Final Report on the State’s Budget and Financial Management Framework

TWELFTH REPORT TO THE PARLIAMENT
OCTOBER 1995
PUBLIC ACCOUNTS AND ESTIMATES COMMITTEE

TWELFTH REPORT TO PARLIAMENT

FINAL REPORT ON
THE STATE'S BUDGET AND FINANCIAL
MANAGEMENT FRAMEWORK

OCTOBER 1995

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Final Report on the State's Budget and Financial Management Framework
October 1995

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PUBLIC ACCOUNTS AND ESTIMATES COMMITTEE

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CHAIRMAN'S INTRODUCTION

The Committee's inquiry is in response to the May 1993 report of the Victorian Commission of Audit. The Committee's Interim Report on its inquiry into the State's Financial and Budgetary Framework was tabled in May 1994.

Much has been achieved since the tabling of these documents. Substantial progress has been made towards the introduction of full financial accounting into the public sector. Indeed, departments have moved quickly to implement these reforms, and will prepare audited accrual based financial statements for the 1995/96 financial year.

The report highlights the ongoing work of the Government's major reforms and achievements for the State's budgetary and financial framework. These include the Management Improvement Initiative, the Integrated Management Cycle, the introduction of the ORACLE information system and the greater focus given to funding of outputs, rather than inputs.

A firm base has been developed from which the future benefits of these reforms to the State will be realised. However, there are still areas which require close management, particularly in relation to asset recording and valuation; and human resource and training issues. There is a need for vigilance in the full introduction of these reforms and the Committee will continue to review their progress.

I thank the other members of the Public Accounts and Estimates Committee for their contributions to this Inquiry. On behalf of the Committee, I thank Mr Craig Burke, who was Director of Research for the main part of the inquiry and Mr Garry Ferris, Research Officer, for their briefing of the Committee, advice, analyses and drafting of the report, and Mr Sean O'Reardon for providing administrative support. I would also like to acknowledge the assistance of Mr Mario Abela in this inquiry.

Hon. G. Graeme Weideman, MP, JP
Chairman
EXECUTIVE SUMMARY

The Report of the Victorian Commission of Audit, tabled in Parliament in May 1993, made just over forty recommendations to improve the State's budget and financial management framework. The Committee's Interim Report on this subject highlighted some of the major reforms and significant achievements, as well as key remaining issues. These included the need for accrual based budgeting and whole of government financial statements for the State of Victoria.

Accrual Financial Management which is at the heart of budget and financial management reform will:

- enhance and extend public and Parliamentary accountability by clearly disclosing, for the first time, the FULL cost of services provided by the public sector whilst maintaining control over cash flows;

- assist decision making at both Ministerial and Agency level by promoting a management culture focused on the effective and efficient deployment of resources and the achievement of outputs, and not just inputs consumed in delivering services;

- improve performance monitoring through accrual based budgeting and performance indicators set on the full cost of outputs;

- enable inter-generational comparisons by allowing the public, Ministry and Management to judge whether the current generation has added to or reduced the net worth of the State for future generations;

- promote meaningful agency and government comparisons;

- provide better information for setting capital and maintenance spending priorities

- assist devolution of responsibility and understanding of the state and form of the stock of public sector assets and similarly provide an understanding of the State's financial obligations or liabilities.
However, Accrual Financial Management will only deliver the maximum benefit to Victoria if there is a fundamental and genuine shift in the management culture of the budget sector at all levels. The responsibility for this shift rests with the Department of Treasury and Finance. Accrual based financial information must be used for management purposes throughout the year, not just limited to the production of accrual based financial statements at year end.

The implementation of accrual based budgeting within the government sector is essential for the successful implementation of Accrual Financial Management.

The Department of Treasury and Finance should be proactive in the education of agencies and departments on the use of accrual based information and in the dissemination of that information to the Parliament and the public.

The Report endorses whole of government reporting prepared on an accrual basis. These reports provide a set of financial statements that enable Parliament and the general public to obtain a concise and timely overview of the State's financial position. The inclusion of appropriate performance measures as part of whole of government financial reports is crucial to the success of these reforms.

A major focus of the inquiry was on financial accountability and the Committee's report highlights the inclusion of a Statement of Responsibility in the Victorian Whole of Government Financial Statements which clearly identifies who is responsible for the fair presentation of the financial statements and their compliance with applicable legislation and accounting standards. This should also expressly provide that the whole of government financial statements fairly present the State's contingent liabilities.

Key issues requiring close management by the sector include asset recording and valuation particularly valuations of cultural and heritage assets, and the level of accounting skills and training requirements within the sector.

The Committee has received substantial commitments from the Department of Treasury and Finance that the existing implementation timetable will be met.
FINDINGS AND RECOMMENDATIONS

Finding 2.1 (page 39)

The Committee finds that Accrual Financial Management, as envisaged by the Committee, will:

(a) enhance and extend public and Parliamentary accountability of departments by clearly disclosing, for the first time, the FULL cost of services provided by the public sector. It will also show the level of resources (or assets) used to provide those services;

(b) assist decision making at both Ministerial and Agency level by promoting a management culture focused on the effective and efficient deployment of resources and the achievement of outputs, and not just inputs consumed in delivering services;

(c) maintain control over cash flows;

(d) improve performance monitoring through accrual based budgeting and performance indicators set on the full cost of outputs;

(e) enable inter-generational comparisons by allowing the public, Ministry and Management to judge whether the current generation has added to or reduced the net worth of the State for future generations;

(f) promote meaningful agency and government comparisons;

(g) provide better information for setting capital and maintenance spending priorities by disclosing the depreciated value of the States' stock of non-current assets;

(h) assist devolution of responsibility by providing more meaningful information on operating performance and financial position; and

(i) assist understanding of the state and form of the stock of public sector assets and similarly provide an understanding of the State's financial obligations or liabilities.
Finding 2.2 (page 40)

The Committee finds generally in support of Proposed Australian Accounting Standard ED62 Financial Reporting by Governments, and in particular supports the following key aspects that:

(a) a broad definition of government should be adopted in deciding which entities to include in whole of government financial reports based on the accounting concept of control; and

(b) whole of governments financial statements should fully consolidate the assets, liabilities, revenues and expenses of controlled entities.

Recommendation 2.1 (page 40)

The Committee recommends that:

(a) summary details of actual outcomes against Parliamentary appropriations should be separately identified within whole of government financial reports; and

(b) documents containing whole of government financial reports should also include performance indicators to assist users of these reports to determine whether the Government is achieving its objectives effectively and doing so economically and efficiently.
Finding 2.3 (pages 40-41)

The Committee finds that:

(a) Victorian Whole of Government Financial Statements should include a Statement of Responsibility, as opposed to a Statement of Compliance or other such statement, which clearly identifies who is responsible for the fair presentation of the financial statements and their compliance with applicable legislation and accounting standards;

(b) in light of the substantial potential financial risks to the State and the ongoing problems in the management of the State's contingent liabilities, the Statement of Responsibility should expressly provide that the whole of government financial statements fairly present the State's contingent liabilities. This will ensure that appropriate emphasis is placed on this very important matter;

(c) the Statement of Responsibility should also include a representation that the internal controls relevant to the preparation of the financial statements have been effective throughout the reporting period; and

(d) several options exist in respect of which signatories should appear on the Statement of Responsibility in whole of government financial statements. The Committee proposes that the Minister for Finance and the Secretary of the Department of Treasury and Finance should undertake this responsibility.

Recommendation 2.2 (pages 41-42)

The Committee recommends that the Statement of Responsibility for Victorian Whole of Government Financial Statements should include statements with the following tenor:

In our opinion, the Victorian Whole of Government Financial Statements, comprising Statement of Financial Position, Operating Statement, Statement of Cash Flows and Notes To and Forming Part of the Financial Statements:

(a) present fairly the financial transactions during the year ended 30 June 199X and the financial position of the Victorian Whole of Government as at 30 June 199X;
(b) present fairly the contingent liabilities of the Victorian Whole of Government as at 30 June 199X; and

(c) have been prepared in accordance with the Financial Management Act 1994 and Australian Accounting Standards.

The Department of Treasury and Finance is responsible for establishing and maintaining a system of internal control designed to provide reasonable assurance that the transactions recorded are within statutory authority and properly record the use of all public financial resources by the Victorian Whole of Government. To the best of our knowledge, this system of internal control has operated effectively throughout the reporting period.

We are not aware of any material circumstances which would render any particulars included in the financial statements misleading or inaccurate.

Recommendation 2.3 (page 42)

The Committee recommends that the Report of the Auditor-General on Victorian Whole of Government Financial Statements should, in addition to that already provided in his reports on public sector financial statements, include an opinion on whether the statements fairly present the extent of contingent liabilities, that is the State's exposure to financial risk.

Finding 3.1 (page 58)

The Committee supports the mandatory nature and guidance provided in the ministerial directions issued by the Minister for Finance in respect of annual reports to the Parliament.

Finding 3.2 (page 58)

The Committee finds that the form and content of annual reports to the Parliament is critical to Parliamentary accountability. Therefore, mandatory requirements, similar to the existing ministerial directions, should be prescribed in a regulation under the Financial Management Act 1994. This approach would not inhibit the Department of the Treasury and Finance from continuing to provide guidance on these important matters.
Recommendation 3.1 (page 59)

The Committee recommends that regulations, similar to the existing ministerial directions issued by the Minister for Finance, be issued under the Financial Management Act 1994 to prescribe the form and content of annual reports to the Parliament, including financial statements.

Finding 5.1 (page 94)

The Committee finds that:

(a) the role played by the Department of Treasury and Finance is critical to the successful implementation of Accrual Financial Management. The Department's role includes providing strong consistent leadership in the form of policies, guidance and support while ensuring that the accountability framework is both maintained and improved. Equally important is the Department's responsibility to monitor compliance with its policies and Ministerial Directions issued pursuant to the Financial Management Act 1994;

(b) departmental accrual based financial statements must comply with accepted Australian Accounting Standards and Concepts as required by the Department of Treasury and Finance;

(c) departments have expressed high levels of satisfaction with assistance provided by the Department of Treasury and Finance, however, a need for further guidance in certain areas has also been identified; and

(d) the absence of Australian accounting standards or other professional pronouncements on issues such as the valuation of assets is a significant problem, but not an impediment to the introduction of accrual accounting in the Victorian budget sector. The Victorian budget sector must continue to move towards the introduction of accrual accounting, and accrual financial management. Equally timely action by the Accounting Profession's standard setting bodies is also critical to provide the necessary guidance on contentious and difficult accounting issues, such as the valuation of assets.
Finding 5.2 (page 102-103)

The Committee finds that Accrual Financial Management will only deliver the maximum benefit to Victoria if:

(a) there is a fundamental and genuine shift in the management culture of the budget sector at all levels. The responsibility for ensuring that a genuine shift in culture occurs within the budget sector rests with the Department of Treasury and Finance;

(b) accrual based financial information is used for the day-to-day management of budget sector agencies. The Committee stresses that accrual based financial information must be used for management purposes throughout the year, not just limited to the production of accrual based financial statements at year end. This is not to denigrate the substantial importance of annual accrual based financial statements, which fulfills a critical accountability function,

(c) budget sector agencies are made accountable on an accrual accounting basis through an accrual based budget. It is critical that reforms are not limited to accrual based reporting with budget sector managers continuing to be held accountable solely on the basis of cash based budgets;

(d) performance measurement and reporting is a key element of accrual based financial management reforms. Accrual based whole of government financial reports to the Parliament, in common with all annual reports to the Parliament, should include performance measures; and

(e) the Department of Treasury and Finance should be proactive in the education of agencies and departments on the use of accrual based information and in the dissemination of information to the Parliament and the public on how to interpret and utilise reports prepared using accrual-based information.

Finding 5.3 (page 129)

The Committee finds that:

(a) valuation of cultural and heritage assets for financial reporting purposes is very beneficial, necessary, possible and not prohibitively costly;
(b) reliable and accurate valuations of cultural and heritage assets are integral to the development of full and accurate accrual based financial reporting in the Victorian public sector;

(c) cultural and heritage assets should only be included in accrual based financial reports when they meet professional accounting standards and concepts’ requirements for recognition of an asset; and

(d) it is acknowledged however, that valuation methodologies for cultural and heritage assets will continue to be refined over time and that a definitive and universally agreed approach does not exist for all such assets at this time. Importantly the appropriate stakeholders in all Australian jurisdictions, such as the accounting profession, auditors-general, central agencies and key operating agencies, need to reach some agreement on a uniform approach to this issue.

Finding 5.4 (page 129-130)

The Committee notes:

(a) the action and commitments made by the Minister for the Arts and his department to value all cultural and heritage assets under their control by May 1997, for financial reporting purposes; and

(b) the commitments given by the Department of Conservation and Natural Resources to comply with existing timetables to introduce accrual based financial reports, including asset valuations.

Finding 6.1 (page 139)

The Committee:

(a) welcomes the unqualified assurances it has received from the Department of Treasury and Finance that all departments will prepare audited accrual based financial statements for the year ended June 1996, including asset valuations. The Committee intends to hold the Department of Treasury and Finance to its undertaking, which is critical to the timely introduction of Accrual Financial Management within the Victorian public sector; and
(b) notes that the Department of Arts, Sport and Tourism will not be in a position to prepare accrual based financial statements until June 1997.

Finding 6.2 (page 156-157)

The Committee:

(a) is concerned that departments may be underestimating the severity of problems associated with accounting skill levels and training, both are critical to the successful introduction of Accrual Financial Management;

(b) finds that the timing of accrual based training for departmental staff must link with opportunities for staff to use and develop those skills in their day to day work; and

(c) finds that it is a responsibility of the Department of Treasury and Finance to monitor the development of accrual accounting skill levels within departments.

Finding 6.3 (page 158)

The Committee finds that financial management reform and the ongoing emphasis on financial matters generally within the Victorian public sector requires that each agencies' Chief Finance Officer must be part of the senior management team and should report directly to the Chief Executive Officer of each agency.
FUNCTIONS OF THE PUBLIC ACCOUNTS AND ESTIMATES COMMITTEE

The Public Accounts and Estimates Committee is constituted under the Parliamentary Committees Act 1968, as amended. It presently consists of nine Members of Parliament drawn from the Legislative Council and the Legislative Assembly.

The Committee carries out investigations and reports to Parliament on matters associated with State financial management. Its functions under the Act are to inquire into, consider and report to the Parliament on -

(a) any proposal, matter or thing connected with public administration or public sector finances;

(b) the annual estimates or receipts and payments and other Budget papers and any supplementary estimates of receipts or payments presented to the Assembly and the Council -

if the Committee is required or permitted so to do by or under this Act.
ACRONYMS AND ABBREVIATIONS

AARF  Australian Accounting Research Foundation
AAS  Australian Accounting Standard
ACPAC  Australasian Council of Public Accounts Committees
ADM  Administrative Level
ANAO  Australian National Audit Office
CPA's  Certified Practicing Accountants
DoF  Department of Finance (Commonwealth)
DSE  Department of School Education (New South Wales)
EBRC  Economic Budget Review Committee
ED  Exposure Draft
GAAP  Generally Accepted Accounting Practice
GFS  Government Finance Statistics
GPFR  General Purpose Financial Reports
GTE  Government Trading Enterprises
IMC  Integrated Management Cycle
IMF  International Monetary Fund
JCPA  Joint Committee of Public Accounts (Commonwealth)
MII  Management Improvement Initiative
MP  Member of Parliament
NSWPAC  New South Wales Public Accounts Committee
OECD  Organisation for Economic Co-operation and Development
PAC  Public Accounts Committee (New South Wales)
PSSB  Public Sector Standards Board
SAC  Statement of Accounting Concepts
SES  Senior Executive Service
SoR  Statement of Responsibility
UK  United Kingdom
UN SNA  United Nations System of National Accounts
USA  United States of America
VPS  Victorian Public Service
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LIST OF PERSONS OR ORGANISATIONS PROVIDING SUBMISSIONS/EVIDENCE

• Prof. R. R. Officer, Chairman and Mr S. R. Eslake, Executive Officer of the Victorian Commission of Audit.

• The Hon. A. Stockdale, MP, Treasurer of Victoria, Dr M. Vertigan, Secretary, Mr R. Reeves, Deputy Secretary, Mr T. Martin, Director Budget Management and other representatives of the (former) Department of the Treasury.

• The Hon. I. Smith, MP, Minister for Finance, Mr F. King, Acting Secretary, Mr R. Paice, Comptroller-General and other representatives of the (former) Department of Finance.

• Mr C. A. Baragwanath, Auditor-General of Victoria.

• Department of Transport.

• Department of Education.

• Department of Health and Community Services.

• Department of Premier and Cabinet.

• Department of the Arts, Sport and Tourism.

• Department of Conservation and Natural Resources.

• Department of Justice.

• Mr Frank Micallef, Senior Project Officer, Australian Accounting Research Foundation.
PUBLIC ACCOUNTS AND ESTIMATES COMMITTEE - The Honourable R.I. Knowles moved, by leave, That, contingent upon the Royal Assent being given to the Parliamentary Committees (Amendment) Bill, the Honourables P.R. Hall, T.C. Theophanous and D.R. White be members of the Public Accounts and Estimates Committee.

Question - put and resolved in the affirmative.

JOINT INVESTIGATORY COMMITTEES - Motion made, by leave, and question - That contingent on the coming into operation of the Parliamentary Committees (Amendment) Act 1992 -

Mr Baker, Mr Hyams, Mr Plowman (Benambra), Mr Smith (Glen Waverley), Mr Thomson (Pascoe Vale) and Mr Weideman be members of the Public Accounts and Estimates Committee.

(Mr Gude) - put and agreed to.
## REPORTS OF THE PUBLIC ACCOUNTS AND ESTIMATES COMMITTEE

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1.1 Background and Link to the Committee's Interim Report to the Parliament

The report of the Victorian Commission of Audit, which was tabled in the Parliament in May of 1993, made just over forty recommendations to improve the State's budget and financial management framework.\(^1\) The Committee commenced its inquiry approximately one year after that report was tabled in the Parliament. The overall objective of the inquiry is to assess the implementation of the Commission of Audit's recommendations in respect of the State's budget and financial management framework.

The Committee's first report on its inquiry, entitled *Interim Report on the State's Budget and Financial Management Framework*, highlighted some of the major reforms and significant achievements by the Government related to the State's budget and financial management framework. Those achievements included a robust and credible system of forward estimates; an integrated budget sector management cycle; a program to introduce accrual accounting in all departments; a focus on funding outputs/outcomes, not inputs; the Management Improvement Initiative and reform's to the State's financial management legislation.\(^2\)

The Committee's report also highlighted the following key remaining issues to be addressed:

(i) the need for clear policy commitment to accrual based budgets and whole of government financial statements;

(ii) continued emphasis on the development of meaningful, consumer focused output measures;

(iii) the need to expedite the introduction of accrual accounting in departments;

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(iv) the successful implementation of information systems improvements and development of a comprehensive information technology strategy;

(v) advancement of the timing of the delivery of the budget so it is presented to Parliament prior to the year to which it relates; and

(vi) publication of sensitivity analyses in the Budget Papers.3

The Committee's interim report in particular highlighted two major areas requiring further action at that time. Firstly, there was no clear commitment or timetable for the introduction of accrual-based budgeting for the State of Victoria; and secondly, no commitment had been made or a firm date set by the Government in relation to the preparation of whole of government financial statements.4 This current report focuses on subsequent progress on these and related areas. Other key remaining issues, such as the development of output measures, are being considered as part of the Committee's inquiry into the annual budget estimates.5

The response from the Department of Treasury and Finance to the Committee's Interim Report (refer Appendix H), which has not yet been tabled in the Parliament, was received just prior to the final adoption of this Report. It is the view of the Committee that the comments contained in the response by the Department did not require amendment to the Committee's draft Report. However, detailed consideration will be given to these comments in a subsequent report of the Committee.

3 ibid page ix
4 ibid Finding 5 and Recommendation 2, Finding 9 and Recommendation 4, pages xii and xiii respectively
1.2 Objective/Terms of Reference

1.2.1 Objective

The overall objective of the Inquiry is to assess the implementation of the recommendations of the Victorian Commission of Audit in respect of the State's budget and financial management framework.6

The Committee has conducted its inquiry in two phases.7 The Committee's objective for this phase of the Inquiry was:

To ensure timely preparation of meaningful whole of government financial reports and budgets on accrual basis as recommended in the Committee's Interim report on the State's Budget and Financial Management Framework.

1.2.2 Terms of Reference

In accordance with the Parliamentary Committees Act 1968, the Public Accounts and Estimates Committee conducted its Inquiry with the following terms of reference:


1.3 Method of Inquiry

This report comprises the second and final component of the Committee's inquiry. The Committee will continue to pursue some of the key outstanding issues raised by the Commission of Audit, related to the State's budget and financial management framework, as part of its ongoing review of the Budget Estimates. The Committee acknowledges that some of the proposed reforms are

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7 ibid page 1.
of such magnitude and importance that their full implementation will take time and require ongoing monitoring and refinement.

The Committee adopts the same fundamental methodology for each of its inquiries, comprising preliminary investigation, planning and terms of reference definition, information gathering and analysis, review and reporting. The Committee inquired into the State's budget and financial management framework through:

- appointing a consultant to assist the Committee to carry out the initial phase of the Inquiry;8

- monitoring progress against recommended action included in the Committee's Interim Report on the State's Budget and Financial Management Framework;

- seeking written and oral submissions;

- examining submissions received from government agencies and other interested parties;

- analyses of relevant reports or documents issued by other bodies;

- undertaking formal and informal discussions with relevant parties, including members of the former Commission of Audit;

- consideration of key issues at several public hearings;

- examination of central agency guidelines and directives, and the relevant legislative/regulatory framework;

- consideration of selected key issues as part of the Committee's ongoing review of the Budget Estimates; and9

- a short visit to New Zealand to study its considerable public sector financial management reforms.

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8 ibid page 2 to 3.
1.4 Legislative Requirements - Response by the Responsible Minister

Section 40(2) of the Parliamentary Committees Act 1968 provides that:

Where a report to the Parliament of a Joint Investigatory Committee other than the Public Bodies Review Committee recommends that a particular action be taken by the Government with respect to a matter, the appropriate responsible Minister of the Crown shall, within six months of the report of the Committee being laid before both Houses of the Parliament, report to the Parliament as to the action (if any) proposed to be taken by the Government with respect to the recommendation of the Committee.

Consequently this section of the Parliamentary Committees Act 1968 requires the responsible Minister to respond to the recommendations of the Committee in the Parliament within six months of the Committee's report.
2.1 Improved Financial Accountability - An Objective

The Westminster system of parliamentary government, which operates in Australia, requires that the Government of the day must account for its handling of funds entrusted to it. The Committee exercises Parliament's power of scrutiny and review over public finance, ensures that extravagance and waste are minimised and that sound and proper financial practices are in place. It examines the accountability of the public sector to Parliament and thereby to the electorate.¹

Public accountability allows informed public debate and participation in decision making. It also enables public scrutiny of the spending of public monies and the exposure of the public purse to current or future financial obligations. The Committee views itself as a key element of the State's accountability framework, or overall system of control.²

The accountability framework is an amalgam of many different aspects and includes the Auditor-General, the tabling of annual reports of public sector bodies in the Parliament (pursuant to the Financial Management Act 1994), the Freedom of Information Act 1982, Parliamentary Committees, including this Committee, and the Ombudsman. The accountability framework imposes a necessarily greater degree of accountability on the public sector than that expected of private sector organisations.

The Financial Management Act 1994 sets out key elements of the legislative framework for financial accountability in the public sector (refer Chapter 3).

The State’s Budget and Financial Management Framework

By making the activities of the public sector more transparent to both the Parliament and the public, through improved financial management and reporting practices, the achievement of the public sector's accountability obligations are more completely fulfilled.

2.2 Emphasis on Cash Accounting

The budgetary and financial management framework used in Victoria has been structured primarily for the preparation of information on a cash accounting basis. This framework focuses on two fundamental cash based reporting formats: firstly the Government Finance Statistics (GFS) format (used primarily for Budgetary purposes) and the Public Account format (used primarily for Parliamentary appropriation purposes).

GFS information is prepared on both a budget (including a capital and current account) and non-budget sector basis. The Public Account format however, primarily reports on transactions to and from the Consolidated Fund and Trust Fund.

The limitations of the above framework is twofold in that it fails to recognise all the assets and liabilities of Government and incorporate all those entities controlled by Government. Further it does not report on the full cost of services provided by the sector (refer paragraph 2.6). It is therefore difficult to obtain an accurate understanding of the financial position or performance of the sector, or individual departments.

The Auditor-General noted these weaknesses in an address to members of Parliament when he stated that:

Cash based reporting against budget demonstrates compliance with Parliament’s authorisations to spend monies, and provides valuable input for the next round of budget allocations decisions. However, whether such

3 Public Sector Accounting Standards Board of the Australian Accounting Research Foundation, ED 62 Financial Reporting by Governments, March 1995, pages 5-6
reporting results in the disclosure of information which is sufficient for an assessment of the efficiency and effectiveness with which resources have been managed, and is appropriate for accountability purposes is questionable. The lack of information about resources controlled, changes in those resources and the cost of providing services would appear to undermine the relevance of such reports for economic decision-making purposes and the discharge of accountability.4

This concern was also raised in Proposed Australian Accounting Standard ED 62 Financial Reporting by Governments, when the Public Sector Accounting Standards Board commented that:

Whilst there has been a significant effort directed towards standardising the financial reporting practices of the Commonwealth, state and territory governments, no uniform framework exists for the preparation of comprehensive, full accrual-based general purpose financial reports by governments. Most of the financial reports currently prepared by the Commonwealth, state and territory governments are cash-based and/or are not comprehensive in respect of the information contained in them or the entities which they encompass. In addition, there is diversity in the reporting practices adopted by governments.5

Mr A. J. Hyams, member for Dromana, highlighted the importance of accrual accounting as a tool for the financial management of Victoria when he told the Victorian Parliament that:

... we will never have a truly meaningful and accountable system until we have fully adopted accrual accounting ... In the 1990s it is totally inappropriate in a modern commercial world for any economic entity, and certainly an entity as important as the state of Victoria, to proceed any longer without fully accurate, meaningful and useful financial statements, and accrual accounting will be a significant step towards these goals ...

5 Public Sector Accounting Standards Board of the Australian Accounting Research Foundation, ED 62 Financial Reporting by Governments, March 1995, page 5
Victoria must jump out of the managerial stone age directly into the 21st century.  

2.3 Key Recommendations of the Victorian Commission of Audit

The report of the Victorian Commission of Audit highlighted the need for significant improvement in financial accountability and reporting in the Victorian public sector. The recommendations emanating from Chapters 5 and 6 of the Commission's Report, (refer Appendix A), addressed key issues concerning the budgetary process, accountability and internal control.

The report of the Victorian Commission of Audit recommended that:

The Victorian Government should introduce a system of full financial accounting, which measures the full costs of providing services. Budgeting and reporting to Parliament, on a whole-of-government basis and by individual departments, should be presented in this form.

This Inquiry examines progress in the implementation of these recommendations by the Victorian public sector (refer Chapter 1). The need for continued vigilance in the full implementation of the recommendations of the Victorian Commission of Audit was highlighted by Professor Bob Officer (Chairman of the Victorian Commission of Audit) in a meeting with the Committee when he suggested that:

I do not think accrual accounting is an end in itself. The real problem is people coming in and doing accrual accounting, like program budgeting in the early 1980s, because unless these processes are used they will disappear.
...

It is critical for the government that the structure of departments and, more particularly, the entities delivering these services is right, so they realise the

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6 Mr A. J. Hyams, Parliamentary Debates (Hansard), Wednesday 30 March 1994, page 745
only way they can satisfy the requirements and demands being placed upon them is by reporting back through an accrual-type system.\(^8\)

The Victorian Government has undertaken a reform program which is consistent with recommendations of the Victorian Commission of Audit and comprises several policy initiatives. These initiatives are discussed in Chapter 3 of this Report.

The introduction of full financial accounting, (that is accrual accounting), and whole of government reporting represent significant reforms to the financial management framework of the public sector. These reforms are key elements of Accrual Financial Management (refer paragraph 2.5 and 2.6).

There are three levels of issues associated with the successful implementation of Accrual Financial Management which are contained in Table 2.1 (refer Chapters 5 and 6).

<table>
<thead>
<tr>
<th>Level</th>
<th>Reform</th>
<th>Key responsibility area</th>
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<tr>
<td>Level 1</td>
<td>accrual accounting in departments</td>
<td>agency level</td>
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<tr>
<td>Level 2</td>
<td>whole of government reporting</td>
<td>central agency level</td>
</tr>
<tr>
<td>Level 3</td>
<td>accrual budgetary system</td>
<td>central agency level</td>
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2.4 The Independent Committee of Inquiry into National Competition Policy (the Hilmer Report)

The Committee of Inquiry which produced the 'Hilmer Report' was established in October 1992 by the Prime Minister. This followed agreement by all Australian governments on the need for a national competition policy and its basic principles. The Report recognises that Australia, for all practical purposes, is now a single integrated market, increasingly exposed to domestic and international...

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\(^8\) Professor Bob Officer, *Minutes of Evidence*, 26 October 1994, page 2
competition. A national competition policy, according to the Report, aims to promote and maintain competitive forces to increase efficiency and community welfare, while recognising other social goals.\(^9\)

Whilst it is acknowledged that the primary focus of the Hilmer Report is on the introduction of competition to all sectors, particularly Government Trading Enterprises, the Report also provides compelling reasons for the introduction of financial management reforms, such as accrual financial management, in the public sector.

The key recommendations of the Hilmer Report that are relevant to public sector financial management reform relate to competitive neutrality and the introduction of competition. Competitive neutrality only occurs when the operating environment (that is the regulatory and other requirements) for private sector firms and government businesses competing in the one market, is the same. Following the achievement of competitive neutrality it is then possible to properly judge whether there may be a more economic way of providing such services.

Establishing the full cost of services provided by the public sector is a primary step in the measurement of a program's performance and enabling comparisons with other potential service providers. Once equipped with full cost information Government can also more realistically price its outputs (where applicable) and make apparent the extent to which the taxpayer is subsidising these outputs.

2.5 Accrual Financial Management - An Accountability Framework

Accrual accounting and accrual financial management are terms which require further clarification. In its narrowest sense accrual accounting refers to the preparation of annual general purpose financial reports on an accrual basis. The accrual basis of accounting means that revenue and expenses are recognised as they are earned or incurred, and are brought to account in the period to which they relate. Accrual accounting therefore seeks to match costs incurred with the

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benefits earned, and revenues with goods or services provided. Cash accounting on the other hand, in its simplest form, merely reports cash flows within a defined period. The nature of cash accounting is such that it is open to manipulation.

Accrual financial management, as envisaged by the Committee, represents a set of reforms designed to improve and extend the nature and practice of financial management and accountability in the public sector. Accrual financial management uses several different sets of information, which are reported on a number of different levels, to better manage resources and achieve adequate accountability. The following diagram illustrates the key components of accrual financial management.
Accrual based information should become an integral part of the management process within departments and the sector generally.

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10 An entity is any authority, department or public body as defined by the Financial Management Act 1994.

11 An economic entity is a group of entities of which one controls the other entities to achieve its objectives; this is the accounting profession's definition as contained in Statement of Accounting Concepts 1.
Mr Ian Galchan MP, former Chairman of the New South Wales Public Accounts Committee, elaborated on this aspect at the Ninth Biennial Conference of the Australasian Council of Public Accounts Committees when he said:

*When any organisation goes through a change as fundamental as the introduction of accrual accounting people within that organisation are given a chance to look at how they have been doing things in the past, to assess their past results and to reorganise themselves.*

The Vice-President of the United States, Al Gore, in relation to a report he made about accrual accounting, said:

*We discovered that several other governments were also reinventing themselves ...*

They are very interesting words, 'reinventing themselves'. I believe they say a lot about the process of change that accrual accounting brings about in government departments and their attitude to efficiency in the way they manage their assets. He went on to say:

*from Australia to Great Britain ... throughout the developed world, the needs of information age societies were colliding with the limits of industrial era governments...*

That is very important also. Governments had a system of accounting that was back in the dim Dark Ages. There were limitations on the results that could be achieved from using that system of accounting.\(^\text{12}\)

The recognition that the introduction of accrual accounting into the public sector is necessary, inevitable and will only be successful if it is accompanied by a sympathetic change in management practices, is of fundamental importance.

