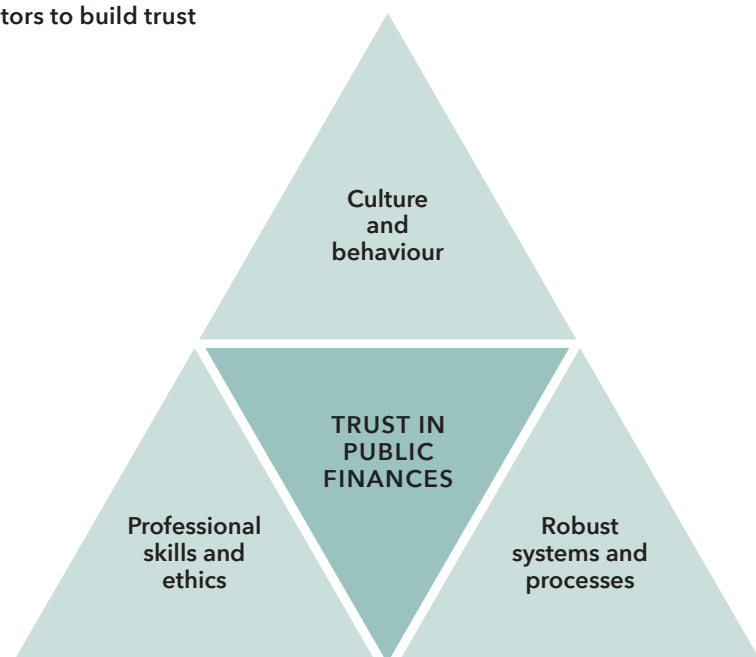
- **Transparency.** Accurate and accessible records so citizens can see where money is raised and spent.
- **Assurance.** Figures and processes checked by independent experts.
- **Accountability.** Decision makers are clearly identified and subject to strict rules and oversight.
- **Objectivity.** Policies are based on accurate, up-to-date information and rigorous analysis.

Three functional factors are required to apply these principles in practice. Figure 4 illustrates the interaction of these elements.

All three factors have to be present for the overall system to work and deliver the principles in practice.

- **Culture and behaviour** – which supports the behaviours and values required of good public servants – integrity, selflessness, objectivity and the belief that public money must be managed for the public good not individual benefit.
- **Professional skills and ethics** – which provides the level of technical skill and diligence needed to ensure that high quality public financial management is possible. Professional skills must be underpinned by strong ethical codes.
- **Robust systems and processes** – to ensure that complete, accurate, reliable and timely information can be produced for citizens and stakeholders. These systems and processes need to combine comprehensive data collection and validation with rigorous analysis and review. Their design should facilitate scrutiny and audit.

Figure 4: Functional factors to build trust



# Culture and behaviour

## A SUPPORTIVE CULTURE

Culture is ‘the way we do things here’. For effective public financial management it needs to support the behaviours and values required of good public servants – integrity, selflessness and objectivity in support of the belief that public money must be managed for the public good. Our report *Public Finances in Practice* discusses the importance of a culture that takes public financial management seriously.

Leaders need to stress the importance of strong public finance management and their actions must be consistent with that message. Citizens trust their leaders when they see them making decisions in the public interest. That trust is lost when decisions are based on calculations of political or private gain.

While culture is more than a set of rules, clear public statements of intent have a positive impact. The following case study demonstrates how one country has sought to create an ethical culture in public life.

### CASE STUDY: ASSERTING POSITIVE VALUES

In South Africa the basic values and principles that govern public administration have been written directly into the Constitution. These include:

- the need to ensure the impartial, fair and equitable provision of services;
- the efficient, economic and effective use of resources; and
- the promotion and maintenance of a **high standard of professional ethics**.

These principles apply to every part of government and all public enterprises. In a diverse country, this has helped provide an overarching set of norms to guide those who work in public administration and finance.

## ACCOUNTABILITY AND TRANSPARENCY

Effective public financial management demands that people and organisations are held accountable for their actions. There must be an individual and collective commitment to:

- accepting responsibility for the stewardship of public money;
- being accountable when behaviour falls short of expectations; and
- supporting feedback mechanisms that create pressure for improvement.

True accountability demands transparency, especially with respect to how:

- resources are raised, managed and used;
- individuals have discharged their responsibilities; and
- those responsible for governance evaluate performance and, if necessary, sanction individuals who fall short of standards.

### INSIGHT

A strong and supportive culture will mean that public financial management is taken seriously and made effective.

## GOVERNANCE AND CONTROLS

Effective governance structures are also needed to define responsibilities, reinforce expected values and behaviours, and ensure consequences for both good and bad performance. In many countries a distinction exists between political heads of government departments responsible for policy, and administrative heads responsible for financial management. These officials have personal responsibility to demonstrate that resources are being used in accordance with legal and ethical provisions. This clear distinction makes it possible to attribute actions to individuals and evaluate their performance.

### CASE STUDY: DEFINING GOOD FINANCIAL MANAGEMENT IN LIBERIA

A consistent legal and regulatory framework underpins many reform programmes. *Liberia's Public Financial Management Act 2009* places transparency and accountability at the heart of public financial management.

It is accompanied by a set of regulations for officials, the first stating 'the public shall be provided with full access to all appropriate information concerning the financial affairs of the Government.' The legally-binding *General Rules for the Management of Public Funds* issued under the Act go into considerable detail, for instance on the content of an accounting manual for civil servants which 'shall contain relevant procedures for the keeping of accounts, preparation and format of financial statements'.

Some countries do not have a direct legal basis for financial regulations but bring together a range of requirements and precedents to guide behaviour. In the UK, for example, this can be found in the publication *Managing Public Money*.

