The Auditor-General

Audit Report No.2 1999–2000
Financial Control and Administration Audit

Use of Financial Information in Management Reports

Australian National Audit Office

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Canberra ACT
15 July 1999

Dear Madam President
Dear Mr Speaker

The Australian National Audit Office has undertaken a financial control and administration audit in accordance with the authority contained in the *Auditor-General Act 1997.* I present this report of this audit, and the accompanying brochure, to the Parliament. The report is titled *Use of Financial Information in Management Reports.*

Following its tabling in Parliament, the report will be placed on the Australian National Audit Office's Homepage—http://www.anao.gov.au.

Yours sincerely

Ian McPhee
Acting Auditor-General

The Honourable the President of the Senate
The Honourable the Speaker of the House of Representatives
Parliament House
Canberra ACT

AUDITING FOR AUSTRALIA

The Auditor-General is head of the Australian National Audit Office. The ANAO assists the Auditor-General to carry out his duties under the *Auditor-General Act 1997* to undertake performance audits and financial statement audits of Commonwealth public sector bodies and to provide independent reports and advice for the Parliament, the Government and the community. The aim is to improve Commonwealth public sector administration and accountability.

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Edward Hay

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Results in brief

1. The effective use of financial information is a critical component of an organisation's[1] performance management framework. The appropriate combination of financial and non-financial data reflects overall organisational performance, and performance at program and work unit levels.

2. In this audit, the ANAO examined what financial information is currently used, who uses it and how well it is used. The audit also assessed whether the current processes for defining, accumulating and producing financial information were appropriate for the new accrual based performance management framework which is to be in place for 1999–2000.

3. The audit found that most of the organisations reviewed narrowly defined their managers' financial responsibilities and associated accountabilities. The latter typically only included the management of cash and the achievement of expenditure against budgets at the time. If that approach were to be general and ongoing it would fundamentally limit the effective use of financial information in the Commonwealth public sector. It would also determine the financial information managers demand and how they use it. The new accrual-based environment requires a different approach as well as different information.

4. Little evidence was found of managers actually using available financial information, including accrual-based data, for day to day operations and strategic decision making nor to assist in the performance management of program delivery. To some extent, this is likely to result from the lack of suitable and timely data in a form that could be used for analytical and decision-making purposes.

5. Until organisations adopt a broader view of the financial management responsibilities of their managers to include cost effectiveness and the use of more quantitative as well as qualitative performance information for planning, controlling, budgeting and reporting, the potential benefits that could accrue from the new performance management framework are not likely to be fully realised. This is consistent with the findings from the survey results reported in

[1] The term organisation is used throughout this Report when referring to both Agencies (*Financial Management and Accountability Act 1997*) and bodies (*Commonwealth Authorities and Companies Act 1997*).

'*beyond bean counting*'[2] which noted that less than four per cent of core Commonwealth agencies used accrual data for internal management reports and less than 20 per cent used financial ratio analysis.

6. The audit also found that line management and finance areas are generally not well prepared for the new accrual output-outcomes environment in terms of both their understanding of the new environment and the skills necessary to maximise the management benefits.

7. To realise these benefits, managers will need to understand and use accrual financial information effectively to support strategic planning, control and decision-making. Considerable senior management leadership and commitment will be required to plan and coordinate implementation of the new framework in order for this to be achieved. However, that commitment will need to extend to all areas of organisations for full implementation of the framework.

8. As indicated in Audit Report No.20 of 1998–99;

> *The most significant challenge will be managing the cultural changes necessary to move from a regime focused on management and accountability for cash resources to one which utilises accrual information to manage and to ensure accountability for the use of all resources available to an entity.*[3]

9. Recent appointments of professionally qualified Chief Finance Officers (CFO) in very senior positions in a number of major Agencies reflects a heightened awareness of the importance of the independent professional advice that can be provided by a CFO to improve the quality of information for management decision-making and accountability.

10. As part of the audit a comprehensive report was provided to each organisation subject to the audit that provided an assessment of their performance against each of the audit criteria detailed in Appendix 1.

11. A number of better practice guides that are a major output of our audits, on using financial information will be published shortly by the ANAO based on better practice observed during recent audits and that identified in the private sector.

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[2] Management Advisory Board, *beyond bean counting—Effective Financial Management in the APS—1998 & Beyond*, Canberra, December 1998, (p. 22 and 23).

[3] Audit Report No.20, 1998–99, *Audits of the Financial Statements of Commonwealth Entities for the Period Ended 30 June 1998—Summary of Results and Financial Outcomes*, Canberra, (paragraph 1.11, p. 21).

Summary and Recommendations

Audit summary

Background to the audit

1. This Financial Control and Administration 'across-the-board' audit examined the use of 'financial information'[4] in seven Commonwealth organisations. These audits were undertaken by the ANAO to provide an indication of the issues likely to confront public sector organisations generally in the new accruals-based accounting environment. As such, they highlighted potentially significant opportunities as well as risks for organisation management. The audits also provide a degree of assurance about suitable initiatives being undertaken by organisations and draw attention to relevant issues for the information of the Parliament and the Executive.