The financial information contained in financial statements prepared on an accrual basis, (which includes details of cash flows), is markedly different to that

\(^{12}\) *Transcript of Proceedings 9th Biennial Conference Australasian Council of Public Accounts Committees, 31 January-1 February 1995, pages 63-64*
contained in reports prepared using only cash accounting. The introduction of accrual accounting should not be seen as the end of cash based accounting. The monitoring of cash flows will always remain crucial to the operation of any organisation and is a part of accrual financial management.

Professor Carrick Martin Deputy Vice-Chancellor (Administration) at Macquarie University, highlighted the importance of using accrual accounting for decision making by management by stating that:

_We will always need cash flow reporting for budgeting and accountability, but accrual accounting adds that extra dimension by providing a measure of surplus and a balance sheet that has meaning-some. (sic) The real significance for chief executive officers, though, is in the provision of accounts that are understandable, integrated, comparable and internally consistent, but above all, offering a more comprehensive view of the organisation's performance and obligations over a longer time horizon and they should therefore facilitate better decision making at all levels of management._

Accrual accounting however is not an end in itself but rather an important tool in the production of reliable and relevant financial information. As noted by the South Australian Commission of Audit:

_It is important to view accounting and financial reporting as tools intended to assist in better management and not as ends in themselves._

The Organisation for Economic Co-operation and Development in a report on accrual accounting stated that the successful introduction of accrual accounting can only be achieved by an organisation undergoing a cultural change, investing in new information systems and recruiting staff with appropriate skills:

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13 **Proceedings of the Seminar on Accrual Accounting: The Scorecard to Date (Report No 82) New South Wales Public Accounts Committee, February 1995, page 78**

14 **South Australian Commission of Audit, Charting the way forward, improving public sector performance, April 1994, Volume 1, pages 244-45**

16
The introduction of accrual accounting implies a requirement for substantial investment in management information systems in order to support ex ante budgeting requirements and to support improved management practices. It requires a cultural change by managers within departments and agencies through an understanding and acceptance of how to use the additional information and of the potential benefits which it provides, and a commitment to change. This in turn requires an investment within individual departments and agencies in re-skilling either through recruitment or training, and by central management agencies in disseminating best practice.15

It is clear therefore, that the substantial change in financial reporting for the public sector resulting from the introduction of accrual financial management cannot be done in isolation from other changes within an organisation. There is a overriding requirement to ensure that the corporate plans of departments provided clear direction on the staging and timing of these reforms, with strategies addressing the following issues:

- implementation of measures to address the introduction of new financial management systems to assist in the preparation of the required information for reporting purposes;

- identification within departments of the importance of the Chief Finance Officer to the successful implementation of the reforms and ongoing management of the department; and

- development and introduction of ongoing training programs for appropriate staff on these reforms.

These aspects were addressed by this Committee in its recent questionnaire as a means of establishing how well these financial reforms were being implemented within Victorian departments (refer Chapter 6).

The adoption of an accrual financial management approach underpins the Victorian Government's reform of the public sector - namely the Management Improvement Initiative (refer Chapter 3). One of the main principles of the Management Improvement Initiative is to "focus on clear responsibility and accountability for results" to be achieved by "transparent and public reporting of performance of public agencies". Achieving this within a "business-like" environment requires a clear understanding of the resources controlled by the public sector (that is assets and financial obligations) along with the full cost of services provided. These are the two major deliverable's of an accrual financial management system.

2.6 Benefits of Accrual Financial Management

2.6.1 Introduction

Experience in the New Zealand public sector has shown that accrual accounting and related reforms has yielded many benefits. Cash flow information has been supplemented by information about the full cost of operations of agencies and their overall financial position. The specification of outputs of each program together with the cost of producing those outputs has enabled Ministers to evaluate priorities and monitor service delivery. The major benefits in New Zealand as identified by Mr Ian Ball, a former senior manager at the New Zealand Department of the Treasury at the time of their implementation, are the improved level of information for fiscal management at a micro and macro level; the production of a balance sheet and the introduction of the capital charge regime (refer paragraph 2.6.2), which provides departments with the ability to better manage assets and liabilities. The latter has enabled a more efficient utilisation of assets and a greater assessment of the level and management of financial risk, with an improved cash and debt management.16

16 Ball, I., Implementing Accrual Accounting in the Public Sector - The New Zealand Experience, Presentation to the Interdepartmental Accounting Group, Gold Coast, 12-14 October, page 10.
The South Australian Commission of Audit identified the following benefits of Accrual accounting:

**Improved accountability:** under cash accounting, accountability is narrowly defined to cover the use and application of cash. An accrual approach to accounting helps users of statements to assess financial management performance on a far broader basis.

**Contribution to better financial policies and financial performance:** accrual accounting can provide a basis for the measurement of the financial position and the net worth of the budget sector thereby enabling an assessment of the impact of current policies on that sector and the whole of government.

**Liability Management:** under cash accounting, the emphasis is on cash and yet even then there is still inadequate information to manage cash balances and cash flows properly. The cash basis of accounting does not maintain integrated information on accounts payable and accounts receivable.

**Inventory Management:** the accrual basis of accounting permits the reporting of the stock of goods that are maintained by agencies. While in many agencies inventories are not a substantial item, there are a number of significant exceptions, particularly in the areas of health and education. Once stocks of goods are identified, it is possible to establish an optimal inventory policy that minimises the amount of working capital tied up in this area.

**Measurement of the full cost of services:** recording transactions on a cash basis ignores those expenses that are incurred in a particular period, but which may not be represented by a cash outflow. An example of this is an accruing expense associated with employee benefits such as superannuation and long service leave. The failure to record these expenses will understate the true cost of goods and services that are
provided, with consequent effects on demand, supply and pricing, and future economic viability. 17

The use of financial information generated using accrual accounting is therefore crucial for policy makers in deciding the extent that goods and services currently provided by the public sector should continue to be provided by the public sector.

2.6.2 Full Cost of Services Provided by the Public Sector

Cash accounting fails to capture the full cost of all inputs used to generate outputs in the public sector. An illustration of this is the treatment of the cost of buildings (an input) used to provide secondary education programs (an output) under the cash and accrual methods. Cash accounting records the entire purchase or construction cost of the building as part of capital account or works and services spending in the year paid. Cash accounting therefore does not record a cost in subsequent years for the use of buildings to provide secondary education (excepting maintenance and related spending). This understates the true cost of providing secondary education in subsequent years.

Accrual accounting, on the other hand, records the purchase or construction cost of the building as an asset in the Statement of Financial Position (Balance Sheet). Each year the accrual accounting approach allocates a portion of the building cost to the operating statement, (that is depreciation), which puts a cost to the use of buildings in that year’s secondary education program (this is in addition to any maintenance and related costs). The accrual accounting approach therefore progressively allocates the cost of an asset over its useful life. Therefore the full cost of providing outputs is not distorted under the accrual accounting basis as occurs under the cash accounting approach.

The South Australian Commission of Audit notes in its report:

Accrual accounting can also play an important role in removing the illusion that goods and services provided by some government departments

17 South Australian Commission of Audit, Charting the way forward, improving public sector performance, April 1994, pages 245-246
are cheaper than those provided by other organisations because of the failure to account fully for all the expenses which are incurred. This, in turn, permits informed decisions to be made about the extent to which those goods and services should be provided by the public sector or by the private sector.\textsuperscript{18}

As indicated earlier, other examples of costs which accrual accounting ensures are correctly matched to the production of outputs include superannuation and long service leave charges.

A further illustration of the need to completely and correctly allocate costs to outputs concerns those costs which have been traditionally paid centrally under the cash accounting system, (and therefore not allocated to individual outputs or departments). An example of these types of costs include interest charges (that is the cost of capital) which are primarily paid centrally through appropriations to the Department of Treasury and Finance. The introduction of a capital charge on departments is a mechanism to allocate part of this cost back to the departments who use those capital funds. In this way the benefits of making these payments centrally continues but also the costs recorded by departments in delivering their outputs is more complete. Capital funds used by departments, just like in the private sector, have a cost. Without a capital charge that cost would continue to be borne centrally rather than being allocated to departments. Again this would understate the cost of departmental outputs. The Treasurer as part of the 1994-95 Victorian Budget Papers, in announcing this charge, stated that:

\textit{...a departmental capital charge is to apply to all departments from the 1994-95 financial year, in order to distribute part of the centrally-funded annual cost of capital to departments. ... The charge for 1994-95 is being calculated as 8 per cent of a department’s State-funded capital outlays. Departments will receive a credit of 8 per cent of the proceeds of the department’s disposal of assets over and above those already included in the forward estimates applying as a permanent addition to departmental allocations. The provision of such credits will provide a greater incentive to departments to}

\textsuperscript{18} ibid page 246
dispose of under utilised assets, thereby improving asset management efficiency.  

2.6.3 Resource Management

An important aspect of accountability relates to the efficient and economic deployment of resources in the form of assets. Departments hold considerable stocks of assets, many of which were not accounted for under cash accounting. Fulfilment of a department's accountability obligations requires accounting for all the assets and liabilities they control on behalf of the community.

A capital charge encourages departments to better manage their asset base by imposing an additional cost on departments in acquiring and holding assets (refer paragraph 2.6.2). The Victorian Commission of Audit made the following related observations:

Departmental accounting systems have historically failed to record either the value or the consumption of the State's asset base. This has, in turn, led to asset replacement needs being ignored. The full cost of providing government services including the cost of the capital assets consumed has also traditionally not be measured, which has implications for pricing, cost recovery, contracting out, accountability and performance.

If managers are not aware of, or accountable for, the full cost of service provision they are more likely to choose the wrong service delivery alternatives, hold on to assets unnecessarily and not effectively maintain asset stocks. ...

Traditionally, asset management has been poorly understood by public sector management and as a consequence has received insufficient attention. Management interest in an asset has declined once the decision to acquire it is made. Once acquired or constructed, assets have been treated as free goods ... and the link between assets and their service outcomes has not been made.  

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19 1994-95 Budget Paper No 2, Budget Performance and Outlook, September 1994, page 4-14/15
Asset management is not only important in terms of correct pricing signals and investment decisions. Making departments accountable for the resources that they control also creates an imperative to maintain and utilise those resources in an economic and efficient manner.

The achievement of greater efficiency in asset management however is only part of the overall benefits of accrual accounting in relation to resource management. For example accrual based financial statements detail asset values and accumulated depreciation for non-current assets (such as buildings). Accumulated depreciation indicates the amount of an asset's service potential that has been consumed. This information not only conveys the value of resources controlled by the department but also provides an indication of the remaining usefulness or service potential of certain assets and when they may need to be replaced. This data can also be compared to that of previous years to indicate whether there has been any significant changes to a department's asset base.

2.6.4 Whole of Government Reporting

Introduction

The Committee strongly endorses the promotion of whole of government reporting in Victoria and other jurisdictions, prepared on an accrual basis. Governments should prepare general purpose reports which provide information about their financial position, performance and financing and investing activities, including compliance with spending mandates from the Parliament. These reports should be prepared in accordance with agreed accounting standards, concepts and conventions. The full accrual basis of accounting should be adopted in the preparation of the statements of financial position and operating statements of government.
The State's Budget and Financial Management Framework

The Chairman of the New Zealand Finance and Expenditure Committee, highlighted the main benefits of whole of government reporting as being able to:

- condense a large mass of data into a single set of meaningful and useful information. It will make information accessible to members of Parliament, the electorate in general, and other users of this information, such as the media and financial markets;

- provide a picture of the overall financial position or net worth of the government reporting entity at particular times;

- enable comparisons to be made of changes in the government reporting entity at particular times; and

- allow assessments to be made of the performance of the government reporting entity in its stewardship of the resources available to it.\(^\text{21}\)

These comments are consistent with the Committee's view that the purpose of whole of government reporting is to provide a set of financial statements consistent with generally accepted accounting standards that enable the Parliament and the general public to obtain a concise and timely overview of the State's financial position. Importantly whole of government reporting will enable inter-generational comparisons by allowing the public, the Ministry and public sector management to judge whether the current generation has added to or reduced the net worth of the State for future generations.

Composition of Whole of Government Financial Statements

Professor Bob Walker alerted to issues associated with the preparation of whole of government financial statements when he stated:

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\(^\text{21}\) Correspondence of 19 October 1994 from the Chairman of the (New Zealand) Finance and Public Expenditure Committee, to the Chairman of the Public Accounts and Estimates Committee in his capacity as Chairman of the Australasian Council of Public Accounts Committees
Whether we use cash accounting or accrual accounting, the difficulty is that the reported numbers are not very useful to analysts because we keep changing how the agencies are classified. We have seen the Budget Sector shrink as more and more agencies are put off-budget. ... In short, I believe that the major limitation of the usefulness of public sector information, both cash and accrual, is that the reports of budget results only cover this sub-set of entities ... until government reports cover a consistent set of entities from year to year not much reliance can be placed on the figures, whether you use cash or accrual accounting. 22

The Committee concurs with Professor Walker that it is desirable that there is consistency in the definition of what comprises government for the purposes of producing whole of government reports. However when changes to the definition of 'whole of government' become necessary, the impact of these should be detailed in subsequent reports so that meaningful comparisons over time are still possible.

In addition the Committee supports Professor Walker's view that a wider interpretation of what comprises government should be adopted for whole of government reporting purposes. The Committee notes that the Accounting Profession, through Proposed Australian Accounting Standard ED62 Financial Reporting by Governments (paragraphs 28 and 35), has proposed a conceptual basis for defining government using the accounting concept of control. The relevant clauses state:

Paragraph 28:

Any of the following factors would normally indicate the existence of control by a government of another entity:

(a) the existence of a Ministerial or other government power which enables the government to give directions to the governing body of that entity on its financial and operating policies;

22 New South Wales Public Accounts Committee, Proceedings of the Seminar on Accrual Accounting: The Scorecard to Date (Report No 89), February 1995 pages 62-63
(b) the government has broad discretion, under existing legislation, to remove a majority of members of the governing body of that entity; or

(c) the government has a majority of the votes that are likely to be cast at a general meeting of that entity.

Paragraph 35:

A government must have the capacity to deploy the resources of another entity in pursuit of its own objectives for control over that entity to exist. Depending on the nature of the resources of the entity, control over those resources by a government implies that it can exchange them, use them to provide goods or services, exact a price for another entity's use of them, use them to settle liabilities or hold them. Accordingly, a government does not control another entity where:

(a) it cannot dominate the financial and operating policies of the entity, notwithstanding that both entities have similar objectives. ...

(b) it cannot benefit from the deployment of the resources of the entity, notwithstanding that it has the capacity to dominate the financial and operating policies of that entity. ...

(c) it can only influence, but not dominate, the financial and operating policies of the entity. The wide ranging powers of governments mean that they can influence the financial and operating policies of many entities, particularly those which are financially dependent on government funding. ...

(d) it does not have a presently exercisable ability or power to redeploy the assets of another entity for its own benefit...

The Committee however acknowledges, that difficulties exist in defining government for these purposes and that refinements to the definition will evolve over time.
The Committee proposes the following information needs of parliamentarians in respect of whole of government reports:

(a) total expenses and revenues of the whole of government, which will assist the assessment, inter alia, of the full cost of the government's activities in a year compared to that year's revenues;

(b) total value of assets available to assist government to achieve its objectives and changes in the total stock of assets over the year;

(c) total debt levels and financing costs associated with current government activities and other financial or contingent liabilities (which may have an effect on the amount of taxes, other revenues and borrowing's which the government may need to raise in the future);

(d) details of cash inflows and outflows;

(e) in addition to information on the value of non-current assets, heritage and cultural assets should be separately categorised due to their differing attributes which affect their potential transferability or saleability;

(f) information revealing whether the Government is achieving its objectives effectively and doing so economically and efficiently as indicated by performance indicators. These performance indicators should be included in documents containing whole of government financial reports;

(g) information about the assets, obligations and net costs of the budget sector and major programs;

(h) a comparison of actual financial results against that budgeted; and

(i) details of compliance with spending and other Parliamentary mandates.

Points (a) to (f) are provided for by Proposed Australian Accounting Standard ED62 Financial Reporting by Governments, with reporting on performance
indicators (point (f)) optional. Paragraph 112 of Proposed Australian Accounting Standard ED62 Financial Reporting by Governments states that:

Where performance indicators are included in the general purpose financial report of a government, these shall satisfy the concepts of relevance and reliability, and be presented in a manner which satisfies the concepts of comparability and understandability.

Point (g), concerning the issue of information about assets, obligations and net costs of the budget sector is also addressed by Proposed Australian Accounting Standard ED62 Financial Reporting by Governments. However, the proposed standard does not explicitly require disaggregation at program level.

Points (h) and (i) are currently not provided for within Proposed Australian Accounting Standard ED62 Financial Reporting by Governments. Paragraph 14 of the proposed standard however, does allude to such potential requirements.

With regard to point (h), the 1993/94 Financial Statements of the Government of New Zealand contain details of actual cash flows and estimated (that is budgeted) actual cash flows. Estimated actual cash flows are as published in the Economic and Fiscal Outlook of the Government of New Zealand.\textsuperscript{23} Subsequent to the release of the 1993/94 Financial Statements, New Zealand has begun to issue progressive monthly Financial Statements of the Government of New Zealand for the 1994/95 financial year. These Statements include Forecasts (based on the revised fiscal forecasts released in the Economic and Fiscal Update) for the Statement of Financial Performance, Statement of Financial Position and Statement of Cash Flows. The addition of budget forecasts in accrual based financial statements significantly increases their usefulness and meaning for the public sector at whole of government level. This matter is further considered later in this report.

Point (i) concerns whole of government financial statements containing details of compliance with spending and other Parliamentary mandates. This is a requirement for Financial Reports of Government Departments as set out in

\textsuperscript{23} Financial Statements of the Government of New Zealand for the five months ended 30 November 1994, pages 68 to 69.
Australian Accounting Standard AAS29 Financial Reporting by Government Departments. Again the addition of this summary level information in whole of government financial reports significantly increases their usefulness and meaning for the public sector (refer Chapter 4).

Risk Exposures for the State

The State's (and the taxpayers) financial risks, at the whole of government level, are best described as contingent liabilities. Contingent liabilities are not actual liabilities, they represent circumstances under which there is the possibility due to some future event that an actual liability could arise. Contingent liabilities can arise from guarantees, indemnities and other forms of support provided by the Government.

The Budget Sector's contingent liabilities, those of which that can be quantified, amounted to some $20 billion at 30 June 1994 compared with $22 billion as at 30 June 1993. The State's contingent liabilities at 30 June 1994 include those arising from the sale of the State Bank of Victoria, Tricontinental (and subsidiaries), the Home Opportunities Loans Scheme, the Melbourne Cricket Club and the Formula One Grand Prix.

Proposed Australian Accounting Standard ED62 Financial Reporting by Governments expressly provides for the recognition of contingent liabilities in whole of government financial statements (as part of the notes to the financial statements). Contingent liabilities are defined in the proposed standard as:

items in the nature of liabilities which, as at the reporting date, are not recognised in the Statement of Financial Position because they have been

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24 Australian Accounting Standard AAS 29 Financial Reporting by Government Departments, paragraph 149.
26 ibid page 159
27 ibid page 159
assessed as being not likely to give rise to a necessity for the Government to make payments in respect of them.\textsuperscript{28}

The Report on Performance Audit of the Auditor-General of Victoria by Mr Fergus Ryan acknowledged that the public sector is more complex than the private sector, with financial and non-financial criteria being relevant in the analysis of risk exposures for the State. The Report emphasised the importance of the role of the Central Agencies in quantifying and managing the level of the State's financial risk, by stating:

\begin{quote}
These roles are key to ensuring that the pervasive controls are in place and operating effectively. Unless these are fully evaluated any risk identification process may miss some key risks.\textsuperscript{29}
\end{quote}

The Report recommended that the Auditor-General give greater recognition to the role of the Central Agencies in ensuring that appropriate effective controls are in place to manage the State's risks.\textsuperscript{30}

The Auditor-General in his Report on the 1993-94 Finance Statement commented that:

\begin{quote}
While some action was taken by the Department of the Treasury to address the deficiencies in the recording and monitoring of the State's contingent liabilities, I still cannot provide assurance to the Parliament as to the full extent of these liabilities.\textsuperscript{31}
\end{quote}

It is of great concern to the Committee that deficiencies continue to exist in the Department's management of the State's contingent liabilities, especially as they are of such magnitude that they continue to prevent the Auditor-General from providing an assurance to the Parliament on the full extent of the State's

\begin{footnotes}
\item 28 Public Sector Accounting Standards Board of the Australian Accounting Research Foundation, ED 62 Financial Reporting by Governments, March 1995, page 73
\item 30 Ibid page 24
\end{footnotes}
contingent liabilities. The Committee also notes that this is an issue upon which both it and the Auditor-General have previously raised concerns in reports to the Parliament.

The Committee concludes therefore, in light of the substantial potential financial risks to the State and the ongoing problems in the management of this area, that the Statement of Responsibility should expressly provide that the whole of government financial statements fairly present the State's contingent liabilities. This will ensure that appropriate emphasis is placed on this very important matter.

Statement of Responsibility


GPFRs 33 should contain a statement of responsibility (SOR) signed by the chief executive responsible for each agency. The SOR should contain a confirmation that the statements have been presented fairly in accordance with Statements of Accounting Concepts and Accounting Standards. If this is not the case, the statement should be qualified. They should also contain a representation that the internal controls relevant to the preparation of the agency’s GPFRs have been effective throughout the reporting period. 34

In support of the Victorian Commission of Audit recommendation 10 of the Committee's Seventh Report to the Parliament stated:

It is recommended that the Minister for Finance include a specific reference to internal controls in the certification statement expected to be required under the new regulations to be made under the Financial

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33 General Purpose Financial Reports.
34 for a complete list of recommendations from Chapters 5 and 6 of the Report of the Victorian Commission of Audit see Appendix A
Management Act 1994. At the time of writing the relevant regulations had not been made.\textsuperscript{35}

Subsequently Ministerial Direction 9.2.2, issued pursuant to the Financial Management Act 1994, prescribed the following in respect of Statement of Responsibilities:

(iiv) The Financial Statements of an entity must to the extent applicable be signed and dated by the Accountable Officer or, in case of a public body, the Accountable Officer and a member of the governing board on behalf of the board, and the chief finance and accounting officer, stating:

(a) whether, in their opinion, the financial statements present fairly the financial transactions during the financial year and the financial position at the end of the year;

(b) whether, in their opinion, the financial statements are drawn up in accordance with these Directions; and

(c) whether, at the date of signing, they are aware of any circumstance which would render any particulars in the financial statements to be misleading or inaccurate.\textsuperscript{36}

The Financial Statements of the Government of New Zealand contain a Statement of Responsibility, the first part of which is signed by the Minister of Finance, whilst the second part is signed by the Secretary to the Treasury. The Statement of Responsibility is worded as follows:


\textsuperscript{36} Directions of the Minister for Finance, \textit{Financial Management Act 1994}, April 1995, pages 8 of 24 and 9 of 24
Minister of Finance:

I accept responsibility for the integrity of these Financial Statements, the information they contain and their compliance with the Public Finance Sector Act 1989.

In my opinion, these Financial Statements fairly reflect the financial position of the Crown as at 30 June 1994 and its financial performance for the year ended on that date.

Secretary to the Treasury:

These Financial Statements have been prepared by the Treasury in accordance with the provisions of the Public Finance Act 1989. The Financial Statements comply with generally accepted accounting practice.

The Treasury is responsible for establishing and maintaining a system of internal control designed to provide reasonable assurance that the transactions recorded are within statutory authority and properly record the use of all public financial resources by the Crown. To the best of my knowledge, this system of internal control has operated adequately throughout the reporting period.37

The 1992-93 New South Wales Public Sector Consolidated Financial Statements contain a Statement of Compliance which is jointly signed by the Secretary and the Chief Accountant of the New South Wales Treasury. This Statement appears below:

In our opinion, the NSW Public Sector Consolidated Financial Statements:

(a) give a true and fair view of the operating results and cash flows of the NSW Public Sector for the year ended 30 June 1993 and of its financial position at that date;

have been prepared, where applicable, on the basis of the financial reporting requirements as prescribed in the Public Finance and Audit Act and the Treasurer’s Directions for statutory bodies and departments; and

are in compliance with Statements of Accounting Concepts and all applicable Australian Accounting Standards.38

These two statements both refer to the fair presentation of the financial statements and compliance with applicable legislation and accounting standards. Importantly the New Zealand Statement of Responsibility includes undertakings related to the system of internal control (as recommended by both the Committee and the Victorian Commission of Audit). Further the New Zealand example is a statement of responsibility rather than merely a statement of compliance (as is the case in New South Wales).

Neither example however, makes an explicit representation in respect of contingent liabilities. The inclusion of this latter aspect in any Statement of Responsibility is imperative to ensure a fair view of the financial position of the jurisdiction is obtained.

The Committee proposes the following Statement of Responsibility for Victorian Whole of Government Financial Statements:

Statement of Responsibility

In our opinion, the Victorian Whole of Government Financial Statements, comprising Statement of Financial Position, Operating Statement, Statement of Cash Flows and Notes To and Forming Part of the Financial Statements:

(a) present fairly the financial transactions during the year ended 30 June 199X and the financial position of the Victorian Whole of Government as at 30 June 199X;

38 New South Wales Public Sector Consolidated Financial Statements 1992-93, page 12
(b) present fairly the contingent liabilities of the Victorian Whole of Government as at 30 June 199X; and

(c) have been prepared in accordance with the Financial Management Act 1994 and Australian Accounting Standards.

The Department of Treasury and Finance is responsible for establishing and maintaining a system of internal control designed to provide reasonable assurance that the transactions recorded are within statutory authority and properly record the use of all public financial resources by the Victorian Whole of Government. To the best of our knowledge, this system of internal control has operated effectively throughout the reporting period.

We are not aware of any material circumstances which would render any particulars included in the financial statements misleading or inaccurate.

Several options exist in respect of which signatories should appear on the Victorian Statement of Responsibility. Options include any or a combination of the Minister for Finance, the Treasurer, the Secretary of the Department of Treasury and Finance or the State's Chief Accountant (that is the Deputy Secretary Accounting and Financial Reporting Division of the Department of Treasury and Finance). The Committee proposes that the Minister for Finance and the Secretary of the Department of Treasury and Finance should undertake this responsibility.

The other key certification made in financial statements is that of the respective Auditor-General. The Auditor-General:

> provides assurance to Parliament and the public regarding the fair presentation of financial information presented by public sector entities in their financial statements.39

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This requires the Auditor-General to form an opinion on public sector financial statements. The Auditor-General’s Report on public sector financial statements contain a definition of the Audit Scope, an Audit Opinion, and where appropriate Audit Qualifications. The purpose of this Audit Qualification is to highlight areas of deficiency, particularly non-compliance with Australian Accounting Standards and accepted accounting principles and practices.

The Financial Statements of the Government of New Zealand contain a Report of the Audit Office which elucidates the purpose of the report and its findings. The Financial Statements for the year ended 30 June 1994 contained the following Report of the Audit Office, as signed by the New Zealand Controller and Auditor-General:

Authority and Scope of Audit

The Financial Statements on pages 12 to 63 as required by section 27 of the Public Finance Act 1989, were prepared by the Treasury, and are the responsibility of the Government. My responsibilities include a requirement, pursuant to section 30 of the Public Finance Act 1989, to express an opinion on the Statements based on the results of our audit.

My office conducted the audit in accordance with generally accepted auditing standards, with the objective of obtaining reasonable assurance that the Financial Statements are free from significant errors or omissions. In the audit my officers reviewed the evidence to support the amounts and disclosures in all Statements. They also assessed the accounting practices used.

Audit Opinion on the Financial Statements

In my opinion, the Financial Statements of the Government of New Zealand fairly reflect, in accordance with the accounting policies set out on pages 35 to 39:
Benefits of Financial Management Reform

- the financial results and cash flows for the year ended 30 June 1994
- the financial position as at 30 June 1994.\(^{40}\)

The 1992-93 New South Wales Public Consolidated Financial Statements also includes a Report from the Auditor-General (Appendix B), which contains a definition of the Audit Scope, Audit Qualifications and an Audit Opinion. The format of this Report is consistent with that contained in the Victorian Auditor-Generals Report which is included in the Annual Reports of Victorian Government Departments (Appendix C contains the Auditor-General's Report for the Department of Finance, as included in the Department's 1993-94 Annual Report).

The Committee is of the view that the report of the Auditor-General upon the Victorian Whole of Government Financial Statements should also expressly refer to the State's contingent liabilities. The Committee has prepared a suggested Auditor-General's Report for Victorian Whole of Government Financial Statements, modelled on the Auditor-General's Report on the 1993-94 Department of Finance financial statements (Appendix C):

Auditor-General's Report

Audit Scope

The accompanying financial statements of the Victorian Whole of Government for the year ended 30 June 199X, comprising operating statement, statement of financial position, statement of cash flows and notes to the financial statements have been audited. The Minister for Finance and the Secretary to the Department of Treasury and Finance are responsible for the preparation and presentation of the financial statements and the information they contain. An independent audit of the financial statements has been carried out in order to express an opinion on them as required by the Financial Management Act 1994.

\(^{40}\) Financial Statements of the Government of New Zealand for the year ended 30 June 1994, September 1994, page 64
The audit has been conducted in accordance with Australian Auditing Standards to provide reasonable assurance as to whether the financial statements are free of material misstatement. The audit procedures included an examination, on a test basis, of evidence supporting the amounts and other disclosures in the financial statements, and the evaluation of accounting policies and significant accounting estimates. These procedures have been undertaken to form an opinion as to whether, in all material respects, the financial statement are presented fairly in accordance with Australian Accounting Standards and comply with the requirements of the Financial Management Act 1994, so as to present a view which is consistent with my understanding of the financial position of the Victorian Whole of Government, its contingent liabilities, and the results of its operations and its cash flows.

The audit opinion expressed on the financial statements has been formed on the above basis.

Audit Opinion

In my opinion, the financial statements present fairly the financial position of Victorian Whole of Government, including its contingent liabilities, as at 30 June 199X and the results of its operations and its cash flows for the year ended 30 June 199X in accordance with Australian Accounting Standards and comply with the requirements of the Financial Management Act 1994.

The Committee commends the initiatives undertaken by the Governments of New Zealand and New South Wales with regard to the preparation of audited Whole of Government Financial Reports.
Finding 2.1

The Committee finds that Accrual Financial Management, as envisaged by the Committee, will:

(a) **enhance and extend public and Parliamentary accountability** of departments by clearly disclosing, for the first time, the FULL cost of services provided by the public sector. It will also show the level of resources (or assets) used to provide those services;

(b) **assist decision making at both Ministerial and Agency level** by promoting a management culture focused on the effective and efficient deployment of resources and the achievement of outputs, and not just inputs consumed in delivering services;

(c) **maintain control over cash flows**;

(d) **improve performance monitoring** through accrual based budgeting and performance indicators set on the full cost of outputs;

(e) **enable inter-generational comparisons** by allowing the public, Ministry and Management to judge whether the current generation has added to or reduced the net worth of the State for future generations;

(f) **promote meaningful agency and government comparisons**;

(g) **provide better information for setting capital and maintenance spending priorities** by disclosing the depreciated value of the States' stock of non-current assets;

(h) **assist devolution of responsibility** by providing more meaningful information on operating performance and financial position; and

(i) **assist understanding of the state and form of the stock of public sector assets and similarly provide an understanding of the State's financial obligations or liabilities.**
Finding 2.2

The Committee finds generally in support of Proposed Australian Accounting Standard ED62 Financial Reporting by Governments, and in particular supports the following key aspects that:

(a) a broad definition of government should be adopted in deciding which entities to include in whole of government financial reports based on the accounting concept of control; and

(b) whole of governments financial statements should fully consolidate the assets, liabilities, revenues and expenses of controlled entities.

