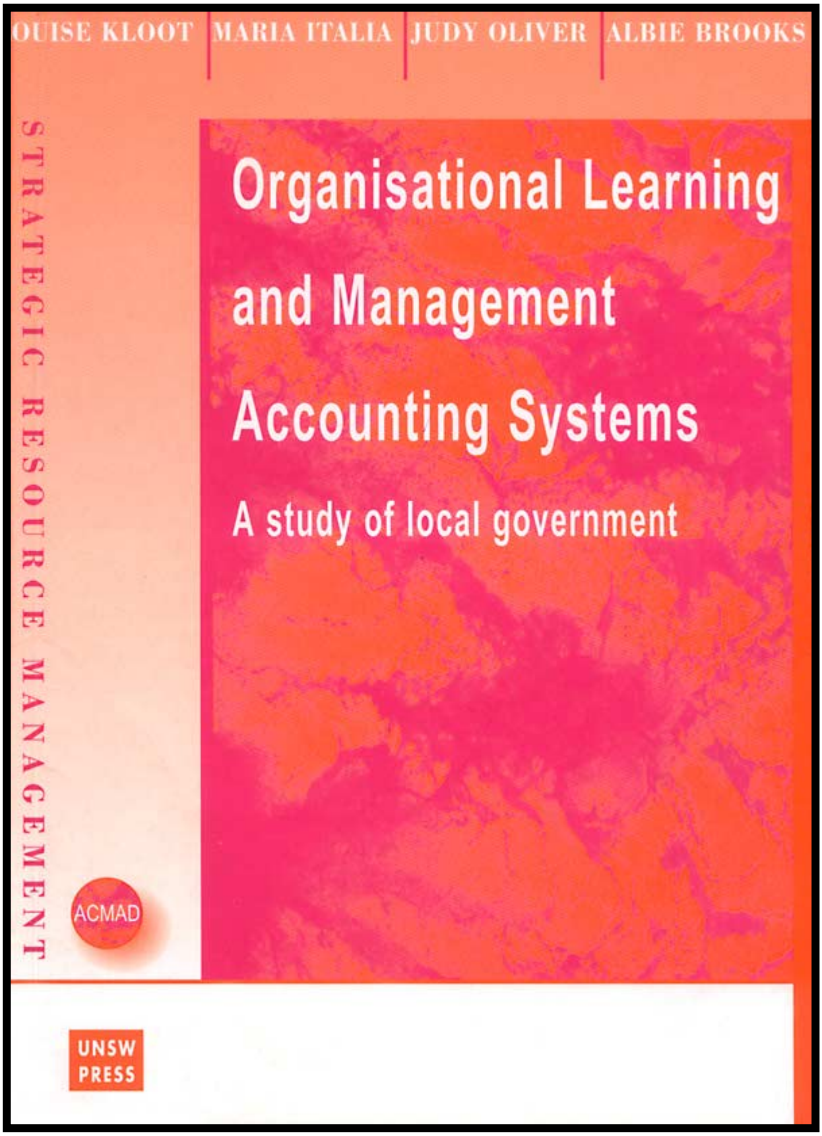
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STRATEGIC RESOURCE MANAGEMENT
Organisational Learning and Management Accounting Systems
A study of local government
ACMAD
UNSW PRESS

ORGANISATIONAL LEARNING AND MANAGEMENT ACCOUNTING SYSTEMS

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Chartered Accountants

ACMAD

A UNSW Press book

Published by
University of New South Wales Press Ltd
University of New South Wales
Sydney 2052 Australia
www.unswpress.com.au

First published 1999

National Library of Australia
Cataloguing-in-Publication entry:

Organisational learning and management accounting systems: a study of local government.

ISBN 0 86840 713 5.

1. Strategic planning-Australia. 2. Customer relations-Australia. 3. Local government-Australia.
I. Kloot, Louise. (Series: Strategic resource management).

352.340994

Printer BPA, Melbourne

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Organisations are devices for creating value through the effective use of resources. While they need to create value for all contributors of resources, a premium is placed on value creation for customers and shareholders. After all, an organisation is unlikely to be able to offer inducements to other resource contributors if it does not provide value to its customers. Also, shareholders are aware that failure in value creation for customers will be reflected in the value that they can receive. Value creation for customers and shareholders, then, is broadly regarded as the litmus test for judging organisational effectiveness.

Value creation by organisations takes place against a backdrop of fast moving competition in resource and service markets, and increasingly rapid shifts in the value expectations of customers. Under these conditions it is insufficient to meet or beat the competition with present service offerings; new service offerings have to be invented and made competitive, as previous offerings cease to be serviceable and are thus devalued.

As service offerings change, so will the materials, technologies, skills and processes that are needed to produce them. New service offerings require different constellations of resources and new relationships with new resource contributors.

An organisation's *strategies* define how it proposes to create value for customers in terms of its service offerings over the immediate period and the opportunities it seeks over a longer term. Whether or not an organisation will be successful in these endeavours will depend on its *capabilities* for doing so.

Strategies, then, have to deal with both the known (the creation of value through present service offerings) and the unknown (the invention of service offerings that will create value in an as yet unknown future). And capabilities need to sustain both the organisation's present effectiveness in offering services and its future renewal by capitalising on opportunities as they emerge.

An organisation's success in strategy realisation or renewal will be dependent on its effectiveness and creativity in managing resources. This places a premium on *strategic resource management* and on new ways of understanding organisational resources, resourcing and resourcefulness. What are an organisation's resources, what forms do they take and how can they be used effectively and not wasted? What constellations of resources constitute strategic capabilities, useable now in meeting the competition and converting possibilities into future opportunities? And what strategic capabilities are sufficiently distinctive to constitute the core competences underlying an organisation's continuing identity?

These questions are answered in the Strategic Resource Management Series. Each volume will address them in relation to particular subject matter, drawing on relevant theories and providing illustrations from contemporary organisational practice.

PREFACE

In recent years, on-going change has affected organisations of all types. The pace and inevitability of change has led organisations to appreciate the importance of learning and to realise that, if they are to survive and prosper, the rate of learning must keep up with the speed of change.

Nowhere has change been more prevalent than in the public sector. Governmental re-thinking of its role in the economy and ever-increasing requirements for accountability, responsibility, efficiency and performance in publicly owned enterprises have resulted in some agencies being privatised, others opened to previously absent competition, still others to contracting out or to competing themselves in an open market. Even local government has not been exempt from these pressures, particularly in Victoria.

The changes to local government in Victoria, as this book points out, are `arguably the most significant changes in the Australian public sector', embracing: councillors being replaced, for a period of time, by commissioners; forced amalgamations and boundary reform; compulsory competitive tendering; a new emphasis on corporate planning; and the need to become more cost-conscious and customer-focused.

One vital tool in coping with change is the appropriate use of management accounting techniques. In this paper, the authors found that management accounting both assists organisational learning, and itself changes as a result of organisational learning.

This research studies:

- the extent of the use of management accounting practices in Victorian local government
- the relationship between management accounting and organisational learning in a context of significant environmental change during a time when organisational learning is crucial to the continued survival of the organisations studied.

Although the research is concerned with local government, the findings of this paper are applicable more broadly. The imperatives for learning and the technologies which sponsor that learning are common to all organisations.

Acknowledgments

This research was funded by ACMAD.

The report was only made possible by those managers in local government who gave freely of their time to be interviewed. The authors wish to thank them for their assistance. Due to guarantees of confidentiality, the names of the councils and the managers who participated cannot be disclosed.

The authors are also indebted to Professor Bill Birkett and two anonymous reviewers for their insightful comments on earlier drafts of the paper.

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INTRODUCTION

Over the last decade, worldwide reform has been occurring in public sector management. Local government in Victoria is no exception. Indeed, it has been subjected to arguably the most significant changes in the Australian public sector.

In Australia, local government is subject to regulation and legislation imposed by the various state governments. The Victorian State Government has promulgated change in local government through forced amalgamations and boundary reform, compulsory competitive tendering (CCT), and compulsory corporate planning.

In addition, local government instrumentalities throughout the country have been affected by the issuing of accounting standard AAS27 Financial reporting by local governments. In Victoria, these changes have largely coincided with the election of a state government dedicated to improving the state's poor macro-economic performance, particularly in the government sector.

Until 1993, the Victorian Government imposed strict accounting, reporting and other regulations on local government to ensure the efficiency and smooth functioning of the sector, thus implying that local governments could not introduce good management techniques for themselves. The Municipal Accounting Regulations specified in great detail accounting and financial practices and reporting formats: for example, there were six pages of procedures about opening mail and banking monies received in the mail, whilst electronic payments or receipts were illegal. These regulations did not promote flexibility or appropriate management accounting practices, being primarily concerned with financial reporting on a modified accrual basis (Kloot 1991).

In addition, the need to report in standard formats to the Victorian Grants Commission and other state and federal regulatory bodies took precedence over sound management accounting practices. The statutory format resulted in reports which were unsuitable for management reporting and for evaluating the overall position of municipalities (Hoban 1995). For example, measuring performance on anything other than a fixed-budget format was difficult unless councils maintained a second set of accounts.

The overall result of these regulations and required reporting formats was a lack of useful management accounting practices and reports (Kloot 1991). Since 1993, however, extensive changes in local government have created a climate which is more conducive to the development and use of management accounting. In addition the changes themselves have been facilitated by appropriate management accounting information.

The effect on management accounting and organisational learning of three of the local government reforms specific to Victoria are studied in detail in this report. These reforms are: corporate planning; CCT; and amalgamation and boundary reform. In addition to the reforms, the research also studies the effects of changing organisational models and how they relate to local government, and specific changes in budgeting practices and financial accountability.

Corporate planning

The Victorian Local Government Act was amended in 1992 to require councils to undertake `corporate planning'. (The term `corporate planning' is used in preference to `strategic planning' as the latter, in local government, implies land use planning.) Until that time, corporate planning was not common in the industry (Kloot 1991, 1995). Reasons for this neglect of planning include:

- annual elections of councillors, which encouraged annual planning horizons
- accounting regulations, which required that capital expenditure be written off in the year in which it was incurred
- annual estimates, which required details on a functional basis, rather than a program or service basis.

Following the amendment to the Local Government Act, councils were obliged to undertake a corporate planning process, with a requirement for three year plans which identify objectives, strategies and performance indicators.

Compulsory competitive tendering

Competitive tendering is the process by which the provision of government services is subjected to open tender. Private sector providers, in-house providers and other government agencies may compete for the right to provide services to both internal and external customers.

Competitive tendering has been widely used in the United Kingdom, France, New Zealand and the United States as part of the privatisation process, and as a major tool in changing to a more managerialist culture in government. Competition policy is on the agenda at both federal and state level in Australia, and is filtering down to local government.