2. The effective use of financial information is a critical component of an organisation's performance management framework, whether it operates under a cash, modified cash / accrual or a fully accrual-based environment. It is a companion to non-financial performance information which, when the two are used in combination, can provide highly useful indicators of the overall performance of organisations, programs and work units. Indeed, only through the inclusion of cost and financially based information can an organisation fully demonstrate performance and discharge accountability for effective delivery of government policy objectives including, importantly, adequate reporting.

3. The Government has recently introduced an accrual-based performance management framework focused on outputs and outcomes to be implemented in parallel with the 1999–2000 budget. This framework includes accrual-based management (which delivers information about the full costs and benefits of new and existing activities), output (ie. product) based management (which focuses management both on what, and to whom, services are delivered) and the outcomes to be achieved (which are often referred to simply as the 'results required').

4. One objective of this framework is to provide the Parliament with information on the full cost implications of organisations' activities and spending proposals.

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[4] For the purpose of the audit, financial information is defined simply as all the events and transactions captured in the accounting records of an organisation.

5. A related objective is to bring about a fundamental change to the way organisations manage their resources. In this latter regard, within the new performance management framework, organisations will move beyond accrual reporting and will be funded, and expected to manage, on an accrual basis[5]. This will necessitate the development of financial systems and internal reporting arrangements that provide managers with access to full cost financial information. This information will be required to enable discharge of managers' accountabilities for the efficient, effective and ethical[6] use of resources to assist in their day to day decision-making processes, and to help relate outputs to outcomes.

Objectives, scope and criteria

6. This audit was programmed at this time in the transition process to assess whether, and/or determine where, organisations need to improve their use of financial information if they are to realise the full benefits of the new performance management framework.

Objective

7. The objective established for the audit was to provide assurance to the Parliament on the effectiveness of the use of financial information in management (internal) reports and form an opinion on whether:

- the financial information produced for management purposes was relevant to, and satisfied, managers' planning, operational and reporting needs; and
- the current processes for defining, accumulating, producing, assessing and reporting financial information to satisfy those managers' needs were appropriate for the new accrual-based performance management framework including external reporting.

Scope

8. The audit considered what financial information was currently used within organisations, who uses it and how it is used.

9. To this end the audit evaluated the underlying processes by which the financial information made available to management was defined, captured and delivered.

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[5] Op cit., *beyond bean counting—Effective Financial Management in the APS—1998 & Beyond*, (p.13).

[6] *Financial Management and Accountability Act 1997*, section 44.

10. The audit was also undertaken against the background of the issues raised in the 1997 ‘*beyond bean counting*’ Report mentioned earlier and the introduction of the accrual-based performance management framework.

Evaluation criteria

11. The financial management frameworks and underlying processes were evaluated against a set of ‘better practice’ principles and supporting evaluation criteria developed for the audit by the ANAO. In summary the better practice principles cover whether:

- managers’ requirements for relevant financial information were clearly defined and understood;
- the organisation’s processes produced the required financial information; and
- managers use the financial information produced for better performance.

12. The evaluation criteria are detailed in Appendix 1.

Audit opinion

13. In the seven organisations[7] reviewed, the financial responsibilities of managers were narrowly defined. Consequently, the suite of financial information provided to managers was limited. The focus was largely on accountability for compliance with budgets and managing expenditure (typically on a cash basis). This was despite the move to accrual-based reporting over recent years.

14. Wider financial management responsibilities (and hence accountabilities) in terms of the management and use of resources to achieve efficient and effective outputs and outcomes were not well defined. Accordingly, the financial information available did not align with these broader responsibilities.

15. Limited opportunities had been taken to use <u>available</u> financial information, including accrual-based information, for day to day and strategic decision making to assist in the performance measurement of program delivery.

[7] The audit reviewed four Agencies and three Authorities.

16. Current processes for defining managers' broader financial information needs in an accrual-based framework will therefore be largely ineffective in the new framework.

17. Although managers are able to use available financial information to support decision making in the former cash-based environment, the implementation of the new performance management framework poses major challenges to organisations. Basically, the latter requires managers to understand how to use accrual financial information effectively to support decision-making in managing their resources efficiently and in the cost effective delivery of outputs and the achievement of outcomes. Limited training so far provided to prepare management for the new environment limits the effective implementation of the new framework.

18. Finance areas are also not well equipped to meet the challenges of the changed finance function role which will require finance staff to assist management, among other things, with the analysis and interpretation of financial information.

19. Considerable effort and senior management commitment at all levels of organisations will continue to be required to plan and coordinate implementation of the new framework in order to meet these challenges successfully.

20. These opinions are based on the findings discussed in detail in chapters two and three of this report.

Recommendations

Recommendation No.1 Para. 1.25

It is **recommended** that organisations establish clearly their financial objectives as part of their corporate planning and management processes and clearly integrate identified financial management responsibilities and accountabilities for all key positions.