Recommendation 2.1

The Committee recommends that:

(a) summary details of actual outcomes against Parliamentary appropriations should be separately identified within whole of government financial reports; and

(b) documents containing whole of government financial reports should also include performance indicators to assist users of these reports to determine whether the Government is achieving its objectives effectively and doing so economically and efficiently.

Finding 2.3

The Committee finds that:

(a) Victorian Whole of Government Financial Statements should include a Statement of Responsibility, as opposed to a Statement of Compliance or other such statement, which clearly identifies who is responsible for the fair presentation of the financial statements and their compliance with applicable legislation and accounting standards;
(b) in light of the substantial potential financial risks to the State and the ongoing problems in the management of the State's contingent liabilities, the Statement of Responsibility should expressly provide that the whole of government financial statements fairly present the State's contingent liabilities. This will ensure that appropriate emphasis is placed on this very important matter;

(c) the Statement of Responsibility should also include a representation that the internal controls relevant to the preparation of the financial statements have been effective throughout the reporting period; and

(d) several options exist in respect of which signatories should appear on the Statement of Responsibility in whole of government financial statements. The Committee proposes that the Minister for Finance and the Secretary of the Department of Treasury and Finance should undertake this responsibility.

Recommendation 2.2

The Committee recommends that the Statement of Responsibility for Victorian Whole of Government Financial Statements should include statements with the following tenor:

In our opinion, the Victorian Whole of Government Financial Statements, comprising Statement of Financial Position, Operating Statement, Statement of Cash Flows and Notes To and Forming Part of the Financial Statements:

(a) present fairly the financial transactions during the year ended 30 June 199X and the financial position of the Victorian Whole of Government as at 30 June 199X;

(b) present fairly the contingent liabilities of the Victorian Whole of Government as at 30 June 199X; and

(c) have been prepared in accordance with the Financial Management Act 1994 and Australian Accounting Standards.
The Department of Treasury and Finance is responsible for establishing and maintaining a system of internal control designed to provide reasonable assurance that the transactions recorded are within statutory authority and properly record the use of all public financial resources by the Victorian Whole of Government. To the best of our knowledge, this system of internal control has operated effectively throughout the reporting period.

We are not aware of any material circumstances which would render any particulars included in the financial statements misleading or inaccurate.

Recommendation 2.3

The Committee recommends that the Report of the Auditor-General on Victorian Whole of Government Financial Statements should, in addition to that already provided in his reports on public sector financial statements, include an opinion as whether the statements fairly present the extent of contingent liabilities, that is the State's exposure to financial risk.

2.7 Interstate and Overseas Experience

The quiet but substantial revolution represented by the introduction of accrual accounting and associated financial management reforms has been gathering momentum throughout public sector bodies of a number of countries from the mid 1980s. The key reformers during this period has been the Government of New Zealand, New South Wales and Victoria. A number of European countries, including Spain, Greece, Poland and the United Kingdom as well as the USA and Canada are also currently implementing financial management reforms premised on the introduction of accrual accounting and the production of whole of government financial statements. A discussion of interstate and overseas experiences in financial management reforms is included in chapter 4.

41 New South Wales Public Accounts Committee, Proceedings of the Seminar on Accrual Accounting—The Scorecard to Date (Report No 89), February 1995 page 60
CHAPTER 3: CURRENT FINANCIAL MANAGEMENT REFORMS

3.1 Results Based Management Structure

The Victorian Government has undertaken a reform program which is consistent with recommendations of the Victorian Commission of Audit (refer Chapter 2) and comprises several policy initiatives. This chapter overviews some of the key related reforms.

The 1995 Autumn Economic Statement highlights a shift in emphasis in financial reporting away from inputs and processes to a focus on outputs and outcomes. This shift in focus is a central theme of the Report of the Victorian Commission of Audit.\(^1\) The 1995 Autumn Economic Statement elaborated on this change in focus by stating that the implementation of a results based management structure must be supported by financial and accounting arrangements which link the financial resources applied to the outputs achieved and discloses all costs incurred by management in the delivery of those outputs.\(^2\) The 1995 Autumn Economic Statement also identified the provision of high quality services at least cost to the taxpayer as one of the most important and challenging objectives for the Government.\(^3\)

The results based management structure is primarily intended to ensure that management delivers quality services within cost and performance parameters that have been negotiated between government and departments. As stated in the 1995 Autumn Economic Statement, a performance agreement will be developed between chief executive officers and the government for the delivery of services, against which departmental performance will be judged.\(^4\)

The two key components of results based financial systems identified by the Government are:

- the setting of government-wide financial goals and fiscal policy parameters; and

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\(^{1}\) Report of the Victorian Commission of Audit, Volume One, May 1993 page 158. Refer also paragraph 3.3 of this report.


\(^{3}\) ibid page 7-1

\(^{4}\) ibid page 7-3
• the setting of objectives for individual departments within broad policy parameters.\textsuperscript{5}

The \textit{Financial Management Act} 1994 establishes the reporting and management framework within which government is able to specify more explicitly the outputs it requires, including the contracting arrangements for purchasing those outputs, either using internal or external providers.\textsuperscript{6}

The 1995 \textit{Autumn Economic Statement} and 1994-95 Budget Paper No 2 \textit{Budget Performance and Outlook} contain an overview of current financial management reforms which support a results based management structure. The primary measures include:

• the implementation of full accrual accounting in all budget sector agencies by 30 June 1996, (the former Department of Finance developed an Accrual Accounting Manual in 1994 to assist Victorian government departments to achieve implementation by that key target date);\textsuperscript{7}

• the development of whole of government reporting on an accrual basis, (based on Proposed Australian Accounting Standard ED62 \textit{Financial Reporting by Governments}), as an adjunct to Government Finance Statistics;\textsuperscript{8}

• the preparation of financial reports on a timely basis for tabling in Parliament;\textsuperscript{9}

• the appointment of a chief finance officer;\textsuperscript{10}

• the introduction of amendments to financial legislation;\textsuperscript{11}

• development of new cost attribution requirements; and\textsuperscript{12}

\textsuperscript{5} ibid page 7-5
\textsuperscript{6} ibid pages 7-3-7-4
\textsuperscript{7} ibid page 7-5
\textsuperscript{8} ibid page 7-5
\textsuperscript{9} ibid page 7-5
\textsuperscript{10} ibid page 7-5
\textsuperscript{11} ibid page 7-5
\textsuperscript{12} 1994-95 Budget Performance and Outlook (1994-95 Budget Paper No 2) page 7-3
• enhancement of the budget planning system.\textsuperscript{13}

3.2 Management Improvement Initiative

The Management Improvement Initiative (MII) and the Integrated Management Cycle (IMC) are important elements of the Victorian financial and public sector reform process.\textsuperscript{14}

The MII has three principal objectives:

• to increase the efficiency, effectiveness and appropriateness of budget sector resource allocation through a stable, performance-oriented budget process with a medium-term focus;

• to increase the quality of information about budget sector and broader State public sector financial initiatives; and

• to increase flexibility in managing inputs consistent with a greater focus on outputs produced.\textsuperscript{15}

The key reforms of the MII are:

• clear and over-riding focus on managing for results and clear accountability for those results;

• transparent reporting of performance of public agencies;

• clear and consistent policy directions and priorities for action are to be set by Government and widely communicated;

• clear specification of objectives and responsibilities, single points of responsibility and clear reporting of progress and 'bottom line' results;

• systematic, coherent and integrated strategic direction coming from central agencies; and

\textsuperscript{13} ibid page 7-3
\textsuperscript{14} Department of Premier and Cabinet, 1993/94 Annual Report
\textsuperscript{15} A Management Initiative for Victoria, 1 October 1993, Chapter 2
• real devolution of management responsibility and authority to the 'coal face', procedural flexibility and flatter management structures.\textsuperscript{16}

The Committee will continue to review progress in the implementation of this important initiative.

The IMC integrates corporate and business planning and reporting with budget development. This process is illustrated in Chart A.

\textsuperscript{16} ibid Chapter 2
The IMC and MII provide the overall framework and reporting structure for the implementation of accrual financial management reforms. Accrual accounting is a tool to provide the financial information necessary to achieve greater accountability.
3.3 Increased Focus on Outpuis

The increased focus on outputs and outcomes is a critical aspect of the Victorian financial management reforms. Indeed the Victorian Commission of Audit in its Report stated that:

_The unifying theme of the Commission's framework for budget management in Victoria is the need for a focus on outcomes and outputs, rather than inputs. Keeping the focus on what the government is doing, rather than how it is doing it (although this is also important) is the key to responsible allocation of resources._

_A focus on outputs dictates:_

- _regular program reviews;_
- _full financial management information on the costs of government services; and_
- _clear management accountability._  

The Committee supports the above views and was greatly encouraged by the progress made by recent governments in New Zealand to enable a resighting of focus from inputs to outputs and outcomes. Indeed the New Zealand Government has been at the cutting edge of developing this approach to the delivery of public services.

'Outputs' are defined as the goods and services produced by departments, whilst 'Outcomes' are defined as the effects on the community of an output or set of outputs. Outputs include the provision of services such as health care, the administration of regulations, policy advice and other end products of public sector programs.

Outcomes are a matter for Government policy in the New Zealand model and therefore the responsibility of the Minister, whereas chief executives of

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18 ibid page 155.
departments in New Zealand are instead responsible for outputs they have contracted to provide.

The 1995 Autumn Economic Statement identified the increased focus on outputs as the basic building block for government decision-making and consequently the foundation of much of current financial management reforms. This will allow increased resource management flexibility and defines accountability based on delivery of value added.19

To assist in the shift of focus from inputs to outputs by departments, the Management Improvement Division of the Department of the Treasury and Finance has undertaken the Specification of Outputs and Performance Project. The key deliverable's of the Project are:

- the development of an output specification methodology;
- the development of an output performance standard methodology;
- the preparation of a guidance manual on the specification of outputs and setting of output standards for issue to departments; and
- the provision of training to key Treasury staff.20

The guidance manual will be produced during the 1995-96 financial year. The use of this manual will enable departments to improve the quality of output specification in their business and corporate plans and the Budget Papers.

This initial step, will be followed during 1996-97 by the introduction of:

- an output based budget system that specifies outputs, quantifies cost and quantity and commences the difficult task of quality measurement;
- an accountability structure that measures the achievement of specified targets;
- full separation of policy, regulation, and contract management from operational service delivery units;

19 The Age, Saturday 8 April 1995
20 ibid
• the creation of organisation structures that encourage competition; and

• introduction of corporate monthly reporting requirements covering key information needed to manage individual departments. 21

In the Committee's Ninth Report to the Parliament it noted that 1994-95 Budget Paper No. 3 Budget Estimates is the second set of Budget Papers to include actual and estimated output measures/units, which is a major and fundamental advance for the Budget Papers. 22 The Committee's report however, also found that:

the adequacy of output measures in the 1994-95 Budget Papers again varied between and within departments. In some areas output measures were more in the manner of statistics rather than indicators of performance. The development of outcome measures for presentation in the Budget Papers is also critical to performance evaluation. Meaningful quantitative and qualitative performance measures are critical for the analysis of the efficiency and effectiveness of service delivery and for the identification of achievements from improved management practices. 23

The Committee found that the general issue of performance measurement needs further research and development and will continue to evolve over time. Key attributes of performance measures, such as output and outcome measures, were also listed in the Committee's Report. 24 The Committee reiterates its previously stated intention to continue to review and comment on output measures included in the Budget Papers. The Committee also looks forward to the issue of the guidance manual on output specification referred to earlier and commends the Department of the Treasury and Finance on this initiative. It is critical that timely progress is made in the refinement of output specification methodology and related systems and structures given that some controls over inputs have already been modified to facilitate an output focused approach.

23 ibid page 32
24 ibid pages 32-33
Related recommendations of the Committee from its Ninth Report to the Parliament include that:

the Budget Papers should not only include estimated current year output measures and actual prior year output measures, but should also include prior year estimated output measures and benchmarks (where available);

the Financial Management Act 1994 should require all public sector agencies to include performance measures in their annual reports and that the Budget Papers must include performance measures;

performance measures provided by public sector agencies in annual reports, pursuant to the proposed legislative requirements, should be certified by the respective Accountable Officers. In addition the Auditor-General should be required to express an opinion on the relevance and appropriateness of those performance measures; and

all Budget sector bodies be required to table in the Parliament, within 28 days of the presentation of the Budget to the Parliament, a supplementary budget estimates document which provides sufficiently detailed Budget estimates information at sub-program level, including performance and benchmark data (where available).  

3.4 The Legislative Framework

3.4.1 Introduction

An essential part of promoting greater financial management and accountability is to have a legal imperative placed on agencies to properly account for their activities and use of public monies.

To enact the desired alterations to the financial reporting framework the government has undertaken a number of legislative changes. Amendments to the Appropriation Acts, early in the Parliamentary term of the current

25 ibid pages 21 and 34.

3.4.2 The Former Annual Reporting Act 1983

The former Annual Reporting Act 1983 provided a legislative basis for annual reporting to the Parliament by Ministers in relation to departments and public bodies. A series of very detailed regulations were issued pursuant to the former Annual Reporting Act 1983 prescribing the form and content of annual reports, including financial statements, of administrative units (departments), business undertakings, contributed income sector bodies and public sector superannuation schemes.

The Committee supports the principle of legislatively mandating the form and content of public sector annual reports to the Parliament.

The former Annual Reporting Act 1983 was subsequently repealed by the Financial Management Act 1994.

3.4.3 Financial Management Act 1994

The major themes of the Financial Management Act 1994 (the Act) are improved accountability and improved reporting in the public sector, as well as providing mechanisms for the financial management of government departments.

The Act aims to:

• improve financial administration of the public sector;

• make better provisions for the accountability of the public sector; and

• provide for annual reporting to the Parliament by departments and public sector bodies.\(^\text{26}\)

\(^{26}\) Section 1 of the Financial Management Act 1994 page 1
The key sections of the Act (sections 44, 45, 46 and 49) that are relevant to this Inquiry are contained in Appendix D. These sections clearly state the overall responsibilities of key personnel in preparing annual reports and financial statements for presentation to the Parliament.

The momentum of the legislative reforms was further enhanced by amendments during 1995 to Section 45 of the Financial Management Act 1994, requiring:

* a report of operations and financial statements to be prepared as soon as practicable after the end of each financial year and the financial statements to be submitted to the Auditor-General within 8 weeks after the end of the financial year.

Further related amendments to Clause 12 of the Audit Act 1994 now require the Auditor-General to submit this audit opinion on financial statements to the relevant Minister within four weeks of the receipt of these statements by the Auditor-General.

3.4.4 Ministerial Directions

Introduction

The Financial Management Act 1994 (the Act) provides authority for the Minister for Finance to issue directions with respect to matters of financial administration which must be observed by all departments (deemed to be an authority under the Act) and public bodies. Part 1 Section 8(1) of the Act states:

* Directions
  
  The regulations may authorise the Minister to give to an authority or public body, an accountable officer or a chief finance and accounting officer directions in writing for or in relation to any of the matters for and in relation to which regulations may be made under this Act.*

27 Financial Management Act 1994, Page 5
Financial Management Regulations 1994

The Financial Management Regulations 1994 came into operation on 1 July 1994. Section 12 of those Regulations empower the Minister to issue directions in relation to annual reports and financial statements, section 12 (1)(e) states:

The Minister may give to any authority or public body, an accountable officer or a chief finance and accounting officer directions in writing in relation to the form and content of financial statements, additional information requirements and reports of operations of -

(i) authorities and their subsidiaries and related bodies, including information to be disclosed in respect of affiliated bodies; and

(ii) public bodies; 28

Directions of the Minister for Finance under the Financial Management Act 1994

The reporting requirements under Part 9 of the Directions of the Minister for Finance under the Financial Management Act 1994 provide a comprehensive set of directions and guidelines for the form and content of annual reports and financial statements prepared by departments and public bodies. Key features of the directions pertinent to this Inquiry include the requirements that financial statements:

(a) be prepared on an accrual basis (except where a Department has temporary approval from the Minister of Finance not to do so);

(b) comply with Australian Accounting Standards; and

(c) comply with accounting policy papers released from time to time by the Department of Finance.29

28 Financial Management Regulations 1994, Page 4
29 These are contained in Section 9.2.2(ii) of the Directions of the Minister of Finance under the Financial Management Act 1994, pages 7 of 24 to 9 of 24
It is the Committee's view that the production of general purpose financial reports on an accrual basis and in accordance with Australian Accounting Standards will ensure such reports provide a fair view of the operations and financial position of departments and public bodies.

The form and content of annual reports, including financial statements, is a critical element of public financial administration and accountability.

The Directions of the Minister for Finance provide greater guidance than the regulations issued pursuant to the former Annual Reporting Act 1983 (refer paragraph 3.4.2) in respect of the form and content of annual reports, including financial statements.

The Committee has previously explored the rationale for a change from regulation to ministerial direction to impose a key requirement on the public sector. In that previous instance the requirement related to the establishment and maintenance of an internal audit function rather than the form and content of annual reports to the Parliament. Nevertheless the following extract provides part of the rationale used on that occasion for the change in approach, as explained by representatives of the former Department of Finance:

Committee - ...since the repeal of the audit regulations 1993 there has been a shift from the regulations to a ministerial direction. What is the import of that and how does it affect the difference between regulation and ministerial direction and the implications so far as the Parliament is concerned, or accountability to Parliament? Does it make any difference?

Representative of the (former) Department of Finance - The aim of giving ministerial direction was to enable us to have greater flexibility to move quickly to have things changed-when the real world changes we can change with it quickly. In addition to giving the direction, we are giving an interpretation of what we are aiming to get out of the direction, and then the comments around that direction are elaborated on, so there is an interpretation of what we are aiming for. There is no lessening of control. With the new legislation we have set up audit

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committees and there are people from outside the area and the signing off of the documents that come would be part of the act.\textsuperscript{31}

The use of ministerial directions to impose a requirement on public sector bodies promotes administrative efficiency and can, as noted above, include greater guidance. The Committee notes however, that using a ministerial direction, as opposed to a regulation can have a significant impact on parliamentary accountability in four key respects:

- parliamentary scrutiny;
- the ability of the Parliament to disallow;
- sanctions; and
- perceptions.

Parliamentary scrutiny

The Scrutiny of Acts and Regulations Committee is a joint investigatory committee of the Parliament and has several functions. Its statutory functions of scrutiny of primary legislation includes all new bills, all subordinate legislation (that is all statutory regulations) and any particular piece of legislation referred to it under the \textit{Parliamentary Committee Act 1968} (the Act).\textsuperscript{32} The Act's procedures for consultation, tabling, publication and scrutiny only apply to subordinate legislative instruments which fall within the description of Statutory Rule.

A ministerial directive is one example of the many types of subordinate instruments of a legislative character which are not subject to parliamentary scrutiny by the Scrutiny of Acts and Regulations Committee because they are not Statutory Rules. On the other hand however, regulations issued pursuant to the former \textit{Annual Reporting Act 1983}, would have been subject to scrutiny


\textsuperscript{32} \textit{Scrutiny of Acts and Regulations Committee, First Annual Report, April 1994, Page 1}
by a Parliamentary Committee. In addition because regulations are tabled in the Parliament they are also open to review by any member of Parliament.

Disallowance by the Parliament

Section 59(4) of the Financial Management Act 1994 states that:

*Regulations made under this Act may be disallowed in whole or part by resolution of either House of the Parliament in accordance with the requirements of section 6 (2) of the Subordinate Legislation Act 1962.*

The operation of this section therefore establishes Parliament's ability to examine and disallow a regulation issued under the Financial Management Act 1994. The Parliament cannot exercise the same power in respect of ministerial directions because they are not Statutory Rules.

Sanctions

A regulation issued pursuant to the Financial Management Act 1994 may impose a penalty not exceeding 5 penalty units for contravention of the regulations.\(^3\) Consequently, a Department Head may be subject to a monetary sanction where non-compliance with a regulation has occurred which includes such a provision. However, non-compliance with ministerial directions is a matter between the Minister and the Department Head. Unlike a regulation, ministerial directions do not specify a sanction, monetary or otherwise.

Perceptions

The use of a ministerial direction, rather than a regulation, to impose an obligation upon public sector bodies may lead to a perception that the matter in question may be of lesser importance than those deemed to warrant a regulation. This may be particularly so where a matter which was formerly

\(^{33}\) as contained in Section 59(1)(2)(e) of the Financial Management Act 1994, page 32
included in a regulation is later included in a ministerial direction, as has occurred with the form and content of annual reports to Parliament. Nevertheless the matter would still be perceived as important. The risk in such a misinterpretation is that attention to such matters may be less than is desirable or intended.

The Committee is strongly of the view that the form and content of annual reports, including financial statements, is critical to public accountability and efficient, economic and effective public sector financial management. The Committee believes therefore that regulations should again be issued on this matter, similar to the existing directions of the Minister for Finance under the *Financial Management Act* 1994 (but excluding introductory and guidance provisions) to dictate the form and content of annual reports and financial statements for departments and public bodies. This approach would restore an appropriate level of parliamentary accountability and is commensurate with the critical nature of these matters. This approach would not inhibit the Department of the Treasury and Finance from continuing to provide guidance on these important matters.

**Finding 3.1**

The Committee supports the mandatory nature and guidance provided in the ministerial directions issued by the Minister for Finance in respect of annual reports to the Parliament.

**Finding 3.2**

The Committee finds that the form and content of annual reports to the Parliament is critical to Parliamentary accountability. Therefore, mandatory requirements, similar to the existing ministerial directions, should be prescribed in a regulation under the *Financial Management Act* 1994. This approach would not inhibit the Department of the Treasury and Finance from continuing to provide guidance on these important matters.
Recommendation 3.1

The Committee recommends that regulations, similar to the existing ministerial directions issued by the Minister for Finance, be issued under the Financial Management Act 1994 to prescribe the form and content of annual reports to the Parliament, including financial statements.
CHAPTER 4: FINANCIAL MANAGEMENT REFORM IN OTHER JURISDICTIONS

4.1 Interstate and International Experience

The quiet but substantial revolution arising from the introduction of accrual accounting and associated financial management reforms has been gathering momentum throughout public sector bodies of a number of countries from the mid 1980s. The key reformers during this period have been the national governments of New Zealand and Australia and the state governments of New South Wales and Victoria. A number of European countries, including Spain, Greece, Poland and the United Kingdom,1 as well as the USA and Canada, are also currently implementing financial management reforms premised upon the introduction of accrual accounting and the production of whole of government financial statements.

The Committee has inquired into the experiences of other jurisdictions to ensure that any lessons to be learned are being heeded in Victoria. The following comprises a brief summation of some of the key issues.

4.2 New Zealand

4.2.1 The New Zealand Experience

Introduction

New Zealand is a world leader in public sector financial reporting. Not only has the public sector been able to successfully implement accrual accounting it has done so in a relatively short period of time. The first raft of reforms were introduced in 1989 with the passage of the Public Finance Act 1989. By July of 1990 all government departments had introduced accrual accounting and were

1 Proceedings of the Seminar on Accrual Accounting - The Scorecard to Date (Report No 89) NSW PAC, February 1995 page 60

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The State’s Budget and Financial Management Framework

reporting on that basis. The Table below outlines the key reforms, which are discussed in following paragraphs.

<table>
<thead>
<tr>
<th></th>
<th>Date</th>
<th>Key reform</th>
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<tr>
<td>1</td>
<td>1989</td>
<td><em>Public Finance Act passed</em></td>
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<tr>
<td></td>
<td></td>
<td>First five departments implemented accrual accounting</td>
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<tr>
<td>2</td>
<td>June</td>
<td>All departments except three implemented accrual accounting</td>
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<tr>
<td></td>
<td>December</td>
<td>All departments implemented accrual accounting</td>
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<tr>
<td>3</td>
<td>1991</td>
<td>Capital charge introduced (for departments)</td>
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<tr>
<td></td>
<td>July</td>
<td>First core Crown Financial Statements (that is accrual based), for the six months to December</td>
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<tr>
<td></td>
<td>December</td>
<td>First core Crown Financial Statements (that is accrual based), for the six months to December</td>
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<td>4</td>
<td>1992</td>
<td>First annual core Crown Financial Statements (that is accrual based)</td>
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<td></td>
<td>June</td>
<td>First consolidated crown financial statements (that is accrual based whole of government financial statements), for the six months to December</td>
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<td></td>
<td>December</td>
<td>First consolidated crown financial statements (that is accrual based whole of government financial statements), for the six months to December</td>
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<tr>
<td>5</td>
<td>1993</td>
<td>First annual consolidated crown financial statements (that is accrual based whole of government financial statements)</td>
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<tr>
<td></td>
<td>June</td>
<td>Output specification for non-departments</td>
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<td></td>
<td>November</td>
<td>Output specification for non-departments</td>
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<td>6</td>
<td>1994</td>
<td>Purchase agreements introduced</td>
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<td></td>
<td>February</td>
<td>First accrual accounting based budget for the Crown</td>
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<tr>
<td></td>
<td>June</td>
<td><em>Fiscal Responsibility Act passed</em></td>
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2 Ian Ball, Central Financial Controller The Treasury, New Zealand, Implementing Accrual Accounting in the Public Sector: The New Zealand Experience, Presentation to the Interdepartmental Accounting Group Conference 1994, Gold Coast, Australia, 12-14 October 1994, page 7
The Public Finance Act 1989

The Public Finance Act 1989 together with the State Sector Act 1988 introduced a radically different system of financial management and accountability into central government administration in New Zealand. The Public Finance Act 1989 resulted in:

- chief executives being responsible for outputs, whilst Ministers were to be responsible for outcomes;

- an appropriation system based on outputs;

- devolution of financial management and control from central agencies to departments;

- departments and the Crown being required to produce a series of financial statements that are more comprehensive than those required of private sector companies, through a statement of service performance (comparing outputs produced against objectives) as well as annual financial statements; and

- a more timely scrutiny process of the Government's spending intentions through earlier introduction into the House of Representatives of the Estimates.

Steering Group

The New Zealand government appointed a steering group in June 1991 to undertake a review of state sector reforms. The overall conclusion of the steering group, which was supported by Ministers and observers, was that performance had improved in most key areas as a result of the reforms. However the areas of concern identified were:

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3 Report of the Controller and the Auditor-General of New Zealand (Fourth Report for 1994), page 32
4 ibid pages 32-33
• support for government-wide strategy co-ordination;

• improved specification of required performance standards and measures in chief executives agreements;

• specification and review of performance; and

• senior management development.\(^5\)

There were a number of issues related to financial management raised in the steering group’s report, that are of relevance to this inquiry including:

• the need for further clarification of the process for specifying outputs and the need to further develop cost allocation systems to support decisions about outputs;

• the support available to members of Parliament to fully use the improved level and quality of information now available to it to assess performance;

• the perception on the part of Ministers that the reforms have increased the exposure to risk from poor departmental decisions;

• the role of central agencies, especially duplication of functions and the compliance costs associated with the new reporting requirements; and

• a lack of shared understanding of the purpose and operation of incentives and the effectiveness of incentives, such as the capital charge, in guiding resource management decisions.\(^6\)

There have been a number of developments which have advanced the reforms since the publication in November 1991 of the steering group’s report. Firstly, the implementation of the Public Finance Amendment Act 1992 was instrumental in enabling the first audited accrual based financial statements for New Zealand to

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\(^5\) ibid page 33

\(^6\) ibid page 33-34
be produced for the financial year 1992-93. Amendments to the Public Finance Act 1989 and the introduction of the Fiscal Responsibility Act 1994 also helped place financial management within a longer term strategic framework of overall fiscal management.\footnote{ibid pages 33-4}

The financial management environment in central government has continued to evolve with emphasis placed on continuous improvement in financial management to enhance overall government performance and accountability.\footnote{ibid page 34}

\textit{The Capital Charge}

Under the cash accounting regime there is a tendency for departments to stockpile capital (that is assets) as there is no real incentive to review whether or not an asset should be kept (refer Chapter 2).

To overcome this situation a capital charge was levied on all departments in July 1991. This meant that departments had to pay a fixed percentage on all their net assets. This charge was equivalent to the interest charges the Treasury was being charged on funds it had borrowed to finance departments.\footnote{Morris, R, \textit{The New Zealand Experience with Accrual Accounting: Speech to the Australian Standing Treasuries Liaison Committee, Melbourne, 2 November 1994, page 4}} In this way the full cost of operating departments was determined.

The capital charge also had a significant impact on asset management. Given that departments had to pay a premium for assets under their control many departments identified assets surplus to their requirements. The result was that idle or surplus assets were disposed of freeing up funds for other activities.

\textit{Generally Accepted Accounting Practice}

In New Zealand the Financial Reporting Act 1993 made compliance with standards issued by the Accounting Standards Review Board mandatory for both
the private and public sector. The *Fiscal Responsibility Act* 1994 further obliged the Crown to report on Generally Accepted Accounting Practice (GAAP) basis.\textsuperscript{10} There is no separate set of accounting standards for the public sector and existing commercial standards have been broadened to address issues unique to the public sector.

Departments were given considerable freedom to manage their resources, being able to spend up to $5 million on capital expenditure without further authority provided there was no requirement for an injection of capital.\textsuperscript{11} They also had responsibility for implementing accrual accounting within their particular environment. This meant that departments were free to choose their own accounting software. This ensured that systems were tailored to the needs of each individual department and there was 'ownership' of the system selected.

Treasury provided limited direction setting best practice rather than prescribing rules. The result was that departments were required to assess their particular needs and environment and develop accounting policies accordingly. The only significant restriction that remains on departments is their inability to borrow.\textsuperscript{12}

Annual financial statements are completed and audited within three months of the end of the financial year. Monthly financial data is sent to Treasury by the middle of the following month, consolidated, analysed and formally reported to Parliament. This process takes less than six weeks from the receipts of the raw data from agencies to the tabling in Parliament.\textsuperscript{13}

Agencies had experienced skill shortages and to alleviate this shortage staff with relevant skills were imported from the private sector. Subsequently, over time systems were developed and enhanced, and the level of accrual information used in preparing financial reports was increased, with the emphasis shifted to management issues.\textsuperscript{14}
Purchase Agreements

The New Zealand experience has shown that accrual accounting is a precursor to improving management cultures within public sector agencies. Mr Ian Ball from the New Zealand Treasury, a major player in the implementation of accrual accounting in New Zealand, suggests that:

Accountability for the performance of the remaining departments pivots on the relationship between the responsible minister and the chief executive. By removing the previous input controls over people and money, the chief executive of each department now has the necessary authority to make management decisions.15

In New Zealand a contracting model was adopted to provide the foundations for the change in the management culture of the public sector. Mr Ball concluded that:

The contracting model is at the heart of the reforms. Appropriation is for price (payment for delivery of outputs), not cost (cash for inputs) ... The contract with providers is called a 'Purchase Agreement', which contains terms and conditions similar to (although less detailed than) any private sector contract.

The following minimum requirements apply to purchase agreements:

- description of outputs
- term of agreement
- performance measures and standards
- procedures for assessing performance
- reporting requirements
- dispute resolution procedures
- rewards and sanctions
- procedures for amendment of the agreement

Overall, better choices can now be made between the quality, quantity and cost of outputs.\(^\text{16}\)

Such a system creates a need for accrual based accounting information. That is, there is a requirement on managers to know what outputs are being generated and at what cost (that is the full cost). Without such an incentive, accrual information becomes redundant to the management culture of the organisation.

