

**Incorporating Activity-Based Costing/Management
Into The Results-Based Budgeting Technique:
A Bulletproof Anti-Corruption Management Control Tool:
A Case Study**

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ABSTRACT

The World Bank declared political corruption as the “single greatest obstacle to global development.” It has become one of today’s most pressing global and ethical problems.

Results-Based Budgeting (RBB) is a technique, which has recently become a popular tool in order to enhance transparency and accountability. Particularly among governments and not-for-profit institutions. Recent international and local government corruption ratings have alerted their respective communities on the need to hold public officials, civil servants, and directors of companies and organizations accountable for their decisions made, and even those not made, but should have been made.

Activity-Based Costing/Management (ABC/M) is a technique, which has demonstrated its effectiveness in managing, controlling, and reducing overhead costs/expenses. Instead of managing costs vertically, ABC/M promotes cost management horizontally, i.e., based on activity costs consumption, not allocation.

This paper proposes an original model, which incorporates (ABC/M) into the RBB. This model represents an effective management control tool, which intends to prevent collusion among the various parties; thus, reducing corruption. Furthermore, this model sponsors lean management, e.g., sponsors effectiveness and efficiency in these organizations.

Through a specific example this study develops a model, which clearly identifies the value-added and non-value-added activities in pursuing the missions of government and not-for-profit institutions.

Keywords: anti-corruption techniques, RBB, ABC/M, government institutions.

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I. Introduction

The “single greatest obstacle to global development,” as declared by The World Bank, political corruption has become one of today’s most pressing global and ethical problems (Everett et al., 2006). This is already a widespread agreement, which is reflected, for example, in the Convention Against Corruption created in 2004 by the United Nations as the first global legally binding international anti-corruption instrument. Corruption may be defined as an action to secretly provide a good or a service to a third party so that he or she can influence certain actions which benefit the corrupt, a third party, or both in which the corrupt agent has authority (Senior, 2006). For purposes of this study corruption is limited to a Private-to-Public context. That is, a private party (a citizen or a corporation) who pays money, or equivalent, to a public party (a politician or a public official) in order to obtain an advantage or avoid a disadvantage.

The propitious conditions, for corruption to take place include: wide authority, little accountability, easiness of collusion, perverse incentives, lower salaries, rewards for performance, employment security, low education level, low professionalism level, etc. In short, corruption seeks a personal gain over and above the collectivity wellbeing or gain, even to the detriment of the collectivity. Corruption interferes with the progress of the collectivity: economic, cultural, education, spiritual, etc.

Results-Based (or Performance-Oriented) Budgeting (RBB) is an approach that emphasizes outcomes (performance) as opposed to outputs, inputs, or processes. One of its objectives is to foster transparency and accountability. In the recent past, many governments have attempted to implement such an approach with the understanding that public sector accountability must shift from inputs to measure the results of what an agency does, and to tie incentives to achieving those results (Osborne, 1993).

Activity-Based Costing and Management (ABC/M) is a technique developed in the early 1980s by Cooper and Kaplan (Cooper and Kaplan, 1988) with the aim of managing, controlling, and reducing overhead costs, or indirect expenses (OH expenses). These expenses represent a group of miscellaneous expenses with no specific nomenclature. Hence, the particular difficulty to control them. The proportion of OH expenses, with respect to the budget, has been significantly increasing lately. This makes them incredibly attractive for corrupt public officials to exercise their profitable activities.

The purpose of this paper is to develop a model, which incorporates ABC/M into the RBB technique. The latter focuses on the impact of the government program budgets (the building), while the former represents the bricks. This model posits to discourage collusion among management members since the activities (the bricks) often times take place in several departments. Thus preventing collusion. Furthermore, this model also pursues cost reduction as a result of an effective cost management. This is different from cost reduction. The former reduces costs as a result of an intelligent cost management. The latter requires flexible ethics.

The remainder of this paper is organized as follows: section II reviews relevant literature, and places this study within it. Section III develops and presents the Model. Section IV summarizes its results. Section V concludes the paper with a summary and offers a discussion of future research and application(s).