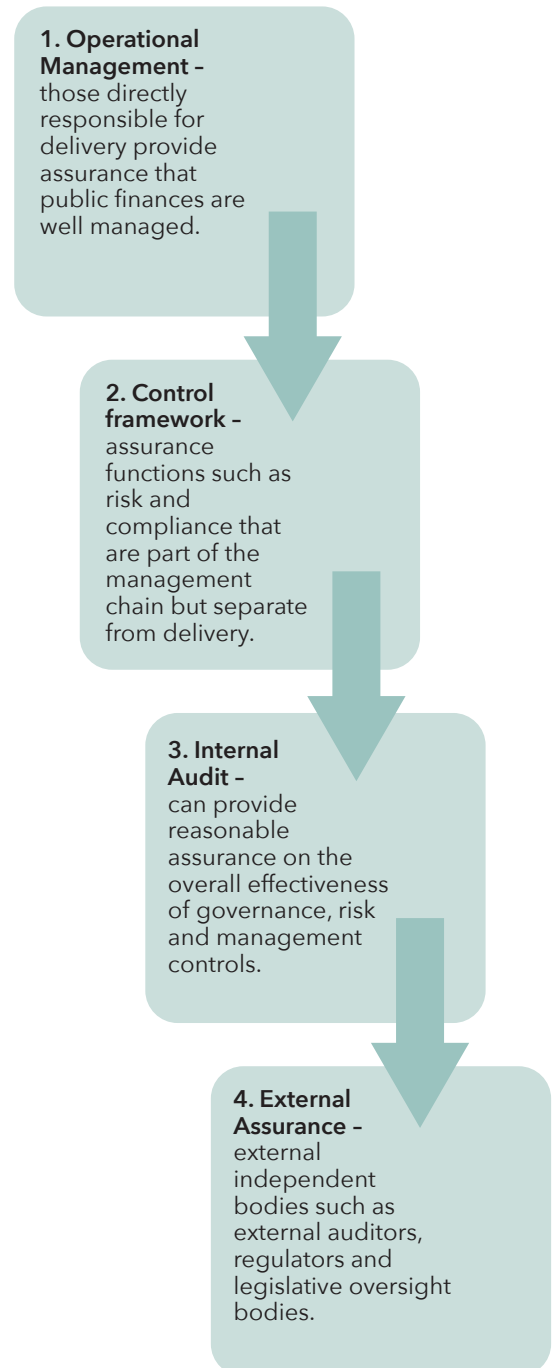
### ASSURANCE

Those charged with governance need to be assured that the people managing public money on a day-to-day basis are fulfilling their responsibilities.

Effective controls and assurance processes usually involve management and internal and external auditors. One widely used assurance model is the 'four lines of defence' model illustrated in Figure 5.

Of course while it is important to have controls and reviews, it is also important that public sector managers are held accountable and the findings of these processes are acted on and, perhaps more importantly, seen to be acted on.

Figure 5: The four lines of defence



# Professional skills and ethics

## THE COMPLEXITIES OF PUBLIC FINANCIAL MANAGEMENT

Public financial management is complex due, in part, to the fact that public sector bodies operate in a political environment. Any society has a wide range of needs and desires so objectives can sometimes compete with each other. The relationship between citizens and the state, together with the way public services are funded and delivered, can result in a tangled web of rights and obligations. Figure 6 illustrates the context for public financial management.

Moreover, objectives are not always financial or even fully measurable. As Albert Einstein once observed, 'Everything that can be counted does not necessarily count; and everything that counts cannot necessarily be counted'.

Managing the public finances to deliver public goods and services while maintaining the overall sustainability of the system requires public finance professionals to not only have technical finance skills but also an understanding of the wider context and how finance relates to the delivery of policy.

Figure 6: Public financial management



It follows that technical know-how, though vital, is not enough to make public sector financial professionals effective. They have to understand what 'good' looks like across the entire public financial management system. This means appreciating that they operate in a political context supporting the delivery of lawful government policies.

### A range of professional skills

Previous ICAEW reports (such as *A Modern Finance Ministry*) highlighted how professionals – accountants, lawyers, economists and others – are essential for effective public financial management. However in addition to these skills, some other elements are needed, including those set out in Figure 7.

Recruiting and retaining skilled professionals when budgets are tight is always a challenge. But neglect carries a far higher cost.

### INSIGHT

Finance professionals have a vital role to play throughout public sector organisations but a wide awareness of the importance of financial management is even more important.

Figure 7: Wider role for finance skills

<b>Broad range of skills</b>	<ul style="list-style-type: none"> <li>• Ability to contextualise and interpret complex information</li> <li>• Communication, collaboration, negotiation and influencing skills</li> </ul>
<b>Wider financial awareness</b>	<ul style="list-style-type: none"> <li>• Professional finance skills not restricted to the finance ministry or finance function</li> <li>• A grasp of the relevance and importance of finance at all levels</li> </ul>
<b>Embedded in decision making</b>	<ul style="list-style-type: none"> <li>• Finance must be at the 'top table' and be involved in all decision making</li> <li>• Finance staff integrated within all management and decision making structures.</li> </ul>

### CASE STUDY: IMPROVING PROFESSIONAL FINANCIAL SKILLS IN FRANCOPHONE AFRICA

Accountancy skills are a bridge between good financial management and national development. Yet many governments employ few professional accountants and this is increasingly recognised as a key constraint on financial management reforms. The World Bank sees the need to develop links between the accountancy profession and the public sector, and the International Federation of Accountants (IFAC) has highlighted how a lack of these have led to slow progress in Francophone Africa.

Representatives from the profession gathered in Madagascar in October 2016 with support from the World Bank and the African Development Bank. The country's Minister of Finance declared that 'We should ... work towards integrating more accountants in public administrations to enhance services to citizens.' Delegates discussed strengthening Professional Accountancy Organisations (PAOs), membership bodies comprised of professional accountants and accounting technicians. PAO membership is low in Francophone Africa where only accountants working in audit practice are registered as members. This differs from English-speaking countries where membership is open to all qualified technicians and professional accountants.