The Fiscal Responsibility Act 1994

The introduction of the Fiscal Responsibility Act 1994 foreshadowed a requirement for governments to run surpluses until such time as a prudent level of debt is achieved. The increased level of financial information resulting from

\(^\text{16}\) Ian Ball, Central Financial Controller The Treasury, New Zealand, Implementing Accrual Accounting in the Public Sector- The New Zealand Experience, Presentation to the Interdepartmental Accounting Group Conference 1994, Gold Coast, Australia, 12-14 October 1994, pages 5-6.
the reforms enabled more informed and rigorous debate within the Parliament as well as the wider community.

The New Zealand Treasury is currently looking at improving the presentation of financial statements and educating both the Parliament and the public in the interpretation of accrual based information.

Issues identified for future review by the New Zealand Auditor-General, during late October 1994, include:

- the level of decision-making delegated within departments, for example, where the capital charge has been imposed as a cost element in the budgets of lower-level managers;

- the degree of sophistication and accuracy in the application of cost allocation systems within departments;

- the nature and materiality of risks borne by the Crown through its ownership of Crown entities; and

- consistency in the application of accounting policies across the central government sector.\(^\text{17}\)

4.2.2 Committee Visit to New Zealand

During February 1995 the Committee undertook a brief visit to New Zealand to study the development of whole of government financial reporting and related matters. The Committee took the view that it was important to the development of whole of government financial reporting in Victoria, and the Committee's inquiry, that it independently seek advice from a country which is recognised as a world leader in this field.

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\(^{17}\) Report of the Controller and the Auditor-General of New Zealand (Fourth Report for 1994, page 36
Whole of government financial reporting and accrual accounting should be seen as an end rather than an end in themselves. The objective of financial management reform is improved accountability and better resource management (through improved management information and decision making). The importance of the Committee's inquiry cannot therefore be understated. It encompasses fundamental issues of public and parliamentary accountability and a reform program involving a substantial investment of public monies which will shape the future management of public finances for many years to come. The need to get the reforms right is beyond doubt. Also beyond doubt is the need for the Committee to be fully informed on related issues.

The New Zealand visit was considered important to the conduct of this inquiry because:

- New Zealand is a world leader in this area and is reasonably close and assessable;

- Australian governments and the local accounting profession are at a comparatively very early stage in the development of whole of government financial reporting and related financial management reforms;

- without the opportunity to discuss key issues and solutions applied with a country that has encountered and overcome many of the problems now facing Victoria, the Committee's ability to gainfully contribute to the development of whole of government financial reporting and make practical recommendations would have been significantly reduced; and

- the visit also provided an opportunity to explore other issues currently before the Committee related to its other inquiries (such as the Committee's ongoing inquiry into the budget estimates) and to liaise with a similar Committee in a different jurisdiction on issues of common interest.

The Committee's delegation consisted of the Honourable G. G. Weideman, JP, MP (Chairman), the Honourable I. M. J. Baker, MP (Deputy Chairman), Mr A. F. Plowman, MP and Mr C. S. Burke (Director of Research).
Financial Management Reform in Other Jurisdictions

The Committee's delegation met with several key groups as set out in appendix E and gathered substantial documentation for its inquiry (refer appendix F). The Committee appreciates the substantial time and assistance provided by the various organisations the delegation visited.

This report draws heavily on the advice and information gathered during the Committee's visit to New Zealand. The Committee's delegation was able to test arguments previously put to it in Australia during the visit and discuss issues with key people who have first hand knowledge of the issues. The Committee's other ongoing inquiries have also greatly benefited and will continue to do so.

4.3 Australia

4.3.1 The New South Wales Experience

The introduction of the New South Wales Public Finance and Audit Act 1983 overhauled financial management requirements for all government departments and authorities. Accrual accounting was made mandatory for statutory authorities at that time, but a similar requirement was not then imposed on departments.\(^{18}\)

In 1988 the New South Wales Public Accounts Committee held a seminar on accrual accounting. At the seminar the New South Wales Auditor-General publicly supported the extension of accrual accounting to the budget sector. The introduction of accrual accounting and budgeting to the budget sector was subsequently announced by the then new Greiner government in October 1989. This announcement followed the publication of the Report of the New South Wales Commission of Audit. That Report had recommended that accrual accounting be adopted by budget sector agencies and that implementation be effected in stages.\(^ {19}\)


\(^{19}\) ibid page 59
Initially the implementation of accrual accounting in the New South Wales budget sector was to be undertaken over a five-year period, with 70 budget sector agencies involved in the conversion to accrual accounting. However by 30 June 1994, inside the five year time frame, the whole budget sector was on full accrual accounting. The 1992 amendments to the New South Wales Public Finance and Audit Act 1983, requiring departments to prepare financial statements on an accrual accounting basis, was the legislative imperative that hastened the implementation.\(^20\)

The New South Wales Treasury have planned for the implementation of a budget estimate process based on accrual accounting principles, but will not introduce it until the 1996-97 budget year as a result of the need to upgrade existing computer systems.\(^21\)

The New South Wales 1993-94 consolidated financial statements, prepared on an accrual accounting basis, were the first whole of government financial statements for that State and are a substantial achievement. A small number of differences of opinion did however lead the New South Wales Auditor-General to issue a qualified opinion on those financial statements.

The New South Wales Treasury sees its role as that of a head office accountant of a large corporation, providing the policy framework within which all 'subsidiaries' will report. The Treasury's policy position for the introduction of accrual accounting is that departments should follow existing accounting standards.\(^22\) New South Wales has adopted in full Australian Accounting Standard AAS 29, Financial Reporting by Government Departments but still have some reservations concerning the requirements of Australian Accounting Standard AAS1 Profit and Loss or Other Operating Statements related to asset recognition and its impact on the Operating Statement. The New South Wales Treasury has issued its own guidelines in relation to the valuation of assets.\(^23\)

\(^{20}\) ibid page 59-60
\(^{21}\) Proceedings of the Seminar on Accrual Accounting - The Scorecard to Date (Report No 89) NSW PAC February 1995, page 16
\(^{22}\) ibid page 18
\(^{23}\) ibid page 17
Three Different Financial Reporting Formats

Departments in New South Wales are required to produce financial reports based on three distinctly different reporting formats; Government Finance Statistics (GFS), accrual accounting and cash based accounting. Departmental information systems have experienced difficulties in producing reports on all three formats to meet internal and external (for example the New South Wales Treasury) information needs. Further the concurrent use of three different financial reporting formats has created some confusion within departments. Lastly concerns exist over a possible excessive focus on GFS based information, at the expense of accrual based information, by the New South Wales Treasury.

Mr Ken Barker, General Manager (Finance and Assets Management) of the New South Wales Department of Health, stated at a recent Seminar on Accrual Accounting that:

*The next item I come to is the difficulty with Treasury caused by this GFS focus. This causes us undue problems in that we have given all our chief executive officers, as we call them, who run the area health services, and the general managers clear line of financial accountability and Treasury keeps coming back to a GFS approach.*

The New South Wales Department of Health has sought to create clear lines of financial accountability within the portfolio based on accrual accounting, however the New South Wales Treasury apparently maintains a primary focus on the GFS approach. This then leads to mixed signals to managers as to the basis of their accountability. Mr Barker elaborated on this confusion:

*In terms of internal reporting, this caused us great dilemmas last year in that people did not know what they were being held accountable for. You have the Minister not knowing which figure he has to focus on; you have the Finance Committee of the Department not knowing what is going on; and at the board level, recognising some of our boards have private sector people on them who are used the private sector, they are scratching their*

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24 ibid page 44  
25 ibid pages 44-45
heads and wondering what is going on when getting this cash GFS stuff and yet they have accrual budgets on which they are expected to have their performance assessed. Yet when we get our audit certificate, that is on an accrual accounting basis.  

In terms of the management implications, our people are still confused because of the complexities between GFS, cash and accrual and we are trying to resolve that changing the way we report information back to them. I do not believe that will change unless we at the departmental level only can handle the hassles of government and Treasury wanting to know cash information so that it is no longer an issue for the people who work for us. While ever they get embroiled in the cash issues that come up from time to time in the health system and they are not looking at it on an accrual basis, it will always be a problem because they do not know what they are doing and they have to work out what they are responsible for. 

I have spoken about the revamped internal reporting. We are continually pushing out accrual information and it is my view that if we can stop the system focusing on cash and keep that for Treasury and the Department, that will make their life a lot easier. We have acquired in-house briefs, where they put up financial information to examine the accrual impact.

The confusion that exists within departments in New South Wales was also succinctly addressed by Mr Colin Broad, Assistant Director (Finance), Department of Consumer Affairs when he said:

Certainly in our organisation the concept of GFS, accrual accounting and all of the rest of it is very difficult to explain to senior management staff, and in my case, two Ministers, one of whom has a Bachelor of Commerce degree. At the coal face it is very difficult.

Mr Baker concluded on this issue by saying that:

\[26 \text{ ibid page 45} \\
27 \text{ ibid page 45} \\
28 \text{ ibid page 84}\]
I think those at Treasury have to change their emphasis to be more accrual focused. ...

I also believe they have to fully fund their accrued items and they have to make agencies responsible for those accrued items; by that I mean depreciation, which comes into the capital charging policy, and also the provision of superannuation and employees' leave entitlements.\textsuperscript{29}

Ms Thuy Mellor, Chief Accountant - New South Wales Treasury, commented at the same Seminar that As the Budget appropriation remains on a cash basis, the perception that "cash is king" is reinforced.\textsuperscript{30}

The continuing primary emphasis in New South Wales on GFS and cash based accounting information, as well as a requirement to also report on an accrual accounting basis, clearly has caused valid disquiet. This is a situation, the continuation of which, cannot be justified on the basis of financial accountability and the prudent management of public sector resources.

It is clear that each format serves different purposes. For example cash accounting information reports spending against Parliamentary appropriations while GFS information is important for budget monitoring purposes. In the private sector, a focus on both accrual accounting information and cash flows is important. The problem then is that the public sector has two key cash based reporting formats in addition to accrual based information. Clear lines of accountability are critical to efficient resource management in the public sector.

The prospect of Victoria also running three different financial reporting formats, with the obvious inefficiencies that would bring for the State, is something considered later in this report.

The debate over the continued use of GFS as a basis for preparing financial information has been underway for a number of years. The Australian Bureau of Statistics has acknowledged some shortcomings in the GFS, which is an adaptation of the United Nations SNA, particularly in relation to the exclusion

\textsuperscript{29} ibid page 49  
\textsuperscript{30} ibid page 19
of unfunded superannuation liabilities. This has not reduced the use of GFS for budgetary purposes as demonstrated by its adoption by the Commonwealth of Australia and the States, but also by the United Nations, the International Monetary Fund, and the 120-odd countries around the world who are currently using it.\textsuperscript{31}

The New South Wales Treasury undertook a post-implementation review of accrual accounting in a number of departments during 1992. One of the outcomes of the review was an apparent lack of understanding of the usefulness of information prepared on an accrual basis, and therefore a lack of commitment to accrual accounting by senior management. The introduction of accrual accounting was also seen as something imposed by New South Wales Treasury. Additionally the review raised the concern that there was a lack of staff with appropriate levels of skills to provide support to operational managers in interpreting the more comprehensive data that was now available.\textsuperscript{32}

The main problems identified by the New South Wales Treasury in the implementation of these reforms were:

- the identification and valuation of assets;
- the weakness or deficiency in internal control systems;
- documentation of procedures; and
- the maintenance of ledgers under accrual accounting and cash.\textsuperscript{33}

Ms Thuy Mellor, Chief Accountant - New South Wales Treasury, highlighted that a number of departments were concerned that one part of the New South Wales Treasury was asking departments to maintain ledgers on an accrual basis, whilst another arm of Treasury required departments to report on a cash basis. This apparent inconsistency by the New South Wales Treasury in relation to departmental reporting requirements, and in particular the apparent lack of

\textsuperscript{31} ibid page 85
\textsuperscript{32} ibid page 19
\textsuperscript{33} ibid pages 18-19
support for utilising information produced on an accrual basis, fuelled that concern.

The four lessons learnt by the New South Wales Treasury, as articulated by Ms Mellor, were that:

*The introduction of accrual accounting was seen as something imposed by Treasury, that it was a technical exercise carried out by the accountants, and that it had nothing to do with the day-to-day management process. I should acknowledge that Treasury has been partly responsible for this view because we have not articulated very well the linkage between accrual accounting/budgeting and the cash budget appropriation process.*

*In addition, we were also given to understand that there has been lack of staff with appropriate skills to provide support to operational managers in interpreting the more comprehensive data which is now available and to assist managers to understand how to use such information in their day-to-day operations and decision-making.*

Ms Mellor suggested that the New South Wales Treasury, if they had the opportunity to undertake the reintroduction of accrual accounting again, would implement the following processes.

Firstly, they would take more time to articulate more clearly the following:

- the purpose of the financial management reform program;
- the importance of the accounting reform in the overall management process; and
- how managers can use the more comprehensive information in their day-to-day operations.*

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*34 ibid page 19  
35 ibid page 19*
Secondly, with the benefit of hindsight, more time would be spent in developing and explaining the linkages between accounting and budgeting and the budget appropriation process, as well as clearly explaining the parliamentary control mechanisms that are embodied in the accrual budgeting regime.

Thirdly, the New South Wales Treasury would clearly define the role of its budget officers in an accrual budgeting and accounting environment.

Finally, the New South Wales Treasury would enhance the existing level of, and develop additional benchmarks for use by agencies as targets for financial management in program activities, and how this information can be used by operational staff in meeting their day-to-day responsibilities.\textsuperscript{36}

The focus of the reforms, as seen by Ms Mellor, has been improving financial allocation, management and accountability, which has resulted in improved budgetary, accounting and reporting systems. These reforms however have apparently concentrated more on inputs and processes rather than outputs and outcomes. The emphasis on better management emanating from these reforms may not have therefore resulted in better service according to Ms Mellor. The next initiative for the New South Wales Treasury will be to translate the improved systems and processes into better service for the taxpayer.\textsuperscript{37}

\textit{The New South Wales Department of School Education}

At the New South Wales Public Accounts Committee's Seminar, Mr Ken Dixon, Deputy Director General (Resources), Department of School Education (DSE), stated that the initial step undertaken by the department in the implementation of accrual accounting and other financial management reforms was to secure sufficient resources, both financial and non-financial.\textsuperscript{38} A budget allocation of $5.6 million was obtained as part of the 1991-92 capital works program, and a working party and steering committee was established to oversee the project's implementation. The steering committee was chaired by the Deputy Director

\textsuperscript{36} ibid page 20
\textsuperscript{37} ibid page 21
\textsuperscript{38} ibid page 30
General (Resources) from the department with representatives on the steering committee from regions, the Treasury and the Audit Office.

Mr Dixon highlighted the need for a well developed change management strategy which identified the key issues to be overcome in the implementation stage. External consultants were also engaged to assist in the implementation of the reforms through the training of financial and non-financial managers and clerical staff.\textsuperscript{39}

The next step was the selection of a new financial management system. The DSE purchased, in 1992, an information technology system comprising a general accounting module, purchasing, accounts payable, accounts receivable, and fixed assets. This was later upgraded by the addition of a cash management module.

The DSE developed internal accounting polices covering a range of accounting applications and issues. The department allocated a lot of time to the writing of new procedures manuals as well as the identification and recruitment of key staff, and the implementation of appropriate training programs.\textsuperscript{40} The development of a new chart of accounts was another key feature of the development process.

Mr Dixon acknowledged the difficulty in being required to account and report on both a cash funding basis (against its parliamentary appropriations and other funding sources), and the preparation of financial reports using accrual accounting. This aspect has raised issues in relation to the ability of the new financial management software to produce the relevant reports.\textsuperscript{41} The initiatives undertaken by Victoria to address these difficulties is addressed in Chapter 5 of this Report.

\textsuperscript{39} ibid page 32
\textsuperscript{40} ibid pages 31-32
\textsuperscript{41} ibid page 36
4.3.2 The Commonwealth Government Experience

The Commonwealth initiated an extensive reform process in 1983 to improve the management and performance of the Commonwealth Public Sector. The reforms were aimed at providing managers with greater flexibility to manage with the expectation of improved performance and accountability.42

In 1992 the then Minister for Finance, the Hon Ralph Willis MP, announced the implementation of a financial reporting framework for Commonwealth agencies based on accrual accounting concepts. The effect of this change in reporting framework is that from 1994-95 the annual financial statements of all Commonwealth agencies will be prepared on an accrual accounting basis, with recognition given to revenues, expenses and the full range of assets and liabilities managed by each agency.43

The Joint Committee of Public Accounts (JCPA) in their recent Report Report 338, Accrual Accounting - A Cultural Change, concurred that accrual information is an essential tool for modern public sector management and that it is not possible to make accurate assessments of the cost of service provision and the efficiency of program performance without regular access to accrual based information. The Report highlighted the importance of the introduction of accrual based financial management systems and the education of parliamentarians, managers and other users in the use of accrual based information.44

Many Commonwealth agencies however, apparently see accrual accounting as merely another task to be performed without any recognition that accrual accounting marks a different level of accountability and management. Changing organisational culture therefore remains the most significant issue or challenge. The Commonwealth Department of Finance (DoF) has actively tried to address these perceptions by issuing guidelines and numerous technical bulletins on

44 ibid
these issues. Commonwealth departments however, still have concerns with the timing of changes to these guidelines.\(^45\)

The Australian National Audit Office (ANAO), in its Report *Audit Report No. 16 Follow-up Audit: Accrual Reporting—Are Agencies Ready?*, found that 60% of agencies had no intention of using accrual based information in the next two years.\(^46\) This is quite an indictment of the apparent resilience of existing management within Commonwealth agencies toward accrual accounting or an indictment of how it is being implemented in the sector. Moreover, it indicates that unless there is a fundamental shift in the way in which public sector managers are made accountable, particularly with regard to accountability on information that is based on accrual accounting, it is unlikely that the full benefits of accrual accounting will be realised.

The ANAO recommended that the DoF play a leading role in promoting the benefits of accrual reporting to agencies and their staff. The DoF accepted this finding and undertook to strongly promote the need for departments to identify their skill requirements. In an attempt to redress the apparent current imbalance in the level of accrual accounting skills within the Commonwealth public sector the DoF has conducted a number of presentations on the new financial management reforms and has organised or assisted in the development of appropriate courses at universities and within departments. Most of these courses have been run utilising existing DoF staff with limited input from the private sector accounting firms.\(^47\)

The JCPA noted in its recent Report:

> The Committee notes that there is a basic incoherence in the Commonwealth’s financial management system—funds are appropriated on a cash basis, but end of year reports are now made on an accrual basis. This in the Committee’s opinion is not only inelegant but also sends mixed

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messages to managers. Managers are inclined to focus on cash— it is cash they have been appropriated— but the end of year accrual reports mean they are held accountable for more than just managing cash. Such a system is likely to undermine the potential of the reforms undertaken to date.

The Committee has recommended, therefore, that their should be a major review of the Commonwealth's system of budget appropriations to consider the merits or otherwise of requiring that budgets be prepared and appropriations made on an accrual basis....

In concluding, Mr Speaker, I would like to emphasise that the recent introduction of accrual reporting across the Commonwealth public sector should be seen as only one step in the reform process. The Committee has found that the core sector area still retains a cultural attachment to cash accounting and the Committee believes there is a danger that the reform processes will stall unless the Government sets new targets beyond just accrual reporting.

The Government should articulate a clear vision for the future of financial reporting in the Commonwealth, incorporating whole of government reporting, accrual management and, possibly, accrual based budgeting. A statement of direction from the Government would give great impetus to the tentative steps now being taken by agencies toward accrual accounting and accrual management.48

These comments reinforce earlier issues raised in New Zealand and New South Wales on the acknowledged difficulties to be overcome in implementing these reforms. Later Chapters of this report further develop these issues and their implications for Victoria.


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5.1 Implementation Issues

The transition from a budgetary and financial framework that is premised on cash based accounting to one utilising accrual accounting cannot be efficiently and effectively undertaken without substantial forward planning and analysis of major issues for the public sector.

Major issues associated with the introduction of accrual based financial management reforms occur both at a sector wide level and at departmental level. These issues include:

- the role to be played by the central agencies (which includes leadership, guidance and policy roles) and by the Victorian Auditor-General’s Office;

- asset recording and valuation;

- the adequacy of existing information systems and the implementation of new information systems;

- human resource and training issues;

- the appropriateness and adequacy of Australian Accounting Standards;

- the production of periodic (that is monthly, quarterly and annual) financial reports on an accrual accounting basis and the use of that information for decision making by public sector managers;

- accrual based budgeting;

- the mechanics of consolidating many different financial reports into a whole of government financial reports; and

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accountability.

This chapter addresses a number of these issues at a sector wide level. Departmental level issues are considered in Chapter 6.

The Victorian Auditor-General acknowledged the magnitude of the issues associated with the implementation of accrual based financial management reforms when he stated that:

... there is now general acceptance right throughout the political scene in Australia that the time for accrual accounting has arrived.

The problems faced in Victoria will be fairly significant. I would think a significant staff training exercise would be involved. I also think our management information systems, particularly our financial management information systems, will have to be upgraded.¹

Mr Michael Board MP, a member of the Western Australian Public Accounts and Expenditure Review Committee, has identified six major problems associated with the introduction of accrual accounting to the Western Australian government sector:

• uncertainty with regard to whole of government accounting policies;

• non resolution of the ownership of assets;

• difficulties associated with formal valuations of certain fixed assets;

• increased work pressures on staff emanating from the pace of reforms;

• the difficulties associated with attracting relevant accounting expertise at the rates offered in the public sector; and

• priorities may not be directed in the right areas.2

5.2 Accounting Guidance

5.2.1 The Role of the Department of Treasury and Finance

The role of the central agencies as the primary driver of the implementation of financial management reforms has been identified as critical by all jurisdictions. The primary functions for the central agencies are the development and implementation of policy statements and accounting manuals, and the provision of training and direction in the implementation of appropriate financial management systems.

Prior to the amalgamation of the former Department of the Treasury and the Department of Finance into the Department of Treasury and Finance, the functions of managing, monitoring and preparation of the State's Budget resided in the Department of the Treasury. While, the setting of accounting policy and reporting standards for the public sector, management of the operation of the public account, and the implementation of accrual accounting across the public sector resided in the Department of Finance.3

The creation of the new department will facilitate a more holistic approach to the implementation of accrual based financial management (including accrual based budgeting).

The Department of Treasury and Finance plays a pivotal and key role in the implementation of accrual based financial reforms. Not only will the Department provide leadership in the form of policies, guidance and support, the Department has a fundamental responsibility for ensuring that the accountability framework is both maintained and improved.

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2 ibid pages 67-8
The State's Budget and Financial Management Framework

The Accounting and Financial Reporting Division (as successor body to the Office of the Comptroller-General) of the Department of Treasury and Finance has responsibility for developing and implementing policies on financial control and management systems to improve the management of resources within State agencies. The Department has formally adopted Australian Accounting Standard AAS 29 Financial Reporting by Government Departments and is overseeing its implementation within Victorian government departments.

5.2.2 Devolution of Responsibility

In correspondence with the Committee the former Minister for Finance outlined the role of the then Department of Finance as follows:

The Department of Finance through the Office of the Comptroller-General is the "primary driver" of Victorian public sector accounting policy, providing the impetus for the implementation of the departmental Accrual Financial Management project ... Although there is devolution of responsibilities to operating departments, it proposed to achieve consistency of reporting via Ministerial Directions made under the Financial Management Act 1994, allowing improved co-ordination of policy and establishing Victoria as a centre of excellence and driving force for change in Public Sector Financial Management.

Devolution of responsibility however, should not absolve the Department from ensuring adequate controls are in place, at both central agency level and operating department level, to monitor compliance with Ministerial Directions and central agency policies. The Ministerial Directions issued under the Financial Management Act 1994 clearly impose substantial responsibilities on operating departments to have adequate systems of internal control.

An illustration of the important compliance monitoring role of the Department of Treasury and Finance, arises from comments made by the Auditor General in

4 Department of Finance, Annual Report 1993-94, page 7
5 Submission from the former Minister for Finance, 11 November 1994
respect of the management of investments by the public sector. The Auditor-General observed that:

while some improvement has subsequently been made ... the current audit confirmed that the central monitoring function is still largely inadequate. Element of accountability is the compliance monitoring function of central agencies.\(^6\)

The Auditor-General's Special Report also noted in respect of central agencies that:

the effectiveness of any guidelines depends, to a large degree, on the effectiveness of compliance monitoring procedures established to support the guidelines. Such monitoring not only provides incentive to agencies subject to the guidelines to achieve compliance but also provides information vital to any assessment of the extent to which the guidelines have met their objectives.\(^7\)

The Department of the Treasury's response to the above comments of the Auditor-General included:

It is not the intention to make Treasury the overall manager of the State's investments. ... However, it is agreed that Treasury should have appropriate information reported to it to ensure that it can monitor and respond to developments relating to investment risk and performance.\(^8\)

In correspondence with the Committee, and subsequent to the publication of the Auditor-General's Special Report, the former Department of the Treasury highlighted the process being implemented to improve monitoring of the performance of investment funds:

\(^7\) ibid page 89
\(^8\) ibid page 90
Treasury prefers a supervisory framework which is one on which the Board of each of the funds and authorities has clear responsibility for the management of risk and for the performance of its fund. Where funds and authorities have in place effective processes for the management of their investment portfolios, Treasury could add little value unless it was willing to replicate within Treasury the processes which should be established within each fund or authority... Treasury's concern has been to establish appropriate guidelines and to ensure that the Boards have in place the appropriate processes to establish responsible investment strategies.

It is not the intention to make Treasury the overall manager of the State's investments. Treasury's role is to monitor the performance and risk of the funds individually and in aggregate. Treasury can raise any concerns it has with regard to either performance or risk with individual funds or with them collectively.... However, it is agreed that Treasury should have appropriate information reported to it to ensure that it can monitor and respond to developments relating to investment risk and performance and to monitor risks which are corporate risks for the State as distinct from risks for individual funds ...9

The Department of Treasury and Finance has an important responsibility to not only lead accrual based financial management reform but also to monitor compliance with its policies and Ministerial Directions (issued pursuant to the Financial Management Act 1994).

5.2.3 Accrual Accounting Surveys

The Committee issued a survey of all government departments during November 1994 seeking information on the implementation of accrual accounting (refer Appendix G). The Committee's survey was modelled on a 1994 survey conducted by the Australian National Audit Office (ANAO).10 The

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9 Submission from the Department of the Treasury, 10 January 1995.
10 The results of the Australian National Audit Office survey formed the basis of two reports by the Commonwealth Auditor-General: Audit Report No. 32 1993-94 Efficiency Audit: Accrual Reporting - Are Agencies Ready? and Audit Report No. 16 1994-95 Follow-up Audit: Accrual Reporting - Are Agencies Ready? The audit's specific objectives were to:
ANAQ survey covered all large Commonwealth agencies and a selected sample of small and medium sized Commonwealth agencies. The majority of the questions in the Committee's survey were similar to those contained in that of the ANAO survey to enable comparisons between survey findings. The primary analysis of survey findings is contained in Chapters 6.

In the Committee's survey, 46 per cent of Victorian departments rated the assistance they received from the former Department of Finance to be of "great value" (43 per cent in the ANAO survey), with 54 percent (50 per cent in the ANAO survey) ranking the assistance from the Department to be of "moderate value". Nevertheless, Victorian departments also suggested that the Department of Finance could provide greater assistance in the following areas:

- utilisation of accrual information for better decision making and asset management;

- provision of additional training;

- assistance with consultants;

- forums to discuss, share and resolve issues;

- asset valuation - including heritage and cultural assets;

- consolidations;

- up-to-date manuals and accrual guidance releases;

- guidance on the treatment of book entries such as the "capital charge";

- identify relevant accounting and financial management tasks and related skill needs;
- measure the distribution and adequacy of existing skills against these needs;
- identify skill gaps, both overall and in particular areas; and
- ascertain how such gaps might best be filled, for example, by recruitment, professional development or other means.

For the purposes of the audit, the Commonwealth Budget sector was defined as those departments and agencies which were required to report in accordance with the February 1992 version of the Financial Statements Guidelines for Departmental Secretaries.
The State's Budget and Financial Management Framework

- more practical examples of accounting issues;
- 'best practice' for accounting systems; and
- requirements for whole of government reporting.

The Auditor-General in his Report on Ministerial Portfolios 1994 made the following comments about the former Department of Finance:

The Department of Finance has played a pivotal role in facilitating improvements in the State's financial reporting practices through the development and issue of various guidance releases, policy statements and accounting manuals. In addition, the Department is committed to improving the timeliness of financial reporting to Ministers and the Parliament.

However, there still remains several areas where the Department needs to provide further guidance to entities to enhance the standard of public sector financial reporting. These include:

- accounting for superannuation liabilities;
- consolidated financial reporting;
- disclosure of related party transactions; and
- assessing ongoing financial viability of entities.

Finally, with the recent introduction of accrual accounting for government departments, the Department of Finance needs to ensure that more definitive policy statements are formulated in relation to non-current asset valuation methodologies, so that departments are able to effectively account for such assets.\(^{11}\)

The former Department of Finance released an Accrual Accounting Manual in May 1994, subsequently updated in February 1995, which addressed issues raised by the Auditor-General. The purpose of this manual is to provide guidance to

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departmental finance managers and their staff in relation to the preparation of financial information, including general financial statements, on an accrual basis. The Department, during 1994, oversaw a program for training departmental managers and staff in the concepts of accrual accounting (refer Chapter 6). It also released an exposure draft on Valuation Methodology for Non-Current Physical Assets in April 1994.

Chapter 3 (paragraph 3.4) discussed the repeal of the Annual Reporting Regulations which has lessened Parliamentary accountability and removed the use of monetary penalties. These regulations had the status of subordinate legislation, and non-compliance with these regulations carried a monetary sanction. Under the Financial Management Act 1994, however, such requirements are contained within ministerial directions. These are not legally binding and therefore there are no monetary sanctions associated with non-compliance.

Chapter 6 includes further comment on the Department of Treasury and Finance's role in accounting policies, training and financial management systems.

5.2.4 Accounting Standards

The accounting profession's accounting standards play a crucial role in promoting consistency, relevance and credibility in public sector accounting. Following the introduction of the Financial Management Act 1994 it will be mandatory for all departments to prepare general purpose financial reports in accordance with Australian Accounting Standards.

Accounting standards affecting the public sector are developed by the Public Sector Accounting Standards Board (of the Australian Accounting Research Foundation) which has representatives from major public sector organisations. Private sector corporations are bound to comply with the accounting standards set by the Australian Accounting Standards Board. Any departure from accounting standards by the public sector will greatly mar the ability to compare public sector entities and to achieve consistency in reporting practices.
Key areas not yet covered by professional accounting standards and pronouncements, such as the valuation of non-current assets, have been a matter of some concern to Public Accounts Committees around Australia. At the 1995 Australasian Council of Public Accounts Committees' Biennial Conference the Victorian Auditor-General made the following comments:

One of the tragedies of this whole exercise is that the accounting profession has not kept pace with the problems we are facing, particularly on questions such as the valuation of heritage assets. They have been very dilatory in coming out with definitive standards to guide people. I think it would be very useful if members of ACPAC put their shoulders to the wheel and wrote to the Australian Accounting Research Foundation suggesting that it is about time it issued something definitive in the way of valuation of heritage assets. Otherwise you will get this continual debate and different approaches.12

Consistency in financial reporting is a matter that requires urgent attention. At present there is diversity of approaches being adopted throughout the public sector on matters such as the valuation of non-current assets.

One of the most critical and urgent issues to be addressed is the substantial time lag between the identification of accounting problems and the issue of the necessary accounting standards by the professional bodies. The Public Sector Accounting Standards Board has commenced a project centred on the valuation of assets, however, the release of an Exposure Draft on this issue is not planned to occur until 1996 at the earliest. It is unknown when an accounting standard or other professional pronouncement may be issued, but this cannot occur until after the exposure draft has been released and considered. The Committee acknowledges the substantial difficulties to be addressed by the profession, but it is also mindful of the pressing need for timely action on this issue.