Recommendation No.2 Para. 2.22

It is **recommended** that organisations undertake, in consultation with managers at all levels, an early examination or review to ascertain the latter's understanding of accrual financial information, to establish their training needs and facilitate the necessary training programs. These programs should cover not only awareness of accrual concepts, but also the use of financial information in higher-level management, strategic analysis and reporting.

Recommendation No.3 Para. 2.23

It is **recommended** that organisations review the current skills and experience available in their finance function to ensure that there is sufficient capability and capacity to assist management to operate effectively in the new accrual information environment.

Recommendation No.4 Para. 2.24

In relation to the performance management reform initiatives, it is **recommended** that organisations analyse the critical path toward new systems implementation, change management and corporate initiatives to ensure that the impact of the reforms on the information needs, delivery and use of financial information is adequately assessed and managed appropriately.

Audit Findings and Conclusions

1. Performance management framework

Introduction

1.1 An evaluation of the way in which organisations use financial information has to take account of ongoing financial management and other related reforms.

1.2 Significant reductions in government spending; restructuring of organisations and programs, including the separation of policy and service delivery functions; the requirement for contestability, including the increasing trend towards outsourcing; and the accrual budgeting initiative, including the focus on outputs and outcomes; are examples of the nature of relevant changes being experienced by the public sector.

1.3 The performance management framework, which includes accrual budgeting to be implemented in parallel with the 1999–2000 budget, requires agencies and authorities in the General Government sector to:

- specify and set the 'price' for the outputs they will deliver and describe planned outcomes to which these outputs contribute;
- specify the performance information required to monitor, manage and account for output delivery and the achievement of identified outcomes; and
- report performance.[8]

1.4 The new framework aims to provide much improved and fully integrated financial and other performance information for decision-making by management as well as a better basis for measuring and/or assessing the efficiency and effectiveness of organisations' delivery of programs (or outputs and outcomes).

1.5 To achieve the objectives of the new framework, organisations will require more effective financial management systems. The current drive to introduce new financial management information systems (FMIS) will provide a necessary foundation for the development of improved financial information. However, significant improvement in the understanding of the benefits of accrual information and an increase in

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[8] Department of Finance and Administration, 1998, *Specifying Outcomes and Outputs—Implementing the Commonwealth's Accrual-based Outcomes and Outputs Framework*, Canberra, (p. 8).

financial management skills will have to be developed in order to make best use of the new systems and the resultant financial information. The imperative is to provide useful and timely information to managers at all levels to facilitate their management task.

Internal management framework

> *Effective financial management is intimately connected to the public sector's ability to meet the Government's expectations regarding the delivery of government objectives.*[9]

1.6 The effective use of financial information in management reports, whether cash or accrual based, depends significantly on a robust internal management framework consisting of the following:

- the vision of the organisation translated into clear objectives and strategies;
- the risks to the achievement of these objectives clearly identified, analysed, assessed, prioritised, treated and monitored;
- managers' responsibilities at all levels consistent with the organisations objectives, clearly defined and communicated, and understood by all relevant stakeholders; and
- managers held accountable for their responsibilities, using measures which are linked directly to the objectives of the organisation and which integrate financial and non financial performance information.

1.7 Supporting this structure is the financial management framework that includes those activities that involve managers in making decisions with full knowledge of their financial implications.

1.8 The Office of the Auditor General of Canada has developed a Financial Management Capability Model which could prove useful to senior managers as they strengthen financial management in their organisation. It defines the three essential elements of financial management as:

- *risk management and control—It is essential that an organisation identify the risks it faces (anything that could interfere with its ability to achieve its established objectives); and that it establish a framework designed to manage and control those risks. An essential part of risk management and control is an environment that communicates the purpose, values and ethics of the organisation;*

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9 Op cit. *beyond bean counting—Effective Financial Management in the APS—1998 & Beyond*, (p. 10).

- *information—It is essential that the organisation establish procedures to manage and protect the integrity of its data and to produce the type of information needed by managers to conduct their business and to account for their responsibilities. The organisation must also present this information when it is needed. This element includes management of information systems and information; and*
- *management of resources—This component of financial management focuses on managing and directing the organisation's resources economically and efficiently to achieve corporate objectives. It includes strategic planning, analysis and support for decisions.'*[10]

1.9 An important part of this process is ensuring that management's expenditure decisions have due regard to the requirements for economy, efficiency and administrative, including ethical effectiveness. At the same time program management should ensure that appropriate controls are in place to safeguard assets and account for liabilities and that decisions are made in accordance with legislative and executive financial authority and public sector values and Codes of Conduct.

1.10 In the Commonwealth public sector, financial management covers a broad range of activities, including program delivery, development of accounting policies and establishment of necessary systems and controls. A vital part of an effective financial management framework, which brings all these elements together, is the internal measurement and reporting of operational and program (output and outcomes) information.

Financial management responsibilities and accountabilities

1.11 The audit found that, in most organisations reviewed, the financial information in management reports was often limited to that needed to measure accountability for compliance with budgets and managing cash expenditure. This was consistent with existing accountability regimes that focused on budgeted cash outcomes.