II. Literature Review

Corruption may be defined as an action to (a) secretly provide (b) a good or a service to a third party (c) so that s/he can influence certain actions which (d) benefit the corrupt, a third party, or both (e) in which the corrupt agent has authority (Senior, 2006). It includes: bribery, embezzlement, extortion, influence peddling, unlawful gratuity favor or commission, nepotism, illegal political contribution, etc. Corruption requires collusion between at least two parties: the corruptor (the bribe provider) and the corruptee (the bribe receiver).

The most corrupt areas are the ones whose countries impose greater barriers on trade and foreign investment, which implies that their governance and market structures do not demand transparency and accountability in financial transaction and political measures.

As the most fundamental economic and social causes of corruption, it is usual to find conditions of low income, weak rule of law, and lack of free press (Yadav, 2011). However, the list of potential motivators of political corruption extends to consider a diverse range of factors, such as: size of unofficial economy (Lambsdorff, 1999), political stability (Treisman, 2000; Coviello & Gagliarducci, 2010), domestic economy and trade openness (Wei, 2000), public sector recruitment and wages (LaPorta et. al., 1998; Treisman, 2000), and collusion in public procurement procedures (OECD, 2010). The latter being one of the typical domains in which fighting corruption has been an issue of particular concern.

Collusion and corruption may be different problems, but when it comes to public procurement, they are directly related and have a mutually reinforcing effect. Collusion is an agreement among bidders involved in a procurement process, who conspire to eliminate the element of open competition; while corruption is the misuse of public office for private gain, for example, by accepting a bribe in exchange for granting a contract. However, the effect of collusion and corruption is the same: a public contract is not awarded based on merit assessed in a context of fair competition, so the value of public money is not maximized. Thus, strategies to tackle collusion are also aimed directly at tackling corruption (OECD, 2010).

Between 1999 and 2004, over 70% of project contracts for steel bridges were awarded by the Japan Highway Public Corporation (JHPC) to 47 companies belonging to two bid-rigging associations. The Japanese Fair Trade Commission (JFTC) ordered the JHPC to improve its contract procurement process, arguing that about 20 public officials were involved in bid-rigging practices to ensure future jobs in 45 of the 47 companies. This has been one of the biggest cases corruption involving collusion in the history of Japan (OECD, 2014).

The three major French construction companies (Bouygues, Suez-Lyonnaise and Vivendi) were involved in a corruption scandal named “an agreed system for misappropriation of public funds” (Le Monde, 1998). The companies paid a 2% fee on all contracts to the major political parties of the Ile-de-France region in exchange for awarding tenders for infrastructure work that came to exceed four billion Euros.

The majority of important cases of political corruption in the history of Canada have demonstrated the lack of transparency and accountability of its rulers. The beginning of the contemporary history of political corruption in Canada can be traced back to the early 1870’s with the famous Pacific Scandal (1872 - 1874), where Prime Minister Sir John A. Macdonald and his Conservative Party were facing difficulties to be re-elected in 1872. Macdonald turned to Hugh Allen, president of the Canadian Pacific Railway Company, who was bidding for the contract to construct the transcontinental railway. Macdonald’s campaign received one-third of a million dollars from Allen, a substantial sum at the time, in return for the guarantee that his company would be awarded the contract (CBC News in Review, 2004).

Other famous cases of political corruption in Canada include: the Customs Scandal (1925), where Prime Minister Mackenzie King and his Liberal Party had been receiving large paybacks from “rum runners,” who were illegally exporting liquor into the United States, where prohibition was still the law (Russell, 2011). The Tuna-gate (1985), and the Airbus Affair in 1995 involving Prime Minister Brian Mulroney. The Shawinigate (1997) and the Sponsorship Scandal (2004) of Prime Minister Jean Chrétien (Cameron, 2011).

These cases show a clear predominance of private interests over the public good, leveraged by the lack of a control structure, that fosters transparency, and facilitates collusion.

In the province of Quebec, Canada, a long line of corruption has significantly affected the political structure of the province and had bred a culture of mistrust of the political class. The discredited history of Quebec dates back to the early 1970's, when the well known corruption in the construction industry has been reflected in each infrastructure project.

Results-based budgeting (RBB) is the practice of developing budgets based on the relationship between the program funding levels and the expected outcomes from that program. RBB promotes cost efficiency, i.e. cost reduction.