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However, sole reliance on accounting standards alone may not produce the degree of transparency and accountability required in the public sector. Indeed Professor Bob Walker has argued that:

... if the combination of Corporations Law requirements and accounting standards produces inadequate disclosure in the private sector, then reliance on accounting standards alone would produce even less disclosure in the public sector.\(^{13}\)

There is an important need for monitoring of the nature and quality of financial information produced by departments. It is the responsibility of each department's management to ensure that financial information is reliable and satisfies the requirements set by the Parliament and the Government.

A separate role also exists for central agencies, such as the Department of Treasury and Finance, to monitor financial reporting by entities within the public sector and ensure compliance with appropriate legislation and ministerial directions, in a similar way to the Australian Securities Commission which acts to ensure private sector corporations comply with the corporations law (including accounting standards mandated under that legislation).

The role of the Auditor-General is to provide the Parliament, the public and the Executive Government with independent and objective reports containing information on the adequacy of financial and resource management systems of public sector organisations. The aim of these reports is to improve accountability and encourage economic, efficient and effective use of public resources. The Auditor-General is an independent commentator on financial and resource management issues within the public sector. Although Auditor-General reports contain suggestions for corrective action, it is the prerogative of Parliament and of the Executive Government to act on the advice contained in these reports.\(^{14}\)

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\(^{14}\) 1993-94 Annual Report of the Auditor-General page 4
Finding 5.1

The Committee finds that:

(a) the role played by the Department of Treasury and Finance is critical to the successful implementation of Accrual Financial Management. The Department's role includes providing strong consistent leadership in the form of policies, guidance and support while ensuring that the accountability framework is both maintained and improved. Equally important is the Department's responsibility to monitor compliance with its policies and Ministerial Directions issued pursuant to the Financial Management Act 1994;

(b) departmental accrual based financial statements must comply with accepted Australian Accounting Standards and Concepts as required by the Department of Treasury and Finance;

(c) departments have expressed high levels of satisfaction with assistance provided by the Department of Treasury and Finance, however, a need for further guidance in certain areas has also been identified; and

(d) the absence of Australian accounting standards or other professional pronouncements on issues such as the valuation of assets is a significant problem, but not an impediment to the introduction of accrual accounting in the Victorian budget sector. The Victorian budget sector must continue to move towards the introduction of accrual accounting, and accrual financial management. Equally timely action by the Accounting Profession's standard setting bodies is also critical to provide the necessary guidance on contentious and difficult accounting issues, such as the valuation of assets.
5.3 Accrual Financial Management

5.3.1 Creating a Cultural Shift and Accrual Based Budgeting

Chapter 2 introduced the Committee’s concept of Accrual Financial Management. Accrual accounting should not be seen as an end in itself but rather a means to changing management cultures within the budget sector to improve decision making, resource management and accountability.

Accrual Financial Management will improve accountability to the Parliament and the public by providing more meaningful and useful information. The Westminster system of parliamentary Government which operates in Australia requires that the Government of the day must account for its handling of funds entrusted to it. The implementation of accrual accounting will assist the Government to better fulfil that objective. Further Accrual Financial Management will promote a more efficient use of public monies.

The Committee’s early public hearings on this inquiry indicated a lack of a complete understanding of Accrual Financial Management and its benefits within the budget sector. The ANAO Accrual Accounting Survey (refer paragraph 5.2.3) found that even after the transition to a financial management system based on accrual accounting that there was only a small percentage of agencies where their executive (16 per cent) and program managers (8 per cent) used accrual based information in financial management decision making and program administration.\(^\text{15}\)

The ANAO, in a submission to the Commonwealth Joint Committee of Public Accounts, stated:

\begin{quote}
One of the major aims of the introduction of accrual reporting was to assist agency management to utilise their agency’s resources more efficiently and effectively. The ANAO strongly believes that the significant benefits to be gained in terms of improved management, resource savings and program
\end{quote}

outcomes will only be fully realised when accrual accounting is used as an everyday management tool.\textsuperscript{16}

New South Wales also experienced problems fully realising the benefits of accrual accounting based reforms (refer Chapter 4). Ms Thuy Mellor, Assistant Secretary - New South Wales Treasury, at a 1994 seminar held by the New South Wales Public Accounts Committee on accrual accounting, made the following comments:

If we had the opportunity to do it all over again, I believe Treasury would start by spending more time articulating the purpose of the financial management reform program the importance of accounting reform in the overall management process, and explaining how the more comprehensive information can be used by managers in their day-to-day operations.

In addition, we would spend more time in the process, I mean, we do it now but we should have done it three or four years ago, that we should spend more time developing and explaining the linkage between accounting and budgeting and the budget appropriation processes. As the Budget appropriation remains on a cash basis, the perception that "cash is king" is reinforced.\textsuperscript{17}

Ms Mellor's comments raise a critical issue for the full realisation of benefits from accrual accounting based reforms. New South Wales government departments are still accountable to the Treasury on a cash accounting basis only (refer Chapter 4). Until accrual budgeting is introduced the incentive and benefits for departments and the State to manage on an accrual accounting basis are dramatically reduced. A related problem is that central agencies had not shown the lead in demonstrating the usefulness of accrual information in financial management.


A recent paper by the Organisation for Economic Co-operation and Development noted:

*if changes are limited to accrual reporting and managers continue to operate and be held accountable on the basis of cash budgets, then accrual accounting risks becoming another form of compliance reporting and its full benefits may not be realised.*

In contrast, New Zealand has embraced the use of accrual-based information for decision making, particularly for departments, with the experience being seen as a positive one.

The situation in New Zealand is different from the majority of other jurisdictions for three reasons: firstly, New Zealand has a unicameral system with only two levels of government, national and local. Secondly the New Zealand government uses accrual based whole of government reports. Thirdly, the Treasury of New Zealand implemented extensive training programs to educate agencies and departments on the use of accrual-based information and was proactive in the dissemination of information to Parliament and the public on how to interpret and utilise reports prepared using accrual-based information.

The Victorian Commission of Audit (refer Paragraph 2.3) recommended that the Budget presented to Parliament should be prepared on an accrual accounting basis (recommendation 5.14 refer Appendix A):

*A system of full financial accounting should be introduced, with all the costs of service provision attributed to that service. Appropriations and financial reporting should also be in this format.*

The Victorian Commission of Audit also stated that

*the budget process should seek to fund clearly-defined and measurable outputs which are in turn related to the outcomes which Ministers wish to

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attain, rather than line-item inputs (such as wages and salaries, data processing expenses, rent and supplies). 19

Table 2.1 (refer Chapter 2) identified the introduction of an accrual budgetary system as the third level of issues associated with the successful implementation of Accrual Financial Management.

5.3.2 Performance Measurement

The Victorian Commission of Audit recommended significant restructuring of the public sector and a new management approach to performance, emphasising planning and accountability for outcomes and outputs of Government, rather than inputs and process controls. 20 The Committee, in its Ninth Report to the Parliament, stated:

As public sector managers are given more discretion in the manner in which scarce public resources are being utilised it is important for the accountability of management to be increased through improved management reporting and performance measurement. This inevitably results in a greater emphasis being placed on program evaluation. 21

The Committee's Ninth Report also provided extensive guidance on the key attributes of performance measures. 22

The Victorian Auditor-General in his May 1995 Report on Ministerial Portfolios commented:

Performance indicators which measures a government agency's efficiency and effectiveness may be utilised to enhance management performance, in the following manner:

20 ibid, Volume 1, Pages 151 and 152
22 ibid pages 32-33
firstly, in the area of management planning processes;

secondly, they may, for management accountability purposes, be used for monitoring actual performance against an acceptable set of standards (benchmarks); and

finally, the inclusion of appropriate and relevant performance indicators in the annual reports of government agencies would greatly enhance the usefulness of financial and other information provided to the Parliament and taxpayers.

There are a number of attributes which add to the overall usefulness of performance indicators. These include considerations of adequacy (particularly in relation to qualitative indicators), measurability, freedom from bias, relevance and verifiability. Nevertheless, performance indicators should not be used in isolation as absolute measure of performance, as they can only help to highlight areas of operating performance which may require closer examination and analysis.\textsuperscript{23}

The Committee, also in its Ninth Report, found that the adequacy of output measures in the Budget Papers varied between and within departments. In some areas output measures were more in the nature of statistics rather than indicators of performance.\textsuperscript{24} This same comment can be made in respect of some of the performance measures included in agency annual reports.

Performance indicators should utilise accrual based information to provide users with an indication of the full cost involved in producing outputs and the value of the resources dedicated to the delivery of those outputs. For instance, the full cost to the State of educating one pupil at a country primary school and how that compares with NSW, United Kingdom and New Zealand is useful performance based information. Further information on the value of assets used to provide education and how it has changed over time is also useful performance based information.

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The Committee concurs with the following recommendation of the Auditor-General in his May 1995 Report on Ministerial Portfolios that:

Audit considers that it is desirable that individual government agencies publish both quantitative and qualitative performance indicators against appropriate benchmarks and that these indicators be subject to review by the Victorian Auditor-General's Office when undertaking performance audits so that reliance may be placed upon them by the Parliament and taxpayers. Such information would then provide a sound basis for identifying areas for enhancement in agency performance.

To this end, the development by the Government of a performance management and reporting framework, as part of its Management Improvement Initiative, will go a long way towards rectifying shortcomings in this area.\(^25\)

The issue of performance management has been explored by the Committee at a number of public hearings. For example, in response to a question concerning the existence of mission statements, objectives and performance measures, the following comments were made:

**REPRESENTATIVE OF ARTS, SPORT AND TOURISM:** There is a mission statements; there is a set of objectives; there are performance measures both on the departmental and on a divisional and institutional basis.

**COMMITTEE - In the annual report?**

**REPRESENTATIVE OF ARTS, SPORT AND TOURISM:** In the corporate plan and the business plan of the department. I am not happy that the performance indicators are as outcome-orientated as they should be and it is to that end that I am looking forward to getting a better valuation of the unit costs in terms of the improvements to be made both in the

administration of the departments and the various portfolios, and the costs of the outcomes sought.

COMMITTEE - So you are continuing to refine your performance indicators?

REPRESENTATIVE OF ARTS, SPORT AND TOURISM- Yes, of course, because in certain areas our indicator is to produce 30 000 licences in the year, and that is meaningless in any indication of performance. I would much rather see 30 000 licences produced with a saving of X dollars per licence or without a saving of time.

Again, the general comment is that we do not control all sectors of the tourism community, but if you are not able to influence this, you should not be in the business. I have set, in consultation with the tourism board of Tourism Victoria, indicators which are targets as much as they are indicators, but they are challenging and are within reach.26

Accrual Financial Management, as envisaged by the Committee (refer Chapter 2), delivers both improved management reporting and performance measurement. Improved management reporting, both external (that is through annual reports) and internally, without performance measurement falls well short of realising the full benefit of financial management reform. The Committee's Ninth Report to the Parliament included the following recommendations:

**Recommendation 2.3**

The Committee recommends that the Financial Management Act 1994 should require all public sector agencies to include performance measures in their annual reports and that the Budget Papers must include performance measures.

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26 Department of Arts, Sport and Tourism, Minister of Evidence, 3 November 1994, page 5
Recommendation 2.4

The Committee recommends that performance measures provided by public sector agencies in annual reports, pursuant to the proposed legislative requirements, should be certified by the respective Accountable Officers. In addition the Auditor-General should be required to express an opinion on the relevance and appropriateness of those performance measures.27

These recommendations apply equally to the preparation of whole of government financial reports to the Parliament. Recommendation 2.1 (b) of this report (Chapter 2) provides:

documents containing whole of government financial reports should also include performance indicators to assist users of these reports to determine whether the Government is achieving its objectives effectively and doing so economically and efficiently.

Finding 5.2

The Committee finds that Accrual Financial Management will deliver the maximum benefit to Victoria only if:

(a) there is a fundamental and genuine shift in the management culture of the budget sector at all levels. The responsibility for ensuring that a genuine shift in culture occurs within the budget sector rests with the Department of Treasury and Finance;

(b) accrual based financial information is used for the day-to-day management of budget sector agencies. The Committee stresses that accrual based financial information must be used for management purposes throughout the year, not just limited to the production of accrual based financial statements at year end. This is not to denigrate the substantial importance of annual accrual based financial statements, which fulfils a critical accountability function;

(c) budget sector agencies are made accountable on an accrual accounting basis through an accrual based budget. It is critical that reforms are not limited to accrual based reporting with budget sector managers continuing to be held accountable solely on the basis of cash based budgets;

(d) performance measurement and reporting is a key element of accrual based financial management reforms. Accrual based whole of government financial reports to the Parliament, in common with all annual reports to the Parliament, should include performance measures; and

(e) the Department of Treasury and Finance should actively educate agencies and departments on the use of accrual based information and in the dissemination of information to the Parliament and the public on how to interpret and utilise reports prepared using accrual-based information.

5.4 Asset Records

5.4.1 Introduction

The preparation of accrual based financial statements depends upon reliable and current records of the State's assets. Accurate records of State assets are also crucial to ensure responsible and efficient utilisation of assets.

The Report of the Victorian Commission of Audit noted that the existing level of information on the State's asset base included several categories of assets which have not been quantified and brought to account. The Commission suggested the following reasons for the lack of comprehensive information on assets:

- The task of building asset registers has generally been a low priority of Government and the individual entities in the budget sector.

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- The protracted period for the implementation of asset valuation and reporting program of the previous administration, which was not planned to be finalised until June 1996.

- The responsibility for managing the benefits implicit in an asset or for servicing and repaying liabilities is not allocated.

- Central government agencies do not have a general body of statements which define assets and liabilities or which guides sensible financial reporting.

- Conceptual issues concerning the value of land under roads, regenerative assets and heritage assets have not been effectively resolved.²⁹

The Victorian Auditor-General has also commented on poor asset records within departments:

A key component of meaningful accrual-based financial information is complete and accurate non-current asset information, based on adequate records and independent valuations. Over the past 5 years, the state of assets recording and reporting by some public sector entities, such as public hospital, water bodies and certain entities in the Arts sector has generally been unsatisfactory because of incomplete asset records and the use of subjective valuations. This has been the case particularly in relation to land and buildings and vested assets, such as Crown land and heritage assets, which include the State's Museum, library and art collections.³⁰

Two broad issues stem from the Auditor-General's comments. Firstly, establishing appropriate criteria for the recognition and recording of assets, and secondly establishing an appropriate methodology to value those assets.

²⁹ ibid Volume 1, page 16
5.4.2 Definition of An Asset

A significant issue arising from the creation of asset registers relates to whether certain public sector 'assets' meet the conventional criteria for the definition of assets. Statement of Accounting Concepts SAC 4 *Definition and Recognition of the Elements of Financial Statements* (SAC 4) defines an asset as:

*service potential or future economic benefits controlled by the entity as a result of past transactions or other past events*

A study commissioned by the Department of Arts, Sport and Tourism was critical of the SAC 4 definition of an asset. The Study contended that:

*any Australian financial reporting requirement drawn from SAC4 have a strong chance of being seam as novel at the international level.*

The SAC 4 definition of assets, which is issued by the Australian Accounting Research Foundation, mirrors the asset definition used in many other jurisdictions. Further, there is a strong support in both the United Kingdom and Canada to recognise and report on the value of public sector assets.

There are three important aspects to the SAC 4 definition of assets: the item must provide the entity with some utility or usefulness in achieving its objectives; the entity must have dominant control of the item and the item must have passed to the entity by virtue of some officially sanctioned event. For an asset to be recognised in the financial statements it must also satisfy two recognition criteria:

- service potential or usefulness of the asset will in fact flow to the entity; and
- the asset's value or cost can be reliably measured.

The SAC 4 definition is appropriate to apply to public sector assets and provides a useful framework for the recognition and reporting of assets.

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32 Statement of Accounting Concepts SAC4
The Steering Committee on National Performance Monitoring of Government Trading Enterprises (the Steering Committee) was established at the Special Premiers Conference in July 1991. The role of the Steering Committee is to facilitate the development of a consistent performance monitoring regime for GTEs (Government Trading Enterprises) across the Commonwealth, States and Territories. The Steering Committee proffered the following definition for assets, which is similar to that embodied in SAC 4:

a. assets are the service potential or future economic benefits controlled by the entity as a result of past transactions or other past events; and

b. an asset shall be recognised in the statement of financial position when and only when:

(i) its probable that the service potential or future economic benefits embodied in the asset will eventuate; and

(ii) the asset possess a cost or other value that can be measured reliably.\(^{33}\)

Australian Accounting Standard AAS 29 Financial Reporting by Departments (paragraph 53) states that:

An asset of the government department shall be recognised in the statement of financial position when, and only when, the following criteria are satisfied:

(a) it is probable that the service potential or future economic benefits embodied in the asset will eventuate; and

(b) the asset possesses a cost or other value that can be measured reliably.\footnote{Australian Accounting Standard AAS 29, Financial Reporting by Departments}  

Australian Accounting Standard AAS 29 Financial Reporting by Departments defines the role of Government departments as being to provide goods and services consistent with government policies. The recognition of assets in the statement of financial position results in users of those statements being informed about the amount and types of assets (that is service potential or future economic benefits) deployed by government departments to meet their service delivery objectives. The standard adopts the view that all assets, including infrastructure assets, heritage assets (e.g., historical buildings and monuments), community assets (e.g., parks and recreation reserves) are to be recognised in the statement of financial position, provided they meet the specified asset recognition criteria.

5.5 Assets That Are Difficult To Value - Heritage and Cultural Assets

5.5.1 Overview

Because of the nature of some public sector assets, such as national parks, there may be some difficulty in obtaining a reliable value for such assets. Where a reliable value for an asset cannot be obtained such assets fail the recognition test set out in SAC 4 (refer paragraph 5.4).

There has been some argument within the accounting profession as to whether heritage and cultural assets should be separately defined. Whilst there appears to be some merit in excluding the value of certain types of assets when determining certain performance indicators, such as returns on assets, for the purposes of estimating the total resources controlled by an entity, any subsidiary definition is of limited usefulness. This does not preclude, however, the use of differing categorises of assets in general purpose financial reports to highlight the nature and restrictions associated with certain assets. In fact it is the Committee's view that heritage and cultural assets should be separately categorised in whole of
government financial reports due to their differing attributes which affect their potential transferability or saleability (refer Chapter 2). This approach is consistent with Proposed Australian Accounting Standard ED62 Financial Reporting by Governments.

The Steering Committee described heritage assets as:

> those assets which a Government has decided to, preserve for the duration of their physical life because of their unique historical, geographical, cultural or environmental attributes. Where assets of historical significance, such as historical buildings and works of art, are permitted to be sold or re-deployed by the GTE, or are not required to be maintained indefinitely, they are not heritage assets for the purposes of the following discussion.35

The Steering Committee proposed the following in relation to valuing heritage assets:

> Heritage assets are to be valued consistently with the measurement policies to be applied to other physical non-current assets of GTEs - that is, at deprival value. Classification of assets between those having purely historical or cultural interest and those which also provide a functional service is not relevant to the measurement policies to be applied.

> Where the service potential embodied in the heritage asset would be acquired (through replacement, reproduction, rental, leasing or in any other manner) if the GTE was deprived of the asset, the deprival value of the asset is the current cost of the service potential or future economic benefits embodied in the asset. Where the service potential of the asset would not be acquired if the GTE was to be deprived of it, the asset should be valued at its recoverable amount [i.e. the greater of the net present value of future cash flows and current market selling price. Normally the

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appropriate value is the market selling price if it can be determined reliably with reference to markets for comparable assets.\textsuperscript{36}

Heritage assets therefore, according to the Steering Committee, are to be valued consistently with the measurement policies to be applied to other non-physical assets of GTEs - that is, at deprival value. Classification of assets between those having purely historical or cultural interest and those which also provided a functional service is not relevant to the measurement policies to be applied under the Steering Committee's approach. Details of the deprival value methodology are contained in Steering Committee's report.\textsuperscript{37}

The Committee's review of the asset valuation issue does not aim to recommend the adoption of a particular valuation method, rather it considers the appropriateness of placing valuations on certain assets. The mechanics of arriving at an appropriate valuation methodology is something the Committee proposes to leave to the various authorities or stakeholders. Nevertheless the Committee will monitor the use of valuation methodologies within the sector and in particular the Auditor-General's comments on asset valuations in accrual based financial statements.

The New Zealand Auditor-General made the observation:

\textit{Issues surrounding heritage assets test the boundaries of normal commercial accounting. Money measurement operates in the commercial sector on the basis that assets are exchangeable for other assets or for money... In the case of heritage assets, their unique nature and non-exchangeability is a crucial characteristic. More attention needs to be given to the legal and political characteristics rather than simply their physical characteristics... Legal and moral restrictions reflect the fact that the public do not want to put heritage assets to an alternative use. However, public}

\textsuperscript{36} ibid page 50.
attitudes could change, making the opportunity cost of assets useful information.\textsuperscript{38}

There are many aspects of accounting for heritage and cultural assets which remain unresolved. The Committee takes the view that valuations should be attempted for all assets that can be valued, however crude, and refined over time as the accounting profession develops a definitive approach to such assets. As the Minister of Finance has stated:

So far as we were concerned, as a starting point we did not want the departments to incur great expense to give them a value on the tooth of a dinosaur or something like that. If they had some hypothetical value that seemed reasonable to them, that would be a good starting point.\textsuperscript{39}

In New Zealand the approach has been to value all assets that have a market value.\textsuperscript{40}

Professor Bob Walker appears to take a different viewpoint when he stated that:

The latest annual report of the Warrnambool City Council records the value of assets held by the Council at June 1994. Roads were worth $4.1 million, footpaths about $500,000, and "kerbs and channels" $800,000. But their biggest asset was Norfolk pines, with a value of $6 million.

Warrnambool Council hasn’t gone crazy and invested ratepayers’ funds in softwood forestry. The pine trees are planted around the city, and the $6 million doesn’t represent their value as timber, woodchips or firewood. Rather, the pines are local landmarks, and arguably the most exciting objects in Warrnambool. Pictures of the trees appear on letterheads and brochures. Hence, the rule - conscious accountants at the Council have treated them as heritage assets, as recommended by the accounting profession’s AAS27, Financial reporting by local governments. The


\textsuperscript{39} Minister for Finance, Minutes of Evidence, 8 February 1995, page 23.

\textsuperscript{40} Financial Statements of the Government of New Zealand, 30 June 1994, page 52.
$6 million figure represented the value placed on the trees by the Council. Presumably it reflects council's estimate of the deprival value - $6000 per stem. ...

It is possible other councils will start placing values on flora and fauna or even geographical features. However, it is clear that AARF's idea of requiring the recognition and valuation of heritage assets has been taken up by public sector agencies throughout Australia. Possibly because of the overlapping membership of committees, the spread of ideas has been rapid.

For instance, the Steering Committee on National Performance Monitoring of Government Trading Enterprises has, prescribed the recognition and valuation of heritage assets, and in the process enlarged the usual definition of heritage assets, beyond items of historical, cultural and scientific interest, to include items of geographic significance.\(^\text{41}\)

The New South Wales Auditor-General, in commenting on the view of Professor Walker in relation to the valuation of heritage assets suggested that:

The great libraries of our universities have been valued at less cost than Professor Walker has quoted. And they now can consider more closely the level of insurance they maintain, the amount of security they provide, the reasonableness of maintenance and preservation costs and the possible or actual sale of some of those assets to fund other (more productive) assets. ...

It is also not unreasonable to think that the Art gallery (sic) of NSW might sell and buy paintings so it can achieve its goal for a collection. (And it is not unreasonable; to think that its goals might change or develop over time.) Similarly, the State Library of NSW cannot, ad infinitum, add to its book collection. It has to make choices about its existing holdings.\(^\text{42}\)

The former Economic and Budget Review Committee (EBRC) in 1986 noted in its report on the National Gallery of Victoria that:

The Committee has been told that it is not general practice for public art galleries to disclose the value of art works held in their collections, at least not in any detail. Four main arguments have been put to the Committee in support of this practice.

1. It would be a particularly expensive task to value all the individual art works requiring the deployment of substantial skilled labour resources.

2. The art market fluctuates radically and the determination of a particular value for the collection would soon be out-dated.

3. It would be unwise, from a security point of view, to disclose the value of the collection and especially unwise to disclose the value of each artwork.

4. There is no particular identifiable need for the value of the collection to be known.43

The EBRC contended that:

1. **Knowing the value of the Gallery's works is essential for effective management decision making:**

   • in relation for the overall allocation of funds of the Gallery, for example the maintenance of the Gallery's assets and to provide adequate insurance cover;

   • in relation to security measures taken to protect particular works, for example locating high value works in the most secure places;

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• to ascertain the loss involved in the event of damage or theft; and

• to help assess the effectiveness of the acquisition strategy of the Gallery Trustees and management. The Government, Parliament and the public should have information on how past acquisitions have changed in value. Aesthetic values cannot be the sole criteria for judging acquisitions, especially since such judgements must be of a very personal nature.

2. Government, Parliament and the public have a right to know the value of the Gallery's collection given that it is part of the cultural heritage of the State.44

Heritage and cultural assets represent valuable resources that are being preserved for the community. There is a significant opportunity cost involved with designating land as a national park and not exploiting any mineral reserves or realising the market value of the land. Similarly, considerable costs are incurred in maintaining many heritage assets - for instance the restoration and ongoing maintenance of historic buildings. Therefore, it is important for the Parliament and the public to be aware of the full costs involved in designating and maintaining heritage and cultural assets (and their value).

*A Paper on the 'Valuation of Cultural and Heritage Collections for Financial Reporting Purposes'*

In 1994 the Department of Arts, Sport and Tourism commissioned Professors Carnegie and Wollnizer of Deakin University to prepare a paper on the valuation of cultural and heritage collections. Their conclusions, as contained in the report, are that:

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44 ibid pages 13-14.
Items held in public repositories of cultural and heritage collections cannot properly be described as financial assets, nor do they satisfy the criteria for recognition as an ‘asset’ as defined by the Australian accounting standard setters.

The social and cultural ‘value’ of such collection items cannot properly be measured in financial terms. For those items for which there is reliable evidence of market prices, reliable measures of their value in exchange are obtainable. That cultural and heritage collections held by the public not-for-profit organisations are dedicated to community use - i.e. that they are off the market in the public or community interest - makes the measurement question of no particular consequence for the purpose of financial reporting.

The only financial statements that auditors can authenticate by recourse to reliable (independent) sources of evidence are those that report (unamortised) acquisition prices and independent expert appraisers’ assessments of market value.45

The Committee provides the following summary comments on specific key issues raised by Professors Carnegie and Wolnizer in their report. The Committee notes however that the report raises similar issues to those already considered by the EBRC some nine years ago.

**Issue raised by Professors Carnegie and Wolnizer:**

Evidence of the relative costs and benefits of valuing cultural and heritage collections for financial reporting purposes suggests that there are few, if any, identifiable benefits, as compared with significant costs entailed in obtaining reliable financial valuations.46

45 Professor G D Carnegie and Professor P W Wolnizer *Valuation of Cultural and Heritage Collections for Financial Reporting Purposes*, August 1994
46 ibid page 1
The Committee believes that substantial benefits will accrue and that the costs will be substantially less than indicated by Professors Carnegie and Wolnizer in their report. The authors estimated the costs of arriving at valuations of the collections of the State Library, National Gailey, State Film Centre and Museum as being in excess of $28 million.47

Benefits include achieving an improved level of public accountability and the production of more meaningful management information. Improved management information will assist managers to gauge the adequacy of: insurance levels; security arrangements; maintenance costs; and preservation costs. Lastly such information will also assist decisions about the possible sale of some assets to fund other assets to meet changing needs. The broader benefits of Accrual Financial Management have also been considered by the Committee in Chapter 2 of this report.

Professor Walker has also commented on the issue of the cost of valuing assets:

*It appears valuation would be expensive. In NSW, the Australian Museum has around 40 million exhibits; the State Library holds around 65 million items. It has been estimated that no independent valuation could cost around $1 per item. *<sic>* That places a cost of $40 million to $65 million to arrive at a valuation for inclusion in a balance sheet.*

*Cheaper valuations might be obtained in-house though the figures would be highly subjective and unreliable. But who would use that information?*

*Carneige and Wolnizer of Deakin University point out that the values can't be used for borrowing purposes. They refer to research findings that current users of museum financial statements expressed no support for the inclusion of valuation information. On the contrary, respondents viewed such information as "artificial".*

*In short, the valuation of heritage assets is likely to be a waste of time and money. Even the professional bodies seem to have recognised that:*

47 ibid page 9

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Carnegie and Wolnizer point out that neither the Institute nor the Society have been recording their own libraries at current replacement values.

If AARF and its Public Sector Accounting Standards Board can’t clearly state any benefits to be derived from valuing heritage assets, perhaps they should pause to consider whether there really are any. Perhaps they should think about the costs.  

However the Australian Valuation Office has advised this Committee in respect of the valuation of Victorian cultural collections that:

We would expect that the most basic valuation for financial reporting purposes, based upon an audited sampling approach would cost approximately

State Library $100,000

National Gallery of Victoria $250,000-350,000.

I would not be prepared to quote in respect of the Museum of Victoria without conducting extensive further enquires.....

We pride ourselves on our independence, objectivity and probity

The Minister for the Arts advised the Committee in March of 1995 that:

The relevant arts institutions have each submitted a proposed methodology, timeline, and cost estimate to value the individual collections, and I can advise that the initial cost estimate is far less than the $28 million mentioned in your letter.

49 Correspondence form Australian Department of Administrative Services, 23 February 1995
50 Letter from the Minister for the Arts, 17 March 1995.
The valuation of other public sector assets does not need to involve significant costs as many similar assets, such as schools, can be grouped and valued collectively.\footnote{51}

Issue raised by Professors Carnegie and Wolnizer:

Cultural and heritage collections cannot be properly be described as financial assets, nor do they satisfy the criterion for recognition of an asset, as defined by Australian accounting standard setters.\footnote{52}

Most cultural and heritage assets meet the asset definition in the accounting standards. Assets would only be excluded if they were not able to assist the entity to meet its objectives or could not be reliably measured. The Auditor-General has commented on this issue:

A key component of meaningful accrual-based financial information is complete and accurate non-current asset information, based on adequate records and independent valuations. Over the past 5 years, the state of asset recording and reporting by some public sector entities, such as public hospitals, water bodies and certain entities in the Arts sector has generally been unsatisfactory because of incomplete asset records and the use of subjective valuations. This has been the case particularly in relation to land and buildings and vested assets, such as Crown land and heritage assets, which include the State's museum, library and art collections. In addition, departments have not been required to report non-current asset values in their cash-based financial statements.\footnote{53}

In New Zealand, a valuation has been prepared by the National Library Staff of the National Library collection. This was valued at $NZ 548 million (at 30 June 1994). The Parliamentary library has been valued at $NZ 10 million (30 June 1994)

\footnote{51} This approach is recommended in a policy paper issued by the Department of Finance, Technical Information Paper No. 2: Recognition and Valuation of Non-Current Assets.

\footnote{52} Professor G D Carnegie and Professor P W Wolnizer Valuation of Cultural and Heritage Collections for Financial Reporting Purposes, August 1994, page 1

and the National Archives of New Zealand has been valued at $NZ 919 million (30 June 1994).