1.12 The financial information provided to senior executives and managers had limited direct relevance to program delivery and related outputs and outcomes. Consequently, there was little evident use of financial information to assist in strategic as well as day to day operational decision making. This limitation suggests, for example, that much had to be done to better focus senior executives and managers on accrual-based financial information and the outputs and outcomes budgetary framework.

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[10] Financial Management Capability Model, Office of the Auditor General of Canada, Ottawa, 1999 (p. 3)

1.13 In Audit Report No.7, 1995–96, the ANAO reported

> *that many managers perceived a limited role for financial management within individual programs, such as not exceeding budget or restricting running costs by the nominated efficiency dividend. These perceptions had tended to discourage or limit any meaningful questioning or review of the financial implications associated with service delivery, particularly at a corporate level*[11].

The report also noted that the audit findings were not unique to the Department concerned, but had general applicability across the Commonwealth public sector.

1.14 The results of the 1997 Survey reported in *'beyond bean counting'* noted that just over 50 per cent of core Commonwealth line managers thought that financial management was one of the top three indicators of an organisation's success.[12]

1.15 The current audit found little had changed in recent years in these respects. This can be attributed directly to the continuing gap in understanding the value that financial information can contribute to strategic and day to day management decisions and because managers' responsibilities and associated accountabilities do not often align. As well, data systems simply did not provide the required information to encourage managers to use financial information as part of their management responsibilities.

1.16 Financial management responsibilities incumbent on management are much broader than the management of cash and achievement of expenditure budgets. They include responsibility for planning, controlling, budgeting, reporting and quality management at both strategic and work unit levels. These financial responsibilities are required regardless as to whether an organisation operates in a cash, modified cash or accrual environment.

1.17 Narrowly defining financial management responsibilities significantly impacts on the relationship between these responsibilities and their associated accountabilities. Essentially, management is held accountable only for the narrow set of responsibilities, as defined, rather than the recognised broader set of responsibilities required for effective overall financial management.

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11 Audit Report No.7, 1995–96, *Financial Management* Department of Veterans' Affairs, Canberra (paragraph 2.5, p. 7).

12 Op cit. *beyond bean counting—Effective Financial Management in the APS 1998 & Beyond* (p. 25).

1.18 Continuing such a narrowly defined approach would place a fundamental limitation on the effective use of financial information in the public sector. It also impacts on the financial information managers' demand and on the way they use it. Little evidence was found of managers routinely using available financial information to model, plan and control cash and commitments; to manage quality and cost of operations; and, importantly, to provide information which allows management to choose between alternative courses of action in delivering programs.

1.19 Limited opportunities have been taken to use available financial information, including accrual-based information for day to day operations and strategic decision-making nor to assist in the performance measurement of program delivery. To some extent, this results from the lack of suitable and timely data in a form that could be used for analytical and decision-making purposes.

1.20 These issues become increasingly important as the Government's performance management reforms take effect. As noted earlier, these reforms include the introduction of the output-outcomes initiative; the requirement to budget on an accrual basis (from 1999–2000); and the expectation that organisations will also manage on an accrual basis. These initiatives will provide the framework for a significant change in the way organisations manage and report on their activities.

1.21 However, to gain all the benefits available from these initiatives and to meet the Government's policy requirements, significant effort by organisations will need to be directed towards enhancing managers' skills at all levels in using, and understanding, accrual-based financial information.

1.22 As noted in the foreword to the Canadian 'Financial Management Capability Model',

> *Ultimately, the key to achieving effective financial management in an organisation is a supportive climate or culture that is reinforced by appropriate rewards, recognition and sanctions. This includes strong sustained leadership, shared values, and a shared commitment and purpose. Such a climate recognises the important contribution that effective financial management can make to an organisation.*[13]

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13 Op cit. Financial Management Capability Model'

Better practices

1.23 The audit identified better practices applicable within the current operating environment that should establish a sound basis for organisations to successfully build on as they implement the management approaches and systems necessary for the new accrual environment.

1.24 The audit found the financial management responsibilities of some managers were well defined in performance agreements with a clear recognition of, and links between, their financial responsibilities and the financial information delivered to them.

Recommendation No.1

1.25 It is **recommended** that organisations establish clearly their financial objectives as part of their corporate planning and management processes and integrate clearly identified financial responsibilities and accountabilities for all key positions.

2. Preparedness for reform

2.1 As indicated previously, the Government recently introduced an accrual-based performance management framework focused on outputs and outcomes to be implemented in time for the 1999–2000 budget.

2.2 This audit was programmed at this time of transition to determine the preparedness of a number of organisations to implement these reforms and thereby achieve the full benefits of output-based accrual budgeting and reporting initiatives as early as possible; and also to identify where organisations need to improve their use of financial information for better performance.

2.3 The audit assessed selected organisations' preparedness for the reformed operating environment against the following criteria:

- organisations had appropriately assessed the impact on managers' financial information needs;
- the finance function was properly prepared to provide managers with appropriate analysis and interpretation of financial information;
- organisations' financial management information systems were able to support delivery of relevant financial information to managers; and
- organisations were properly prepared to develop managers' skills so they were able to use the financial information effectively.

