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Notes for closing address by
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Government accounting

- The move by many Governments from cash to accrual accounting, and even budgeting, over the last decade has focussed attention and interest on consolidated whole of government financial reporting.
- It is a moot point as to just how informative and useful accrual based government financial reports are to the various stakeholders. This has been a question posed and commented on by a range of academics, the media, investor groups and, indeed, the general public in recent years.
- Proponents of such reporting (of which the ANAO is one), argue that whole of government financial statements can provide a useful overview of a government's financial performance, its assets and liabilities and cash flows. The financial statements provide credible information upon which informed decisions can be made on the achievement of the government's overall objectives and in respect of choices that a government has made in the allocation of resources according to its various priorities and commitments.
- Over time, the statements will, for example, enable the reader to make an assessment of the degree to which the government is building up, or running down, its assets and/or liabilities.
- Similar sentiments have recently been expressed by the Auditor-General for South Australia, who noted *"It is over time, through the ability to make trend analysis of financial performance and financial position, that these statements become an important public sector financial management tool."*¹
- The accrual measures provide comprehensive information on the revenue generated by government and on the full costs of its products and activities. Such information is an important element by which public sector managers are held accountable for the performance of their agencies in contributing to the achievement of government outputs and outcomes.
- Accrual financial statements provide an important supplement to the government finance statistics (GFS) produced within each jurisdiction. The GFS reports include information on two major fiscal measures². In contrast, the whole of government financial statements provide only one 'bottom line', calculated on a basis consistent with any other financial reporting entity which is therefore arguably easier to interpret by the non-accountant user.
- Recognition of the differences between the public and private sectors and between budget and financial statements pose challenges for harmonisation of accounting standards, but not insurmountable ones.

Enhancing the usefulness of Government Financial Reports

- It would be reasonable to assume that the majority of citizens would not have the necessary understanding of accounting policies and practices to properly interpret what financial statements are conveying. Arguably therefore, this could result in a breakdown in the accountability chain.

- One way of addressing this and ensuring that the financial statements serve their purpose of providing users with an overview of the government's financial performance and position, is to provide additional analysis of the information contained within the financial statements.
- This could be in the nature of a Management Discussion and Analysis (MDA) which would have some parallels with the private sector practice. Most State governments and/or their audit offices conduct such analysis and publish it with the financial statements or the audit report thereon. This illustrates the importance of interpretive information to assist readers to understand both the financial performance and balance sheet position.
- The larger question is whether these financial statements, even when properly interpreted, are a sufficient accountability mechanism for governments. It is a reasonable proposition that the role of governments is amongst other things, to provide services to the community. The primary accountability in this context should therefore be in relation to the quality and quantity of services delivered and the impact of the delivery of such services and government activities on the community. The financial consequences, while important, are secondary to the outcomes to be achieved.
- Given this, I would argue that, even with detailed analysis and commentary, financial reporting by governments does not entirely meet the accountability expectations of constituents as it does not provide information about the services delivered by a government to the community nor does it address the broader impacts of government actions on the community. However, there is a real question as to whether it should.

Triple Bottom Line

- Financial reporting does not measure the quality of services or assets provided to a community by the government. Issues such as the availability and sustainability of infrastructure, the quality of education provided to our children, or the availability of health facilities, have a direct impact upon our wellbeing and are not reflected in traditional financial reporting but are covered in some form in budget documents.
- Similarly, while government actions and decisions can have a significant impact upon the environment, both in terms of the overall policy agenda as well as through internal management practices, there is very little reflection of such impact in financial reports. Nevertheless, there is some such indication normally in budget and other documents, more so at State and Local Government levels.
- Also lacking from the financial reports is any measure of intellectual and human capital which can be significantly impacted by government policies and actions. Again, the question is whether budget documents are a more appropriate forum for such comments/assessments.
- Within the foreseeable future we can expect to see an emergence and consolidation of new modalities of accountability. One example is the so called Triple Bottom Line Reporting (TBL) which has been defined as reporting that provides information about economic, environmental and social performance of an entity.

- TBL aims to provide information to users indicating that the entity is financially secure, minimising or eliminating negative environmental impacts and acting in conformity with societal expectations. Various investment surveys indicate that TBL can be good for business or at least a favourable indication for potential investors.
- TBL could lead to changes in the manner in which public and private sector organisations report performance and discharge their accountability to their stakeholders. The concept of sustainability requires new definitions of performance and the re-articulation of organisational goals.
- This is clearly a ‘greenfield’ area for research and development as far as the accounting profession is concerned. Moreover, because of the trans-border and global issues inherent in TBL, the development of appropriate methodologies and indicators would benefit enormously from international input. This is evident, for example, in the issue of relevant standards, notably in the United Kingdom.
- The potential exists for the accounting profession to contribute to constructive dialogue and rapprochement on such issues and approaches. However any progress may well largely depend on a more knowledgeable and demanding community expressing its preferences in the ballot box and/or share market.