In Victorian local government, competitive tendering has been progressively introduced since 1995. The Victorian process is compulsory: legislation requires that by 1998, 50 per cent of all local government expenditure must be open to tender. Tenderers may be internal business units, business units from other local government bodies or private sector providers. The external tenderers need not even be based in Victoria (at least one tender has been won by a New Zealand body). Although price is not the only factor on which tenders are assessed (quality is extremely important), and the lowest tender need not be accepted, the cost of internal tenders is assessed against the cost of external tenders in all cases.

The advent of CCT meant that individual councils have to compete with both other councils and the private sector in the provision of services.

Amalgamation and boundary reform

At the start of 1993 there were 210 local government bodies in Victoria, exhibiting wide diversity in geographical size, population and financial resources. Geographical size ranged from 4 square kilometers in Fitzroy, to 10 795 square kilometers in Walpeup; population ranged from 670 in Pyalong, to 128 000 in Waverly; and total revenue ranged from $1 200 000 in Lexton, to $227 000 000 in Melbourne. Rate revenue as a percentage of total revenue ranged from 67.1 per cent in Port Melbourne to 31.7 per cent in Echuca and Heywood (Office of Local Government 1993).

During 1993 and 1994 the State Government, following a successful model of reform in New Zealand, implemented boundary reform to create fewer, larger municipalities. The aim was to improve economic performance and reduce rate costs to ratepayers. By the end of 1994, there were 78 local government bodies in Victoria. Existing local councillors were dismissed, and the new municipalities were initially run by state government appointed commissioners. Unlike councillors, commissioners were paid, and were expected to take a more business-oriented approach to local government management. Elections for new councillors were held in 1996 for inner city councils, and 1997 for others.

In order to ensure that promised economic benefits were realised by the newly amalgamated councils, the State Government imposed revenue cuts and rate caps on councils. On average, rate revenue throughout the sector was cut by between 15 per cent and 20 per cent. Within the context of rate cuts and financial stringency, an increased emphasis on accountability and performance was inevitable.

These reforms have resulted in massive change in the environment and the operations of local government. New management techniques being adopted in private and public sectors worldwide, such as Total Quality Management, empowerment, and downsizing (or rightsizing), are affecting structure and process in local government just as they are in other sectors.

The research method

The purpose of the research behind this book was two-fold. Firstly, it was designed to study the extent of the use of management accounting practices in Victorian local government. Secondly, it examined the linkages between some management accounting practices and organisational learning, in an environment of significant change when organisational learning was crucial to the continued survival of the organisations studied. (The State Government had intimated that more amalgamations, resulting in the disappearance of further municipalities, may be forced if municipalities did not achieve satisfactory performance.)

In particular, five factors which have affected local government were analysed to examine their impact on both management accounting and organisational learning, and to study the links between them. These five factors, which are reflected in the succeeding Chapters 2 to 6, are:

- corporate planning
- compulsory competitive tendering
- amalgamation and boundary reform
- changing organisational models
- budgeting practices and financial accountability.

The research model used to guide the research is shown in Figure 1. The five factors in the centre are seen in this research to induce changes in management accounting and increase the capacities for learning in the organisations studied. These changes then may have secondary effects, which call for further enhancements in management accounting as a way of further increasing organisational capacities for learning.

The research was undertaken in a sample of 23 urban and regional Victorian municipalities. Of the 23 municipalities, 18 are located in greater Melbourne, and 5 are located in rural cities.

The researchers interviewed either the CEO (in 12 cases), finance director (nine cases) or management accountant (two cases) of each municipality, using a semi-structured interview format with open-ended questions to elicit as much information as possible. In six municipalities, other senior staff joined the interview at the suggestion of the CEO or finance director, allowing greater insight into current practices. The CEO or finance director, rather than the management accountant, was interviewed whenever possible in order to study whether senior management perceive accounting as meeting its needs.

The interview questions related to the changes taking place in the municipality, and the impact of those changes on management accounting practices from a management perspective. Each interview lasted about an hour and a half and was taped and transcribed for later analysis. The transcripts were coded into general sections, and then examined in detail for themes which emerged. The results have been verified by having two researchers examine the transcripts and write up each section of the report.

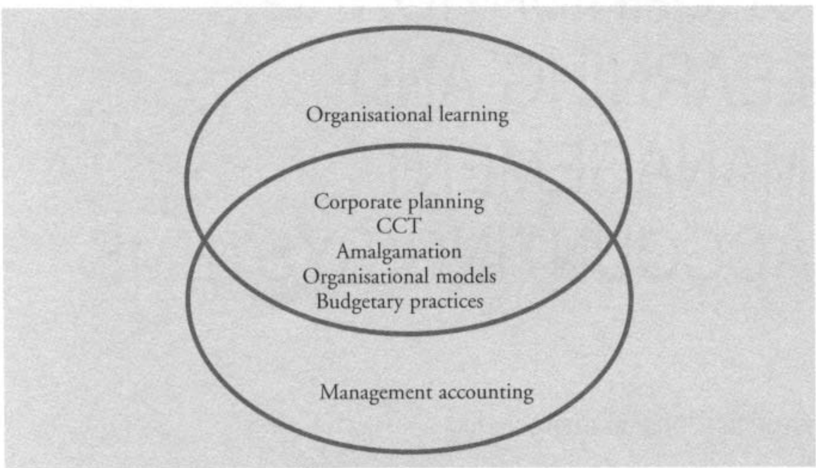

Figure 1

CHAPTER 1

ORGANISATIONAL LEARNING AND MANAGEMENT ACCOUNTING SYSTEMS

Organisational learning

> The rate at which individuals and organisations learn may become the only sustainable competitive advantage, especially in knowledge-intensive industries. (Stata 1989, p. 64)

Organisational learning occurs when individuals within an organisation experience a problematic situation, and inquire into it on the organisation's behalf. In order to become `organisational', the learning that results from individual inquiry must become embedded in the images of the organisation held in its members' minds (Argyris and Schon 1996).

Organisational learning increases an organisation's capacity to take effective action (Kim 1993) and can take place at two levels. At one level, `adaptive' (Senge 1990) or `single loop' (Argyris 1977) learning enables an organisation to continue applying its existing and accepted governing variables, values and norms. For example, a budget variance may result in a minor change in budgeting practice to make the budget more realistic.

At a more fundamental level, `generative' (Senge 1990) or `double loop' (Argyris 1977) learning requires changes in the organisation's operating paradigms. Double-loop learning occurs as a result of identifying and challenging the existing and previously accepted variables, values and norms. For example, an unfavourable sales variance may result in a recognition that an organisation's products or services are no longer meeting market needs, and new strategies may subsequently be formulated.

Double-loop learning is more powerful, and more likely to lead to enhanced long-term performance. However, single-loop learning is also a valid and appropriate form of learning, particularly when the organisation does not face significant challenges.

Double-loop learning may occur in organisations because of:

- a crisis precipitated by some event in the environment
- a revolution from within
- a crisis created by existing management (Argyris 1977).

Local government has experienced two of these events. It has experienced environmental crises: the move to CCT and amalgamation. And it has experienced internal revolution: new CEOs and management teams were appointed to most local authorities. Double-loop learning is therefore to be expected in the industry.

Huber (1991) identifies four `constructs' necessary for organisational learning to occur. These can be linked to either the single- or double-loop learning models, as they provide a platform for determining the level of learning. They are:

- `knowledge acquisition': the process by which knowledge which the organisation recognises as potentially useful is obtained. Prior knowledge enhances and facilitates the acquisition of new knowledge, which is central to organisational learning. Knowledge may be acquired by searching (intentional) or noticing (unintentional).
- `information distribution': the process by which information from varied sources is shared. This determines both the occurrence and breadth of learning. Wide distribution of information results in an enhanced ability of individuals to learn. Organisation-wide information sharing alleviates problems which occur when different levels of managers are not aware of operating conditions.
- `information interpretation': the process by which distributed information is given meaning, and the process of developing shared understandings. A variety of shared interpretations is likely to lead to more organisational learning, whereas differing interpretations may lead to difficulties in reconciling different views, and reduce the level of learning.
- `organisational memory': the process of storing knowledge for future use.

Learning presumes that organisational experiences are maintained and accumulated (Kloot 1997).

Huber's constructs, and single- and double-loop learning can be linked, as shown in Table 1.

Table 1
The links between Huber's preconditional constructs for learning and single and double-loop learning.

Learning construct	Single-loop learning	Double-loop learning
Knowledge	Routine knowledge (e.g. regular performance information)	Non-routine acquisition of knowledge (e.g. searching for special information on the economic environment)
		Creating or instituting new knowledge acquisition practices (e.g. increased training to achieve better practices)
Information distribution	Information remains with small group (e.g. business unit sales given to sales staff)	Information shared more widely (e.g. organisation-wide sales information shared in corporate management group)
		The development of better distribution channels and systems resulting in wider sharing of information
Information interpretation	Smaller group may have similar interpretations (e.g. business unit sales team)	Diverse group more likely to have multiple interpretations (e.g. multi-functional team comprising marketing, accounting, and engineering personnel)
Organisational memory	Stored in routine reports (e.g. variance reports)	Stored in special reports (e.g. strategic planning reports)
		Development of new mechanisms for storing memory

Whilst the constructs can be used to determine if learning has or is likely to take place, the depth of learning (single- or double-loop) is more problematic. There are times when what appears to be a small decision resulting in single-loop learning in fact leads to the more radical changes of double-loop learning. For this reason, most of the discussion of learning in the remainder of this book focuses on the constructs rather than the depth of learning.

Factors which facilitate learning in organisations are:

- managerial fostering of an environment which is conducive to inquiry, questioning and openness (Addelson 1996)
- communities of practice — informal or formal groups of individuals who meet and share tacit knowledge and exchange ideas about work practices (Clegg et al. 1996; Levitt and March 1988)
- the practice of benchmarking both within and across organisations as a manifestation of sharing information in communities of practice
- an organisation's absorptive capacity — the existence of prior knowledge which facilitates the recognition of new knowledge (Cohen and Levinthal 1990).

Management accounting systems

In this study, `management accounting' was used to refer to organisational systems which provided information about the effective use of resources in generating value for a municipality's constituents. These systems might be long-term in orientation (such as in corporate planning) or short-term in orientation (such as in budgeting or targeted cost reduction); or prospective in focus (for instance corporate planning, budgeting) or retrospective (such as accrual accounting, financial reporting). They may utilise financial or non-financial indicators of performance, and be oriented to either control (such as budgeting or cost control) or improvement (for instance through program review or process re-engineering). They may prompt goal-setting (such as through benchmarking) or guide goal-attainment (such as through TQM or Activity Based Costing). In all cases, however, and in one way or another, they shed light on the crucial equation between resource use (in terms of investment, leverage, cost, loss, waste) and value generation (in terms of revenues gained, services provided, and value attributed by constituents).