2.4 Appendix 2 outlines the critical path between the various steps in implementing the reforms. It includes:

- systems implementation—preparing the systems;
- change management—preparing the managers and staff; and
- assessing managers' financial information needs and delivery of appropriate financial information to them in a timely and cost effective manner.

2.5 Appendix 2 has been developed to assist organisations plan for the successful implementation of the new requirements.

Managers' financial information needs

2.6 The audit found that all the organisations reviewed had at least generally focused on meeting the external requirements of the new framework such as defining outputs and outcomes and the information necessary for the preparation of accrual estimates. However, organisations generally had not assessed the likely impact of the new framework on their operations. Not assessed were issues such as whether:

- managers' financial management responsibilities and accountabilities required redefining; and
- managers' financial information needs had changed,

Finance function role

2.7 The audit found that organisations had established training programs to raise awareness of the new framework among finance function staff (including those located in program areas) and, in many cases, generic training developed by the Department of Finance and Administration was used.

2.8 However, organisations had not formally addressed the likely changes in the finance function caused by the new framework, such as:

- its role and responsibilities in implementing the new framework and providing ongoing focused support to managers; and
- the specific skills enhancements required in the finance function and the training and/or recruitment strategies necessary to achieve these enhancements.

2.9 As highlighted in the Canadian Financial Management Capability Model, a key aspect of the model is the changing role of the finance function. In a maturing financial management model, the staff of the finance function begin to move away from performing only the traditional accounting functions to performing as a team player providing valuable support to operational managers[14].

2.10 The audit also found that a number of finance areas are not well equipped to meet the challenges of the changed finance function role which will require finance staff to assist agency management with the analysis and interpretation of accrual based information. These findings increase the risk of managers not effectively using financial information, as well as limiting the likely successful implementation of the Government's performance management framework.

2.11 The recent appointment of professionally qualified Chief Finance Officers (CFO) in very senior positions in a number of major Agencies reflects a heightened awareness of the importance of the role played by financial management in organisations and should result in improved performance of the finance function.

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[14] Op cit. Financial Management Capability Model (p. 9).

2.12 As noted in Audit Report No.20, 1998–99

> *The Commonwealth is facing new challenges in financial management as it moves towards accrual budgeting in 1999–2000 with the associated requirements to identify and measure, to the extent possible, outputs and outcomes under an accrual framework. To meet these challenges, entities will need to ensure high quality accrual information is available throughout the year to assist financial management and accountability.*[15]

Financial management information systems

2.13 Most organisations are in the process of implementing, or have implemented, new FMIS to facilitate the introduction of accrual budgets in 1999–2000. In each case, financial business requirements were defined as part of the implementation process and in some cases, sample financial report formats were also prepared.

2.14 However, the audit found that some organisations are at risk of not achieving the full benefits from their new FMIS because:

- the business requirements and/or report formats did not reflect the full requirements of the new framework which now includes reporting on outputs and outcomes; and
- the implementation has been treated as a stand-alone project, rather than an integral part of the suite of actions and responsibilities in support of the new framework.

2.15 In such cases, organisations may be faced with costly systems enhancements once they have fully understood and defined the requirements of the new framework.

2.16 To some extent this outcome is not surprising. Organisations planned their FMIS implementation projects to meet the external requirement for accrual budgeting. Since then, the introduction of the outputs and outcomes initiative has resulted in a new range of requirements for organisations which must be accommodated within their FMIS. Organisations will need to apply significant resources, as well as appropriate training, to accommodate the new requirements within their financial systems.

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[15] Op cit. Audit Report No.20 1998–99 (p. 6).

Managers' financial skills

2.17 The audit found organisations had generally attempted to raise awareness of the financial reforms among managers. In many cases they have made, or intend to make, available to managers the generic training developed by the Department of Finance and Administration within their organisation.

2.18 However, organisations do not appear to be adequately addressing the likely change in <u>management behaviour</u> required by the new framework, including the specific skills enhancements required and the training and/or recruitment strategies necessary to achieve these enhancements.

2.19 Those organisations which are undertaking or planning to undertake skills training are generally doing so in association with the implementation of their new FMIS, rather than as part of a broader, integrated training effort which covers <u>all</u> aspects of the new performance management framework. This approach recognised the need to give priority to the most urgent activities if the Government's initiatives were to be implemented on time.

Better practices

2.20 The audit found a number of better practices in organisations that had commenced the reform process. These included assessments of the impact of the reforms on accountabilities, responsibilities and organisational structures, as well as the linking of the chart of accounts to the new outputs-outcomes requirements. Some organisations had also undertaken training needs assessments both within the finance function and in relation to line managers.

2.21 The audit also identified that, in one organisation, reform initiatives were communicated to all staff through the development of an accrual accounting home page on the Internet.