The World Bank observed that 'with more inclusive membership, Francophone PAOs have the power to support the production of high-quality financial information, contributing to public and private sector development, economic growth, and the effectiveness of international aid'.

The need to improve government access to financial skills is not restricted to countries with smaller economies. Recent British financial management reforms have explicitly focussed on the need to professionalise staff throughout government.

### Ethical values and behaviours

Commitment to codes of professional behaviour can play a significant role in building trust. The political nature of public spending decisions means that finance staff can be exposed to difficult ethical situations. A coherent set of professional standards, sanctions and assistance helps to support staff in making ethical choices. The existence of an external ethical framework can be a powerful incentive: chartered accountants, for example, are regulated by their professional body and are expected to behave in accordance with a set of ethical values and to act in the public interest.

The wider ethical behaviours of an organisation are important, for example how it responds to whistle-blowers: employees who disclose illegal or dishonest behaviour in the workplace.

### CASE STUDY: THE ICAEW CODE OF ETHICS

Chartered accountants are bound by clear ethical codes which, if conflict arises, can transcend any duties to employers. ICAEW's Code asserts the fundamental principles of integrity, objectivity, professional competence and due care. Failure to uphold these can result in fines and disbarment from the profession. Members are responsible for assessing threats to compliance and for implementing safeguards, with personalised guidance made available through free confidential helplines. The Code describes situations that members might encounter and suggests (or in some cases requires) specific courses of action.

## *Robust systems and processes*

Culture, behaviours and professional skills are all necessary, but on their own they are not enough to deliver a trusted system.

### CORE ACCOUNTING DISCIPLINES

For a government financial system to be regarded as trustworthy the financial control environment should adhere to some basic disciplines. These include:

- maintaining accurate and up-to-date records;
- clarity over who is accountable for what;
- adherence to documented procedures and controls; and
- regular review and reconciliation of account balances.

Good financial management practice will ensure that policies and procedures are documented, established and integrated into financial and operational systems.

Governments should undertake periodic assessments to obtain an understanding of whether their systems are reliable and effective, where risks may exist, as well as guidance on what reforms are needed.

The quality of the control environment is not simply a product of an accounting system. Systems such as Enterprise Resource Planning (ERP) can be powerful tools, but they are only as good as the information entered into them and the processes that support them. There can be no substitute for basic core accounting disciplines.

A key example of how these principles can be implemented is the 'four-eyes' method of separating the initiation and verification of transactions so that an action must be approved by at least two people. This is the best means of preventing any one person acquiring an undue level of control, thus making it safer to delegate authority.

### CASE STUDY: THE 'FOUR EYES' CONCEPT AT THE EUROPEAN COMMISSION

Allegations of financial mismanagement in the 1990s had a damaging impact on trust in the **public finances of the EU**. Following the forced resignation of the Santer Commission, new financial regulations were adopted. These included enhanced processes of decentralised control of financial transactions, based around the 'four-eyes' principle. With the introduction of accrual accounting these controls are now embedded in an ERP system.

### INSIGHT

It is difficult to run any system of financial management effectively without comprehensive, accurate, reliable and timely accounting records.

### The importance of comprehensive information

Information provided by financial and operational systems needs to be relevant, reliable, comprehensive, complete, understandable, up to date and produced on a timely basis. This last point is important as old or late information is not likely to be trusted or useful for decision making. It should be presented in ways which meet the needs of decision-makers and other stakeholders.

The type of accounting approach used is crucial. Cash flow data is not sufficient on its own. The accounting approach must provide a reliable overview of the impact of policy decisions and wider economic events on a government's financial position and performance. Transitioning from cash to accrual accounting is one way to improve the quality of information and so build trust.

Accrual accounting records revenues and expenses as they are incurred, regardless of when cash is actually exchanged. It is hard to see how governments can demonstrate accountability and stewardship for public finances without it.