Organisational learning and management accounting

Although some writers have suggested that management accounting and control systems impede organisational learning (Argyris 1990; Miller 1993;

Hames 1994), appropriate management accounting systems can enhance an organisation's ability to learn by providing means of acquiring knowledge, distributing information, and storing information about resource use and its effectiveness (Kloot 1997; Marquardt and Reynolds 1994). In particular, appropriate management accounting systems can provide information about the `fit' between the organisation and its environment, and suggest courses of action necessary for the organisation to learn and survive when the fit is inappropriate.

The links between single-loop learning and management accounting information are well known. For example, budget variance analysis and budget reports are designed to detect operational problems and suggest solutions which do not normally challenge the operating paradigm. The links between double-loop learning and management accounting information are less well known, but do exist (Kloot 1997). For example, when a budget report indicates the existence of significant changes in the price and quality of components which leads to product re-design and new component sourcing, double-loop learning takes place. Information gathering techniques such as benchmarking and participative decision-making can detect problems which require paradigmatic change for their solution.

Management accounting reports and processes contribute to the creation of the organisational memory, and facilitate transfers of knowledge between and across units.

CHAPTER 2

CORPORATE PLANNING

There has been a significant increase in the sophistication and the level of use of corporate planning since compulsory corporate planning was introduced in 1992. Interestingly, a number of CEOs attributed the improvement in corporate planning not to the legislative requirements, but to the need to manage more effectively in a CCT environment with tight financial constraints:

> The minister wanted a corporate plan by April 1995 so we took an old one, changed the heading and dressed it up a bit and gave it to him. Now we have developed a proper corporate plan to focus on our strategic priorities.

The State Government had imposed revenue cuts and rate caps when this research was being undertaken. The new focus on commercialism fostered a new purpose in councils: `The strategic side of things is the best part of CCT ... we need to manage better under CCT'.

Note that the organisational learning which took place — the change in practices to effectively utilise corporate planning as a management tool — was a result of management accounting needs, rather than as a result of State Government compulsion. Those councils which did not see the value in corporate planning found its imposition by the state was a problem:

> The corporate plan is driven by state government financial controls and revenue targets (rate pegging) which are arbitrary and do not properly compare councils to see if they were initially efficient or inefficient.

Layers of corporate planning

There were several layers in the corporate plans developed in local government:

- community or vision plans
- capital works plans
- three- to five-year financial plans
- three- to five-year corporate plans
- business plans linked to the corporate plan.

Community or vision plans

One quarter of municipalities had very long term plans with time horizons of 20 to 25 years. Reasons given for developing such plans included the desire to have a plan with a sense of what the residents really want; one which reflects residents' vision for the future.

Capital works plans

Twenty per cent of municipalities had specific capital works plans incorporated into their overall corporate plans. This was seen as crucial by CEOs who had past experience in a `stop/start' capital expenditure process, where capital expenditure depended on the residual of rates over recurrent expenses in any year, and could be stopped if recurrent expenditure exceeded expectations. Several councils reported that their infrastructure assets had been allowed to run down following such practices, and a long-term capital plan was seen as essential to rebuild these assets.

Three- to five-year financial plan

Forty per cent of municipalities had specific long-term financial plans. Financial plans were considered to be critical in councils with weak financial status and which thus had an imperative to improve their financial status as soon as possible. Several CEOs spoke of the need to achieve government savings targets and rate reduction targets as the drivers of the long-term financial plan: `The government has effectively reduced our expenditure by $13 million — an 18 per cent reduction'.

Councils also recognised that financial plans drive overall corporate plans.

However, the lack of financial underpinning to broad long-range goals was seen as a problem by one CEO.

Long-term financial plans were seen to be more important than corporate plans in some municipalities, with the CEOs suggesting that their municipalities' financial plans were driving their business plans (rather than the corporate plans driving the business plans and the financial plans). Others explained that the one-year budget overrode any long-term goals.

In those municipalities which lacked financial plans, one reason given for the omission was the inability to develop sophisticated financial models. This indicates that lack of appropriate management accounting leads to a lack of knowledge which impedes organisational learning.

Three- to five-year corporate plan

All municipalities had some form of corporate plan. (This is not surprising as a plan is now required by state legislation.) These plans included broad, long-range goals, short-range goals and specific strategies, action plans and operational goals for the next year.

Business plans linked to the corporate plan

Only two municipalities specifically referred to business unit plans or business plans as the final layer in the corporate planning process. A number of others saw business plans as separate from the corporate plan. The importance of business units, rather than the corporate entity, was also stressed: `More important now are the business plans of business units'.

The planning process

There appears to be a need for tighter links between the corporate plan and the annual budget. A number of councils commented that these links `need a lot more work'. For example, one council created a three-year financial plan, and only then began a review to determine how it could be achieved. Another developed its three-year financial plans with a three-year budget projection based on its annual budget, not on its strategic projections. One CEO commented that the new councillors had no idea of how much it would cost to implement the corporate plan. Another commented that `The corporate planning process is not good. The corporate plan is not a working document: it was amended from one of the constituent municipalities.' These municipalities were not exhibiting double-loop organisational learning, as there was no real improvement in the planning processes.

However, other municipalities had set better processes in place and as such were demonstrating organisational learning. For example, one had a corporate book on corporate planning, produced by commissioners and the CEO. This municipality undertook a series of rolling reviews and plans, and then incorporated all the plans into the corporate plan. It developed ten goals, one of which specifically related to financial management because of its revenue deficit, a lack of cash in the bank and the run-down state of its infrastructure. In this instance, the use of the corporate book exhibited all four of Huber's learning constructs: knowledge acquisition, information distribution, interpretation, and organisational memory.

Managerial involvement in the planning process

Managerial involvement in the corporate planning process is essential to learning: knowledge is acquired, distributed, and interpreted by increased involvement.

All of the municipalities involved at least their senior managers in the corporate planning process. Most involved managers down to the third tier of management, and one involved managers down to the fourth tier. (Typically, there are four tiers of managers in local government: the CEO, directors and two other levels of managers.) The reason for the high level of involvement was to create ownership and thus to foster accountability.

Initiatives included:

- senior managers attending 2-3 day workshops or retreats to develop ideas
- the provision of written feedback to managers
- weekly and/or monthly meetings of managers to review progress against the corporate plan
- encouraging the input of senior and middle managers in plan revisions
- linking the performance pay of the CEO and the directors to achievement of the plan
- some involvement in corporate planning by key players who are not managers.

Such initiatives appeared to have been successful:

> Corporate planning [used to be] seen as very much an upper level management responsibility that everyone else got to read, and say `Oh this is nice', but now we have a much more progressive approach.

> Senior managers don't always take a strategic enough view. The five-year plan is forcing more strategic thinking.

However the communication process was still seen as requiring improvement. Several interviewees commented that information from operational managers was useful in the planning process, but that rather than being communicated directly by those managers the information was provided informally by their supervisors. Others spoke of insufficient feedback being provided to lower-level managers and in particular of the limited involvement of service area managers — despite the fact that this group is heavily involved in annual budgeting and in implementing the corporate plan.

Generally, two-way communication throughout the organisation was seen as important for the planning process, but there was still some way to go in achieving this. A reason given for the lack of communication was the previous `lack of interest': `We've found in the past if you put it out for comment you get very little back'.

Only one municipality specifically mentioned the involvement of the community and special interest groups in the development of its corporate plan. However, in a number of councils, input from the community obtained through benchmarking activities (discussed in Chapter Five) provided information which would flow into the planning process in the future.

Revising the corporate plan

The Local Government Act requires that the corporate plan be reviewed every year, and progress against the plan be measured and reported. To this extent, every council confirmed that an annual review process took place. Some reviewed their plans only because they are required to do so by legislation. These municipalities indicated that they might try to extend the life of their current plans — `We will try to push this plan out for another year' — because it was a `big job' to alter the plan, or because they did not expect to change the corporate plan due to its `generic' nature. These councils suggested that their business plans would change more often than would their corporate plans.

Other municipalities undertook the review process at a more fundamental level, to actively learn from the process. A comment made several times was `We update properly every year. It's a big exercise.'

As a result of the statutory report monitoring process, corporate plans in many municipalities were more realistic and less like a `wish list'. These municipalities treated the corporate plan as a working document, with regular reviews of performance against the plan. Monthly meetings for management to review progress and three monthly reports to council were common, with the comment made that frequent reviews are necessary due to significant changes in the sector. Plans must be altered as circumstance dictates (for instance contracting out $10 million of expenditure may change strategic imperatives). Several councils commented that they revised the corporate plan if needed as a result of such changes.

These councils also reviewed their business plans on a regular basis. However, some councils reported that they no longer require regular reviews in business units which have been successful tenderers under CCT: it is regarded as the units' own responsibility to meet their contracts. One council reported that senior managers now have more time to concentrate on strategic issues as a result of CCT.

The future of corporate planning

Several councils noted that, although they had recently updated the corporate plan, it was expected that the plan would be reviewed again when elected councillors return. A number of municipalities made reference to the uncertainty surrounding the corporate planning process in the context of the loss of commissioners and the return of councillors: commissioners had been seen as more business oriented and able to get things done, and were seen to have an agenda for prudent financial management. Several interviewees suggested that there might be an adversarial relationship between the administration and returning councillors, that the days of political opportunism with a short-term focus may return. (Some inner-city councils had councillors returned while this research was being undertaken. Others still had commissioners at the time the interviews were conducted, although all now have councillors.) One respondent described what happened when councillors did return:

> The corporate planning process is now in disarray. We had a process involving all community groups plus management plus staff but the new councillors discarded both process and plan. We are back to political lobbying — senior management must explain our financial situation to them [councillors]. We no longer have an effective corporate plan — now it's really just annual planning.

Conclusions

Corporate planning is a management accounting technique which has become compulsory in local government. It is therefore undertaken by all, although only about half of the municipalities in this research used corporate planning to induce change and organisational learning.

Those municipalities which did use the planning process to improve organisational knowledge and the distribution of information throughout the organisation have fostered organisational learning. For these municipalities, an increased ability to focus on strategic priorities, to harness the ideas of managers, and to be more accountable has resulted from corporate planning.

Some municipalities undertake corporate planning only because they are required to, not as a management tool to facilitate organisational adaptation. These municipalities have not increased their ability to take effective action, and have not learned from the planning process.

Others used the process effectively to involve layers of management and employees in a series of linked components to change strategic choices in light of environmental changes. Involving layers of management allows for a variety of shared interpretations (Huber 1991) and increases the capacity of the organisation to take effective action (Kim 1993), demonstrating increased organisational learning.