According to Anderson (2008), the objectives for which governments have adopted RBB can be grouped into three categories: budget priorities such as controlling expenditure and improving allocation and efficient use of funds; improving public sector performance; and improving accountability to politicians and the public. Although each country has implemented RBB differently, and even under different names, there are several common characteristics. According to the OECD's Budget Practices and Procedures Survey (2008), 20 out of the 30 OECD member countries use RBB appropriations for at least some of their executive organizations or agencies.

Effective RBB initiatives require well-defined reform objectives and implementation strategies (OECD, 2008). These strategies should include: an overall approach (Anderson, 2008), i.e., top-down versus bottom-up, comprehensive versus partial, and incremental changes versus a "big bang" approach; the process for introducing and managing reforms; and the institutional and human capacities needed to drive and support the reforms and the sequencing and pacing of reforms.

Regardless of the difference in circumstances and objectives under which the reforms towards RBB budgeting occur, governments must decide the way to build performance information in their management systems. In cases like the United States (Shea, 2008), for example, the reforms have been implemented through legislation. This provides a degree of permanence in the event of a change of government. By contrast, the United Kingdom has only used formal requirements and guidelines issued by the central ministries, without directly using the legislation. Several countries, including Canada, have a mix of formal laws and policy guidelines.

In a top-down approach, the primary role in developing, implementing and/or monitoring reform is played by central government ministries or agencies. This approach has the risk of lack of commitment by staff, as it merely establishes rules and enforces them, rather than actually improving performance. Instead, individual agencies are the key actors in a bottom-up approach, where they can choose whether to take part, and they have freedom to develop their own methods to achieve the objectives. On the other hand, however, too little central involvement can mean that there is no pressure to change.

ABC/M posits to reduce the allocation of overhead costs, and instead assign (charge) them as if they were direct costs. ABC/M does not eliminate the need to allocate some indirect costs, but reduce it, in some cases, significantly. ABC/M represents a different approach; instead of just cutting items in the overhead costs (vertical cost cutting), ABC/M consists of identifying the activities that are necessary in the manufacturing of products, or in the delivery of services (horizontal cost managing). The purpose of ABC costing is to lead to practice Activity-Based Management (ABM). Hence, the term: ABC/M, used in this paper.

Since its start in the early 1970s, ABC/M has been primarily aimed at improving the performance of industrial enterprises. However, even from the beginning, the possibility of applying it in the service and public sectors has been contemplated. Its founders themselves (Kaplan & Cooper, 1998) mention that service companies are excellent candidates for ABC/M because most costs in this sector are fixed and indirect.

Kaplan (1994) reported that in the early 1980s, very similar strategies to ABC/M were being implemented by logistics companies, banks, hospitals, and other service companies. Brimson & Antos (1994), in turn, present examples of ABC/M being successfully implemented in telecommunication companies, hospitals, electricity, gas and parcel post companies.

As to the scope of the public sector and the applicability of the ABC/M method, although there has not been a widespread adoption of ABC/M in the public sector (Boned et al., 2006), Evans & Bellamy (1995) present important arguments which support the need for the public

sector to improve its management by implementing ABC/M systems. For their part, Melese et al. (2004) suggested that public sector entities face three major challenges that support the relevance of the ABC/M implementation relating to public service outcomes: a) the need to improve effectiveness – linking resource inputs with outputs; b) the need to improve efficiency – managing costs; and c) the need to improve accountability – linking budgets with performance.

Four different studies were conducted in public hospitals of England by King (1995), showing the benefits that the ABC/M system implementation would have for the British National Health System. Furthermore, Vazakidis et al. (2010) mention the case of the Municipality of Argyroupolis, in Athens, Greece, where ABC/M has been applied since 2005. One of the most recent and complete studies on the subject presents the ABC/M approach used by the Government of South Africa (Oseifuah, 2013). The authors conclude that ABC/M is an effective means to obtain useful and comparable costing information, perceiving improvement in financial performance, cost information for decision making as well as service delivery in the public sector.