Figure 8: Benefits of accrual accounting

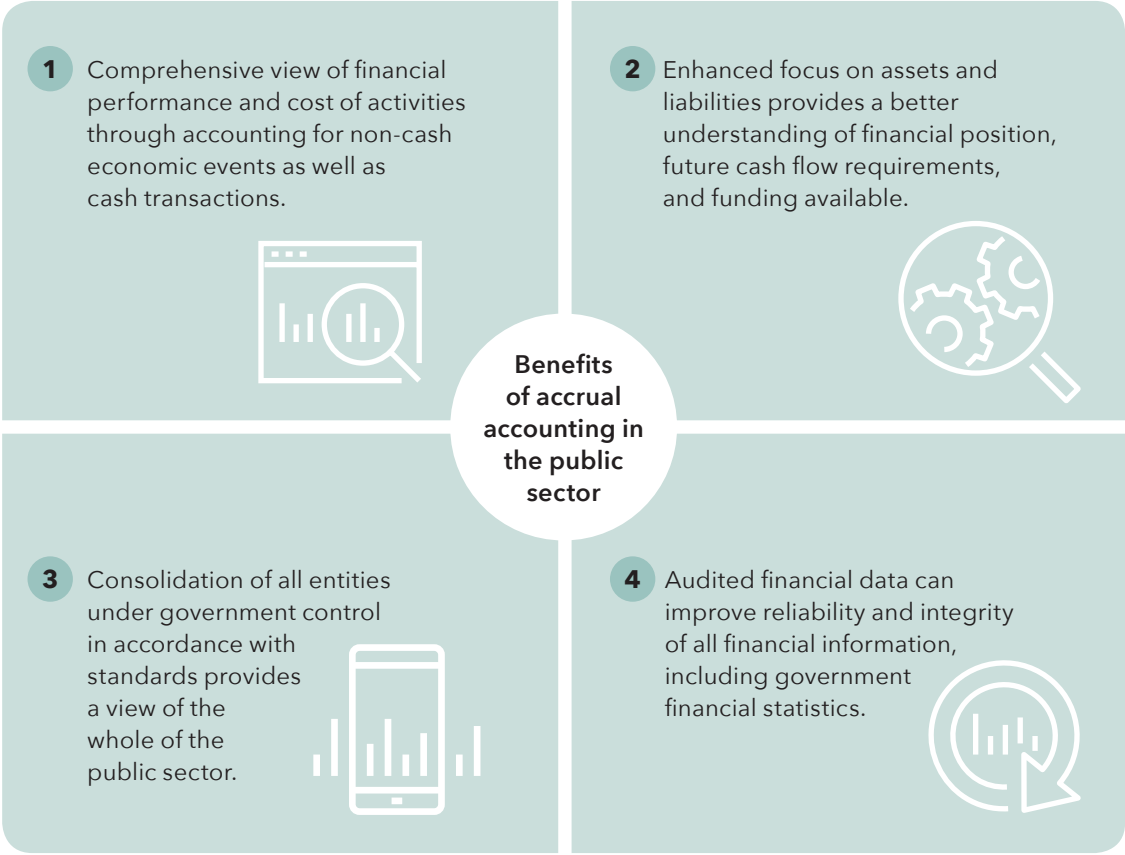


Figure 8 illustrates how accrual accounting provides a complete financial picture, including the:

- full costs of government policies;
- liabilities arising from those policies; and
- funds available to meet a government’s obligations.

Accrual accounting ensures that figures from different parts of government are calculated and presented in a consistent format. Only then can they be a reliable basis for action.

Governments also need to think about how to supply citizens with information about performance and policy outcomes. A clear view of the impact that public financial management has on the delivery of goods and services helps policymakers demonstrate to the public how government policies are improving their lives.

### Integrated reporting

Budget and financial accounting systems work best when integrated into a performance management framework focussed on outputs and outcomes. The Integrated Reporting framework has been designed to facilitate this. The aim is for organisations to look at all their resources and relationships, and to consider the wider impact of decisions on performance and value creation. Adopters of integrated reporting such as the [Maritime and Port Authority of Singapore](#), and [Eskom](#) (South Africa's public electricity company) cite improvements in both performance and levels of trust among stakeholders.

### INDEPENDENT AUDIT

Independent audit is an important way of assuring citizens that they can rely on the numbers presented by government. An auditor reviews accounts and issues an opinion on whether the numbers presented are true (accurate) and fair (presented according to generally accepted accounting conventions).

Internal auditing is carried out within government bodies to provide assurance on the overall effectiveness of governance, risk management and financial controls. Internal

auditors need full access to relevant information and consistent high-level support. They should also have a high degree of operational independence, facilitated by reporting to a non-executive supervisory branch of government such as an audit committee.

External auditing is carried out by, or under the supervision of, a Supreme Audit Institution (SAI) presided over by an auditor general. It provides an independent review of accounts and the underlying transactions of individual entities, together with assessments of whether these are providing value for money. Legal safeguards are needed to guarantee an SAI's independence and mandate.

#### CASE STUDY: BRAZIL'S SUPREME AUDIT INSTITUTION AT WORK

Brazil's SAI, the Tribunal de Contas da União, has undertaken a series of audits of central government's regional development policies in order to identify obstacles to performance. A key finding was a lack of policy coordination between federal, state and local levels which led to changes in programme governance.

# Building trust in practice

## Transparency, accountability, ethical values and public education are the keys to success.

The principles and processes we have discussed will promote trust regardless of a country’s political system. But four sets of tangible activities are also required.

- The importance of the social contract for public financial management.
- The ability to track funds ('follow the money').
- Fraud and corruption controls alongside a focus on ethics, transparency and sanctions.
- Managing political and fiscal risk to ensure a positive climate for investment.

## UPHOLDING THE SOCIAL CONTRACT

The relationship between citizens and state can be viewed as a social contract. If both meet

their duties and responsibilities to the other, the conditions will exist for stable societies to develop and strong economies to grow.

The rule of law is a crucial consideration. Citizens must be confident that they are protected by the law and that government and public servants will act in accordance with it.

The social contract is particularly important for public financial management. Those providing resources to the state need to know that their taxes are being well used.

Lower income countries raise less revenue from taxes as a percentage of GDP than those with higher incomes. This is not solely due to the existence of large informal sectors which are difficult to tax. Where public resources are stolen or squandered, otherwise honest citizens can become reluctant to pay taxes.

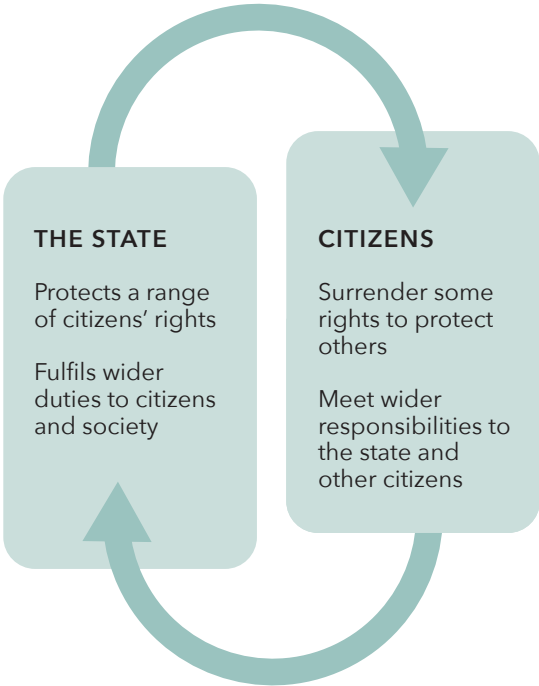
**INSIGHT**

At its core, public trust rests on the existence of a 'social contract' setting out rules that everyone agrees to follow, with genuine consequences for those who don't obey them.