CHAPTER 3

COMPULSORY COMPETITIVE TENDERING AND COSTING MODELS

Municipalities provide a large number of different services to external customers, for example, provision of libraries, road maintenance, parks and gardens maintenance, rubbish removal, after-school programs, and cultural activities such as art galleries. They also provide services to internal customers, such as the provision of financial services, and cleaning of municipal buildings.

In the past, the large majority of both internal and external services were provided by municipal employees. Under CCT, both internal and external services may be subject to the tendering process and the possibility of being out-sourced. However, not all services are subject to the tender process. Several options are available:

- A service may be put to open tender. Both in-house and external bids are seriously considered. An example is the maintenance of parks and gardens: existing gardeners form a business unit to tender for the work in competition with private sector providers.
- A service may be not contracted out, because the council feels uncomfortable with an external contractor providing the service. Several councils gave examples related to human services such as aged care.

- A service may be not contracted out because, although it is small, it is critical, or the cost of supervising the contract with the external providers is close to the cost of performing the service in-house. A rural council gave the finance function as an example.
- A service may be one which the council should not be involved in. It is contracted out, and no in-house bids would be entertained. One council gave as an example preparing meals-on-wheels.

There were fundamental and massive changes in business practices, costing processes and the management accounting information required because of the implementation of CCT. Most municipalities put the majority of services to open tender (more than the 50 per cent is required under the legislation). In order to ensure that in-house providers are competitive, CCT has resulted in a preoccupation with internal processes. CCT has therefore been a catalyst for process re-engineering and for good management practices, and an impetus for organisational change and learning.

The need for cost information

CCT has also been a catalyst for councils to focus on costing. Cost information (which falls into the category of `knowledge') is now needed for the development of tender prices, if internal teams are to compete with external providers. Councils reported that they required and were developing detailed costing information at both unit and business level.

For many of them this was the first time such information had been required. It was in fact a radical departure from past practice, where costs for services were often unknown and frequently deemed unnecessary (Kloot 1991). Some councils reported that there had been no previous attempts to cost any part of the organisation.

Even in those councils which had implemented some form of program budgeting, the detail and level of costs now required was much greater, with a need for costing at a number of levels for comparative purposes. In addition to unit costs for services, costing systems had been developed for total costs for services, for business units, and for functional or corporate overhead areas.

The first stage in cost information development for many councils was to improve their accounting ledger systems and upgrade their IT systems. Previous databases were widely accepted to be inadequate for costing purposes, and the development of databases was a continuing theme. Managers also reported the need to identify and collect physical data related to output (for example, data on the number of library books loaned). Both financial and non-financial information was required on a more timely basis and, in many councils, on-line computer systems had been or were being developed to satisfy this requirement.

Before the introduction of CCT, few managers were concerned with unit (or even total) output costs. Afterwards, most were focused on costs and cost management. Inaccuracies in data were no longer tolerated, resulting in increased awareness and care in costing and recording transactions.

The requirement for timely information had been driven also by the increased accountability demanded of managers in the CCT environment. Business unit managers were now directly accountable for their segments' operating performance.

Developing cost information is an example of the first of Huber's learning constructs: the acquisition of knowledge. Without cost information, there is no basis on which to make fundamental changes in processes and structures.

Overhead allocations

All managers mentioned overhead allocations as an issue in developing costs for CCT purposes. Most were attempting to trace and charge costs direct to departments, rather than making arbitrary allocations, for both costing and control purposes.

In view of the perceived need to monitor these costs, new systems had been developed to identify costs to be allocated, and to re-define allocation bases. Some councils mentioned the need to accurately record and charge depreciation on assets and maintenance charges to asset users — although this was not a high priority in the past (Kloot 1991). Similarly, new systems were being installed to provide information about the differential use of services, for example telephone charging systems and photocopier codes.

One specific area frequently mentioned was the development of cost or charge-out rates for corporate overheads. Some councils identified for the first time what these overheads actually were. There was, however, no consistent view about what is included in corporate overheads: some councils included items such as the CEO's salary, others excluded the same items, treating them as a governance cost.

Reasons other than unit cost development given for the new emphasis on cost allocations included:

- the need for a system of internal charging or transfer pricing (as costs were now driven by service level agreements)
- a perceived need to bring all costs out into the open.

Corporate overhead costs were allocated to all business areas and business units by most councils, although several only allocated costs to successful in-house bidders. In these councils, business areas which were not being put out to tender did not receive overhead allocations, although the allocations were calculated for control purposes. This is an example of distributing information (cost allocations) through the organisation to assist learning and improve control processes. Some councils mentioned that staff were keen to undertake reviews of charge-out rates to keep information up to date, while another noted that there was an awareness that figures were outdated but `there is too much else to do'. One council reported that it had had problems with cost allocations and didn't want to allocate too much into business areas because of these problems.

One major problem with cost allocations and the tender process was identified: if an external bidder won a contract to supply services previously available internally, corporate overhead could no longer be allocated to that business area. New and larger allocations to the remaining internal areas were the result. Consequently, projected savings were not realised as overheads were fixed in the short-term for many councils. One alternative was to compare avoidable costs (not total costs) with an external bid. However, it was recognised that a further problem — that unsuccessful external bidders then insisted that in-house bids were not fully costed — would arise from this practice.

Several councils employed outside consultants to assist in developing methods of overhead allocations. A number of councils stated that this `gave credibility to the figures and they would be more acceptable to the business unit managers'.

Client-provider issues

Several councils reported that the client/provider split inherent in ensuring probity in CCT — `Chinese walls' — was affecting both budgeting and costing practices. A major difficulty in costing referred to by these councils was that, often, those with the most detailed knowledge of costs were on the client side (those who evaluate the tenders), not on the provider side (those who put in bids and must develop the costs) and were thus unable to assist in cost development. In addition, if an in-house bidder were successful, there was no longer any detail in the budget for that service: a single line-item was all that was required. It was then up to the in-house business unit to manage its own costs to achieve the agreed outcome. In-house business units must therefore have accurate costs and ways of monitoring the costs themselves. The majority of councils also no longer provided services such as accounting services to successful in-house business units. Those councils which did provide the services, charge for them on a commercial basis.

The use of Activity Based Costing

There was widespread use of Activity Based Costing (ABC) in local government to allocate overheads and develop service costs. However, although most respondents reported that they used ABC, there appeared to be wide differences in the practices used. Usually ABC development was undertaken by consultants (models developed by Ernst and Young were frequently referred to) in conjunction with council's finance staff. Other councils developed the ABC models themselves, then used an accounting firm (usually one of the `Big Six') to check the model.

Reasons given for using ABC in developing costs for CCT included:

- It helped staff understand cost behaviour.
- Managers became more aware that they must control both direct and indirect costs.
- The methodology provided a justifiable method for charging overheads to areas, thus contributing to an acceptance that overhead allocations were transparent, fair and equitable.
- ABC was believed to produce more accurate costs and to improve the ability to benchmark.
- The methodology allowed better monitoring of costs.
- It provided better information for managing costs and for achieving budgets.
- ABC facilitated cultural change.
- `ABC is like breathing: no other way to go': it is a management tool, not a costing tool.
- ABC helped in understanding the costs of activities and in working through the CCT process.

Overall, the methodology was deemed moderately to very successful by those using it, although subject to continual improvement and change as knowledge improved. Comment was also made that councils must be careful to spend time and money doing business, not just doing costings.

Reasons given for not using ABC were:

- It was too costly to develop even though there might be benefits in the future. (This may be due to an insufficient understanding of ABC: one council, for example, reported that initially it used 28 cost drivers, but consultants recommended cutting the number down to eight.)
- Local government was too diverse to use full ABC, and only a variation would be applicable: `There is no business as diverse as local government'.

- ABC could develop a life and bureaucracy of its own, rather than being an aid to costing.
- Since many ABC systems were developed by one particular Big Six firm, there was a feeling that only one model was developed and everyone was forced to fit that model.

Employee understanding of costing issues

Individuals must learn for organisational learning to occur (Kim 1993). In this context, staff must understand how costs can be used. Most councils reported that staff understanding of costing as an important management issue had increased. There was an increased understanding of the need, for example, to record time for costing purposes. One council, however, reported that there was still little recognition of costing problems, but this may have been related to the desire of the CEO to keep the ledger system for financial reports, not `corrupting' it by using it to develop costs for CCT purposes. Although a minority, senior managers in several other councils also believed the finance function was there for reporting purposes only, not to assist with the development of cost information for management accounting purposes. Even in those councils in which staff understanding of the costing function had improved, there remained a need for enhanced staff understanding of the difference between cost to the council and cost to the customer or price. One council also reported that many staff still did not fully understand the difference between fixed and variable costs, and therefore found it difficult to specify a range of prices if there was likely to be a range in the volume of services to be provided.

There was an awareness of the limitations of many finance staff employed in local government before the reform process. Staff training in all aspects of costing was seen as important if accurate costs were to be developed. Some councils had a business development manager to assist staff in developing business plans and costs, and to develop cost allocations of overheads when in-house teams were bidding. Other councils used consultants (often Big Six firms) to train staff in corporate and business planning, and in developing costs for tender prices. There were differences in the degree of finance staff involvement in staff training. In some councils, the finance staff contributed in a major way to staff training with relation to the behaviour and control of costs, and even developed financial checklists for use in bid preparation. In other cases, finance staff simply provided cost information as and when requested.

Hiring accountants and finance staff from industry was also seen as important in training staff and acquiring the skills needed: accountants could be brought in on short term contracts to develop costings. However there was also a feeling evident in some councils that local government is more complex than any business and therefore outsiders do not understand the special needs of the industry. By contrast, most councils realised the need for a commercial orientation. To highlight this commercial orientation, some councils required successful in-house bidders to pay the council a dividend on municipal assets employed by the bid team.

Cost management

In comparison with earlier times, when rates could be increased if costs rose, there was a pervading feeling that strong cost management practices were increasingly needed to enable reduction of costs, particularly if in-house bids were to be successful. Cost reduction relies on initially knowing what the costs are and how they can be reduced: the province of management accounting.

The process of cost evaluation and the analysis required in order to develop bid prices and to assess tenders in complying with CCT had assisted many councils in cutting costs. The identification of cost drivers and an understanding of how the cost drivers, and hence costs, can be managed, together with detailed cost analyses, allows for more accountability in the future. And this is vital, as in-house tenderers which win contracts must adhere to bid prices and costs, as must external tenderers. In the past, adherence to budgeted costs was not always enforced, as rate revenue could easily be increased.