Government valuations prepared by Valuation New Zealand were used to determine a value for National Parks, Forest Parks and Conservation Areas in New Zealand. This value was $NZ 457 million as at 30 June 1994.\(^{54}\)

**Issue raised by Professors Carnegie and Wolnizer:**

*The social and cultural value of cultural and heritage collections cannot be measured in financial terms. Attempts to do so may mislead financial statement users in their assessments of financial position and performance of arts institutions.*\(^{55}\)

Accounting information communicates financial values and does not purport to reflect 'social' values. 'Social' values are totally subjective and it would be virtually impossible to reach agreement on what the 'social' value would be of a tract of land such as the Botanical gardens. It is agreed that such characteristics cannot be adequately captured by financial information. However, the economic benefit of such land includes the market value of the land that could be realised and any cash flows that could be generated from entrance charges or leases.

However, market values do incorporate, to some extent, the scarcity value of cultural and heritage assets. It is important to note that such valuations do not attempt to capture the aesthetic or cultural value of an item. For financial reporting purposes only the dollar value of the State's investment in the item is being measured.

It could be argued that valuations for financial reporting purposes can take in a part of the cultural or heritage value of certain assets. For example the difference between the cost of replacing Parliament House with a modern building and the

\(^{54}\) *Financial Statements of the Government of New Zealand, 30 June 1994, September 1994, pages 51-52*

\(^{55}\) *Professor G D Carnegie and Professor P W Wolnizer Valuation of Cultural and Heritage Collections for Financial Reporting Purposes, August 1994, page 1*
cost of recreating the existing building using the same materials and design is a measure of the cultural or heritage value of Parliament House.

It is important to emphasise that the value of an asset is a construction of values for each of the asset's characteristics. For instance, the Rembrandt in the National Gallery has a market value which reflects not only the skill of the artist but the age of the painting, its scarcity value and so on. Obviously, the painting is 'worth' more to the State of Victoria because of the cultural and educational benefits enjoyed by visitors to the Gallery. That is the reason for holding the painting and not realising its market value.

This, in the Committee's view, does not justify placing no value on such an asset. Values are currently able to be determined for insurance purposes to accommodate the risk of loss. Correspondingly a value should be able to be disclosed representing the stock of financial resources tied up in such assets. Such information can then be used to make informed decisions on the adequacy of resources devoted to providing particular public outputs.

**Issue raised by Professors Carnegie and Wolnizer:**

> The only financial statements that auditors can authenticate by recourse to reliable (independent) evidence are those that report (unamortised) acquisition prices, current market prices, and independent expert appraisers' assessments of market value.\(^{56}\)

The valuation of most heritage and cultural assets can be based on acquisition costs or market values. Other curatorial valuations would be accepted by auditors as long as the methodology used was disclosed and was consistent and objective in approach (and without material error).

Many items that comprise the State's cultural collections are highly valuable works of art with significant market values. Other cultural objects such as

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\(^{56}\) ibid page 1
artefacts and natural history collections may have nominal market values but will still have a substantial cultural value.

Many of these principles have been supported in a discussion paper released by the Australian Accounting Research Foundation. In that paper Mr Tom Rowles argues that:

Without information about all non-current physical assets reported on a consistent basis, information contained in financial statements will be incomplete from the point of view of providing information for economic decision making and accountability, and entities will not be fully accountable for the resources they control.\(^{57}\)

Issue raised by Professors Carnegie and Wolnizer:

Reporting of cultural and heritage collections as assets in balance sheets for financial reporting purposes is not mandatory in the USA, UK, Canada and Europe.\(^{58}\)

The Committee acknowledges that reporting of cultural and heritage collections in financial statements is a relatively recent development and that Australia and New Zealand are world leaders in this area.

The public sector professional accounting bodies in both Canada and the UK have recommended that the majority of cultural and heritage assets be valued and reported on. In the UK a number of museums have been privatised and are now operating and reporting on a full commercial basis.

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\(^{57}\) IAC, Newsletter Vol. 18 No. 3, September 1994.

\(^{58}\) Professor G D Carnegie and Professor P W Wolnizer Valuation of Cultural and Heritage Collections for Financial Reporting Purposes, August 1994, page 1
Issue raised by Professors Carnegie and Woynizer:

Evidence of accounting practices by arts institutions indicates a very low incidence of valuations of cultural and heritage collections for financial reporting purposes.\(^5^9\)

The survey conducted by Professors Carnegie and Woynizer appears to relate to those jurisdictions which do not require accrual based financial reports. The Committee also notes that current practice should not necessarily influence 'best practice' for the future.

Conclusion

The Committee, in a November 1994 public hearing, received assurances from representatives of the Department of Arts, Sport and Tourism in relation to the valuation of heritage and cultural assets:

**REPRESENTATIVE FROM THE DEPARTMENT OF ARTS, SPORT AND TOURISM** - I know, but just at present we are talking about the valuations of the department's assets, the way depreciation is handled in a situation where it is not financed on that sort of basis.

I am not critical of the picture but I am saying some issues of accrual accounting are special for government, and that must be clear to you from your previous inquiries as well as your own knowledge of the background. But the question of public good has to be faced if we are to put values on things.

One of the major problems I am facing relates to the arts institutions and valuation of assets. That subject has been of interest to the Auditor-General for some time. It is under current inquiry as to how to cope with the problem of, first of all, identifying the assets and then valuing them in circumstances where they can change.

\(^5^9\) ibid, page 1

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COMMITTEE- Do the assets include such things as racecourses?

REPRESENTATIVE FROM THE DEPARTMENT OF ARTS, SPORT AND TOURISM - No. Two of the four city courses are on Crown land so it does not apply to racecourses but it includes the value of the collection of the gallery, the collection of the museum and of the library. They are quite large collections and have not been satisfactorily valued from the Auditor-General's point of view. That is a major task.

The other element which is concerning the chairmen of the various trusts and boards associated with the arts institutions is the effect of valuations both of their collections and the real estate on their reporting. They all like to report on operating surplus. They are concerned that the valuations which can fluctuate over time will affect that bottom line. The problem has to be dealt with.

COMMITTEE-- When do you think the department will produce a complete set of audited financial statements on an accrual basis?

REPRESENTATIVE FROM THE DEPARTMENT OF ARTS, SPORT AND TOURISM - We will produce them by 1994-95.60

These comments were reinforced at a February 1995 public hearing with the Minister for the Arts:

COMMITTEE-- What about valuations?

MINISTER FOR ARTS, SPORT AND TOURISM - Valuations are a major issue. I shall address each of those matters with regard to accrual accounting. This year all agencies presented reports on an accrual accounting basis. Valuations still remain an issue. It is planned that for the year ending June 1995 the department will produce a report based on accrual accounting. It will be an unaudited report, but for 1996 it will be an

60 Minutes of Evidence, Department of Arts, Sport and Tourism, 3 November 1994, page 3

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audited accrual accounting report that will deal with all agencies within the department.

The valuation of assets is a vexed question. The institutions have taken the view that it is largely impossible to properly value collections in museums and galleries. Officers and I have met and have agreed that institutions have to value their collections for accounting and insurance purposes. A strategy has been addressed to implement that over the next three years.

Each agency is required to document the cost and evaluation methodology it intends to apply to its own collection. The department will then finalise that strategy with the Department of Finance. That is intended to take place later this month. Meetings are being held with the presidents and directors of each organisation to determine that the process is on target.

COMMITTEE— The consultancy will be valuable to that process, will it?

MINISTER FOR ARTS, SPORT AND TOURISM - The consultancy is on accrual accounting and not so much on the valuation of assets. The department did not commission a report on the valuation of assets. The University study said it was inappropriate to value them. Nonetheless, valuations will certainly take place.

COMMITTEE— What is the policy in New Zealand? Given that they have introduced accrual accounting, how do they value their art works?

MINISTER FOR ARTS, SPORT AND TOURISM - I do not know how they do it, but they do it somehow. Different Australian states are approaching it in different ways. The different techniques of doing it are being investigated. If we went down the normal path and if we were to value a house, we would get a sworn valuer to value it and it would cost a certain amount of money. It has been estimated that if one did that for, say, the National Gallery’s collection one would be spending millions of dollars on valuations, because each individual work is a work of art and has to be separately assessed by somebody with the expertise to assess that particular painter or that particular class of work.
COMMITTEE-- That is where I thought it may be valuable to know how New Zealand does it. As members of the committee we may be able to assist.

MINISTER FOR ARTS, SPORT AND TOURISM - I am sure somebody must know. I am not sure how they do it in New Zealand.

COMMITTEE-- I believe New South Wales has had its Auditor-General apply accrual accounting - with a dozen or so qualifications, which will change in the ensuing years. The committee is concerned that it will be used as an excuse for not introducing accrual accounting. I believe it is as simple as that. As a committee we would prefer to see a report from the Auditor-General, at least. He can give qualifications to the documents, which will change over the years but which will improve the system. We realise the problems, but accrual accounting may ultimately be used as an excuse to put that off until the year 2000. The committee does not think that is appropriate. New South Wales has taken up the issue and has had qualifications on buildings like Parliament House, which is worth so much, and so on.

MINISTER FOR ARTS, SPORT AND TOURISM - The department and I accept that view. We have a plan in place to achieve it. I draw a distinction between real estate and collections. So far as real estate is concerned, the department has now obtained valuations for the National Gallery, the Arts Centre and so on. The difficult part is the valuation of collections. That is being proceeded with. We will do it in conjunction with the Auditor-General to ensure that he is happy with the mechanisms that are put in place to achieve it.61

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61 ibid pages 3-4
The Auditor-General in his latest Report on Ministerial Portfolios on the issue of valuation of Heritage and Cultural assets commented:

It is pleasing to note that at a recent hearing before the Public Accounts and Expenditure <sic> Committee, the Minister for the Arts informed the Committee that a strategy has been developed for the institutions to value their part of the State Collection for financial reporting and accountability purposes and for insurance purposes, with the implementation of that strategy to take place over the next three years. It is acknowledged that the Department is now making considerable progress towards valuing all cultural and heritage assets under its control, with all valuations to be completed by May 1997.62

The Committee commends the action and commitments made by the Minister for the Arts and his department.

Given the importance of including heritage and cultural assets it is important that the Department of Treasury and Finance and the Public Sector Accounting Standards Board provide clear and definitive guidance on what the minimum requirements are for reliable measurement of such assets. The Victorian Auditor-General's Office is also a major stakeholder in this area.

5.5.2 National Parks, Forest Parks and Conservation Areas

The other primary cultural or heritage assets that have generated asset valuation related concerns are National Parks, Forest Parks and conservation areas. In New Zealand however National Parks, Forest Parks and conservation areas have been successfully valued through methodologies based on a number of criteria:

Valuation New Zealand uses sales evidence of land in the same general location with comparable topography and vegetation cover. Values are then typically adjusted downwards to reflect restrictions on the use of national parks and the invariably smaller land areas in private sales.63

The New Zealand approach appears to provide a reliable means of estimating the value of these heritage areas. The New Zealand Auditor-General did not qualify these valuations in his report on the whole of government financial statements.

The Department of Conservation and Natural Resources currently does not disclose the value of Victoria's national parks and state forests. Disclosure of the value of these assets will result in a considerable increase in the Department's asset base. The crucial issue is that all assets are recognised so that a complete picture of the resources controlled by a department can be obtained. It is also important that when values for those assets are included in the Department's financial statements that sufficient explanatory information is also included to assist users to interpret the financial statements. Similarly, significant changes to valuation methods need to be disclosed and the effect of such changes clearly stated.

The Committee discussed the issue of asset valuations at a public hearing earlier this year, the following extracts identified key issues considered at that hearing:

REPRESENTATIVE OF THE DEPARTMENT OF CONSERVATION AND NATURAL RESOURCES: At this stage in moving towards accrual accounting, we now have a good handle on all the plant and vehicles, the buildings we occupy and so on. That was the first stage. We have data on that, it amounts to $196 million. We are currently in the process of valuing the roading network, a major asset of which we have stewardship. The third component is the land base, which is by far the largest. It is a vexed area for which we cannot give full answers at this stage.64

MINSTER FOR CONSERVATION AND ENVIRONMENT: Perhaps I can give an example; how you value wilderness parks or reference areas is a hard one, because it is the single highest classification of public land to the extent that reference areas cannot be used by human beings. I think it would be desirable to have some agreement within the accounting industry about the standards, which would mean that we have valuations

64 Minister for Conservation and Environment, Minutes of Evidence, 25 January 1995,
for those types of land nationwide. That is common. There is no doubt that all we can come up with is our own valuation system. It would be valuable in this pioneering era of valuing the land which is owned and controlled by the state but which will not be sold, and which has no commercial use now or ever, to have a common, agreed approach to that type of valuation.65

COMMITTEE: You may create a circumstance where you raised an issue that is referred to finance, then referred on to the accounting profession and then somebody else, which means that the time frame is not met. I am saying that in this room today you are presenting a sufficient professional capacity to not only identify those issues in all their complexity but also reach a view about what you believe the values ought to be. Therefore you should do it. That does not mean to say that, having done that, you would not need to have discussions with the Department of Finance and the accounting profession about what is correct. Consistent with the views of Bob Officer, Fergus Ryan and the Auditor-General, we argue you should do it.66

MINISTER FOR CONSERVATION AND ENVIRONMENT: There is no doubt about doing it or meeting agreed timetables. We want to take it a step beyond valuing the difficult ones at $1. One of the debates is about the Royal Botanic Gardens. How do you value them? It is slightly more complex in the sense that they will remain in public ownership forever and are under public control, but they have a commercial utility: a licensed restaurant. There is a licensed reception area also. It is a genuine outreach to the bodies that are recommending action on this from the Auditor-General and the accounting profession to state the way of doing it so we can get consistency between national park services and something that becomes a reliable benchmark and therefore has value.67

...
COMMITTEE: Does the department have a policy position on implementation and accrual over a time frame?

REPRESENTATIVE OF THE DEPARTMENT OF CONSERVATION AND NATURAL RESOURCES: Yes, other than the asset valuation, we will have full accrual accounting reports by June 1996.

COMMITTEE: You cannot have full accrual accounting if you do not have the assets valued.

REPRESENTATIVE OF THE DEPARTMENT OF CONSERVATION AND NATURAL RESOURCES: As I said, apart from the valuation issue we will have all the standard accrual accounting requirements.

COMMITTEE: That is an unsatisfactory qualification from our point of view. Valuations have to be resolved; you cannot do it half-baked. The valuations must be resolved within that time frame. If you have a policy position on the implementation of that in the department, we would appreciate a copy. Otherwise you are making a qualified commitment to 1996 because if you say 'not 1996' you are also leaving it open-ended.

REPRESENTATIVE OF THE DEPARTMENT OF CONSERVATION AND NATURAL RESOURCES: As I understand it, the requirement is to have audited accrual accounts by 1996, and we will have that.

COMMITTEE: Which is conditional on the valuation having been done.

REPRESENTATIVE OF THE DEPARTMENT OF CONSERVATION AND NATURAL RESOURCES: I understand what you have said, but I am reinforcing that we are on track to meet that.68

The Committee accepts the commitments given by the Department of Conservation and Natural Resources to ensure timely compliance with existing

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68 ibid page 17
timetables to introduce accrual based financial reports, including the issues associated with asset valuation.

Finding 5.3

The Committee finds that:

(a) valuation of cultural and heritage assets for financial reporting purposes is very beneficial, necessary, possible and not prohibitively costly;

(b) reliable and accurate valuations of cultural and heritage assets are integral to the development of full and accurate accrual based financial reporting in the Victorian public sector;

(c) cultural and heritage assets should only be included in accrual based financial reports when they meet professional accounting standards and concepts' requirements for recognition of an asset; and

(d) it is acknowledged however, that valuation methodologies for cultural and heritage assets will continue to be refined over time and that a definitive and universally agreed approach does not exist for all such assets at this time. Importantly the appropriate stakeholders in all Australian jurisdictions, such as the accounting profession, auditors-general, central agencies and key operating agencies, need to reach some agreement on a uniform approach to this issue.

Finding 5.4

The Committee notes:

(a) the action and commitments made by the Minister for the Arts and his department to value all cultural and heritage assets under their control by May 1997, for financial reporting purposes; and
The State's Budget and Financial Management Framework

(b) the commitments given by the Department of Conservation and Natural Resources to comply with existing timetables to introduce accrual based financial reports, including asset valuations.

5.6 Which Agencies Should Be Included In Consolidated Financial Reports

In Chapter 2 the Committee identified three entity based levels of financial reporting for the purposes of Accrual Financial Management, being whole of government, economic entity and entity level. This raises the issue of which entities should be included in whole of government and economic entity financial reports. Chapter 2 found, having acknowledged the difficulties involved, that decisions about which entities should be included in whole of government financial reports should be based on the accounting concept of control.

The 1993-94 New South Wales whole of government financial statements excluded those agencies that were outside government control, such as universities and local government. Additionally, government instrumentalities that are either privatised or corporatised are also excluded from the New South Wales statements. New Zealand prepares its whole of government financial statements including all crown entities, offices of the Parliament, departments and State Owned Enterprises.

A government or department wide view can only be obtained if financial reports include all agencies controlled by government or the department in accordance with the relevant accounting standard.

The Committee has been assured by a number of departments that they will prepare general purpose financial reports in accordance with Australian Accounting Standard AAS 29 Financial Reporting by Government Departments. Paragraph 31 of that Standard requires that departmental financial reports are to

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69 An economic entity is a group of entities of which one controls the other entities to achieve its objectives; this is the accounting profession's definition as contained in Statement of Accounting Concepts 1.


be prepared in accordance with the requirements of Australian Accounting Standard AAS24 Consolidated Financial Reports, such reports must therefore include a consolidation of all controlled entities.

Australian Accounting Standard AAS24 Consolidated Financial Reports states:

Where the activities of entities within the economic entity are dissimilar it is sometimes claimed that aggregation of the financial report of each of the component entities may reduce the usefulness of the consolidated financial report. However, since the objective in preparing consolidated is to reflect the economic entity as single reporting entity, it does not matter whether the entities comprising the economic entity are involved in dissimilar activities.

The Committee agrees with the approach adopted in the Standard and emphasises the importance of consolidating all controlled entities in departmental general purpose financial reports. In addition the Committee has supported the inclusion of disaggregated information in whole of government financial reports (refer Chapter 2), this approach at departmental level will help to overcome concerns about the usefulness of consolidated information.

The Auditor-General has also raised non-consolidation as an issue to be addressed:

The need for consolidated financial reports of entities which are financially and operationally interdependent has promoted audit comment in recent years. Where one entity is directly or indirectly controlled by another, then their financial transactions should be reported by way of consolidated financial statements in accordance with Australian Accounting Standard AAS 24 Consolidated Financial Reports.72

The Accrual Accounting Manual issued by the former Department of Finance now contains guidelines consistent with the above comments raised by the Auditor-General. The Committee commends the actions taken by the former Department of Finance in addressing this matter.

6.1 Introduction

The Department of Treasury and Finance has undertaken that accrual accounting will be implemented within departments by June 1996. Adherence to this timeline will ensure that all Victorian government departments will be able to produce annual accrual based financial statements in accordance with Australian Accounting Standards by that date. Experience in other jurisdictions however, such as New South Wales, has shown that whilst departments may satisfy annual external reporting requirements, accrual based information may still not be used for the day to day management of departments (refer Chapters 4 and 5).

The Committee considered sector-wide challenges for the implementation of accrual based financial management reform in Chapter 5. The intention of this chapter is to consider key challenges faced by departments in implementing accrual accounting based reforms.

6.2 Implementation Program

The former Department of Finance originally undertook a pilot program to introduce accrual based reporting during 1991-92. The departments participating in this program were:

- Department of Manufacturing and Industry Development;
- Department of Ethnic, Municipal and Community Affairs;
- Department of Sport and Recreation;
- Department of Finance;
- Department of Planning and Housing; and
- the Victorian Auditor-General's Office.
The pilot program required the preparation of a statement of financial position as at 30 June 1992 by each department. Following an assessment of the pilot program, the former Department of Finance resolved to introduce accrual based reporting across the budget sector.

The strategy developed for the implementation of accrual accounting in departments has three stages, over three years. The stages in this process are encapsulated in Table 6.1.

Table 6.1
Accrual Accounting Implementation Program

Stage 1
Preparation and publication of a statement of financial position and associated notes, as supplementary unaudited information.

Stage 2
In addition to a statement of financial position and notes, the preparation and publication of an operating statement, cash flow statement and associated notes; as supplementary unaudited information.

Stage 3
Preparation and publication, as supplementary information, of an operating statement, statement of financial position, cash flow statement and associated notes suitable for audit.¹

The Committee, at public hearing during April 1994, received the following unequivocal assurances from representatives of the former Department of Finance that the implementation timetable would be adhered to:

COMMITTEE - Do we have a timetable for the implementation of accrual accounting?

REPRESENTATIVE OF THE (FORMER) DEPARTMENT OF FINANCE - Yes.

COMMITTEE - Are we on schedule?

REPRESENTATIVE OF THE (FORMER) DEPARTMENT OF FINANCE - We are.

COMMITTEE - When will that eventually be implemented?

REPRESENTATIVE OF THE (FORMER) DEPARTMENT OF FINANCE - Full accrual accounting will be completed in the 1995-96 year - by June 1996.

COMMITTEE - Will all of those decisions be made with regard to valuations, expenses and superannuation allocations? Will they be made according to the timetable so that the system will be implemented on time?

REPRESENTATIVE OF THE (FORMER) DEPARTMENT OF FINANCE - All departments will have a full set of accrual accounting procedures encompassing all the assets we have been talking about.²

This was reinforced at a later public hearing during September of that year:

COMMITTEE - I will ask one or two questions about the timing of the implementation of accrual accounting. What is the commitment to timing here? What is your specific program? My third question is: are you on track? So far you have mentioned some achievements that have been made and some that are planned, but is that according to the initial blueprint, the initial strategic plan you have for the implementation of accrual accounting? Mr White referred to delays or log jams or the major hurdles you have to get over. But are they delaying you or were they anticipated and are they being dealt with within the sort of time span expected?

REPRESENTATIVE OF THE (FORMER) DEPARTMENT OF FINANCE - The only variation in the timetable that you were previously advised of is this movement of the Department of Arts, Sport and Tourism into 1994-95

² Minutes of Evidence, Department of Finance, 13 April 1994, page 8

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instead of accounts for the year ended June 1994. There is a total commitment that by June 1996 we will have fully reported and audited accrual reports for all government departments. We are on track for that. We believe we have been successful in the measures we have taken so far to try to identify or to identify the deficiencies in terms of systems and skills, and we have no concern that we will not meet our deadlines.

The implementation or the introduction of the new accounting systems that will enable departments to simultaneously produce accrual, cash and government finance statistics (GFS) reports is the important measure, but it is an essential measure if they are going to be effective.

THE COMMITTEE - You are on track with your plans?

REPRESENTATIVE OF THE (FORMER) DEPARTMENT OF FINANCE- Yes.  

The Secretary of the Department of Treasury and Finance reaffirmed these commitments at a meeting with the Committee on 19 July 1995.

Target dates for departments to achieve Stage 3 appear in Table 6.2.

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3 Minutes of Evidence, Department of Finance, 28 September 1994, pages 9-10
4 See Table 6.1
Table 6.2
Target Implementation Timetable
November 1994

<table>
<thead>
<tr>
<th>Department Name</th>
<th>Target Date for Audited Statements</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Group 1</strong></td>
<td></td>
</tr>
<tr>
<td>Department of Finance</td>
<td>1994</td>
</tr>
<tr>
<td>Office of the Auditor-General</td>
<td>1994</td>
</tr>
<tr>
<td>Department of Planning and Development</td>
<td>1994</td>
</tr>
<tr>
<td>Department of Arts, Sport and Tourism</td>
<td>1995 (was 1994)</td>
</tr>
<tr>
<td><strong>Group 2</strong></td>
<td></td>
</tr>
<tr>
<td>Department of Agriculture</td>
<td>1995</td>
</tr>
<tr>
<td>Department of the Treasury</td>
<td>1995</td>
</tr>
<tr>
<td>Department of Health and Community Services</td>
<td>1995</td>
</tr>
<tr>
<td>Department of Justice</td>
<td>1995</td>
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<tr>
<td>Office of the Director of Public Prosecutions</td>
<td>1995</td>
</tr>
<tr>
<td>Office of Chief Commissioner of Police</td>
<td>1995</td>
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<tr>
<td>State Revenue Office</td>
<td>1995</td>
</tr>
<tr>
<td>State Electoral Office</td>
<td>1996 (was 1995)</td>
</tr>
<tr>
<td><strong>Group 3</strong></td>
<td></td>
</tr>
<tr>
<td>Department of Conservation and Natural Resources</td>
<td>1996</td>
</tr>
<tr>
<td>Department of Education</td>
<td>1996</td>
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<tr>
<td>Department of Transport</td>
<td>1996</td>
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<tr>
<td>Department of Minerals and Energy</td>
<td>1996</td>
</tr>
<tr>
<td>Department of Business and Employment</td>
<td>1996</td>
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<tr>
<td>Office of the Governor</td>
<td>1996</td>
</tr>
<tr>
<td>Office of the Ombudsman</td>
<td>1996</td>
</tr>
</tbody>
</table>

Source: Correspondence dated 11 November 1994, from the former Minister for Finance

5 This is Stage 3 per Table 6.1
The former Department of Finance, Office of the Auditor-General and the Department of Planning and Development met the fore-mentioned deadline, and the relevant Annual Report for 1993-94 for each of these departments included accrual accounting based financial statements.

The Committee considers it essential that the timetable be strictly adhered to if the implementation of accrual accounting, and associated financial management reforms, is to be achieved in a reasonably timely fashion.

In public hearings with the following departments the Committee received assurances that the implementation timetable would be achieved:

- **Department of Justice (30 November 1994);**
- **Department of Education (22 February 1995);**
- **Department of Conservation and Natural Resources (25 January 1995);**
- **Department of Transport (22 February 1995);** and
- **Department of Arts, Sport and Tourism (3 November 1994, and 8 February 1995).**

However, the Department of Arts, Sport and Tourism conceded at public hearing that they would not complete the valuation of all the assets they control by their target dates, instead a projected date of May 1997 has been put to the Committee. It is the Committee's view that no system of accrual accounting can be achieved without all resources controlled by an entity being reported in the financial reports (refer Chapter 5, paragraph 5.5).

The Committee understands that the former Office of the Comptroller-General (and its successor body) conducts regular meetings with key finance staff from each of the departments. The institution of an ongoing forum for significant information sharing is an excellent mechanism for producing synergies in the implementation process and monitoring overall progress.
Finding 6.1

The Committee:

(a) welcomes the unqualified assurances it has received from the Department of Treasury and Finance that all departments will prepare audited accrual based financial statements for the year ended June 1996, including asset valuations. The Committee intends to hold the Department of Treasury and Finance to its undertaking, which is critical to the timely introduction of Accrual Financial Management within the Victorian public sector; and

(b) notes that the Department of Arts, Sport and Tourism will not be in a position to prepare accrual based financial statements until June 1997.

6.3 Planning

The OECD in its report on accrual accounting reforms commented that:

A high implementation strategy is desirable to incorporate the broad interests of all parties within government so as to ensure all the needs of users are addressed. Virtually every country has chosen an implementation strategy which seeks to incorporate the broad interests of all parties to the public sector performance and accountability process in the design of arrangements.6

The successful implementation of accrual accounting requires a coordinated and planned approach to modifying the accounting culture and systems within departments. The New South Wales experience (refer paragraph 4.3.1) demonstrated some of the implementation issues, associated with internal reporting, financial accountability and the use of accrual based information by management for decision-making purposes, that planning should address. The development of corporate and strategic plans that highlight and address these issues is crucial for creating a cultural shift and changing management processes within departments.

Without strategic plans and timetables identifying critical events and deadlines, it is unlikely that accrual accounting can be implemented effectively and efficiently. Such plans should detail all the steps and contain sufficient information on the requirements for departments to successfully address the substantial issues associated with the execution of accrual accounting and other financial management reforms. These issues include staff training, identification and valuation of assets and design or modification and implementation of necessary accounting systems.

The importance of a clearly defined, comprehensive and structured corporate plan is paramount for departments; even more so at times when departments are facing substantial policy and cultural changes. The Committee developed this point at a public hearing with the Department of Arts, Sport and Tourism:

COMMITTEE: Therefore, for accrual accounting to make sense you need a management prepared to sit down and produce a mission statement for its organisation, to produce a set of objectives for its organisation and to produce a set of performance indicators and that the set of accounts produced as a consequence of accrual accounting are essentially an instrument to be used in the context of having a mission statement, a set of objectives and a set of relevant performance indicators relevant in the sense that they bear some relationship to the objectives.

Therefore, I put it to you that it is the expectation of this committee that in the course of preparing accrual accounts for 1994-95 we would be seeking from you an expectation that you would be simultaneously producing a mission statement for the organisation which would be prepared by the senior management after consultation with both the government and senior management, and middle management and service deliverers; that you will produce and identify in your annual report a set of objectives for the department and a set of performance measures that match the objectives which then make sense of why we are doing accrual accounting.\(^7\)

Notwithstanding the undertakings given by departments the Committee highlights the value of a comprehensive implementation strategy to ensure the timely and efficient introduction of accrual financial management.

\(^7\) Minutes of Evidence, Department of Arts, Sport and Tourism, 3 November 1994.
6.4 Challenges faced by Departments

Paragraph 5.2.3 (Chapter 5) introduced the Committee's Accrual Accounting survey and an earlier similar survey conducted by the Australian National Audit Office (ANAO). The Committee undertook its survey to assess the implementation of accrual accounting within departments.

A comparison of the Committee's and the ANAO's survey results indicates a great deal of correlation in the problems identified by agencies. However, in Victoria the main raft of problems appear to be associated more with information systems than with accounting skills deficiencies, according to respondents to the Committee's survey.

Whilst many of the problems identified in the Committee's survey were common to all departments not all of them were deemed major issues. Chart 6.1 identifies the incidence, as opposed to the severity, of each problem raised.
Chart 6.1
Problems raised by Victorian departments and Commonwealth agencies

Source: Accrual Accounting Surveys by the Committee and the ANAO

The following problems were identified by more than 60% of Victorian departments and Commonwealth agencies:

- deficiencies in accounting or financial management systems (Victoria: 85%, Commonwealth: 62%);

- obtaining accrual information from cash based financial systems (Victoria: 77%, Commonwealth: 73%);

- staff unfamiliar with requirements from financial statements (Victoria: 62%, Commonwealth: 69%); and

- assigning values to assets (Victoria: 62%, Commonwealth: 62%).

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The respondents to both surveys were also asked to identify the severity of identified problems as either major or minor. Chart 6.2 details those problems categorised as major.

The area of greatest concern to Victorian departments was deficiencies in accounting or financial management information systems (55% of Victorian departments identified this as a major problem). Paragraph 6.5 considers developments in this area. The other three key areas considered to be major problems were recognising assets (33% of Victorian departments identified this as a major problem, refer paragraph 5.4), obtaining accrual information from cash based financial systems (30% of Victorian departments identified this as a major problem, refer paragraph 6.5) and asset valuation (25% of Victorian departments identified this as a major problem, refer paragraph 5.5).

Chart 6.2
Issues identified by Victorian departments and Commonwealth agencies as major problems

Source: Accrual Accounting Surveys by the Committee and the ANAO
Victorian departments were also asked by the Committee's survey to indicate if identified problems had been resolved. This information is contained Chart 6.3.