Recommendation No.2

2.22 It is **recommended** that organisations undertake, in consultation with managers at all levels, an early examination or review to ascertain the latter's understanding of accrual financial information, to establish their training needs and facilitate the necessary training programs. These programs should cover not only awareness of accrual concepts, but also the use of financial information in higher-level management, strategic analysis and reporting.

Recommendation No.3

2.23 It is **recommended** that organisations review the current skills and experience available in their finance function to ensure that there is sufficient capability and capacity to assist management to operate effectively in the new accrual information environment.

Recommendation No.4

2.24 In relation to the performance management reform initiatives, it is **recommended** that organisations analyse the critical path towards new systems implementation, change management and corporate initiatives to ensure that the impact of the reforms on the information needs, delivery and use of financial information is adequately assessed and managed appropriately.

Canberra ACT
15 July 1999

Ian McPhee
Acting Auditor-General

Appendices

Appendix 1

About the audit

Background

1. The effective use of financial information can:

- improve the effectiveness and / or efficiency of operations and program delivery; and
- assist in improving accountability and corporate governance generally.

2. The ANAO decided to undertake an audit of the use of financial information in management reports because:

- the move to accrual accounting and budgeting provided a timely opportunity to contribute to improvement in the financial management of agencies in the Commonwealth Public Sector; and
- in a broad sense, examination of this topic would be particularly useful as organisations are about to embark on a program of management reform designed to better recognise their existing responsibilities and more closely align their external accountabilities with those responsibilities as part of the move to an outputs-outcomes focus for management purposes.

Audit objectives

3. The objectives of this audit were to provide assurance to the Parliament on the effectiveness of the use of financial information in management (internal) reports and form an opinion on whether:

- the financial information produced for management purposes was relevant to and satisfied managers' planning, operational and reporting needs; and
- the current processes for defining, accumulating, producing, assessing and reporting financial information to satisfy managers' needs were appropriate for the new accrual-based performance management framework.

Audit scope

4. The scope of the audit was limited to the use of financial information for management purposes (although this was considered in the context of the overall suite of performance information provided to managers).

Better practice principles

5. Managers need performance information (including financial information) to assist them in:

- discharging their responsibilities; and
- meeting their accountability objectives and imperatives.

6. Accordingly, the principles of better practice used by the ANAO to develop evaluation criteria for the audit address the specification, delivery, and use of financial information in management reports.

7. To be fully effective, these principles require all elements of good corporate governance to be in place, in particular:

- the vision for the organisation must be translated into clear objectives and strategies; and
- risks to the achievement of those objectives must be clearly identified, analysed, assessed, prioritised, treated and monitored.

8. The principles of better practice used in this audit were:

- managers' requirement for relevant financial information is clearly understood;
- the organisation's processes produce the required financial information; and
- managers use and report on financial information effectively.

Areas of focus and evaluation criteria

9. The areas of focus, and the associated evaluation criteria, were as follows:

Areas of focus	Evaluation criteria
Managers' financial information needs given their current responsibilities	The organisation has implemented processes to accurately determine managers' current financial information needs
The likely impact of the reformed operating environment on managers' financial information needs	The organisation has appropriately assessed the likely impact of the reformed operating environment on managers' financial information needs
The extent to which the organisation's FMIS delivers financial information which meets managers' needs	Financial information delivered to managers is consistent with their needs
The extent to which managers' financial information needs are met through other channels including "work around" systems	Financial information delivered to managers is consistent with their needs

Areas of focus	Evaluation criteria
The extent of surplus financial information	Financial information delivered to managers is consistent with their needs
The mode of delivery and format of presentation for financial information delivered to managers	Financial information is delivered to managers by a mode and presented in a format, which facilitates their understanding of that information
The process of analysing and interpreting financial information for delivery to managers	The finance function's analysis and interpretation enhances the value of the financial information delivered to managers
The likely impact of the reformed operating environment on the role of the finance function and on the organisation's Financial Management Information System	The finance function is properly prepared to provide managers with appropriate analysis and interpretation of financial information in the reformed operating environment The organisation is properly prepared for its FMIS to support delivery of relevant financial information to managers in the reformed operating environment
The extent to which managers use the financial information delivered to them	Financial information delivered to managers is used by them in making decisions
Managers' skills in analysing and interpreting the financial information delivered to them	Managers have the necessary skills to analyse and interpret the financial information delivered to them
The likely impact of the reformed operating environment on the skills required by managers to analyse and interpret financial information	The organisation is properly prepared to develop managers' skills so that they will be able to use financial information effectively in the reformed operating environment

Performance information

10. Planning for this audit commenced in May 1998. The audit commenced in July 1998 and the fieldwork was substantially completed in January 1999.

11. The total time elapsed from commencement of planning to tabling of the audit report was 11 months. This included two months for selection of the service provider (refer below).

12. A feature of this audit was the appointment of PricewaterhouseCoopers to manage the day to day audit process and conduct most of the audit fieldwork.

13. The total cost of the audit was $545 000. The average cost of the fieldwork at each of the seven organisations was $78 000. A number of better practice guides on using financial information that are based on the results of recent audits will be issued shortly and are separately costed.