Except for two, all councils participating in the study `market tested' or benchmarked all services. Even if a council had made a decision that a service would not be contracted out, that service would usually be market tested so that all services were placed on a commercial footing in an internal contracting environment. The idea of wanting everyone operating on a commercial footing was mentioned consistently throughout interviews. By requiring all services to be benchmarked, a service previously earmarked as `non-contractable' might be re-defined and contracted out if in-house costs were too high. Several CEOs referred to the desire to challenge all parts of their councils for efficiency, and the need to know both internal and external costs to achieve this. These executives also referred to the need for external cost comparisons, as no internal past costs existed for comparison or measuring improvement over time.

Program managers are undertaking regular service reviews in all councils now, and this is the first time for some councils. They are specifying:

- what each service is
- whether services are being provided because of custom, rather than by design

- what is involved in providing each service (in terms of its delivery and output requirements
- how the service should be provided in the future.

Managers are being forced to analyse every service to specify its service level. From this analysis, the contract specification, which forms the basis for cost development, is prepared. Managers are also being forced by the requirements of `arm's length transactions' to separate service planning from service provision from service delivery, and to separate the costs of each of these functions.

Analysing bids

Some councils reported that the financial aspects of CCT tenders were of critical importance in assessing bids, but these were in the minority. The majority reported that although the financial aspects were very important, other aspects of bids such as quality, merit, and community needs could not be ignored. The importance of the financial criteria generally ranged from 50 to 75 per cent of the total assessment. One council adopted a rule that external bids must be at least 10 per cent lower than in-house bids to be considered on price.

Few councils used any discounted cash flow (DCF) techniques in assessing long-term contracts, even for contracts in excess of five years. The reasons for this were:

- a lack of understanding of DCF techniques, with comments such as `only a few understand it' and `finance people aren't good at it' common. If finance staff were better trained, DCF techniques could be employed.
- a perception that the use of DCF techniques is limited to the analysis of capital expenditure and, in the current climate, there is little capital expenditure being undertaken
- a feeling that capital projects are driven, not by financial returns, but by whether or not the community wants them.

Those councils which did use DCF techniques did so because they appreciated that consideration of the whole-of-life of projects leads to good business decisions. The use of DCF was a recent phenomenon. For one council, it only started with the need to assess the first bid under CCT, suggesting that the learning associated with better processes was facilitated by CCT. The identification of an appropriate rate of return was suggested as a major difficulty by one user of the technique.

Conclusions

CCT has been both an organisational learning device and a catalyst for the development of modern costing and management techniques in local government. The management accounting developments discussed above were not evident in previous studies of local government undertaken in 1991 and 1995 (Kloot 1991; 1995), when the environment was stable and there was no need to change practices and processes.

Appropriate management accounting information is essential for the effective operation of CCT, and thus has been developed by most municipalities. As demonstrated here, management accounting information provides the knowledge which allows municipalities to learn and adapt to a radically changed CCT environment. Management accounting systems, in the form of costing information, also distribute information, and provide for information interpretation: two of Huber's learning constructs. In addition, if costing information is retained in the form of reports, municipalities are storing knowledge for future use: they are developing organisational memory.

Management accounting information increases the capacity of municipalities to take effective action when tendering and deciding between tenders. The learning which occurs when the ability to take effective action is increased is essential for municipalities to survive in the new, more commercial environment.

CHAPTER 4

AMALGAMATION AND BOUNDARY REFORM

Amalgamation and boundary reform resulted in the formation of fewer and larger municipalities. Indeed, newly amalgamated municipalities may have included parts of up to four prior municipalities. It was necessary for the new municipalities to develop single management and administrative systems. The development of new accounting systems was part of this process. Up to four different accounting systems had to be replaced with a single integrated accounting system. The processes adopted to achieve this integration varied, but it could have been expected that most councils would take this opportunity to develop accounting systems which could be used not only for financial reporting but also for management accounting purposes.

Accounting system change

Most of the councils in this research concentrated on integrating diverse systems or acquiring new systems for financial reporting purposes. There was little emphasis on management accounting uses of the accounting systems which were eventually adopted. To this extent, the systems integration did not lead to improved internal processes, or learning.

The reasons for this concentration on financial reporting uses were varied. The major reason appears to have been the enormity of the task required to consolidate a number of systems (the majority of respondents spoke of problems in the consolidation process):

> It took two years to integrate the systems ... it was chaos trying to do it.

> Twelve months after amalgamation everything was still an absolute mess. I came in with a helicopter view and gave clear instructions and we finally consolidated the systems.

> The accounting system at [A] was done chronologically, not by any accounting method that is normal.

> It took about 15 months — developed by combining aspects of the four systems.

Several CEOs spoke of the decision to use several systems initially and to gradually consolidate in the hope of reducing the impact of the task. This process often led to further problems:

> The first year we ran with four systems. We had unbelievable problems. [Council X] was happily going broke, [Council Y] just fell over the [break-even] line. For the first nine months we had no system for anything and you had to re-invent things, to discuss with six or eight people before you could make a decision. We went with the [Z] system — [it] had good reasons for its systems.

The most common method for consolidation of the accounts of constituent municipalities was to choose a system already in use in some part of the new municipality. The system was often chosen on pragmatic grounds:

> We adapted one of the existing systems, which had the capacity to take on extra — it was expedient, not necessarily the best system: the other one was too small.

> The large system overwhelmed the small — the large one had such momentum ... the data conversion would have been enormous if we had chosen the other one.

> The finance director from [Council A] just insisted on using the system he was familiar with — [Council B]'s accounts had to fit in — he gathered a group of [A] people around him and that was that.

Some municipalities were able to easily amalgamate two or more systems, as they used the same systems:

> Two of the three had the same system so that is what we went with.

> The job wasn't too big. [Council D] and [Council E] had the same computer systems, same hardware, same software, but the way the systems were used was poles apart, so we tried to get the best of both worlds when we merged ... just bought a new mainframe for capacity and added in [E's] accounts.

Only two municipalities took advantage of the need for change to acquire completely new systems. Both these municipalities referred to the size of the task involved in choosing and implementing new systems, but it was deemed necessary because of the failings of the old systems:

> Neither was able to deliver what we wanted, so we went to tender and picked the best system. The old systems had no integration of planning, community services and so on — staff recruited from the private sector asked why not, so we went ahead.

Although some municipalities saw the need for more business-oriented accounting systems, the majority used systems specifically developed for local government, largely suited to financial reporting needs. Other municipalities perceived the need for better accounting information systems which could be used for purposes additional to financial reporting, and the need to move to a more commercial information system. Six referred to the inability of their current systems to do what was wanted in the new environment. They recognised that a more business-oriented system is likely to provide better information to enhance learning in the competitive environment of CCT:

> We went to a specific local government system and it's very difficult - developed in the days before business units. It can't do what we want.

> ... not appropriate for what we are trying to do now.

> The system needs to be further developed to meet our requirements.

However, several interviewees believed that they needed local government-based accounting systems because of the special requirements of local government:

> You will not find a more complex organisation in the world than the large Victorian council and the diversity in what they do is mind blowing.

> ... can't use a private sector system owing to the complexity and range of functions in local government.

One CEO, however, made the point that the only really different function required in local government is the property rating system, and his municipality was looking for a commercial system which could have the property system incorporated.

Employee responses

As stated previously, individual learning is necessary before organisational learning can occur. If employees are enthusiastic about change and working with new systems, organisational learning is facilitated. Only one CEO reported that finance and accounting staff responded positively to the changes which were required. The staff in this municipality drove the accounting changes. Despite the enormity of the task, they decided what was required and how to achieve the requirements. Another CEO commented on the cultural differences between people from different former municipalities who were now sitting side by side. This CEO formed a team with members from both of the former councils, and they chose to use one of the former systems after analysing what was important from their old systems and why they did things. A team effort resulted in a successful transition to the new system. Both of these municipalities exhibit forms of organisational learning.

A further three respondents reported a mixed response: that some people showed initiative and innovation in deciding what was needed and really contributed to getting things done, but others did not.

However, the majority of interviewees reported some problems with the change to an integrated system. Lack of individual learning prevented organisational learning, the major problem being lack of knowledge. Two interviewees suggested that the lack of suitably qualified and experienced accountants contributed to their problems, with one council having no qualified accountants after the amalgamation of four councils and another having two `of only average quality':

> People were not trained so they were not understanding how accounting systems operate and their role, so they want to stay with what they know. There was a very negative reaction to the changes we needed to make.

> It wasn't a question of resisting change, more a question of understanding the needs particularly with CCT and costing issues.

A further problem was resistance to change, or the desire to stay with what was known. A CEO and a finance director, respectively, described how their employees reacted:

> Even though the two previous councils had the same software and hardware, there were cultural differences. If you asked a question you were given the answer appropriate to their previous situation — they didn't want to know the answer from the other council. It was like a grieving process — they had worked with a process for years, then they turned around and were told there is a better way.

> Most of the finance staff came into my office at some time to say they wanted redundancy — they hated the changes, they wanted to leave. Only two out of about fifty didn't ask to leave.

Other councils described their employees as having their own barrow to push, and being very protective of their jobs. In other municipalities, strong finance directors from one of the previous municipalities were able to `railroad' their systems into being adopted as the new standard, leaving the others to change.

Conclusions

Very few municipalities used the need to consolidate and integrate a number of accounting systems as an opportunity to acquire new accounting systems capable of providing management accounting information: they did not take this opportunity for organisational learning.

The majority utilised a system or systems which already existed within the newly merged municipalities for the ease of conversion and consolidation. Even though a number of municipalities recognised the deficiencies in their current systems, the dimensions of the changes resulted in few being able to obtain new systems: they tried to minimise the change in this area. However a number did plan to make changes to their accounting systems in the future.

The majority of interviewees reported some personnel problems in changing their accounting systems, with many employees reluctant to change from familiar systems, or being protective of their jobs. Lack of individual learning prevented organisational learning occurring.

Overall, despite the need for new accounting systems in amalgamated municipalities, amalgamation as such has not resulted in changes in management accounting practices. Although it was frequently recognised by CEOs and finance directors that existing accounting systems did not provide necessary management information, changes which had been made to management accounting systems and practices were the result of other factors.

Whilst amalgamation has resulted in radically different organisations and in changed organisational structures, overall little organisational learning (defined as an enhanced capacity to take effective action) has taken place. Amalgamation does not appear to have increased decision-making capacity in the new organisations. In some ways the opposite has occurred, with differences developing over which systems to use and how to use them. This confirms the linkages between organisational learning and management accounting. Both management accounting practices and organisational learning levels resulting from amalgamation are inadequate.