Figure 9: Tangible ways to build trust in the public finances



Figure 10: The social contract



### Ensuring independent public bodies

We've seen how an independent Supreme Audit Institution (SAI) is an important actor in a country's accountability chain. Constitutional or legislation provision must provide sufficient protection from government control. Other bodies play vital roles: parliamentary committees examining the conduct and spending of government departments, an independent judiciary and a police force which will investigate public life without fear or favour.

#### CASE STUDY: PROTECTING EXTERNAL SCRUTINY OF PUBLIC ADMINISTRATION

South Africa's Public Service Commission works to maintain effective and efficient public administration and a high standard of professional ethics in the public service. [The Constitution](#) requires that:

- the Commission is regulated by national legislation rather than government;
- it is accountable to the National Assembly rather than to the executive;
- commissioners 'must be fit and proper persons with knowledge of, or experience in, administration, management or the provision of public services'. They may be removed from office only on grounds of misconduct, incapacity or incompetence; and
- other organs of state must assist and protect the Commission to ensure its independence, impartiality, dignity and effectiveness.

### Building trust by educating citizens

Transparency and accountability are maximised when information on public financial management is directly available to citizens and the media. An engaged population is far more likely to be confident about investing for the future, especially if government is responsive to its concerns.

This means educating citizens in the basics of public financial management: to what use taxes are being put, what public goods and services are being delivered and to whom. Without this understanding, levels of public trust will be low. A [recent survey](#) of 10,000 people across the EU found that:

- a majority of those surveyed struggled to understand the state of public finances;
- only one in five trusted their government's ability to manage public finances;
- countries with the highest level of distrust were those with the greatest demand for information; and
- a clear correlation exists between low levels of trust in financial management and lack of confidence in plans for financing core public spending.

Public accounts presented to international standards are complex and accessible only to those with a high level of financial literacy. Ministries, public agencies and state-owned enterprises should provide financial information in ways which most people will find reasonably easy to understand. This needs to be available in local, as well as official national languages, in easy to understand formats and without charge.

Information should be made available directly to the media, an indispensable channel of communication between government and society. Ministers should also be available to answer questions arising from this information.

### CASE STUDY: THE PHILIPPINES' CITIZENS' BUDGET

The Philippines publishes a Citizens' Budget providing an overview of how the state raises and spends money. This allows citizens to monitor government plans and activities against expected outputs and outcomes.

A presidential message sets out national goals and key facts are presented via concise text alongside explanatory colour charts and graphics. Citizens are informed, for instance, about the cost to public finances of a 1% rise in inflation or a 1% rise in interest rates.

Countries which have transitioned to accrual accounting (including Britain, France and Australia) are also providing consolidated information on assets and liabilities to make these matters more accessible to ordinary citizens.

### Building trust through citizen participation in the budgeting process

In some parts of the world, local governments are experimenting with involving citizens more directly in the decisions about how government bodies spend their money. This following case study from Brazil examines Participatory Budgeting, a process through which citizens present their demands and priorities to government and negotiate local budget allocations.

### CASE STUDY: PARTICIPATORY BUDGETING AT LOCAL LEVEL

**Participatory Budgeting** (PB) began in 1989 in Porto Alegre, a city of 1.5m people in southern Brazil. The number of local participants reached 40,000 in less than a decade, indicating PB's ability to encourage citizen involvement.

Every 12 months city officials must present accounts from the previous year, showing spending against agreed criteria together with progress in delivering investment plans. There are also several rounds of meetings where public representatives can hold the municipal administration to account. By directly involving often marginalised groups in decisions on the spending that most affects them, PB has led to direct improvements in the provision of public goods and services.

More than 250 Brazilian municipalities have now adopted PB. A 2014 academic study found that 'municipal governments that adopted Participatory Budgeting spent more on education and sanitation and saw infant mortality decrease as well ... Participatory Budgeting's influence strengthens over time, which indicates that its benefits do not merely result from governments making easy policy changes.

'Instead, Participatory Budgeting's increasing impact indicates that governments, citizens, and civil society organizations are building new institutions that produce better forms of governance ... the cities are also retraining policy experts and civil servants to better work with poor communities. Finally, public deliberation about spending priorities makes these city governments more transparent, which **decreases corruption**'.

### **Encouraging public debate: The role of civil society**

Governments benefit from criticism as it helps keep them aware and responsive. The concept of civil society comes into play here, with non-governmental organisations and institutions representing various interests and points of view. Such groups will often disagree with each other as well as government, but the clash of opinions forces interests to justify their ideas and produces diverse independent perspectives on public finance.

Successful **anti-corruption efforts** are often led by a 'coalition of the concerned' – politicians and officials, the private sector, individual citizens, communities and NGOs. In the Dominican Republic these formed the Participatory Anti-Corruption Initiative, a forum which has taken on powerful interest groups in many areas, including medical procurement. By 2014, reforms had lowered drug prices, improved medication quality and reduced public spending in this field by 64%.

### **Publishing data on tax compliance**

Another way of enhancing trust is through publishing information about tax compliance. At the most basic level this entails data about overall collection rates, together with reports on action taken to recover revenues from those who have not paid what is due. Norway goes so far as to publish all taxpayers' income, assets and taxation annually (though this policy rests on a high level of social cohesion and trust in public institutions).

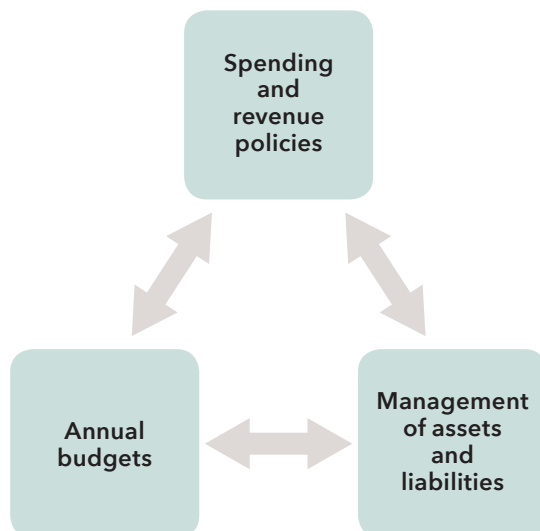
## EFFECTIVE PUBLIC FINANCIAL MANAGEMENT

The term 'public finances' includes spending and revenue policies, annual budgets, and the management of assets and liabilities. Figure 11 illustrates these components. Various measures can be used to establish public confidence in each of them.