III. The Model

Although RBB was not developed as antidote against corruption, it can be used to such a purpose. That is the contribution of this paper. As long as the programs are not housed in only one department, but rather spread throughout several departments, collusion will be, if not prevented, significantly reduced. Furthermore, the incorporation of ABC/M into the RBB model will be an additional deterrent for collusion.

The model developed in this study starts with a traditional budget of a fictitious city, i.e., Tomelopitos. Exhibits 1 and 2¹ show the traditional budget of such a city. Traditional budget management focuses on the inputs, i.e., salaries, rent telephone, advertising, promotion, etc. From this perspective the budget reports concern the percentage of the budget already

¹ Please, consult the Exhibits in the RBB and ABC/M file included in this submission

spent, etc. The implication is that if the budget has already been used up, the objective for which the budget was created, was achieved. Nothing could be further from the truth. In fact, the budget could have been used up but its objectives not necessarily been achieved.

Following this rationale, Exhibits 1 and 2 show the respective budgets are grouped by departments, which facilitates collusion within each department. In addition, this approach limits cost reduction decisions to either reducing or eliminating each of the items composing the department budget, e.g., in the Department Of Administration one could reduce salaries in Administration, Community Development Administration, etc.

RBB focuses on the outcomes as opposed to the outputs or inputs. An outcome is the impact on society of a specific program. For instance, a more educated population is the outcome (impact) of an education program for children with limited resources. An output is an indicator for an objective. For example, 2,000 kids of eighteen years of age should graduate from high school this year. An input is a measure of the resources invested (budget) in a specific program. For example, a budget of \$3 million back-to-school for kids having dropped out of high school program.

Traditionally, the budget control is limited to properly spending the \$3 million budget. RBB is concerned about the impact on society by the fact that dropout students did go back to high school, i.e., outcome.

The RBB budgeting technique would suggest a break down of the city's budget into its respective programs (see Exhibit 3). These programs may be undertaken by more than one department, which would make it more difficult for collusion across the departments.

Exhibit 4 shows the city's budget, with its respective program budgets, and their necessary activities. This would allow both for an effective (outputs) and efficient (inputs consumption) of the budget. The ABC/M technique identifies the activities available to the program managers. In fact, it is possible than one activity may be needed by more than one program. Since this activity will cost the same for any program, which needs it, collusion

would be close to impossible. There are managers responsible for activities, and managers responsible for programs. Thus, the managers of the various programs, and activities would be monitoring each other.

Exhibit 5 shows how the activity costs are assigned to the various activities. Exhibit 6 shows the same concept, except that instead of using percentages, it includes now the respective amounts in dollars.

Exhibit 7 shows the total costs (budgets) per activity, their respective cost drivers, and the unit cost per cost driver. This is what would allow the program managers to practice ABM. That is, to decide whether they would need a specific activity, how much of it, etc. Or, managers could decide to actually outsource a specific activity. Outsourcing decisions can only be made, if program managers know how much a specific activity costs in-house. Otherwise, outsourcing decision would be a toss-of-the-coin decision.

IV Summary and Discussion

The advantage of the model presented in this paper is threefold: a) it focuses on the budget's output, as opposed to whether or not the budget was spent (the RBB effect), b) the best manner to spend such a budget (the ABC/M effect), and c) it prevents management collusion (the RBB and ABC/M effect).

In actual current practice governments concentrate on whether or not the budget was spent. The implication is that if it was spent, something good took place to the benefit of society. This could not be further from the truth. Entire budgets could have been spent, and yet no change at all could have taken place in society, e.g., crime rate, high school dropout rates, functional illiteracy rates, etc. could have remained as high as before. In fact, the monies could have been used for personal interests other than the intended ones (the RBB effect).

The use of ABC/M would ensure effectiveness and efficiency of the monies spent. The fact of having an activity in-house encourages management to continuously monitor and compare such an activity with the out side offer. This forces the activity manager to ensure

effectiveness and efficiency, otherwise such an activity would be outsourced (the ABC/M effect).

Finally, the combination of RBB and ABC/M prevents collusion among the management team. The program and activities managers would monitor each other, and be monitored by central management as well.

A limitation of this model is that, as far as we could see, no such a model has been used in actual practice. However, nothing seems to impede its implementation.

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