CHAPTER 5

CHANGING ORGANISATIONAL MODELS

Organisational models have changed in many ways in the last decade, a period of high uncertainty (Kloot 1997), and local government like many other organisations is in the process of changing its organisational structure and management practices. Downsizing, flattening structures, re-engineering of business processes, using value chain analysis, focussing on quality, and placing more emphasis on the external environment are all responses to environmental change (Otley 1994). Some of these practices are being utilised by local government. As management control is closely coupled to organisational models, this research studied how management accounting has facilitated new organisational practices, and how management accounting is assisting or hindering change in organisational models.

Downsizing

Over the last decade local government has downsized considerably. In Victoria, the number of employees fell from 40 000 in 1993, to 15 000 employees in 1997 (The Age 30/6/97). As in other industries, the numbers of middle managers have also reduced, with those remaining now having an increased range of responsibilities (Otley 1994).

Downsizing, however, has not been driven by a perceived need within local government to keep up with modern management practices. Rather, most of those interviewed suggested that it has largely been driven by the State Government's agenda of council amalgamations, which resulted in duplicated positions. Downsizing was necessary to eliminate these duplicated positions; for example, to have one director of finance in place of three former directors if three municipalities were amalgamated. Rate revenue cuts imposed by the State Government meant that further reductions in staff numbers were a financial necessity as councils struggled to meet their rate reduction targets.

The requirements of CCT (see Chapter 4) also affected staff numbers. The need to be competitive for CCT led to a need to reduce costs and improve work practices. As one CEO remarked: `Redundancies were a big financial burden — but we would not make CCT targets without them'.

Further redundancies and downsizing resulted when in-house business units lost bids to external contractors in the CCT process. While some former employees may have found positions with external contractors, they no longer worked for the councils, even if they continued to perform similar tasks.

Although councils focused on inefficiencies and mapping processes to determine what staff cuts were needed, accounting systems appear to have complemented the downsizing process. One council reported that it changed the way it dealt with staff in order to save administration and finance processing time, and thus costs. Many councils reported that accounting information and reports were a critical input into the decision to downsize:

> Financial evaluation is being done all the time - it is an input into all management decisions including downsizing.

> Accounting information is needed to measure payroll costs, record costs correctly. Downsizing relies on labour cost information from the accounting system.

> We need good information to identify reduction targets.

However, it was also reported that problems with accounting systems hindered the process. One council reported that its finance processes and systems did not communicate well with its human resources systems in obtaining accurate data; another reported that poor systems did not provide the accurate information required for efficiently managing downsizing.

Although accounting affected downsizing decisions, the converse was not always the case. In some municipalities, downsizing had little or no impact on accounting systems or on management accounting system design. Several CEOs stated that, although amalgamation had resulted in downsizing and resource rationalisation increased efficiency, there had been no change in accounting reports, except that changes made for other reasons had changed the information provided to a smaller number of managers.

In contrast, several interviewees suggested that downsizing and rationalising had put added emphasis on the financial reports. One council reported growth in its management accounting area, which was then putting more emphasis on the reporting side as opposed to statutory number crunching. Another reported that `Downsizing means that we have had to find better and more efficient ways of doing things — we started from scratch and we use the accounting system a lot better than we did previously'. In these councils, accounting needs and accounting resources had changed as a result of downsizing.

Some councils commented on the significant disruption caused by the loss of so many people, including senior finance staff. The effects were seen as essentially anti-learning, in that a great deal of knowledge, information and organisational memory left with employees.

One CEO suggested that losing half the organisation reduced demand for accounting reports. Another commented that the changes had been so significant that it was not possible to compare the old antecedent councils and the new council: there were many fewer employees, and new systems related to working in teams and giving people data they needed to manage drive the new council. These new systems had forced organisational learning to occur.

It should be noted that downsizing was of major concern in most of the municipalities participating in this study. Managers discussed this issue, and employee empowerment, in far more detail than quality management and benchmarking.

In summary, while there was a strong link between the use of management accounting information and downsizing decisions, the converse was not found. Downsizing as such did not have a high impact on management accounting system design. However, there was (as indicated below) a consciousness of management accounting's contribution to empowerment and teamwork practices, both of which were allied to downsizing.

Empowerment and teamwork

Employee empowerment became an important management issue in the 1990s, both within and outside local government. With downsized organisations and the loss of levels of middle managers, there was a trend towards devolution of accountability and responsibility, and local decision making. Flatter organisation structures no longer require hierarchical control systems, and employee empowerment, with its devolved responsibility, has been suggested as a replacement for traditional control systems.

Most of the councils studied had introduced new concepts of teams and business units, and were devolving responsibility down the organisation resulting in the empowerment of lower level managers and employees. This was largely attributed to two factors: firstly the requirements of CCT and, secondly, the new environment which emphasised increased responsibility and accountability at all levels of municipal management, from the CEO down. Increased accountability results in empowerment becoming a form of management control.

Under CCT, in-house teams bid for jobs in competition with external tenderers. There is a need to maintain a division between the clients (those in council who are buying the service) and the providers (those in council who are supplying the service) to ensure probity of the tendering and selection process. There is thus a need to devolve responsibility to the provider teams and the client sectors.

The development of appropriate management accounting structures and the availability of accounting information were critical in ensuring employee empowerment and the effective use of a business unit or team structure. The fact that empowerment places strong demands on management accounting systems was a recurrent theme in virtually all councils in this study. Empowerment is driven by the availability of information and the ability of managers and team leaders to use that information. Effective empowerment is thus strongly linked to organisational learning, which also requires information and individual learning:

> We need the accounting, presentation of accounting or costing material to be available to drive empowerment at this stage.

> Empowerment means all managers need some sort of financial skills because more accountability means more reliance on information.

> Accounting information assists managers so that also impacts on the amount of teamworking that takes place.

> ... set up business units for CCT. These units operate as teams and the managers are responsible for costs so they need specific costing information and eventually revenue information.

There was evidence that management accounting systems had been restructured to meet the needs of managers in an environment of devolved responsibility. Previously, reports had concentrated on departments or, in some cases, programs. Detailed accounting control reports had gone only to department managers and directors, not to lower level managers.

Management accounting reports were now providing detail at the business unit level for unit level managers:

> Finance now has much more emphasis on producing the reports people want — now customer driven emphasis on moulding reports for the people who control the costs and are accountable for the costs. In the past, finance produced reports that finance wanted to produce, and that were appropriate for the Grants Commission, not for internal management use.

> Some reports have needed to be restructured to give the empowered business units the specific information they require. It took time to get it right — we needed feedback from the business units as to what they required.

> Accounting systems are now driven by managers' needs. We need to give people the information they require without a lot of the rubbish they don't need.

> ... new management information system which sits on top of ledger system so that data for that service unit can be accessed, can trend it, graph it, get exception reports, budget information.

> Business units require a different level of detail and information compared to the organisation, and conversely as the organisation tenders out its programs it doesn't need the detail, only line by line entries, so that the corporate budget will be simpler and the business unit information will be much more detailed. Eventually in the interests of probity and accountability there is a need to separate the business units' and the council's accounting systems.

Several CEOs who wanted to encourage a more corporate view of the world commented on the negative effects of CCT on the development of a corporate level team attitude, as opposed to a business unit level team spirit. There was a perceived need to improve interaction across departments, but this was difficult if teams were likely to benefit if they did not share information with other departments. This is an example of anti-learning, as lack of information distribution will impede learning. It was suggested that accounting systems need to deliver aggregated data across departments in addition to appropriate information for responsibility areas, to build a corporate view:

> [There is a] conflict between teamwork and competitive tendering. The provision of budgeting and financial information to managers who must become very hard nosed and cost conscious and focused as business unit managers under CCT will work against teamwork. Currently these same business unit managers share information at weekly lunchtime meetings but as they have to become focused on their own business units they won't really care about the rest of the council. The conflict is that some of those same people are the ones who contribute to a lot of

> the corporate planning, who pick up initiatives and are in tune with the community. The information managers possess about their own areas is their greatest competitive strength and may keep them in a job so that they will no longer share information.
>
> Sensitive information relating to client/provider split cannot be shared and this impacts negatively on the idea of teamwork at the corporate level. However, teams are empowered and accountable and this helps build team spirit in the business units.

A consistent theme was that accounting systems had to be appropriate for the new environment of increased accountability through the organisation. Accounting systems had been altered to provide information for lower level managers and teams to monitor their own performance in line with their increased level of accountability. Management accounting systems, which in the past had presented performance reports at an aggregate or departmental level, were changed, radically in some cases, to provide business unit level performance information. Again, this is an example of management accounting information providing the knowledge and information distribution which is required for organisational learning to occur:

> ... expect that managers will take responsibility for budget or service problems, so they need information about problems.
>
> We decentralise the budget system to put responsibility down to lower levels, but when the chips are down we also centralise the decision making. Everyone has the responsibility, though, for at least understanding. Accounting reports have altered because reports are now produced in a way that allows people to monitor their own budgets. Team leaders are responsible for entering and explaining variances.
>
> People in business units have to take responsibility for their own accounts, so from day one we have structured the accounts to give them their own information rather than departmental accounts. Finance keeps on eye on anything which looks a bit out of place, but the system forces the managers to explain to their managers any variances — they would not have been as accountable in the old days.
>
> ... more accountability, moved down the organisation. Successful teams have a specification and a price they have to monitor closely so have to have information, provided through finance — [this] requires a change in information and accounting reports.
>
> ... more lower level delegation and financial responsibility so managers need information about performance.

Thus accounting systems affect the trend for devolution of responsibility and accountability, and empowerment of employees. Without management accounting information at business unit or team level, employees cannot monitor their units' performance, and cannot be held accountable for their results. There is stronger evidence that empowerment places increasing demands on the accounting system. It appears that accounting systems and reports are being changed to facilitate employee empowerment and the functionality of business units.

Total Quality Management, continuous improvement and learning

The concepts of Total Quality Management (TQM) have become an integral part of the philosophy of many businesses worldwide. TQM has been driven by the perceived benefits of improved competitive position and reduced costs relating to improved quality. In Australia, some of the importance placed on TQM has been linked to the requirement that businesses wishing to deal with the Federal Government were required to be ISO 9000 certified. (However, this requirement has recently been dropped.)

As local government moves to the external provision of many of its services, it could be expected to require quality assurance from its contractors, whether they be in-house or external service providers. This would suggest an increased emphasis on quality throughout local government, and a move by in-house providers to formally seeking ISO certification or, at least, embrace TQM principles.

This research found few municipalities seeking formal ISO certification. Only one municipality had achieved certification, with another intending to gain certification in part only of the organisation: the physical services area. However, CEOs in all municipalities reported that their municipalities were focused in some way on quality, and were emphasising the need to improve their processes and service delivery. This was seen as particularly important in the context of CCT and the perceived need to ensure quality outcomes for ratepayers, regardless of who provides the services.