Fiscal policies should be based on macroeconomic and fiscal forecasts prepared independently of government, which are in turn published and assessed by civil society. Spending plans should take account of these forecasts, allowing for contingencies, assets and liabilities so that nothing is left out.

Annual budgets must then be implemented within a system of effective standards, processes and internal controls, ensuring that resources are obtained and used as intended.

**Figure 11: Key areas of public financial management**



### CASE STUDY: ANALYSING PUBLIC FINANCIAL DATA IN MOLDOVA

The World Bank has established the [Open Budgets Portal](#), the first one-stop shop for budget data worldwide. In 2011 Moldova became the first country in central Europe to put its expenditures online, with the public and media now accessing more than 200 datasets. A Moldovan civil society organisation is working with the World Bank to present budget information to citizens. This involves transforming complex data from transactional systems and unstructured datasets into structured information for direct use and analysis.

#### Being able to follow the money

It is vitally important that decision-makers, citizens and other stakeholders can 'follow the money' – see how an activity is funded, how and why it has been used in the way it has, and its results.

Information on public finance management must be accurate, comprehensive, accessible and consistent with underlying accounting records and other information.

Raw financial and performance data then has to be presented in ways that citizens can query and break down. This helps make government responsive to pressure to make continuous improvements.

In many countries, the forecasting activities of government are also scrutinised by a 'fiscal watchdog' to ensure that projections of revenue, expenditure, deficit and debt have not been manipulated in the interests of a ruling political party.

### Comprehensive accounting records as a catalyst for trust

Comprehensive accounting records, and accrual accounting in particular, provide a more accurate and detailed understanding of the nature of revenue and expenditure. These make it more difficult to distort financial results simply by delaying cash transactions. A further benefit is the preparation of a complete set of audited financial statements, including reconciliation of financial results to budgets.

Countries like South Africa, Sri Lanka and the Philippines, which have adopted this approach, have found that audited financial statements at both departmental and national level now give a clearer indication as to whether spending:

- has remained within budget;
- has been spent on agreed policies;
- has been spent in accordance with rules and regulations; and
- provides value for money.

More recently, country-by-country reporting under the G20/OECD Base Erosion and Profit Shifting (BEPS) project has begun with the aim of providing transparency of transfer pricing and other methods used to reduce tax liabilities.

### CASE STUDY: KEEPING TABS ON SPENDING IN UGANDA

[Uganda's Budget Information website](#) promotes transparency and accountability by showing detailed information on how resources are allocated and used, plus performance indicators from national down to parish level. Citizens and other stakeholders can provide feedback on service delivery in their local area and report suspected corruption. An SMS and telephone service is available to improve access for marginalised communities.

### CASE STUDY: TRANSPARENCY OVER TAX LIABILITIES IN NIGERIA

Several global initiatives have been launched to improve tax transparency, notably by focussing on how some multinational enterprises reduce their tax liabilities. Nigeria was the first African government to implement the [Extractive Industries Transparency Initiative \(EITI\)](#). It undertook a comprehensive audit of the oil sector value chain to verify that all payments were correct and settled. This revealed \$9.8bn in outstanding recoverable revenues from 1999 to 2008, including an estimated \$4.7bn owed by the state-owned Nigerian National Petroleum Corporation (NNPC). At least \$2.4bn of the lost revenue was recovered.



**INSIGHT**  
Fraud and corruption can be tackled by a combination of increased transparency and ensuring that no-one is above the law.

**TACKLING FRAUD AND CORRUPTION**

Fraud and corruption destroy trust. Where a citizen’s only regular interaction with the state is paying bribes to access public services, his or her willingness to pay tax is bound to be reduced.

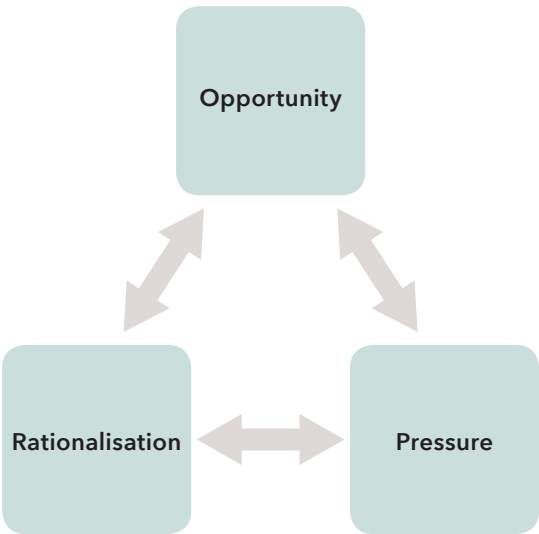
**Fraud and corruption risk and control**

An understanding of how fraud and corruption occurs is central to designing effective strategies to counter them. The ‘fraud triangle’ in Figure 12 identifies three factors that must to be present:

- **Opportunity:** weakness in an organisation’s internal controls;
- **Pressure:** the individual’s motive for fraud or corrupt practice; and
- **Rationalisation:** how an individual attempts to justify their crime.

Prevention requires action to tackle all three factors.

Figure 12: The fraud triangle



**A focus on ethics and transparency**

Public trust depends on a belief that officials will do the right thing and be held to ethical standards. This requires a range of hard and soft controls promoting integrity and ethical behaviour.