Appendix 2

Preparing to implement reform

1. Most agencies are in the process of implementing change initiatives across a wide front to meet a range of external and internal requirements. The Government's output-outcome based accrual budgeting reform is one of the most important of these initiatives.

Integrated planning

2. An integrated implementation plan should be based on careful consideration of;

timing and resource requirements:

- when should different tasks be completed to meet the external and internal deadlines?
- how and to whom should the progress and results of individual initiatives be communicated?
- what level of staff time and other resources (eg contractors) will be necessary?
- how much will implementation cost, and how can progress be monitored and maintained?

risk management strategies:

- *hazard:* what are the risks of something going wrong and how to manage it if it happens?
- *uncertainty:* what are the risks associated with unexpected change such as impact of administration restructuring on system implementation?
- *management:* how should such risks be managed if they eventuate?

roles and responsibilities:

- who should be involved, should it include both finance staff as well as operational managers?
- what should senior management do to gain ownership?
- what role should finance staff play to facilitate the reform implementation? Should they be out-posted to operational areas to help managers to understand the implications of the reforms?

Critical path

3. A fully integrated implementation process would include the following key components:

- systems implementation (preparing the systems);
- change management (preparing the managers and staff); and

- assessment of managers' financial information needs and delivery of financial information to them.

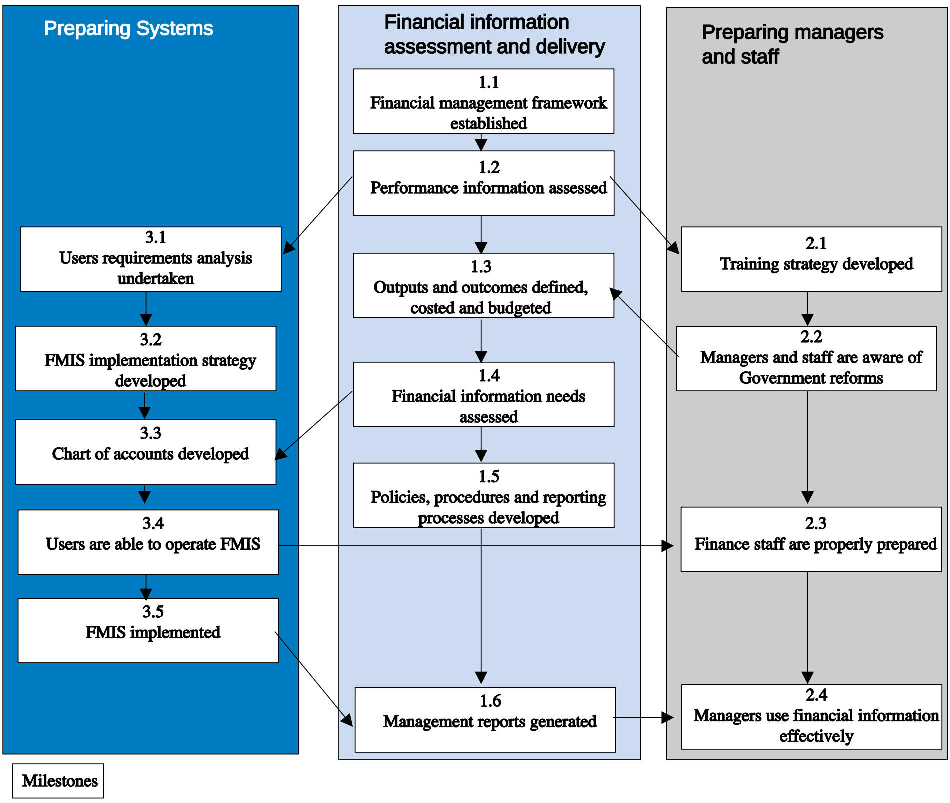
4. A well-managed implementation process will involve detailed consideration of the critical path between the different components. The sequence has to be well considered as different components affect one another and are often implemented in parallel.

5. Failure to understand the critical path between the different components may result in:

- costly system re-engineering;
- duplicated manual effort; and
- unfulfilled expectations and criticisms.

6. An illustrative critical path analysis for implementation, with suggested milestones in each component, is shown as follows:

Figure 1



Suggested steps in implementation

7. Once the critical path of the implementation process (including nominated milestones) has been set out, steps that are necessary to achieve the milestones sequentially must be performed; these may include some or all of the following:

Financial information assessment and delivery

8. Financial management framework established. See Figure 1, (1.1):

- define the financial management requirements and strategic directions of the organisation;
- define and communicate financial management responsibilities (including service, assets and treasury management responsibilities) and the accountability framework to be adopted, using a top-down approach; and
- define the role of finance function in budgeting, accounting, reporting (including interpretation and analysis) and providing advice on financial matters (eg. cost/benefit analysis).

9. Performance information assessed. See Figure 1, (1.2):

- develop corporate performance information framework (eg. balanced scorecard approach or 3-Rs of performance approach), and key performance indicators (KPIs) (both financial and operational) for the organisation that are integrated with the organisation's vision;
- develop KPIs at the division or program (or output and outcome) level that are consistent with the corporate KPIs; and
- develop performance indicators at the individual level that are consistent with the division's or program's KPIs. The performance indicators should be incorporated as part of each individual manager's performance agreement.