The reasons given for not following the ISO path were:

- the expense of obtaining accreditation
- the conviction that there is no need for external approval if municipalities are internally focused on quality and best practice
- contractors are required to guarantee quality and outcomes: `there is no need for councils to add an extra layer of quality assurance'
- more concern with continuous improvement than certification
- the belief that accreditation `just means ticking the right box which doesn't achieve anything'

- the CCT process will achieve quality outcomes
- the feeling that there has been too many changes to local government, without considering certification at this time.

Several municipalities had formal quality plans and processes for each business unit or segment to ensure consistency of procedures and, subsequently, of outcomes. Internal quality audits were undertaken in several councils. Two councils employed a quality specialist, and a third had an organisational change department which runs quality training and identifies issues which will lead to achieving continuous improvement. In one municipality, the emphasis on quality was a major thrust of the corporate plan. In documenting plans and procedures, formal quality processes are laying down organisational memory, which contributes to organisational learning.

Quality management was being introduced as part of the CCT process. A number of councils assessed quality systems as part of the assessment of tenders. These councils required successful bidders, whether they were in-house or external providers, to have quality monitoring systems. One interviewee believed: `the CCT process will do the quality job'. Another commented that `We have come up with new ideas to improve what they are doing to win their tender — that's what it is all about'.

The majority of councils, however, appeared to have an informal focus on quality rather than an explicit policy. Comments included:

> ... too busy in day to day tasks to make it [quality] explicit
>
> [The CEO] subscribes to continuous improvement in the guise of re-engineering.
>
> ... no formal program but emphasis on quality throughout the organisation — there is a recognition of the need for quality.
>
> A very thorough leadership program has been implemented to change the culture and the organisation.
>
> Having everyone thinking about quality and continuous improvement are the aims of process mapping — if there's no change it's not worth the investment.

Thus, although interviewees reported that their municipalities were focused on quality, this focus was largely informal. Management accounting information was not, for the most part, utilised in quality processes in local government, although its usefulness was recognised by several respondents.

In the absence of formal procedures and reporting mechanisms, it is uncertain how much emphasis lower-level managers and employees placed on quality, even where the CEO had a quality focus. In addition, the informal emphasis makes learning more difficult (as not all employees will receive the information they need), and organisational memory may be lost in the absence of reports.

Externally sourced information for benchmarking

The use of external information is essential for the survival of organisations in periods of environmental change. Such information allows organisations to detect when existing goals and processes no longer match external challenges (Coopey 1995), and leads the way to double-loop learning as these goals are queried and replaced.

Benchmarking has been undertaken in some local governments for several years. It began with a pilot study under the auspices of Australian Local Government Ministers (LGM 1995). This pilot study required local governments included in the study to compare their services:

- internally
- externally with competitors
- externally with other local government organisations
- externally with the `best in class'.

The pilot study noted that much of the cost information which should be used for benchmarking purposes was not immediately available. Further, the information had to be created manually, as the accounting systems generally lacked the flexibility to generate cost and other relevant data. The extent to which benchmarking was actually taking place was not measured, but it was implied that there was little benchmarking due to the data limitations: another example of the lack of management accounting information impeding organisational learning through lack of knowledge.

Consistent with these difficulties in obtaining relevant cost data, this research found that councils did not use cost data significantly for benchmarking, although several councils explicitly stated that they needed more accounting and costing data to assist in the benchmarking process. Developing more and better indicators for benchmarking in the future will have an impact on and highlight accounting, in that there will be a need for more management accounting information specifically directed to benchmarking. One council reported that a great deal of the required information was probably in the accounting system, but information from previous years was hard to access as they had no time to dissect the accounts to obtain a history of their new city to benchmark over time (all the municipalities had been affected to a greater or lesser extent by amalgamation). Another concern was the lack of consistency of accounting measures in local government:

> It is difficult though because nobody really accounts for things in the same way. Things can go horribly wrong if you are comparing apples and pears but think they are all apples.

Most municipalities concentrated on customer surveys to obtain external information for benchmarking. They were very concerned with ratepayers' perceptions of the quality of the services they provided, and whether they were providing the right services. The customer surveys were conducted using a mixture of internal departments or employees and external consultants:

> We do plan to do a lot more customer surveys - we are committed to transparent local government.

> [The] marketing department is in charge of customer surveys. Each service must have a minimum of two customer surveys a year — telephone or written, focus groups to contact the community at large.

> Our customer services department is working very hard to be customer-focused: they send out a survey card with the rate notice every year. The council monitors complaints and requests.

> ... much more customer focused and send out customer surveys on specific services and a broader community survey about overall performance.

> We are doing a generic customer survey to develop a customer satisfaction index .... [We] want to trend things over time to gain a broad working statement of things that need attention. We are tracking customer inquiries and producing monthly management report on complaints, outcomes and outcome times.

Benchmarking also takes place against both local government and private providers. A reason given for benchmarking only against local government is that services in local government are so diverse that private providers do not represent a fair comparison: `We can't be compared to the private sector for another two to three years — until the industry gets itself together'. Some CEOs reported that industry networks allowed them and their officers to benchmark within local government on an informal basis.

Most of the municipalities were either currently benchmarking against the private sector or moving towards such benchmarking. A number of councils suggested that CCT required them to compete against private providers or that best practice might be found in the private sector, and they had to move in this direction even if lack of information currently had them benchmarking only in local government:

> Benchmarking is important for both the client side and the provider side in the bid process.

> We are not interested in what other councils do. We are benchmarking ourselves against private providers for each of our 90 or so services — that's best practice.

> Other local governments will be the first port of call for benchmarking, but we must be competitive with the private sector, so benchmarking against them will be an issue.

Several respondents, however, reported that benchmarking within the industry was at that time harder to achieve. Firstly, council officers were too busy to network with other councils. Secondly, the competitive nature of the industry resulted in some reluctance to reveal information about costs and competitive position to possible competitors. Benchmarking for some is thus more concerned with quality and processes, not cost. Although these negative views about benchmarking were limited to three councils, another interviewee (a CEO) stated that he was unaware of the extent of benchmarking — he thought there was very little in the industry, and his council was still developing a process for benchmarking for use in CCT.

In contrast, other CEOs reported that they had won awards for their processes, so that other councils were obviously using them as benchmarks. Some councils, too, were part of formal industry groups for benchmarking purposes.

In summary, use of external information obtained from customers, other councils and the private sector was widespread in local government for benchmarking purposes. This knowledge contributed to organisational learning. However, there was limited use of accounting and costing information in the benchmarking process due to current deficiencies in the data. Moves towards better accounting systems to provide cost and management accounting information were under way. In addition, as the industry itself moves to a more competitive and privatised focus, the use of accounting information should increase. One danger is that managers may become less willing to share information as competition policy has an increasing impact on the industry.

Conclusions

Changing organisational models have resulted in improved levels of organisational learning, due to increased levels of knowledge and increased information distribution and interpretation, particularly in the areas of employee empowerment and benchmarking. This has resulted in improved ability to take effective action. The use of management accounting information in assisting changes to organisational models and management practices was, however, mixed. Appropriate management accounting information was a crucial input into decisions about downsizing, and to the proper implementation of employee empowerment. Employee empowerment was leading to different requirements for the type and quality of management accounting reports. TQM, largely an informal process in local government, has had little impact on accounting, nor has it been affected by accounting information. Benchmarking, however, was linked to management accounting information. It, and its associated learning, suffered from a lack of appropriate information and knowledge. The development of better management accounting systems will assist the implementation of benchmarking.

Again, the links between organisational learning and management accounting information are visible. Where changing organisational models lead to high levels of organisational learning (employee empowerment and benchmarking), there is appropriate use of good management accounting information.

CHAPTER 6

BUDGETING PRACTICES AND FINANCIAL ACCOUNTABILITY

The budgeting process has always been of great importance in the management of local government. In the past, it served the following functions:

- determination of the rate revenue to be raised and the amount of funds to be raised from other sources
- authorisation of expenditure throughout the year by local government officers
- a means of achieving control over municipal activities
- co-ordination of operations
- a required performance reporting device for the Office of Local Government and the Victorian Grants Commission.

The budget process prior to the amalgamation of councils and the replacement of councillors with commissioners was often a highly political one, with councillors having the final say. The budgets set by councillors were the result of a process which included a reasonable level of participation by lower level managers within municipalities. However, as councillors were able to simply increase rates if expenditure was likely to exceed projected revenue, many municipalities were not particularly cost-conscious and did not perceive a need to reduce the costs of running their services (Kloot 1995). (Indeed, the possibility of substantial cost savings by changing the culture and attitudes of managers was a driving force in the State Government's policy of forcing amalgamations.)

Previous research found differences in the ways in which budget reports were used as control devices in local government. Some municipalities used frequent variance reports to generate knowledge needed to identify and correct problems. Others relied on infrequent reports and did not treat problems which emerged with any sense of urgency (Kloot 1995), leading to very limited single-loop learning.

Today, budget variance reports are used as a control device to identify problems which may be solved either within the existing operating framework (single-loop learning) or at a more fundamental level by questioning underlying policies and assumptions (double-loop learning: Argyris 1977).

Effective budgeting systems are crucial to organisational learning. In Huber's terms, formal budget information and reports provide knowledge, distribute information through an organisation and develop organisational memory. Effective decentralised budgetary systems go one step further: they increase the levels of information distribution and interpretation and lead to enhanced learning. Good budgeting systems thus increase an organisation's ability to take effective action.

The research for this report examined: whether the budgeting process had become more or less decentralised; the level of budgetary control now being exercised; the reporting frequency and perceived inadequacies of reports; the level of involvement of lower level managers in the process; and whether program- or zero-based budgeting systems were used.

The degree of centralisation of budgetary processes

Seven municipalities reported that their budgeting processes had become more centralised since the amalgamation process, but that this was essentially temporary — they expected or were already making deliberate moves to decentralise the process. The reasons for centralising the process in the finance department, and subjecting it to strong executive management control, were largely to do with factors such as lack of knowledge. For instance there was the need to provide training and education programs for staff who were unfamiliar with good budgeting procedures:

> Some projections were very wrong but managers continued to insist they would achieve budgets — they didn't. It was very disappointing ... there are still gaps in the training ... a finance person is working with groups to help them set their budgets.

> It has been a whole education process ... very centralised [in order] to be an education process. We taught people how to do their own on-line enquiries.

> ... lack of understanding of budgets and costs even at senior management level.

Another reason given was the lack of a single system throughout the municipality. There were still different systems, inherited from antecedent municipalities, in different parts of the organisations.