Hard controls include codes of conduct and regulations. Softer controls include values and norms to guide correct behaviour. One way to develop understanding is through formal ethics training, encompassing both public financial management and wider public administration.

Leaders need to build and support a culture that is conducive to ethical behaviour and an example for others. This includes being accountable for failures that occur within the organisations they lead, even where their own personal behaviour has not been unethical.

Building trust where it has been eroded by fraud and corruption also needs a commitment to transparency, including an ability to follow the money. This can highlight where fraud and corruption may have taken place.

**CASE STUDY: THE IntoSAINT INTEGRITY AUDIT**

The Netherlands Court of Audit helps officials understand the soft controls which provide the most effective encouragement of ethical behaviour. Its Self-Assessment Integrity Tool (**IntoSAINT**) analyses integrity risks and assesses management systems. The assessment is conducted during a structured two-day workshop moderated by a trained facilitator. Targeted at corruption prevention it is a ‘qualitative tool’ that enables the user to design a tailor-made policy while encouraging staff to think in terms of vulnerabilities and risks. It is being used by SAIs globally to help develop integrity policies and raise awareness of integrity among public officials.

### CASE STUDY: HARNESSING TECHNOLOGY TO EXPOSE CORRUPTION

The World Bank has developed an 'Integrity App' which enables users to submit confidential reports (including photographs) about fraud and corruption in the projects it finances.

In Pakistan, government departments in Punjab are using smartphones to collect real-time data on the activities of government field staff.

Other technologies increasingly being used in the fight against corruption include big data and data mining. This permits the interrogation of large amounts of data to identify potentially corrupt behaviour.

The Corruption Research Centre Budapest has used datasets on public procurement in EU countries to identify abnormal patterns (such as unusually short bidding periods) and collusion between bidders and officials.

### Accountability and sanctions

Where individuals have been found to be engaged in fraud or corruption, it is important that they are held accountable, face appropriate sanctions, and are seen to face those sanctions. There can be no true accountability where individuals are not liable for their actions.

The pervasive effect of fraud and corruption on the social contract makes it important that citizens should know how accountability mechanisms and sanctions apply. Without this it will not be possible to change perceptions of fraud and corruption, nor to build and maintain trust.

### CASE STUDY: THREE PILLARS OF ANTI-CORRUPTION IN SINGAPORE

Singapore consistently ranks among the least corrupt countries in the Transparency International Corruption Perceptions Index. It is determined to be known internationally as a corruption-free city state.

National anti-corruption policy rests on three pillars.

- Legislation providing strong criminal penalties which the judiciary have not hesitated to apply. The Prevention of Corruption Act states that an acceptor of 'gratification' can be considered guilty even if he does not intend to, or does not in fact, return the favour, or even if he does not have the power, right or opportunity to return the favour. It expressly disallows admission of evidence to show that any alleged gratification is customary in any profession or trade.
- A **Corrupt Practices Investigation Bureau** probes allegations against the public sector, as well as illegal commissions or kickbacks in private business. Empowered by the country's Constitution and reporting directly to the Prime Minister, the Bureau enjoys full legal standing and functional independence.
- A civil service reporting framework enables officials to report wrongful practices or behaviour either internally or to the Public Service Commission, an independent body with the authority to dismiss and exercise disciplinary control over civil servants.

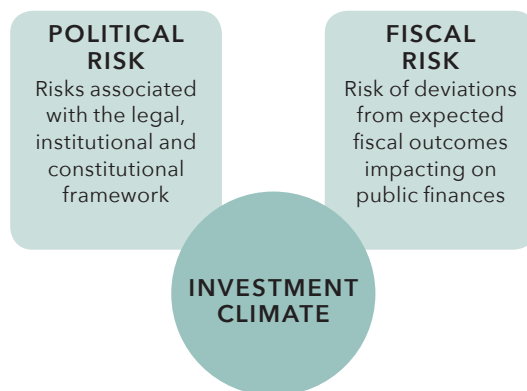
**INSIGHT**

Economies that operate with high levels of trust are attractive destinations for investors and attract high levels of inward investment.

**THE RIGHT CLIMATE FOR INVESTMENT**

Economic actors need confidence if they are to invest their own resources. Predictability encourages trust, investment and enterprise. The investment climate is affected by two sets of risk that relate to government (Figure 13).

**Figure 13: Risks affecting the climate for investment**

**Political risk**

Political risk encompasses the legal, institutional and constitutional structures of a state. Investors need to know that the rule of law is respected, and they will not be subject to arbitrary changes in taxation or regulations. Strong public financial management can reduce political risk by providing a transparent and accountable basis for government policies.

Reducing political risk also requires political legitimacy. Laws and policies need to be formulated in a participative manner and applied without discrimination. This is especially important in the delivery of public services. Individuals, groups and firms need to know that they are being treated equitably and that others are not being illegitimately favoured.

Seizures of private property, the rigging of elections and a refusal to abide by constitutional norms has done grave damage to parts of sub-Saharan Africa. But countries like Botswana and Namibia, with a commitment to law and stable political frameworks, have been able to start developing sustainable economies.

**Fiscal risk**

Fiscal risks are major deviations from generally expected outcomes. When these materialise revenues can fall dramatically at the same time as demand for public welfare services increases. This can lead to sharp increases in government deficits and debt taking many years to bring under control, even with higher taxes and spending cuts. The global financial crisis of 2008 reduced British tax revenues by approximately 7% and the Greek public debt crisis led to a 25% reduction in GDP. Such occurrences undermine confidence in the competence of government.

Governments that publish regular reports on macroeconomic risks, specific fiscal risks and long-term fiscal sustainability build investor confidence. The creation of the independent Office for Budget Responsibility in the aftermath of the 2008 financial crisis helped restore investor confidence in the UK's public finances. Similar bodies in other countries have contributed to a sense that forecasts are not subject to political influence.