Performance measurement

- A common theme in ANAO audits is that performance measurement and reporting are intrinsic to the whole process of public management, including planning, implementing, monitoring and evaluation and public accountability.
- Performance measurement within the Australian Public Service (APS) is increasingly focussing on more than just a financial bottom line. Assessments typically cover a range of measures both quantitative and qualitative. For example, an agency or entity has to be accountable for the implementation of the Government’s requirements with respect to public sector reforms and for meeting relevant legislative, community service and international obligations. This point has been recently emphasised by Max Moore-Wilton, Secretary, Department of Prime Minister & Cabinet, as follows:

“Ministers and Departments do have an obligation not just to achieve the bottom line that is often the key outcome sought by private companies. We owe it to the community to establish public trust that we work with integrity and put public interest ahead of personal gain. Ensuring the transparency of our process can focus our minds on the needs of each individual decision we take to be justifiable in terms of strict propriety.”³

- In order to accurately assess performance, it is necessary to identify both the financial and non-financial drivers of agency business. Within the Commonwealth sector, such assessment is underpinned by the introduction of the outcomes and outputs framework associated with the implementation of accrual budgeting. The outcomes and outputs framework focuses on what agencies are producing (outputs), the resources they are administering on behalf of the government (administered items) the purpose of outputs and administered items (outcomes) and the cost, in accrual terms of these activities. This model is

intended to assist management decision making and performance by focussing attention on the government's goals and objectives.

- The identification of appropriate performance indicators, together with reporting of actual results against these performance indicators, becomes a key plank within this new accountability framework.
- That framework is becoming more complex, or at least less clear, in an environment of greater collaboration, partnerships and networking across agencies within and across levels of government and including both profit and not-for-profit private sector organisations. Such arrangements raise issues of governance, including assessment of performance.
- In assessing overall organisational performance, the use of techniques such as the balanced scorecard approach that compliments financial measures with operational measures such as customer satisfaction, efficient internal processes and the organisation's innovation and improvement activities are becoming more prevalent.
- The scorecard approach underlines the importance of the various linkages between strategy and operations, budget and performance. It also requires attention to be given to measuring performance, where practicable, and to articulating a credible basis for assessing qualitative, or so-called 'soft' indicators of success. A parallel is the distinction between 'price' and the 'value for money' concept, with the later often embracing many non-price factors.
- Most agencies have developed, appropriately, some form of balanced scorecard to assess their own performance in terms of both financial and non-financial indicators for key results areas. Most executive reporting systems, however, leave room for considerable improvement when it comes to producing integrated management information. The importance of quality information for decision-making purposes means that systems integration and focussed management information must be on the priority list for most agencies. Without credible performance information, there is no baseline to assess performance and measure output delivery and its contribution to identified outcomes.

Concluding comments

- The inherent limitations of financial statements could be seen to imply that the efforts (and costs) of governments in implementing such reporting have not been effective. I would argue that this is not the case, although most would acknowledge that more could be done. Whole of Government reporting can contribute to our understanding of government's financial performance. It gives a valuable insight into the financial operations and, provided accounting policies are fully disclosed and consistently applied, also gives a useful overview of a government's financial position and the impact of a government's policies and actions on this position over time. In this respect, it supplements the more detailed performance information provided within the financial statements of individual entities and budget related documents.
- The question remains as to whether it is possible for the bottom line of public sector financial statements to be a true performance indicator, arguably not in the traditional private sector sense. Just as public sector agencies do not have an

overriding objective of generating profits, it could be argued that their financial statements should therefore not be constructed to focus unduly on this aspect.

- A wider issue is how financial statements can remain relevant when they fail to address questions such as the Government's impact on the environment, the quality of assets provided to the community by the government and the intellectual capital available to the community from within government.
- Emerging developments such as triple bottom line reporting and the reporting of intellectual capital take us a lot further than where we are today. Despite government's late start into the accrual environment, it might be time to take a more complementary role in making financial reporting more meaningful and useful in these wider respects.
- It would obviously be better to anticipate, rather than to react to, user demands in the interest of greater accountability for performance as required of a more responsive public sector. The imperative is to be clear as to what purposes consolidated government financial statements are meant to serve. There is no doubt we can, and should, improve their usefulness in coverage, consistency, and simplicity. This is as much a challenge for the profession as it is for account preparers and auditors.

NOTES AND REFERENCES

¹ Government of South Australia, 2001. *Report of the Auditor-General for the year ending 30 June 2001, Part A: Audit Overview*. Adelaide. p.88

In the Report, the SA Auditor-General himself examines some of the trends emerging in the financial situation of the SA Government. For example, at pp61 *et seq*, he examines emerging trends in State Debt, unfunded superannuation and other liabilities against targets set by Government, including, for example, the elimination of unfunded superannuation liabilities by 2034.

² The Government Finance Statistics (GFS) statements report on two major fiscal measures as follows:

- the GFS net operating balance which is calculated as GFS revenue less GFS expenses; and
- the GFS net lending or fiscal balance which includes net capital expenditure but excludes depreciation.

As with the accounting statements, the GFS statements transitioned from a cash to an accrual basis during the 1990s in Australia.

³ Moore-Wilton, Max 1999, address at the Presentation of the 1997-1998 Annual Report Awards, Institute of Public Administration (ACT Division), Canberra, 27 April, p. 3.