A third reason given for centralisation was perceived problems with information systems, which could not provide financial information for local monitoring:

> Cash flows are our critical indicator and the system can't monitor cash flows at a decentralised level.

From a cost point of view, there was a need to achieve large budget savings, which could only be achieved with strong centralised control:

> Managers felt left out but we really needed to make some savings so that was being done through a centralised decision-making process.

The majority of municipalities (16) were, however, decentralising their budgeting processes, and in the process distributing more information and increasing the level of information interpretation. These municipalities were providing strong central guidelines and setting centrally determined parameters, then pushing responsibility for budget development and monitoring down to business unit level. Usually a brief was prepared detailing the budget guidelines for the year, and training sessions were held if required. In half the municipalities the finance department co-ordinated the process; in the other half co-ordination was largely the responsibility of the corporate or executive management group. Co-ordination by finance included the development of budget models (using, for example, software based on Microsoft Access) and on-line inquiry systems to assist managers to develop their budgets and monitor their results:

> ... more centralised in terms of where we are going but we are paying managers to manage so they have control.

> ... accounting people provide structure but responsibility is totally decentralised — each operating team works out its numbers.

> [The CEO] making them [business units] responsible so they can't blame finance.

> ... more centralised in terms of requirements but very decentralised input of data.

Interestingly, one municipality reported that it had a decentralised process because of a lack of co-ordination. It had been formed from four different municipalities, all of which had different systems, so there was no easy way of centrally monitoring the budget process.

Budgetary control

All the municipalities studied had centrally set requirements for monitoring performance against budget. This was seen as a critical function. Every respondent agreed that budgetary control had become much tighter in the current climate of rate capping (the State Government set the municipalities non-negotiable rate reduction targets of up to 20 per cent) and the introduction of CCT. For the first time, municipalities could not make up revenue shortfalls by raising rates. The theme of tight control due to managing in a much tighter financial position was a recurrent one by interviewees:

> ... very difficult financial circumstances ... must be controlled .... everyone is much more cost and budget conscious than before.

In addition, there was an external push for tight budgetary control: the Office of Local Government requires timely reports of progress against budget, as do reports prepared to conform with AAS27.

Business units in local government are now required to survive in a commercial world, so there is much greater emphasis by business unit managers on budgetary comparisons — `they sink or swim by what they do' — than in the past. In contrast to the past, when `some worked on the big bucket theory — there was only a central account — they had no responsibility', business unit managers now had authority and responsibility to perform, and were far more accountable. Several respondents reported that managers were also more able to take responsibility for budgetary control, as forecasts were more accurate and information systems were better equipped to give them the data they needed. In several municipalities, respondents reported that, whereas previously the control reports focused on line-items, the management group now required a program or business unit approach. The responsible persons now had the tools to help them monitor at this level, whereas previously they could not assess their performance on a unit or program approach until the end of the year.

Cashflow monitoring was described as critical, and looked at very stringently, particularly by commissioners who had come from the private sector. One CEO described his municipality's system as not responsive enough to give detailed cashflow reports against budget at business unit level, and suggested that developing a system which could produce proper cashflow reports was an urgent priority.

All except three of the municipalities produced formal monthly control reports for managers. The three exceptions reported weekly, fortnightly and quarterly. (The council reporting quarterly did so because of information systems problems: more frequent reports were perceived as needed for budgetary control and were an urgent priority.) Across municipalities, the reporting frequency to councillors/commissioners was fairly evenly split between monthly and quarterly.

In addition to the formal reports, just over half the municipalities had some form of on-line access for managers to monitor budget progress more frequently. Those municipalities which had asked managers for feedback on the desired reporting frequency found that managers wanted daily reports if the financial system could be changed to allow it. However, many of these on-line systems gave transaction data which was not as accurate or up-to-date as managers would have liked. A common comment was that adjusting entries may be weeks late. In some instances only raw data was available, and some managers needed the finance department to interpret the figures.

Many respondents mentioned the improvements in reporting frequency and content over the last three years:

> In the past there was just ad hoc reporting.

> Previously there were quarterly reports which no-one really looked at — they were too late.

> Used to have annual reports — I could only find the annual published reports when I came here, no management reports.

> ... previously monthly reports with not much in them.

The move to more frequent reporting, which generates better knowledge, was seen as essential in the current climate of moves to CCT:

> ... getting more commercial now and need better information.

Even more timely reporting was considered essential by some respondents:

> Fortnightly reporting would allow us to tighten the screws, particularly if something is going off the rails.

CCT had a great impact on the budgeting system. Changes in the budget format, to split the budgets into a client side and a provider side, were considered necessary for complete implementation of CCT:

> We have changed staff, processes, the chart of accounts coding mechanism — accuracy has increased markedly.

Whereas previously the budget was considered a tool to set rates, now it was being seen as a management tool in a more commercial climate. There was, however, room for improvement. Interviewees frequently referred to the need to improve IT systems to get better reports. A further requirement was more training for staff:

> Staff need to understand what they are doing, and why it is important for them to follow guidelines. Staff do not need to be creative in finding ways around guidelines — they need to follow them.

Managerial involvement in budget setting

In line with the increased responsibility and accountability being experienced by lower level managers in local government, there was an increased level of involvement in the budget setting process by second, third and fourth tier managers. Cost control responsibility was being pushed down to these managers, so they have a high degree of influence in budget preparation, increasing information distribution and knowledge. Directors were taking a more strategic position, leaving lower-level managers to develop the operating budgets. This had been a change for a number of municipalities:

> Previously senior managers did the budget and the rest of the organisation found out about it afterwards.

In several municipalities, involvement in the budget setting process included field staff and team leaders in addition to lower-level managers. In one municipality, involvement at this lower level was voluntary — staff could become involved if they wished, otherwise the third-tier managers prepared the budget. Several other councils commented that the degree of influence of lower managers and staff depended on each department and the manager's attitude. However, the majority were actively including lower level managers due to the need for these managers to take responsibility for their performance.

Four respondents commented that there was a need for training, and that devolving responsibility had highlighted poor understanding of accounting practices. Managers needed to build their confidence in dealing with accounting reports, as `some staff are paranoid about numbers'.

Program- and zero-based budgeting

Eight municipalities reported that they used a form of program budgeting (PPB: for Planning, Program and Budgeting) in developing the annual budget. The main reason given for its use was that the financial system was still structured around PPB, although several respondents mentioned that PPB had become more difficult to use since the introduction of CCT. Another reason given for using PPB was that the aggregate data found in PPB gave some flexibility in providing services to the community. One respondent offered as a reason for not using PPB the fact that multiple responsibilities which might arise under PPB made it impossible to hold people accountable for their achievements.

Sixteen councils reported using zero-based budgeting (ZBB) for some activities. As up to half the annual budget was `locked in' as a result of prior period decisions and contracts (for instance seven-year garbage disposal contracts) it was unnecessary to use ZBB for all activities.

The reasons given for the use of ZBB included the fact that managers preparing budgets in one year were not involved in the process previously so they had to start from scratch: `most staff built their budgets from the ground up'. Business units tendering for CCT also had to start from scratch, since the costing for CCT was very detailed.

Further reasons for ZBB's use were that, with rate caps and a difficult financial environment, everything had to be justified: `It may be necessary to give lots of programs the axe'. Justifying everything helped people learn about budgeting, and helped change the culture to the concentration on efficiency and effectiveness needed in the new environment. ZBB was used for all new projects every year.

Six councils used both PPB and ZBB.

Conclusions

This study found that the budgeting process and budgetary control systems in local government contribute heavily to organisational learning. As municipalities learn to survive in the new commercial environment that accompanies CCT, the budgeting system provides crucial information to enable them to become more commercially oriented and better able to make effective commercial decisions. The budgetary process and control reports have been changed in most municipalities to provide more focus on timely control at business unit level. Managers are being made more accountable for their units' results through the budgeting system and increased reliance on control reports. Enhanced accountability leads to enhanced decision-making effectiveness and learning.

The budgeting system is also being used to train people and change the culture in local government. Employee training leads to individual learning, which is a necessary pre-condition for organisational learning (Kim 1993).

CONCLUSION

This study provides an insight into some aspects of how management accounting systems are contributing to organisational learning in local government. Local government is operating in a very turbulent environment, with massive change throughout the sector forced by the State Government. In general terms, the industry is changing from a bureaucratic culture to a more commercially oriented, business-like culture. Financial responsibility is an overriding theme in an environment of rate cuts and caps, reduced employment opportunities, and smaller government. This turbulence and the need to change for survival have contributed to the need for local governments to become learning organisations.

Management accounting both assists organisational learning and changes as a result of organisational learning. Management accounting information systems provide the knowledge the organisation needs in order to learn, distribute information throughout the organisation and provide reports which store information in the organisational memory. These are the constructs on which organisational learning is based and, as can be seen in this study, organisational learning is thus inextricably linked to management accounting practices. Management accounting practices may also contribute to the extent to which organisations learn — whether the learning is single- or double-loop learning.

Management accounting systems are contributing in a number of ways to the organisational learning of municipalities. They are being used at a basic level to educate managers. In addition, adapting to the changed, more commercial, environment depends on the availability of accounting information which satisfies the needs of managers, for example in business unit reports, in costing reports, for corporate planning, for responsibility reporting and for an empowered workforce. Without the management accounting systems which have been developed over the last two to three years, municipalities would be in a much less competitive position and would be less likely to meet the requirements of the State Government. The ability of municipalities to take effective action to match themselves to their environment would be reduced.

There was a substantial increase in the availability and use of management accounting information and a general improvement in management accounting systems since previous research was undertaken in 1991 and 1995. Earlier research described a local government sector in which little management accounting information was either used or available. Local government managers are now developing costs for the services and programs the sector provides, and they are becoming very cost-conscious. Their planning and budgeting techniques have improved in that they are taking a more strategic view and are accepting the need for greater accuracy in budget estimates. Performance reports are now stressing the need to monitor cashflows and to match actual performance with budgeted performance. Management accounting reports are being re-designed to provide required information for business units and lower-level managers, thus allowing them to take responsibility for their results. In all these aspects, there are elements of knowledge acquisition, information distribution and interpretation, and placing reports into organisational memory.

These changes in management accounting information are playing a crucial role in helping local governments to adapt to the new environment. The survival of existing councils depends on their ability to take action to manage effectively in this new environment, as there is a threat of further council amalgamations and greater State Government intervention if municipalities do not contain their costs and improve their efficiency. Local government survival thus depends on demonstrating financial accountability and responsibility, measured largely by management accounting systems.

This study also demonstrates the links between management accounting systems and organisational learning. It demonstrates that some forms of organisational learning depend heavily on information acquired and distributed by management accounting systems. It also demonstrates that the development of management accounting systems is to some extent dependent upon the level of organisational learning.

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