Other mechanisms can also help to build confidence that risk is being well managed. These can include controls on the liabilities public bodies are allowed to take on, and rules obliging governments to run a balanced budget over the economic cycle. Some states are particularly exposed to fluctuations in commodity prices (Chile and copper, Saudi Arabia and oil). Reserve funds provide a buffer.

**CASE STUDY: MANAGING COMMODITY PRICE RISK IN TIMOR-LESTE**

The Timor-Leste (East Timor) Petroleum Fund is regarded as a successful natural resource fund and an example for other countries with significant resource wealth. It is designed to prudently and transparently manage petroleum revenues for the benefit of both current and future generations. By providing a stable flow of revenue to government and mitigating risks arising from oil prices and production levels, it provides a sound fiscal basis on which the immediate needs of citizens can be met.

## *Insights*

- With the public sector making up nearly half of the global economy, effective public financial management is a critical factor in the economic success of each and every country.
- Building trust about public money is about putting in place comprehensive mechanisms to demonstrate to citizens that it is being spent for the public good.
- The policy choices of the state create the context in which the private sector economy operates.
- Where states fail to instil trust in their citizens the impact on the economy can be profound and long-lasting.
- Strong social cohesion is an essential part of building effective and sustainable public finances.
- A blend of elements is needed to build the foundations of trust. No country will thrive if any one part is neglected, but where they exist or are fought for, strong economies can be built.
- A strong supportive culture will mean that public financial management is taken seriously and made effective.
- Finance professionals have a vital role to play throughout public sector organisations, but a wide awareness of the importance of financial management is even more important.
- It is difficult to run any system of financial management effectively without comprehensive, accurate, reliable and timely accounting records.
- At its core, public trust rests on the existence of a 'social contract' setting out rules that everyone agrees to follow with genuine consequences for those who don't obey them.
- Fraud and corruption can be tackled by a combination of increased transparency and ensuring that no-one is above the law.
- Economies that operate with high levels of trust are attractive destinations to investors and attract high levels of inward investment.

## *More about the authors*

**Ross Campbell**



Ross is the Director, Public Sector at ICAEW where he leads ICAEW's work to improve standards in the management of the public finances, both in the UK and internationally. Before taking up his current role at ICAEW, Ross was the accounting policy lead and financial reporting standard setter for the UK Central Government at HM Treasury. Other recent senior roles in government include being the group chief accountant at the Ministry of Defence (MOD) and the director at the National Audit Office responsible for the value for money review of defence. Ross has also held a senior civil service role as head of commercial assurance and governance at the MOD, set up and led the department's commercial scrutiny and due diligence team and was also deputy director of the MOD private finance unit.

**Philip Trotter**



Philip is an independent consultant who specialises in providing public finance management advice to clients. In the UK he has primarily worked to support entities looking to meet financial and non-financial objectives within the central government public finance management framework. This includes consultancy engagements and working within government where he developed and led a team of senior finance policy advisors at HM Treasury responsible for providing a range of public finance advice internally and to other government departments. He has also worked extensively with major international public sector organisations, including the European Union Institutions and the United Nations, particularly with respect to transitions to accrual accounting based on IFRS and IPSAS.

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### **MEDIA ENQUIRIES**

Please direct all media inquiries related to this Policy Insight to:

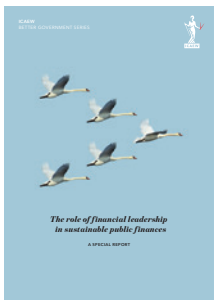
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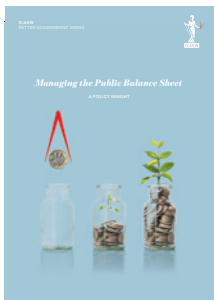
# The Better Government Series

ICAEW supports greater transparency and accountability in public sector finance and provides policy recommendations to ensure taxpayers' money is managed wisely. Our Better Government Series is a series of thought leadership, policy insights, toolkits and best practice special reports on topical public sector financial management issues. Examples include:



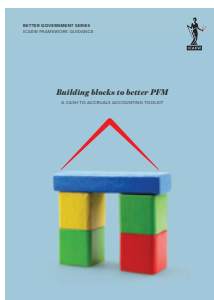
## The role of leadership in sustainable public finances

This special report addresses finance leadership and the role of accountants in the public sector. Rules and regulations imposed on the private sector have been introduced to address poor financial management practices in large companies, but similar standards do not apply to public sector bodies. Stronger standards over data quality, reporting disciplines and transparency could improve efficiency and effectiveness in the public sector.



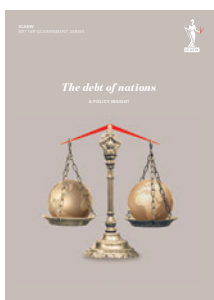
## Managing the public balance sheet

This policy insight aims to help public officials understand what is in their balance sheets. The value of the information about different sorts of assets and liabilities and how some governments around the world are using it to support more effective policy-making. In particular, it is written to help governments ask the right questions to make the most of their financial information.



## Building blocks to better PFM - a cash to accruals toolkit

Using generally accepted tools and standards of project management we have created this practical 'how to' guide which brings together information that is relevant to the implementation of large projects. The toolkit sets out six practical 'building blocks' as the foundation to improve the quality of financial reporting and public financial management.



## The debt of nations

Over the past century, many governments have become increasingly dependent on borrowing to finance public spending. In the last two decades there has been a dramatic increase in borrowing by governments to nearly £30 trillion, more than three times the level of public debt in 2001, raising questions about the sustainability. *The debt of nations* explores the issues relating to public debt through a range of analysis and reflections on borrowing by government. In particular the difficulty of comparing the level of debt between countries and the risks being built up in government in balance sheets.

These publications and others in the series can be found here [icaew.com/publicfinances](https://www.icaew.com/publicfinances)



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