**Chart 6.3**
Problems identified by Victorian departments which have been resolved

Source: the Committee's Accrual Accounting Survey

The results from the Committee's survey suggest that a substantial number of the problems commented upon by Victorian departments had been resolved. These included staff unfamiliar with the requirements for financial statements' preparation (75% resolved); gathering and consolidating information due to its dispersed nature (71% resolved); data integrity (71% resolved); recognising assets (67% resolved); obtaining accrual information from cash based systems (60% resolved); inadequate accounting procedures (60% resolved); lack of accounting definitions or definitions not generally understood (60% resolved).
It is unrealistic to imagine that all problems can be resolved during the implementation phase. The experience in other jurisdictions, such as New Zealand suggests that even after the initial implementation phase there is a need for a substantial consolidation period. This is necessary to ensure that the financial management reforms are able to generate financial statements that give a complete and reliable financial picture of each department:

We started off simply, we put a lot of time initially into establishing basic office routines such as reconciliation of the asset register, bank account, debtors, etc. Such skills were relatively lacking amongst junior staff initially... Over time, we added greater sophistication such as more month-end journals... It took about two years to move from systems development and enhancement phase to a steady state where we began looking to move beyond the numbers and into management issues such as better integration with the rest of the organisation's planning.8

The Joint Committee of Public Accounts (JCPA) in its recent Report Accrual Accounting - A Cultural Change commented that the key elements of the ANAO recommendations were that:

- individual agencies and Finance should take action to improve the level of awareness and understanding amongst staff of the benefits of the financial reporting reforms;

- individual agencies the Department of Finance and the Public Service Commission should take action to identify the type of accounting skills required to effectively implement the reporting reforms, to match staff skill levels to job skill requirements, to provide appropriate training;

- individual agencies should take appropriate recruitment action; and

- individual agencies should implement accounting and financial management information systems suitable for accrual reporting.9

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6.5 Financial Management Systems

Introduction

The ability of a financial management system to bring together all the financial information needed to support planning, review and reporting of a department's financial operations is critically important in the generation of timely, accurate and complete accounting information.

The Committee's survey identified deficiencies in accounting or financial management information systems as the area of greatest concern to Victorian departments. Inadequate financial management systems was reported as a problem for 85% of departments with 55% of those departments identifying it as a major problem. Less than forty percent of departments stated in response to the Committee's survey that they were either not very confident (3 departments) or not at all confident (2 departments) that their current financial management system were able to generate timely, accurate and complete reports.

The introduction of new financial management systems and/or the upgrading of existing systems to cope with needs arising from Accrual Financial Management is critical to both achieving genuine reform and maximising the benefits from reform.

Experience in other jurisdictions, such as New South Wales and New Zealand, indicate that problems associated with financial management systems are one of the most serious and costly issues for financial management reform.

In response to the Committee's survey, all departments acknowledged that they would be upgrading their systems by 1997, with 10 of the then 13 departments planning to undertake upgrades during 1995.

Information Systems' Accounting Modules

All of the thirteen departments responded to the Committee's survey that their standardised accounting systems had modules that could accommodate General Ledger and Accounts Payable, with the next most common accounting modules being Purchasing (10 departments), Accounts Receivable and Budgeting
Departmental Implementation Challenges

(9 departments) and Fixed Assets (8 departments). The least common accounting modules were Cash Management (7 departments) and Costing (5 departments).

Chart 6.4 contains information on accounting modules within Victorian and Commonwealth accounting systems at the date of the respective survey.

Chart 6.4
Victorian departments' and Commonwealth agencies' information systems' accounting modules

![Chart showing accounting module usage percentages for Victoria and the Commonwealth.]

Source: Accrual Accounting Surveys by the Committee and the ANAO

Chart 6.4 shows reasonable consistency between the accounting modules in Victoria and the Commonwealth, with all Victorian and almost all Commonwealth respondents having General Ledger and Accounts Payable modules.
Information Systems' Upgrade

Many Victorian departments were operating a cash based information system (FM-80) at the time of the Committee's survey. These systems are not designed for the production of accrual accounting information. Responses to the Committee's survey indicated that most departments were in the process of upgrading their financial management systems with many departments choosing the ORACLE Financial Management System recommended by the former Department of Finance.

The Joint Committee of Public Accounts (JCPA) in its recent Report Accrual Accounting - A Cultural Change commented on the lack of additional funding by the Commonwealth to assist their agencies in undertaking a smooth transition to accrual financial management. The Report commented:

>To date the Government has not made any special budgetary allocation to help agencies make the transition- agencies have had to fund any upgrades needed to meet the accrual reporting requirement out of their existing appropriations for running costs.

The Commonwealth's approach is in contrast to that adopted in New South Wales and Victoria, where agencies have been able to seek supplementary budget funding to help meet the costs of new information technology systems. A number of witnesses to the inquiry suggested that similar supplementation should be made available to Commonwealth agencies to assist in the move to accrual accounting.

Such funding arrangements could be applied not just to meeting the costs of systems upgrades, but also to provide short term staffing assistance to agencies to allow relevant policy development and training activities to be conducted. This would be in the nature of seed funding to help agencies, particularly small agencies, over the hurdle of the up-front costs.

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10 The Accrual Accounting Survey revealed that departments were not confident that the current FM-80 system could produce accrual based information. Most departments have either moved to a new system such as ORACLE or are in the process of updating their current system.


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Departmental Implementation Challenges

The Secretary of the Department of Treasury and Finance has advised the Committee that the Department has made an arrangement with ORACLE to supply computer software to departments to enable the implementation of accrual accounting, and that $5 million had been allocated in the budget to meet these costs.\(^\text{12}\)

6.6 Accounting Skills within Departments

Introduction

The need for the Committee survey was in part driven by the apparent absence of any comprehensive studies of the accrual accounting skill base within Victorian departments. It is clear that an appropriately skilled workforce is a key ingredient to the successful introduction of accrual financial management.

The Committee's survey measured a narrow range of characteristics in assessing the extent of accounting skills within departments. These included:

- tertiary qualifications in accounting;

- membership of either the Institute of Chartered Accountants or the Australian Society of Certified Practising Accountants (CPA's);

- training activities; and

- difficulties in recruiting skilled staff.

The Committee's survey suggests, based on responses from departments, that problems associated with the availability and quality of accounting skills were of a minor nature only and substantially resolved (refer paragraph 6.4). This outcome is consistent with the Committee's public hearings with departments where issues associated with the ongoing training of staff was not identified as a major concern by departments. The Committee's survey did establish however that the skill base varied widely across departments.

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\(^{12}\) Minutes of Public Accounts and Estimates Committee meeting of 19 July 1995
This outcome is inconsistent with experiences in other jurisdictions (such as the Commonwealth, New South Wales and New Zealand, refer Chapter 4), advice offered to the Committee by Coopers and Lybrand and the view of the central agencies.

The former Department of Finance in a public hearing with the Committee commented that:

The major deficiency rests in the lack of skill of people in the departments to apply accrual accounting systems ... People seem to be lacking in skills and an understanding of the reports they have to produce.\textsuperscript{13}

The Committee is concerned that departments may be underestimating the severity of problems associated with skill levels and training. Consistent with the Committee’s position set out in paragraph 5.2 (Chapter 5), it is a responsibility of the Department of Treasury and Finance to monitor the development of accrual accounting skill levels within departments.

**Extent of Qualified Accountants in Departments**

Chart 6.5 indicates the percentage of specialist accounting roles filled by qualified accountants:

\textsuperscript{13} Minutes of Evidence, Department of Finance, 28 September 1994, page 3
Chart 6.5 shows that when the situation in Victorian departments is compared to Commonwealth agencies there is a substantially greater level of qualified staff in Victoria across all specialist roles, as surveyed. For example all Victorian departments responded that the position of Chief Finance Officer was filled by a qualified accountant, whilst only 57% of Commonwealth agencies stated that the position of Chief Finance Officer was filled by a qualified accountant.

Chart 6.5 requires careful interpretation. It clearly suggests that Victoria is in a superior position when compared to the Commonwealth. However the apparent strength of Victoria's position would be lessened if accounting qualifications had been obtained many years ago. Further any accrual based skills may have been diminished in a cash based environment. Lastly the incentive to acquire or

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14 that is a person who has a tertiary degree in accounting and/or a member of the Australian Society of Certified Practising Accountants or the Institute of Chartered Accountants in Australia.
update accrual accounting skills, either through further tertiary study, or undergoing programs under the auspices of the Australian Society of Certified Practising Accountants or the Institute of Chartered Accountants is also unlikely to be persuasive in an accounting environment dominated by cash accounting.

Training

The need for training has been identified as a major issue by all jurisdictions which have successfully implemented or are implementing accrual accounting and other financial management reforms.

The ANAO survey found that:

Both professional and clerical staff identified accrual accounting as the area of most pressing need for training.\(^{15}\)

The follow up audit by the ANAO indicated that the majority of Commonwealth agencies had addressed the issue of staff training with all staff attending formal training courses in accrual accounting.\(^{16}\)

The Committee’s survey found that departmental staff attended 190 courses during 1994, with more than 150 courses identified as suitable for staff to attend during 1995. The courses fall into the following categories:

- internal (77 courses in 1994; 46 courses in 1995);

- courses conducted by Coopers and Lybrand on behalf of the former Department of Finance (72 courses in 1994; 36 in 1995); and

- and other external courses (78 courses in 1994; 73 courses in 1995).

The majority of courses held during 1994 were attended by staff at the former ADM\(^{17}\) 1 - 8 levels (that is 155 or more than 86% of all courses attended). Only 19

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\(^{17}\) Administrative officer, now replaced by Victorian Public Service (VPS) levels 1 to 5.
Departmental Implementation Challenges

(or less than 14%) of the courses were attended by officers at the former SES\textsuperscript{18} level. The number of courses projected for 1995, according to the Committee's survey, is 155. Staff at the former ADM 1-8 levels are proposing to attend 137 course (more than 89% of all courses) with only 18 (or less than 12%) of courses to be attended by officers at the former SES level.

The Committee was advised by Coopers and Lybrand, consultants who conducted training courses for the former Department of Finance, that training in the concepts of accrual accounting has only been provided to a limited number of people across all levels in all departments. Whilst the concepts and benefits of accrual accounting are being understood, Coopers and Lybrand suggested that only limited opportunities to implement and further develop these skills existed within departments.\textsuperscript{19} Mr Richard Moore, Partner of Coopers and Lybrand commented:

*However, the shortcoming of this approach have been that accrual based financial information is not available for management purposes on an on-going basis, and so such information has not been used to support management decision making. Further to this, the training has been of little benefit as few of the individuals trained have had an opportunity to work with accrual based financial information on an on-going basis.*\textsuperscript{20}

The Committee concurs with these sentiments and considers it essential that staff, once they have undertaken accrual accounting courses, that they are given every opportunity to reinforce and use these skills within their department. The usefulness of investing public monies in training activities will be diminished if this does not occur.

*Recruitment of Qualified Accounting Staff*

Chart 6.6 outlines problems experienced by Victorian departments and Commonwealth agencies in filling specialist accounting positions.

\textsuperscript{18} Senior Executive Service level, now replaced by Executive Officer (EO) levels 3 to 1.
\textsuperscript{19} Letter from Mr Richard Moore, Partner Coopers and Lybrand, 19 May 1995.
\textsuperscript{20} ibid
The primary areas of concern within Victorian departments, as set out in Chart 6.6, was insufficient remuneration (38%), unavailability of appropriately qualified staff (38%) and better prospects in the private sector (30%).

Five of the then 13 departments noted that it is was difficult to attract suitably qualified staff. These departments were implementing the following strategies to overcome difficulties:

- diversifying functions within the finance area of the department;
- encouraging formal tertiary study to existing staff;
- recruitment outside of the public service;
- reviewing grading of present positions;
• use of contract accountants from time to time;

• graduate recruitment drives at tertiary institutions; and

• use of consultants to recruit staff.

An additional issue that was highlighted by some departments in response to the Committee's survey was that the restrictions placed on recruiting staff over the last few years has severely limited the ability of departments to employ qualified accountants.

The ANAO reported that the main strategies which had been put in place to redress difficulties in attracting and keeping staff as:

• a greater emphasis on skills and qualifications in recruiting staff;

• external advertising of positions;

• training of non-formally qualified staff;

• encouraging existing staff to obtain appropriated qualifications, including Studybank assistance;

• raising the profile of accounting positions; and

• restructuring jobs to provide better career paths or to enable qualified staff to focus on the most critical areas.21

Use of Consultants to Fill the Skill Gap

The use of consultants can overcome short term skill deficiencies encountered by departments. However, departments need to ensure that they don't become captive or dependent on consultants on a long term basis. Where consultants are being used to fill skill gaps within the workforce departments should ensure that an adequate skill transfer occurs as part of the consultancy. Alternatively

departments need to close any skill gaps in the longer term by recruitment, training or other means. It is important that departments assess their skill base on an ongoing basis and take the measure necessary to ensure that they have an adequate skill base (sourced internally or externally as appropriate) to meet the ongoing demands of accrual financial management.

Conclusion

The Committee acknowledges that steps are being undertaken within departments to address accounting skills issues. The Committee was advised by the Secretary of the Department of Treasury and Finance that certain actions were underway to build up the level of skills within his department and other departments, key elements are:

- instituting secondments of suitable staff from the private sector to the public sector;

- promoting the graduate program and recruitment of appropriate staff;

- establishment of a Professional Year with a University; and

- a build up of skills within the Department of Treasury and Finance through recruiting four extra staff.\(^{22}\)

**Finding 6.2**

The Committee:

(a) is concerned that departments may be underestimating the severity of problems associated with accounting skill levels and training, both are critical to the successful introduction of Accrual Financial Management;

(b) finds that the timing of accrual based training for departmental staff must link with opportunities for staff to use and develop those skills in their day to day work; and

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\(^{22}\) Minutes of Public Accounts and Estimates Committee Meeting of 19 July 1995.
(c) finds that it is a responsibility of the Department of Treasury and Finance to monitor the development of accrual accounting skill levels within departments.

6.7 Chief Finance Officer

The position of Chief Accountant for the State was identified as important by the Victorian Commission of Audit (refer recommendation 6.14 Appendix A) and was instrumental in leading and promoting the shift to accrual based accounting in New Zealand.

The existence of an equivalent position, of Chief Finance Officer, is equally important at departmental level. The Committee's survey found that all departments had a Chief Finance Officer, which contrasts with the ANAO survey where a minority (32%) of agencies had a Chief Finance Officer position. The Committee's survey defined this position as having the overall responsibility for developing and maintaining the accounting and financial management capabilities of the agency.

Furthermore, the Committee's survey revealed that the level of qualifications and membership of relevant professional organisations for occupants of Chief Finance Officer positions was substantially higher in Victorian departments than for Commonwealth agencies. The proportion of Chief Finance Officers with Accounting or other business degrees was 100% in the Committee's survey (Commonwealth: 57%), which includes a high incidence of membership of the Australian Society of CPA's or the Institute of Chartered Accountants (Victoria: 71%, Commonwealth: 6%). This outcome should put Victoria at a distinct advantage over the Commonwealth.

It is important that the position of Chief Finance Officer (or equivalent) is recognised as part of the senior management team. In the past the accounting function in some organisations was seen as merely a necessary service function and an adjunct to but not part of the senior management team.

The Committee undertook a brief review of departmental organisational charts. Whilst it was sometimes difficult to identify the Chief Finance Officer position in some cases, it did appear on occasion to be at least two levels removed from the departmental head. Nevertheless even in those instances the Chief Finance Officer may still be considered to be part of the senior management team.
The Committee considers that it is of critical importance that the status of this position within departments and the overall decision making process is elevated to a senior level. The successful implementation and monitoring of the budgetary and financial management reforms is predicated substantially on the ability of the incumbent of this position to lead and manage these reforms.

Finding 6.3

The Committee finds that financial management reform and the ongoing emphasis on financial matters generally within the Victorian public sector requires that each agencies' Chief Finance Officer must be part of the senior management team and should report directly to the Chief Executive Officer of each agency.

Committee Room
18 October 1995
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RECOMMENDATIONS FROM CHAPTERS FIVE AND SIX FROM THE REPORT OF THE VICTORIAN COMMISSION OF AUDIT

Recommendation 5.1: Forward estimates system: A rigorous and valid forward estimates system should be developed with the following features:

- a four-year horizon;
- full integration with the accounting and budget management system;
- soundly based revenue and expenditure forecasts;
- ongoing review to determine the level of resources required to deliver government services on a best-practice basis.

Recommendation 5.2: Agreed costing of budget proposals: All budgetary proposals should have an agreed costing extending over the timeframe of the forward estimates.

Recommendation 5.3: Sensitivity estimates: The budget papers should include sensitivity estimates of revenue and expenditures to defined parameter variations (such as inflation and wages, interest rates, and growth in real GSP).

Recommendation 5.4: Reconciliation of estimates: The budget papers should include a reconciliation between previously published forward estimates and the budget outcome, identifying the extent to which variances are due to:

- post-budget decisions;
- variations in parameters such as inflation and wages; and
- inability to implement policy decisions.

Recommendation 5.5: Appropriation structure: Appropriations and subsequent reporting back to Parliament should be in the same form (the GFS format) as the presentation in the budget documentation. This should be on a full financial reporting basis.

Recommendation 5.6: Consolidated Fund balance: The artificial requirement for a positive or balanced year-end result for the Consolidated Fund should be removed.
Recommendation 5.7: Classification of budget items: The definitions of current and capital items should be consistent and relate to economic substance.

Recommendation 5.8: Budget paper information: Information contained in the budget papers should be in a consistent format each year. Where the format has been changed, time series data should be presented in the new format.

Recommendation 5.9: Separation of policy and service delivery: There should be clear separation between the regulatory and policy functions, and service delivery functions of government.

Recommendation 5.10: Promotion of competition in service delivery: Competition should be promoted among public and private service providers, based on the most efficient and effective means of providing services.

Recommendation 5.11: Documentation of the budget process: The budget development process should be adequately documented. A budget manual should be prepared which sets out a timetable and guidelines for agencies to prepare estimates.

Recommendation 5.12: Timing of the budget: Departmental allocations should be approved and announced before the start of the financial year to which they apply.

Recommendation 5.13: Internal review and evaluation: A program of ongoing internal review and evaluation of the efficiency and effectiveness of government programs should be established. This should be linked to both departmental corporate plans and senior executives' published performance indicators. The reviews should consider the need for a program, as well as cost effectiveness. Reviews should be conducted by agency management as part of their regular management and internal control procedures. The central agencies should also conduct reviews for the purposes of broader government management.

Recommendation 5.14: Full financial accounting\(^1\): A system of full financial accounting should be introduced, with all the costs of service provision attributed to that service. Appropriations and financial reporting should also be in this format.

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\(^1\) Full financial accounting is also known as accrual accounting.
Recommendation 5.15: Management flexibility: Budget papers should disclose the full cost funding of a defined set of outputs. Reporting and accountability should be assessed against these budgeted outputs. A necessary prerequisite for this is the flexibility to manage the appropriate mix of inputs.

Recommendation 5.16: Net appropriations: Funding of programs should be on a net appropriations basis. Agencies should be able to retain receipts from authorised trading activities.

Recommendation 5.17: Carry-over facility: The budget should allow a capability for limited carry-over of unexpended funds to the next financial year.

Recommendation 5.18: Borrowing from future appropriations: The appropriation process should allow the possibility of limited borrowings from future years' appropriations, with subsequent Parliamentary sanction.


Recommendation 6.1: Whole-of-government reporting: The State of Victoria should produce a consolidated 'whole of government' general purpose financial report (GPFR) embracing all entities which it controls (in accordance with the existing accounting standard on consolidations). This should be accompanied by separate sub-consolations of budget and non-budget sector entities.

Recommendation 6.2: Operating and cash-flow reporting: Operating performance (on a full financial reporting basis), and cash flows should be reported on by the State and by individual agencies (in statements prepared in accordance with the existing accounting standards), for monthly management accounting purposes, and as an important measure of performance by the State against the budget.

Recommendation 6.3: Reconciliation of differing displays of performance: A reconciliation between statements in GPFR and Government Finance Statistics format reports should be included in the half-yearly and yearly GPFRs prepared by the State for the whole-of-government. The reconciliation should include a clear explanation of the difference in purpose and classification of the two sets of information.
Recommendation 6.4: Reporting of corporate planning: There should be a coherent framework of reporting which integrates and includes the State's corporate planning (at both the state-wide level and the individual agency level) and the budget.

Recommendation 6.5: Budget reporting: The budget should be prepared on a full financial accounting basis, and reporting against the budget should be on the same basis.

Recommendation 6.6: General purpose financial reporting: All departments should prepare and publish general purpose financial reports (GPFRs) which bring to account all the elements of financial reporting (assets, liabilities, revenues and expenses) and which comprise a balance sheet, operating statement, cash-flow statement, appropriate notes and a statement of responsibility. This is in addition to the whole of government GPFR referred to in recommendation 6.1.

Recommendation 6.7: Timeliness of general purpose financial reporting: GPFRs, including those prepared for the whole of government, should be published on both a yearly and half-yearly basis, and be available to the Parliament and public on a timely basis (within three months of balance date).

Recommendation 6.8: Discontinuance of the Finance Statement: When the whole-of-government consolidated financial statements are prepared by the State on a routine basis the Finance Statement should be discontinued. In the interim, the Finance Statement should report Consolidated Fund results only at an aggregate level, leaving detailed program information to be reported in agencies' annual reports.

Recommendation 6.9: Management accounting: Central agencies should be provided with monthly financial reports which relate to the budget and agency corporate plans, and which bring all elements to account.

Recommendation 6.10: Information systems: Each reporting entity should maintain integrated full financial reporting and managerial accounting systems. These should be supported by an effective central reporting mechanism.

Recommendation 6.11: Performance reporting: Each agency should develop a set of performance measures which relate to its published corporate plan.
Recommendation 6.12: Structural considerations: One agency, Treasury, should be responsible for the central managerial processes (ie. planning, budgeting, reporting and control) of the Victorian Government.

Recommendation 6.13: Parent entity: The parent entity should be managed by Treasury under contract from the Government and should prepare GPFRs, for itself and for the whole-of-government.

Recommendation 6.14: Appointment of a Chief Accountant: The Government should appoint a Chief Accountant to:

- be responsible for the preparation of the whole-of-government GPFR;
- provide guidance to individual agencies on the preparation of their GPFRs;
- be responsible for the system of internal controls for the State; and
- provide advice to agencies on their internal controls.

The position should participate in the early adoption of full financial reporting and comprehensive internal control systems.

Recommendation 6.15: Internal control: The chief executives of agencies should be charged with developing systems of internal control which:

- accord with the objectives specified in the agencies' corporate plans;
- are based on the COSO framework;
- are integral to the executives' management approach;
- involve formal assessment and analysis of the risks faced by agencies in achieving their operational objectives, in discharging financial accountability and in complying with regulations, requirements and policy;
- relate control activities and procedures to risks identified, and ensure that information concerning the effectiveness of those activities is provided to the appropriate levels of management on a timely basis; and
- include a monitoring process to ensure that internal control is kept relevant to the objectives of the agencies.

Ministers should also apply the principles of internal control to their own relationships with government agencies.
Recommendation 6.16: Statement of Responsibility: GPFRs should contain a statement of responsibility (SOR) signed by the chief executive responsible for each agency. The SOR should contain a confirmation that the statements have been presented fairly in accordance with Statements of Accounting Concepts and Accounting Standards. If this is not the case, the statement should be qualified. They should also contain a representation that the internal controls relevant to the preparation of the agency's GPFRs have been effective throughout the reporting period.

Recommendation 6.17: Review of internal control systems: The Auditor-General should review (as opposed to audit) the systems of internal control. More detailed investigations into performance would, as in the past, be at the discretion of the Auditor-General.

Recommendation 6.18: Assurance on control: Effective internal audit functions and audit committees should be required as standard features of the system of internal control.

Recommendation 6.19: Resources for internal control: Elements of internal audit should be contracted out if the required resources are not available and it is the most cost-effective option.

Recommendation 6.20: External auditor: The Auditor-General should be responsible, on behalf of the Parliament, for the financial and performance audits of all public sector entities. The Auditor-General should be accountable for resource usage to a committee of the Parliament headed by the Speaker.

Recommendation 6.21: Funding of the Auditor-General's office: The Auditor-General's office should be funded through a Special Appropriation under the control of a Parliament committee chaired by the Speaker. Auditees should be charged for financial audits, but the Parliament should fund all performance audits.
INDEPENDENT AUDIT REPORT
NEW SOUTH WALES PUBLIC SECTOR
CONSOLIDATED FINANCIAL REPORT

To the Treasurer and the Secretary of the New South Wales Treasury

Scope

I have reviewed the consolidated financial report of the New South Wales Public Sector for the year ended 30 June 1993. The Secretary of the New South Wales Treasury is responsible for the preparation and presentation of the consolidated financial report consisting of the accompanying statement of financial position, operating statement and statement of cash flows, together with the notes thereto and the information contained therein. I have conducted an independent audit of the consolidated financial report in order to express an opinion on it to the Treasurer and the Secretary of the New South Wales Treasury.

My audit has been conducted in accordance with Australian Auditing Standards to provide reasonable assurance as to whether the consolidated financial report is free of material misstatement. My procedures included examination, on a test basis, of evidence supporting amounts and other disclosures in the consolidated financial report, and the evaluation of accounting policies and significant accounting estimates. My procedures have been undertaken to form an opinion as to whether, in all material respects, the consolidated financial report is presented fairly in accordance with Australian accounting concepts and standards and the Public Finance and Audit Act 1983 so as to present a view which is consistent with my understanding of the New South Wales Public Sector's financial position, the results of its operations and its cash flows.

Australian Accounting Standard AAS24 "Consolidated Financial Reports" does not address whether consolidated financial reports ought to be prepared at the whole-of-government level. The Statement of Significant Accounting Policies for the consolidation is set out in the notes attached to the consolidated financial report. Included in these notes is a description of the reporting entities comprising the consolidation.

The audit opinion expressed in this report has been formed on the above basis.

Qualifications

1. Land under roads and within road reserves included in the financial report of the Roads and Traffic Authority has been omitted from the consolidated financial report (Note 1(g)). It is my opinion that these assists should be included in the consolidated financial report. If these
assets had been included at the values ascribed by the Authority, infrastructure asset values would be higher by $14,473m. Also, the surplus for 1992-93 would be lower by $1,994m, due to a reduction in the carrying value of this land during the year.

2. Assets and liabilities of the FANMAC Trusts that support the HomeFund program are excluded from the consolidated financial report because they are considered by the NSW Government not to be controlled entities. The face value of relevant FANMAC Trusts bonds and mortgages outstanding approximated $2.6b at 30 June 1993. In my view those Trusts’ assets and liabilities should be recognised in the consolidated financial report as part of the "Consolidated Fund" entity balances. Their recognition would not affect net assets or the operating statement. While those assets and liabilities have not been recognised, a total amount of $379m has been included in the consolidated financial report to support the cost of restructuring the HomeFund program. This amount is independent of the cost to the State which may arise from determinations made by the HomeFund Commissioner (see Note 17).

3. The "Consolidated Fund" entity (Note 1(b)), a materially significant Budget sector entity, had not been legally created as at 30 June 1993 nor had a general purpose financial report for this entity been prepared on an accrual basis for the year then ended. The audited Public Accounts for 1992-93 reported "Consolidated Fund" transactions primarily on a cash basis together with some asset and Liability balances. Various adjustments and estimates were made to arrive at accrual data for inclusion in the consolidated financial report. Uncertainty exists as to the completeness and accuracy of this data.

4. Note 1(f) to the consolidated financial report describes methods used to determine depreciation charges for the Department of School Education’s school buildings and the new South Wales Land and Housing Corporation's residential and commercial properties. In regard to school buildings, because both the carrying value and depreciation charges have not taken into consideration condition assessment, maintenance and refurbishment regimes, or estimated useful lives, it is not possible to assess the appropriateness of depreciation charges and the carrying value of school buildings. For the New South Wales Land and Housing Corporation properties, because of the assumptions used, there is some uncertainty as to the accuracy of the depreciation charges and hence the carrying values of properties. The carrying value of these assets included in the consolidated financial report is material at $12,329m and uncertainty therefore exists as to depreciation charges and the carrying value of non-current assets.

5. Some infrastructure assets controlled by the Department of Water Resources, Irrigation Areas and Districts, have not been included in the consolidated financial report (Note 7). The omitted assets comprise land under and adjacent to infrastructure assets including dams, channels and
water distributory works. Due to the absence of appropriate information I am not in a position to assess the effect of these omissions on the consolidated financial report.

6. As disclosed in note 8 to the financial statements, the Forestry Commission is yet to value part of its forests and plantations on an appropriate basis. The valuation could have a significant impact on the overall carrying value of growing stock, the extent of which cannot be presently determined.

7. The consolidated financial report for the year ended 30 June 1992 has not been audited. Accordingly, I am not in a position to and do not express an opinion on the comparatives for 1992.

Qualified Audit Opinion

In my opinion, except for the effects of the matters referred to in the qualification paragraphs one and two and subject to the effects of such adjustments as might have been required had the outcome of the uncertainties referred to in the qualification paragraphs three to seven been known, the financial report presents fairly the financial position of the New South Wales Public Sector as at 30 June 1993 and the results of its operations and its cash flows for the year then ended in accordance with Statements of Accounting Concepts and applicable Accounting Standards and the Public Finance and Audit Act 1983.

A.C. HARRIS
AUDITOR-GENERAL

23 December 1993
Audit Scope

The accompanying financial statements of the Department of Finance for the year ended 30 June 1994, comprising operating statements, statement of financial position, statement of cash flows and notes to the financial statements have been audited. The Acting Secretary of the Department of Finance is responsible for the preparation and presentation of the financial statements and the information they contain. An independent audit of the financial statements has been carried out in order to express an opinion on them as required by the Annual Reporting Act 1983.

The audit has been conducted in accordance with Australian Auditing Standards to provide reasonable assurance as to whether the financial statements are free of material misstatement. The audit procedures included an examination, on a test basis, of evidence supporting the amounts and other disclosures in the financial statements, and the evaluation of accounting policies and significant accounting estimates. These procedures have been undertaken to form an opinion as to whether, in all material respects, the financial statements are presented fairly in accordance with Australian Accounting Standards and comply with the requirements of the Annual Reporting Act 1983, so as to present a view which is consistent with my understanding of the financial position of the Department of Finance and the results of its operations and its cash flows.

The audit opinion expressed on the financial statements has been formed on the above basis.

Audit Opinion

In my opinion the financial statements present fairly the financial position of the Department of Finance as at 30 June 1994 and the results of its operations and its cash flows for the year ended 30 June 1994 in accordance with Australian Accounting Standards and comply with the requirements of the Annual Reporting Act 1983.

C.A. BARAGWANATH
Auditor-General
Section 44  Accounts to be kept

The accountable officer of a department or public body must ensure that there are proper accounts and records of the transactions and affairs of the department or public body and such other records as sufficiently explain the financial operations and financial position of the department or public body.

Section 45  Reports and financial statements of departments

(1) As soon as possible after the end of each financial year, the relevant Minister of a department must cause to be prepared in accordance with this Part a report of the operations of the department during the financial year.

(2) As soon as practicable after the end of each financial year, each accountable officer for a department must cause to be prepared in accordance with this Part financial statements for the financial year for the department.

(6) The relevant Minister must cause the report and audited financial statements referred to in this in this section to be laid before each House of Parliament before the expiration of the 7th sitting day of that House after 31 October in each year or within such further period as the Minister administering this section upon request in writing form the relevant Minister may determine.
Section 46. Annual Report of a Public Body

(1) A public body must, within 3 months after the end of each financial year of the body, cause to be prepared in respect of the financial year in accordance with sections 48 and 49 and submitted to the relevant Minister an annual report containing-

(a) a report of its operations during the financial year; and

(b) financial statements for the financial year

(2) Subject to sub-section (3), the relevant Minister must cause the annual report to be laid before the Legislative Council and the Legislative Assembly, before the expiration of the 7th sitting day of the Legislative Council or the Legislative Assembly, as the case may be, after it is received by the Minister.

(3) If in relation to a public body it appears to the relevant Minister from the financial statements submitted under this section that the cash payments from all sources made by the public body in a financial year do not exceed $1 000 000, the Minister -

(a) must report to the House of the Parliament the receipt by him or her of the annual report of the public body; and

(b) where a member of either House of the Parliament so requests, cause the annual report of the public body to be laid before each House of the Parliament within 14 sitting days of the House after that request.