10. Outputs and outcomes defined, costed and budgeted. See Figure 1 (1.3):

- develop and define the outputs and outcomes of the organisation in a consultative manner;
- review the definition of departmental and administered assets, liabilities, revenues and expenses;
- identify roles and responsibilities and information gaps in accrual budgeting;
- develop a costing methodology, including identification of cost objects (eg. activity costs, output costs, outcome costs, cost by client, cost by industry), cost types and cost drivers (cost attribution mechanism); and

- develop mechanisms to collect necessary operational and financial information (eg. time analysis) for costing purposes.

11. Financial information needs assessed. See Figure 1, (1.4):

- assess financial information needs of managers based on:
  - managers' defined responsibilities;
  - financial KPIs that managers are held accountable for; and
  - financial information necessary for managers to understand:
    * full cost of services (outputs)
    * efficiency (eg. average cost of service)
    * cost effectiveness (cost of outcomes)
    * economical acquisition of resources (eg. cost of in-house staff vs contractors)
- assess the level of detail and the interpretation and analysis of financial information required by managers; and
- determine the mode of information delivery and presentation format that is appropriate to facilitate managers' understanding.

12. Policies, procedures and reporting processes determined. See Figure 1, (1.5):

- develop Chief Executive's Instructions (CEIs) to align with the Chief Executive's directions on financial management;
- develop accounting policies to establish accounting rules that are consistent with internal and external reporting requirements and the CEIs;
- review current procedures to identify potential inefficiencies and develop procedures that are consistent with the accounting policies, business rules, best practice processes and the way managers will be held accountable; and
- establish reporting process, including roles and responsibilities for recording, collecting, collating and reporting financial information, fully utilising the capabilities of the organisation's systems.

13. Management reports generated to. See Figure 1, (1.6):

- prepare financial management reports using information from the FMIS and other operational systems, incorporating necessary analysis and interpretation provided by finance staff and line managers; and
- grant managers access to on-line reporting, where appropriate.

Preparing managers and staff

14. Training strategy developed to. See Figure 1, (2.1):

- undertake analysis to identify gaps between the skills required in the reformed operating environment and current skills of finance staff and managers; and
- in consultation with staff and managers, develop appropriate training and/or hiring strategies to close any identified gaps.

15. Managers and staff are aware of Government reforms to. See Figure 1, (2.2):

- undertake organisation-specific training to alert managers to the impact the reforms will have on their responsibilities (both financial and non-financial);
- communicate the corporate strategy for implementing the reforms to relevant finance staff and managers; and
- undertake organisation-specific training to enable managers and finance staff to understand the definition of 'outputs' and 'outcomes', and therefore participate effectively in defining the outputs and outcomes of the areas that they are responsible for managing.

16. Finance staff are properly prepared to. See Figure 1, (2.3):

- provide basic accounting training to finance staff who are not financially trained; and
- provide targeted financial management training to enable finance staff to provide necessary support to managers in accordance with their defined responsibilities. Such training may include training on costing of activities and outputs, accrual-based budgeting, provision of strategic financial advice, and/ or cost/benefit analysis.

17. Managers use financial information effectively to. See Figure 1, (2.4):

- involve operational managers, where appropriate, in corporate initiatives to implement the reform, to enable them to understand the issues involved in implementation;
- encourage and reward sound financial management by incorporating financial performance indicators in performance agreements; and
- undertake organisation-specific training on financial management tools and techniques for different levels of management. This may involve using existing costing reports to demonstrate how financial information can be used to support decision making.

Preparing the FMIS

18. User requirements analysis undertaken to. See Figure 1, (3.1):

- develop user requirements specifications that incorporate managers' financial information needs in the reformed environment;
- review system capability to provide necessary financial information; and
- undertake system gap analysis.

19. FMIS implementation strategy developed to. See Figure 1, (3.2):

- identify options to close the system gap;
- adopt a strategy to implement the FMIS. Such strategy should include resources planning and timetables that align with the corporate strategy; and
- prepare a functional specification including interfaces with feeder systems and the executive information system.

20. Chart of accounts developed to. See Figure 1, (3.3):

- support management information needs; and
- capture financial information including appropriate cost centres, output groups, statistical information required in the reports etc.

21. Users are able to operate FMIS to. See Figure 1, (3.4):

- provide system training to users of FMIS. The system training should be synchronised with appropriate financial management training.

22. FMIS implemented to. See Figure 1, (3.5):

- undertake system testing involving relevant users;
- undertake data migration; and
- undertake post implementation review.

23. The above is a check-list for use by an organisation's senior management to test their implementation of reforms related to the use of financial information in management reports. It may indeed prompt other questions and provide scope for a range of better practices relevant to the organisation's outputs and outcomes and performance management framework. Experience tends to suggest that such a transition will take some time to be made effective and requires a significant resource effort as well as a cultural change.

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