(4) If a public body fails to submit to the relevant Minister an annual report as required by this Act, the relevant Minister shall cause that failure and the reasons for it to be reported to each House of the Parliament.
Section 49  Financial Statements

The financial statements referred to in this Part-

(a) must contain such information as is required by the Minister; and

(b) must be prepared in a manner and form approved by the Minister; and

(c) must present fairly the financial transactions of the department or public body during the financial year to which they relate; and

(d) must present fairly the financial position of the department or public body in the manner approved by the Minister; and

(e) must be certified by the accountable officer for the department or public body in the manner approved by the Minister.
FORMAL MEETINGS HELD IN NEW ZEALAND

Monday 13 February 1995

New Zealand Society of Accountants
Ms April McKenzie (Technical Director)

New Zealand Treasury
Mr Richard Morris (Middle Manager Financial Management)
Mr Ken Warren

Tuesday 14 February 1995

New Zealand Finance & Expenditure Committee
Mr Max Bradford (Chairman)
Hon Dr Michael Cullen
Hon Peter Dunne
Mr John Robertson
Mr Tony Ryall
Hon Bob Storey
Hon Jim Sutton

Wellington University
Mr Ian Ball (former Senior New Zealand Treasury Officer, now Senior Adviser to Treasury and Consultant)

Wednesday 15 February 1995

New Zealand Department of Education
Mr Tom Roach (Chief Accountant)
Mr John Gill (Project Manager)

New Zealand Department of Cultural Affairs
Mr Christopher Blake (CEO)
Ms Jane Kominik (Deputy CEO)
Mr Matthew Archer (Finance and Admin Manager)
Mr Martin Durrant (Acting Policy Manager)

Thursday 16 February 1995

New Zealand Audit Office
Mr Martin Matthews, Assistant Auditor-General
(Parliamentary & External Affairs)
Ms Lyn Provost, Assistant Auditor-General
NEW ZEALAND DOCUMENTATION

New Zealand Society of Accountants

- NZ Accounting Standards, January 1995
- Section 3 of the NZ Society of Accountants Members' Handbook 'Public Sector Accounting'

New Zealand Treasury

- Annual Report of the New Zealand Treasury 30 June 1994
- List of Publications/Papers on Financial Management Reform
- Financial Statements of the Govemment of NZ for the five months ended 30 November 1994, 27/1/95
- Treasury overheads on the budget cycle, reporting cycle, appropriations & supply, select committees, key GAAP statements, Statements of financial performance, position and cash flows, statement of contingent liabilities, December Economic and Fiscal Update, Budget Policy Statement, Interpreting the New Indicators
- Article by Mr Ian Ball, Reinventing Government: Lessons Learned from the NZ Treasury, Fall 1994
- Paper, Output Specification by Mr Brian McCulloch
- Speech to the Australian Standing Treasuries Liaison Committee - The New Zealand Experience with Accrual Reporting by Mr Richard Morris 2/11/94
- Speech by Mr Ian Ball, Implementing Accrual Accounting in the Public Sector - The NZ Experience 12-14/10/94
- Pre-Budget Media Briefing on Advantages of Accrual Accounting
- Paper on Making Ministries More Accountable: The New Zealand Experience by Mr Ian Ball, 10/93
- Article by Ms Ruth Richardson, Opening and Balancing the Books - The NZ Experience
- Article on the Fiscal Responsibility Act 7/9/94

New Zealand Audit Office

New Zealand Finance & Expenditure Committee

- Report of the Standing Orders Committee on A New Financial Procedure for the House of Representatives
- List of Members 10/94
- Parliamentary Bulletin 13/12/94
- Letter to Finance and Expenditure Committee from the Audit Office re: Review of the performance of the Treasury for the Year ended 30 June 1994
- Response of Treasury to the Finance and Expenditure Committee's Financial Review Questionnaire 1993-94
- Supplementary Estimates of Annual Appropriations and Departmental Budgets of the Government of NZ for year ended 30 June 1994
- Budget 1994, 30 June 1994
- Economic & Fiscal Outlook 1994, 30 June 1994
- Departmental Budgets 30 June 1995
- Estimates of Appropriations 30 June 1995
- Economic & Fiscal Update 1994 20 December 1994
- Reserve Bank Monetary Policy Statement December 1994
- Reserve Bank Economic Forecasts 8/9/94

New Zealand Department of Education

- Mr Tick the Teacher, Allan Ahlberg
- Self-Management - Winds of Change, Accountant's Journal
- Accountability, Accounting and Financial Performance in Tertiary Institutions, Mr John Gill
- Financial Statements Update, Mr John Gill
- Perspectives on Performance Measurement and Public Sector Accounting, Prof. Dr. Ernst Buschor

New Zealand Department of Cultural Affairs

- Corporate Plan 1994-95 of the Ministry of Cultural Affairs
- Gateways and stories
- Statement of intent for financial year ending 30 June 1997, Museum of NZ
- Vote Cultural Affairs 1994-95

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Public Accounts and Estimates Committee

Implementation of Accrual Accounting

Agency Questionnaire
HOW TO COMPLETE THIS QUESTIONNAIRE

This questionnaire contains three sections, each of which is to be completed on behalf of your department. Section 1 seeks information on the background and skills of your finance staff. Section 2 considers your department's experience in implementing accrual accounting. Section 3 aims to provide a profile of your department's financial information systems.
**Section 1: Finance Staff Census**

1. What is the total number of staff in your finance area at present?

<table>
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<th>Description</th>
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<tbody>
<tr>
<td>Total Number of Staff</td>
<td>545</td>
</tr>
<tr>
<td>Total number with Tertiary Degree</td>
<td>171</td>
</tr>
<tr>
<td>Total number with Other Qualifications</td>
<td>15</td>
</tr>
<tr>
<td>Total number with No Post-Secondary Qualifications</td>
<td>357</td>
</tr>
<tr>
<td>Total number with Membership to ASCPA/ICA</td>
<td>95</td>
</tr>
<tr>
<td>Total number with prior experience in an accrual accounting environment</td>
<td>119</td>
</tr>
</tbody>
</table>
2. Please complete the following details for your specialist finance staff

<table>
<thead>
<tr>
<th>Specialist Roles (refer to attachment A)</th>
<th>Total Number of positions</th>
<th>Accounting Degree</th>
<th>Other Business Degree</th>
<th>Qualified (see below)</th>
<th>Not formally qualified</th>
<th>Position not filled</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chief finance officer</td>
<td>14</td>
<td>11</td>
<td>3</td>
<td>10</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Financial accountant</td>
<td>54</td>
<td>33</td>
<td>3</td>
<td>37</td>
<td>10</td>
<td>3</td>
</tr>
<tr>
<td>Management accountant</td>
<td>49</td>
<td>17</td>
<td>7</td>
<td>22</td>
<td>16</td>
<td>2</td>
</tr>
<tr>
<td>Cost accountant</td>
<td>6</td>
<td>2</td>
<td>1</td>
<td>2</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Accounting policy and procedures adviser</td>
<td>23</td>
<td>11</td>
<td>0</td>
<td>12</td>
<td>8</td>
<td>1</td>
</tr>
<tr>
<td>Accounting and financial management information systems specialist</td>
<td>22</td>
<td>8</td>
<td>6</td>
<td>10</td>
<td>7</td>
<td>0</td>
</tr>
<tr>
<td>Graduate Accountant</td>
<td>16</td>
<td>16</td>
<td>0</td>
<td>14</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Other (please specify)</td>
<td>10</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>3</td>
<td>0</td>
</tr>
</tbody>
</table>

Qualified Accountant = a person who has a tertiary degree in accounting and/or a member of the Australian Society of Certified Practising Accountants or the Institute of Chartered Accountants in Australia.
3. Please indicate which of the following specialist accounting positions your department has considered desirable to fill with formally qualified staff.

<table>
<thead>
<tr>
<th>Specialist Roles</th>
<th>Department has position</th>
<th>Qualifications Desirable</th>
<th>Hard to fill with qualified staff</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>YES</td>
<td>NO</td>
<td>YES</td>
</tr>
<tr>
<td>Chief finance officer</td>
<td>13</td>
<td>0</td>
<td>13</td>
</tr>
<tr>
<td>Financial accountant</td>
<td>12</td>
<td>0</td>
<td>11</td>
</tr>
<tr>
<td>Management accountant</td>
<td>11</td>
<td>0</td>
<td>10</td>
</tr>
<tr>
<td>Cost accountant</td>
<td>4</td>
<td>5</td>
<td>4</td>
</tr>
<tr>
<td>Accounting policy and procedures adviser</td>
<td>9</td>
<td>1</td>
<td>8</td>
</tr>
<tr>
<td>Accounting and financial management information systems specialist</td>
<td>9</td>
<td>2</td>
<td>7</td>
</tr>
<tr>
<td>Graduate Accountant</td>
<td>4</td>
<td>5</td>
<td>4</td>
</tr>
<tr>
<td>Other (please specify)</td>
<td>3</td>
<td>2</td>
<td>3</td>
</tr>
</tbody>
</table>
4. Please indicate reasons if your department has had difficulty in engaging suitably qualified accounting staff. (If your agency didn't experience any difficulties go to Question 6)

<table>
<thead>
<tr>
<th>Reason</th>
<th>Tick all that apply</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insufficient remuneration</td>
<td>5 (38%)</td>
</tr>
<tr>
<td>Lack of career structure in finance/accounting area within the public sector</td>
<td>1 (7%)</td>
</tr>
<tr>
<td>Better career and promotion prospects for accountants in other areas of the public sector</td>
<td>3 (23%)</td>
</tr>
<tr>
<td>Better career and promotion prospects for accountants in the private sector</td>
<td>4 (30%)</td>
</tr>
<tr>
<td>Unavailability of appropriately qualified and skilled staff</td>
<td>5 (38%)</td>
</tr>
<tr>
<td>Perceived limited nature of accounting work in the public sector</td>
<td>3 (23%)</td>
</tr>
<tr>
<td>Other (please specify)</td>
<td>4 (30%)</td>
</tr>
</tbody>
</table>

**NOTE:** The figures add up to more than 13 departments or 100%, as the departments could tick more than one reason listed.
5. What strategies has your agency put into place to overcome these difficulties?

6. What staff training has been undertaken in the last twelve months to assist staff with the implementation of accrual accounting?

<table>
<thead>
<tr>
<th>Level of Staff attending</th>
<th>Number of accrual accounting related courses attended by staff:</th>
<th>Number of IT related courses attended by staff:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Conducted by Internal</td>
<td>DOF</td>
</tr>
<tr>
<td>SES and above</td>
<td>3</td>
<td>10</td>
</tr>
<tr>
<td>ADM 6-8</td>
<td>9</td>
<td>41</td>
</tr>
<tr>
<td>ADM 1-5</td>
<td>22</td>
<td>21</td>
</tr>
</tbody>
</table>
7. What staff training do you plan to conduct in the next twelve months?

<table>
<thead>
<tr>
<th>Level of Staff attending</th>
<th>Number of accrual accounting related courses attended by staff:</th>
<th>Number of IT related courses attended by staff:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Conducted by</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Internal</td>
<td>DOF</td>
</tr>
<tr>
<td>SES and above</td>
<td>5</td>
<td>4</td>
</tr>
<tr>
<td>ADM 6-8</td>
<td>23</td>
<td>23</td>
</tr>
<tr>
<td>ADM 1-5</td>
<td>18</td>
<td>9</td>
</tr>
</tbody>
</table>
Section 2: General Implementation

8. Please indicate at what stage your department is at with respect to the implementation of accrual accounting and when you expect to achieve Stage 3?

<table>
<thead>
<tr>
<th>Stage (as prescribed by the Department of Finance)</th>
<th>Past Year 93-95</th>
<th>Current Year 94-95</th>
<th>Next Year 95-96</th>
</tr>
</thead>
<tbody>
<tr>
<td>ONE: statement of financial position</td>
<td>6</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>TWO: statement of financial position, operating statement, cash flow statement (all unaudited)</td>
<td>7</td>
<td>4</td>
<td>0</td>
</tr>
<tr>
<td>THREE statement of financial position, operating statement, cash flow statement (all auditable)</td>
<td>2</td>
<td>9</td>
<td>9</td>
</tr>
</tbody>
</table>
9. Please indicate whether your department has experienced any of the following problems in preparing its financial statements and the severity of any problems that exist. Could you also indicate if the problems have been resolved.

<table>
<thead>
<tr>
<th>Problems</th>
<th>Problem</th>
<th>Severity of Problem</th>
<th>Resolved</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>YES</td>
<td>NO</td>
<td></td>
</tr>
<tr>
<td>recognising assets</td>
<td>6 (47%)</td>
<td>7 (53%)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>assigning values to assets</td>
<td>8 (62%)</td>
<td>5 (38%)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>inadequate records to substantiate accounting</td>
<td>6 (47%)</td>
<td>7 (53%)</td>
<td></td>
</tr>
<tr>
<td>information</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>data integrity (not complete, inconsistent)</td>
<td>7 (54%)</td>
<td>8 (46%)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>staff unfamiliar with requirements for financial</td>
<td>8 (62%)</td>
<td>5 (39%)</td>
<td></td>
</tr>
<tr>
<td>statement preparation</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>obtaining accrual information from cash based financial systems</td>
<td>10 (77%)</td>
<td>3 (23%)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>inadequate accounting procedures</td>
<td>5 (39%)</td>
<td>8 (61%)</td>
<td></td>
</tr>
</tbody>
</table>

192
<table>
<thead>
<tr>
<th>PROBLEMS</th>
<th>Problem</th>
<th>Severity of Problem</th>
<th>Resolved</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>YES</td>
<td>MINOR</td>
<td>MAJOR</td>
</tr>
<tr>
<td>lack of definition or definitions not generally understood, e.g. distinguishing between capital and maintenance expenditure</td>
<td>5 (39%) 6 (61%)</td>
<td>5 (100%)</td>
<td>0 (0%)</td>
</tr>
<tr>
<td>gathering and consolidating information due to its dispersed nature</td>
<td>7 (54%) 6 (46%)</td>
<td>7 (100%)</td>
<td>0 (0%)</td>
</tr>
<tr>
<td>timing constraints</td>
<td>5 (38%) 8 (62%)</td>
<td>5 (100%)</td>
<td>0 (0%)</td>
</tr>
<tr>
<td>usefulness of accrual Information not understood</td>
<td>3 (23%) 10 (77%)</td>
<td>3 (100%)</td>
<td>0 (0%)</td>
</tr>
<tr>
<td>deficiencies in accounting or financial management systems</td>
<td>11 (85%) 2 (15%)</td>
<td>5 (45%)</td>
<td>6 (55%)</td>
</tr>
<tr>
<td>lack of clear policies from central agencies</td>
<td>6 (46%) 7 (54%)</td>
<td>5 (83%)</td>
<td>1 (17%)</td>
</tr>
<tr>
<td>other (please specify)</td>
<td>0 (0%) 0 (0%)</td>
<td>0 (0%)</td>
<td>0 (0%)</td>
</tr>
</tbody>
</table>
10. What level of assistance, over and above guidance contained in policy documents, has your department sought from the Department of Finance to enable it to meet its financial statement responsibility?

<table>
<thead>
<tr>
<th>Level of Assistance</th>
<th>Please tick one</th>
</tr>
</thead>
<tbody>
<tr>
<td>A great deal of assistance</td>
<td>1 (7%)</td>
</tr>
<tr>
<td>Some assistance</td>
<td>12 (93%)</td>
</tr>
<tr>
<td>No assistance</td>
<td>0 (0%)</td>
</tr>
</tbody>
</table>

go to Question 13

11. Please indicate in which areas assistance was sought:

________________________________________________________________________
________________________________________________________________________
________________________________________________________________________
________________________________________________________________________
________________________________________________________________________
12. How would your department rate the assistance provided by the Department of Finance?

<table>
<thead>
<tr>
<th>Quality of Assistance</th>
<th>Please tick one</th>
</tr>
</thead>
<tbody>
<tr>
<td>Of great value</td>
<td>6 (48%)</td>
</tr>
<tr>
<td>Of moderate value</td>
<td>7 (54%)</td>
</tr>
<tr>
<td>Of little value</td>
<td>0 (0%)</td>
</tr>
</tbody>
</table>

13. Does your department consider that there are areas for the Department of Finance to provide greater support to departments in the preparation of their financial statements?

<table>
<thead>
<tr>
<th></th>
<th>Please tick one</th>
</tr>
</thead>
<tbody>
<tr>
<td>NO</td>
<td>4 (30%)</td>
</tr>
<tr>
<td>YES</td>
<td>9 (70%)</td>
</tr>
</tbody>
</table>
If YES please list areas for which guidance is necessary:

14. Has your department prepared its own internal guidelines for the preparation of its financial statements?

<table>
<thead>
<tr>
<th></th>
<th>please</th>
</tr>
</thead>
<tbody>
<tr>
<td>NO</td>
<td>9 (70%)</td>
</tr>
<tr>
<td>YES</td>
<td>4 (30%)</td>
</tr>
</tbody>
</table>

If YES please list titles of internal guidance or policy documents:

........................................................................................................................................................................
........................................................................................................................................................................
........................................................................................................................................................................
........................................................................................................................................................................
........................................................................................................................................................................
Section 3: Financial Information Systems

Accounting systems record, classify, summarise, process, store, retrieve and communicate information based mainly on financial data resulting from transactions with parties external to the department.

Financial management information systems encompass accounting systems and bring together all financial information needed to support the planning, conduct, control, review and reporting of a department's financial operations.

15. In which calendar year did your department last upgrade its accounting and financial management information system?

<table>
<thead>
<tr>
<th></th>
<th>please enter year</th>
<th>upgrade planned for</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounting systems upgraded in</td>
<td>19</td>
<td>19</td>
</tr>
<tr>
<td>Financial management information systems upgraded in</td>
<td>19</td>
<td>19</td>
</tr>
</tbody>
</table>
16. Please indicate whether your department has the following accounting modules as part of its standardised accounting system:

<table>
<thead>
<tr>
<th>Module</th>
<th>Please tick all that apply</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Ledger</td>
<td>13 (100%)</td>
</tr>
<tr>
<td>Purchasing</td>
<td>10 (77%)</td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>13 (100%)</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>9 (69%)</td>
</tr>
<tr>
<td>Fixed Assets</td>
<td>8 (61%)</td>
</tr>
<tr>
<td>Budgeting</td>
<td>9 (69%)</td>
</tr>
<tr>
<td>Costing</td>
<td>5 (38%)</td>
</tr>
<tr>
<td>Cash Management</td>
<td>7 (54%)</td>
</tr>
<tr>
<td>Other (please specify)</td>
<td>7 (54%)</td>
</tr>
</tbody>
</table>

**NOTE:** The figures add up to more than 13 departments or 100%, as the departments could tick more than one reason listed.
19. How confident are you about the ability of your department's current financial management information systems to produce timely, accurate and complete accounting information for reporting purposes?

<table>
<thead>
<tr>
<th>Level of Confidence</th>
<th>please tick one</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very Confident</td>
<td>4 (30%)</td>
</tr>
<tr>
<td>Quite Confident</td>
<td>4 (30%)</td>
</tr>
<tr>
<td>Not Very Confident</td>
<td>3 (23%)</td>
</tr>
<tr>
<td>Not at all Confident</td>
<td>2 (15%)</td>
</tr>
</tbody>
</table>

20. What are the main reasons for your lack of confidence in the current financial management systems?

---------------------------------------------------------------------------------------------------------------------
---------------------------------------------------------------------------------------------------------------------
---------------------------------------------------------------------------------------------------------------------
---------------------------------------------------------------------------------------------------------------------
---------------------------------------------------------------------------------------------------------------------
---------------------------------------------------------------------------------------------------------------------
The Hon. G. Graeme Weideman, MP
Chairman
Public Accounts and Estimates Committee
Level 19
80 Collins Street
MELBOURNE VIC 3000

Dear Mr. Weideman,

Attached are the Department of Treasury and Finance’s responses to the Seventh and Ninth Reports of your Committee.

You will be aware that an initial response was provided to the Seventh Report in March this year. The supplementary response now provided reflects current developments and specifically addresses each of the Committee’s recommendations.

Yours sincerely,

M J Vertigan
Secretary

Treas Ref: F93/1310/1K and F95/0230/1
# Supplementary Response to the Interim Report on the State's Budget and Financial Management Framework

**By the Public Accounts and Estimates Committee**

*(Seventh Report to the Parliament, May 1994)*

Pursuant to Section 40(2) of the *Parliamentary Committees Act 1968*, this paper provides the supplementary response of the Department of Treasury and Finance to those recommendations contained in the Public Accounts and Estimates Committee's Seventh Report.

**Guide for Readers:**

Following is an explanation of the format of this paper.

|---|------------------|-------------------------|-------------------------|--------------------------|------------------|

**Column 1:** contains the Committee’s recommendations as published in its Seventh Report.

**Column 2:** indicates the status of each recommendation as at October 1995.

**Column 3:** indicates those actions relevant to the implementation of the recommendation that have been taken to date.

**Column 4:** indicates the additional actions planned that are relevant to implementation of the recommendation, together with a timetable for the actions where possible, and/or an explanation of the Government's position concerning the recommendation.

**Column 5:** indicates the Division or Branch of the Department of Treasury and Finance and/or other departments with primary responsibility for further action.

- **AFRD** Accounting and Financial Reporting Division, Department of Treasury and Finance.
- **BMB** Budget Management Branch, Department of Treasury and Finance.
- **BSB** Business Systems Branch, Department of Treasury and Finance.
- **Departments** Departments generally, meaning the 11 Departments and Parliament.
- **DPC** Department of Premier and Cabinet.
- **EPFSB** Economic Policy and Financial Strategy Branch, Department of Treasury and Finance.
- **MIB** Management Improvement Branch, Department of Treasury and Finance.
<table>
<thead>
<tr>
<th>PAEC Recommendation</th>
<th>Accept/Reject</th>
<th>Action Taken to Date</th>
<th>Further Action Planned</th>
<th>Responsibility</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recommendation 1</td>
<td>Accept</td>
<td>A table was published in the <em>Autumn Economic Statement 1995</em> which provides an indication of the sensitivity of various components of revenue and outlays to changes in economic conditions (Table 4.7, page 4-18).</td>
<td>There is to be further development of sensitivity estimates for budget modelling and analysis and to improve the quality of published Budget Information.</td>
<td>EPFSB, BMB.</td>
</tr>
</tbody>
</table>
**PAEC Recommendation**

<table>
<thead>
<tr>
<th>Recommendation 2</th>
<th>Accept/Reject</th>
<th>Action Taken to Date</th>
<th>Further Action Planned</th>
<th>Responsibility</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Accept in part</td>
<td>The Department of Treasury and Finance has previously indicated its acceptance in principle of accrual-based budgets, but accrual reporting arrangements were not sufficiently developed to allow their introduction for 1995-96. The preparation of accrual-based budget estimates depends upon adequate development of accrual reporting arrangements. A timetable has been established which requires one half of all departments to produce audited, accrual-based financial reports for the 1994-95 financial year, with the remaining departments to produce audited reports for 1995-96. At the national level, the Australian Bureau of Statistics has released a draft of a revised Government Finance Statistics (GFS) classification table which would facilitate GFS reporting on an accrual basis. The agreement on Uniform Budget Presentation will be reviewed as part of the process for adopting the new classifications for GFS reporting in Australia. The limitations of cash-based reporting and the need to produce accrual-based data are recognised.</td>
<td>Further consideration is being given to the preparation of the Budget on an accrual basis. This issue will impact primarily upon the depreciation and provisioning aspects of the State balance sheet. Monthly accrual-based management reporting arrangements are being developed by the central agencies which will require departments to produce monthly balance sheets, operating and cash flow statements and output information from July 1996. All departments are required to produce audited, accrual-based financial reports for the 1995-96 financial year. By late 1996, it is expected that budget management functionality of the new Financial Management System will be completed, providing the information necessary for the preparation of accrual budget estimates for 1997-98. The Committee should also note the planned introduction of an output-based budget system in 1996-97.</td>
<td>AFRD, BMB, MIB.</td>
</tr>
</tbody>
</table>

*Supplementary Response to PAEC Interim Report on the State's Budget and Financial Management Framework*
<table>
<thead>
<tr>
<th>PAEC Recommendation</th>
<th>Accept/Reject</th>
<th>Action Taken to Date</th>
<th>Further Action Planned</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recommendation 3</td>
<td>Accept</td>
<td>The early provision of planning allocations to departments commenced with the 1993-94</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Budget. This continued with the Treasurer's <em>Autumn Economic Statement</em> 1994 when</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>interim Appropriation Bills were introduced to enable new capital works to commence on 1</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>July 1994 instead of being delayed until after passage of the September Budget.</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Departmental capital expenditure behaviour now reflects the new appropriation process.</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>The <em>Autumn Economic Statement</em> (AES), in April, is now the vehicle for policy release,</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>with the September Budget papers supporting the expenditure details. In the AES of 1995,</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>fiscal targets to 1998-99 were outlined.</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Now that the AES is a regular annual event, the emphasis in the September Budget papers</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>has changed to one of disclosure of the prior year results and detailed agency information</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>for the forthcoming year. The content, nature and timing of the AES and Budget papers is</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>regularly reviewed.</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>BMB.</td>
<td></td>
</tr>
<tr>
<td>Recommendation 4</td>
<td>Accept in part</td>
<td>In order to achieve Whole of Government reporting, it is essential that accrual reporting</td>
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<td>of the financial transactions of departments be put in place.</td>
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<td>The Accounting and Financial Reporting Division has developed the tools necessary for</td>
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<td>annual Whole of Government financial reporting on an accrual basis.</td>
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<td>(Refer also to response to recommendation 2)</td>
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<td>AFRD.</td>
<td>Subject to the preparation of accrual-based financial statements by all departments and the determination of the scope of Whole of Government, a Whole of Government report will be prepared for the 1995-96 financial year on a trial basis.</td>
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<td>The resolution of all technical issues relating to the Australian Accounting Research Foundation's Exposure Draft ED62 (<em>Financial Reporting by Governments</em>) will enable the consolidated financial reports of Government to be published.</td>
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<td>Action Taken to Date</td>
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<td><strong>Recommendation 5</strong></td>
<td>Accep</td>
<td>A major factor impacting upon the achievement of both this recommendation and recommendation 7 relating to General Purpose Financial Reports, is the establishment by departments of financial management systems that will allow for the production of monthly accrual-based financial reports. At present, accrual-based financial statements are prepared by the processing of year-end adjustments for accrual-based transactions. The Accounting and Financial Reporting Division is monitoring progress with the implementation of the necessary information systems.</td>
<td>It is intended that monthly management reports, including profit and loss and financial statement balances, will be produced monthly from the Government’s central ledger. This requires implementation of the necessary financial systems at both the departmental and central government levels and the expansion of information held on the central ledger to include all public bodies. During 1995-96, the frequency of reporting of management information will be progressively increased to 6-monthly, quarterly, and finally monthly. This information will be held on the central ledger. (Refer also to response to recommendation 2).</td>
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<td><strong>Recommendation 6</strong></td>
<td>Accep</td>
<td>Output measures were defined and published for the first time in the 1993-94 Budget papers (BP4). Improved measures were included in the 1994-95 and 1995-96 Budget papers (BP3). An Outputs Specification and Performance Measurement Project commenced in June 1995. Consultants were engaged to assist with this project. Their primary tasks have been the development of an output specification methodology and the preparation of a guidance manual to be used to improve the quality of output specification in departmental business plans and in budget documentation. The project is nearing completion.</td>
<td>A Guide to Output Specification and Performance Measurement is planned for release later in 1995. The Guide is expected to lead to significant improvement in the processes and principles for specifying outputs. There is also to be further enhancement of the reporting requirements defined by Section 40 of the Financial Management Act 1994. An output-based budget system is proposed for the 1996-97 financial year.</td>
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### Recommendation 7
It is recommended that the Government make a commitment to the preparation of summary half yearly General Purpose Financial Reports, to be introduced in the same year as whole of government financial statements.

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<tr>
<td><strong>Recommendation 7</strong></td>
<td>Accept</td>
<td>A program to introduce accrual-based financial systems commenced in 1991-92. All departments and related agencies are on a 3-year program to produce reports disclosing assets, liabilities and expenses and comprising a balance sheet and operating and cash flow statements. These are to be published in departmental annual reports. (Refer also to response to recommendation 5).</td>
<td>Progress is dependent upon the introduction of accrual management accounting and on other developments in reporting. These initiatives are being implemented via departmental workplans.</td>
<td>AFRD, MIB.</td>
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### Recommendation 8
It is recommended that once whole of government reporting and accrual based budgets are introduced, the Government consider the further need for the Finance Statement within the context of overall information requirements for Parliament. In this context the issue of consistency between the format of budget information and subsequent reporting should also be addressed as noted in Finding 4. (Finding 4 states, inter alia: “Reporting back to Parliament via the Niemeyer Statement is in the Government Finance Statistics format whilst the Finance Statement is based on Consolidated Fund information. Thus, the issue of inconsistency between the format of budget information and subsequent reporting is still to be formally addressed.”)

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<td><strong>Recommendation 8</strong></td>
<td>Accept</td>
<td>Pursuant to legislative change effective 1 July 1994, the Finance Statement is to be replaced by an annual Statement of Financial Operations. The Budget is presented on a Government Finance Statistics (GFS) basis and the Niemeyer Statement reports information consistent with this format. Appropriations by Parliament are on a cash basis and the Statement of Financial Operations reports information on payments consistent with appropriation authority.</td>
<td>The Statement of Financial Operations will be broadened to encompass Whole of Government reporting when the appropriate financial information is available. Under Whole of Government reporting, information consistent with GFS will be presented in the Statement of Cash Flows. We are keen to pursue consistency in reporting. However, given the differing needs of Parliament and other bodies, various formal reporting modes will continue.</td>
<td>AFRD.</td>
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| **Recommendation 9** | **Accept**     | The Government has an Information Technology and Telecommunications (IT & T) strategy that aims to preserve agency devolution and accountability, while at the same time maximising the gains in service delivery and cost reduction that can come from basic standards of inter-operability and from cross-agency technology initiatives. Actions taken to date include:  
- a totally revised IT&T Policy Manual with strong focus on the integration of IT planning into business planning to complement the existing standards-based orientation;  
- an inter-departmental committee of senior officers which has initiated several of the cross-agency initiatives listed below;  
- formation of the Office of Communications and Multimedia within DPC;  
- development of the Victorian Government Electronic Messaging System (VGEMS) to provide an electronic messaging facility across the Victorian Public Service (VPS);  
- development, with VGEMS, of a whole of government electronic directory;  
- a whole-of-government Wide Area Network study;  
- commencement of a VPS-wide Electronic Service Delivery project. | All departments are expected to carry out initiatives consistent with the communications and multimedia strategy laid out in **Victoria 21** for transforming the delivery of services and information. 

The annual departmental review process has a focus on the use of IT&T technologies to meet departmental aims, and on the extent to which the forward planning process has sought to incorporate benefits from the use of the technologies.  

**FMS Project** Further action involves completion of the General Ledger project of central agencies, expected by early 1996, and completion of the budget management stage of the project, planned for late 1996. | AFRD, BMB, BSB, MIB, DPC, Departments. |

*Supplementary Response to PAEC Interim Report on the State’s Budget and Financial Management Framework*
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<td><strong>Recommendation 10</strong></td>
<td>Accept in part</td>
<td>The Financial Management Regulations 1994, and the Directions of the Minister for Finance thereunder, provide a framework for internal control. Given the specific nature of the Directions, regulations are not considered necessary. The Secretary of a department is designated the &quot;Accountable Officer&quot; under the provisions of the <em>Financial Management Act 1994</em>. The Directions indicate it is the responsibility of the Accountable Officer to incorporate risk analysis as a component of the audit process.</td>
<td>The certification of internal control is currently under review. The aim is to encompass the Accountable Officer and the audit committee in the certification process. This would be an internal certification and not published.</td>
<td>AFRD, MIB, Departments.</td>
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