

## **Audit Report No. 21, 1998–99**

### **The Costing of Services**

#### **Introduction**

- 4.1 Cost is a measure of the value of resources consumed in acquiring or delivering a product or service. Accurate costing information enables managers to understand and control the factors that drive costs.<sup>1</sup> Hence it has long been essential in the private sector. Until recently, public sector agencies have not been required to produce and analyse such information.
- 4.2 Commonwealth agencies have traditionally measured resource consumption on a 'cash' basis—recognising costs only when payments were made. However, the introduction of accrual budgeting for the 1999–2000 budget requires agencies to identify and manage the full cost of operations.<sup>2</sup>
- 4.3 Further, as the Australian National Audit Office (ANAO) noted, an 'understanding of costs and their behaviour is also vital in the contestable environment into which the Australian Public Service has moved, and is particularly important to market testing, outsourcing and establishing purchaser/provider arrangements.'<sup>3</sup>

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1 Auditor-General, *Transcript*, p. 41.

2 Auditor-General, *Transcript*, p. 41.

3 Auditor-General, *Transcript*, p. 42.

- 4.4 The purpose of the audit was to identify the way organisations processed and used costing information, and to identify better practices which could be adopted throughout the public service. Specifically, it asked whether processes and uses of costing information were:
- valid;
  - cost effective; and
  - in accordance with the principles of better practice.<sup>4</sup>
- 4.5 The audit report concluded the following.
- Most organisations had simple cost systems where the collection and use of cost information was geared to external requirements rather than management needs.
  - The systems to capture the necessary data were largely unstructured.
  - A small number of organisations had reached the stage where full cost information was used to support decision-making processes.
  - No organisation had reached the stage where costing information on an accrual basis played a key strategic role in overall decision-making.<sup>5</sup>
- 4.6 Of the 10 agencies originally audited by the ANAO, four agencies provided the Committee with follow-up information on their collection and use of costing information. These were the Australian Quarantine and Inspection Service (AQIS), the Australian Customs Service (Customs) the National Library of Australia and the Department of Finance and Administration (DoFA). In addition, the ANAO and the Department of Finance and Administration provided information across the whole of government.
- 4.7 This report discusses the following issues:
- costing methodology;
  - assistance and oversight; and
  - staffing issues.

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4 ANAO, *Costing of Services* (summary sheet).

5 Auditor-General, *Audit Report No 21, 1998-99*, p. 6.

## Costing methodology

- 4.8 The audit showed that most agencies were still in the initial phase of developing costing systems as measured against a three phase model.<sup>6</sup> None of the agencies used costing information as a key part of overall decision making. The management of cash revenues and expenditure was the primary focus of financial control.<sup>7</sup>
- 4.9 The Auditor-General noted that the transition to the more mature phases will be facilitated by:
- an increased understanding of the value and uses of cost information;
  - the implementation of sophisticated cost systems; and
  - an effective costing framework, including an appropriate environment, an effective approach and informed application.<sup>8</sup>

## Committee comments

- 4.10 When discussing with agency representatives the progress being made towards these goals, it became clear that there was substantial variation in the approaches taken by different agencies. As discussed below, the Committee takes the view that greater consistency would be beneficial for the quality of costing information. DoFA should play a central role in facilitating information sharing between agencies and assisting in the process of building appropriate costing frameworks at the agency level.
- 4.11 The Committee regards it as important that agencies quickly move to integrate the capture and recording of cost information into their financial management information systems. A consequence of failing to integrate cost records with financial management information systems is the increased risk of errors arising from data re-keying and the higher cost of data collection and report generation, especially where an agency may be running parallel systems. The Committee strongly supports the ANAO's view that agencies need to fully integrate cost information into their financial management systems.<sup>9</sup>

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6 Auditor-General, *Audit Report No 21, 1998–99*, p. 21. An exception was AQIS, which was in the secondary stage of the development model—Bill Daniels, AQIS, *Transcript*, p. 37.

7 Auditor-General, *Audit Report No 21, 1998–99*, p. 22.

8 Auditor-General, *Transcript*, p. 41.

9 Auditor-General, *Audit Report No 21, 1998–99*, pp. 23, 26.

## Staffing issues

- 4.12 The issue of the availability of experienced staff to assist agencies in implementing accrual accounting systems was discussed at the hearing.
- 4.13 A witness from Customs expressed the view that a shortage of skilled staff was crucial in determining the rate at which agencies were able to implement accrual accounting systems. Customs attempted to address this problem by recruiting staff with accounting qualifications. However, since these were at the junior level, they were not yet in a position to provide the senior management level with the advice needed to implement accrual accounting systems.<sup>10</sup>
- 4.14 The Auditor-General supported this view, commenting that, in addition to installing proper financial reporting systems, staff using the systems had to know what costing information they needed and what this information actually meant in terms of the outputs and outcomes that had to be achieved. The Auditor-General added that while cultural change was occurring, there were also significant structural changes occurring which were changing the nature of people's jobs and the way in which functions were performed.<sup>11</sup>
- 4.15 A witness from the Department of Finance and Administration observed that:
- ...a lot of agencies underestimated the resources they needed to implement accrual budgeting and outcomes and outputs processes. They underestimated the impact of the government's policy on better financial management and linking that into the delivery of policy or services. The only way around that is that the finance area of departments will have to become better skilled or it will have to be outsourced, because they will have to take a greater role in the general business of an agency.<sup>12</sup>

## Committee comments

- 4.16 The Committee notes that significant cultural change is required to support the reform of public sector financial management. This need for cultural change, along with the difficulty experienced by some agencies in attracting and retaining capable staff in this field, leads the Committee to

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10 Michael Roche, Customs, *Transcript*, p. 55.

11 Auditor-General, *Transcript*, pp. 55–6.

12 James Murphy, DoFA, *Transcript*, p. 56.

believe that DoFA should play a stronger role in providing support to agencies.

## Assistance and oversight

### Role of DoFA

- 4.17 The Committee was informed that DoFA had provided guidelines on the costing of outputs as well as advice on the establishment of costing systems.<sup>13</sup> These guidelines provided a checklist for the identification of outputs to assist agencies in the preparation of budget papers. Performance measures for each output were to be identified in terms of price, quantity and quality, with indicators to be developed to monitor and assess the output's contribution to outcomes.<sup>14</sup>
- 4.18 In clarifying its role in providing assistance to agencies on the development of their costing systems, DoFA advised that a substantial part of the work of its Budget Group over the coming year would be assisting agencies to develop costing systems as the first step in delivering pricing outputs. DoFA regarded itself as a clearing house of information as agencies developed their methodologies on costing systems. The department did not intend to impose costing systems, but was available to be consulted.<sup>15</sup>
- 4.19 The witness from DoFA emphasised that it was important that agencies developed their own integrated costing systems because agencies would feel they had ownership of the system. This was because the system should be used for strategic and operational management of their resources rather than just for external reporting, and, as well, it would ensure that the costing system was fully compatible with their financial systems and met their particular needs.<sup>16</sup>

### The need for oversight

- 4.20 The Committee raised with the witness from DoFA the merit of appointing a body to oversee the transition to accrual budgeting.

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13 Jim Murphy, DoFA, *Transcript*, pp. 47–8.

14 DoFA, *How to Measure Outputs*, Commonwealth of Australia 1998, p. 5.

15 Jim Murphy, DoFA *Transcript*, pp. 48–9.

16 Jim Murphy, DoFA, *Transcript*, p. 39.

- 4.21 The need for firm guidance was strongly supported in a submission from Martin A Cocker and Associates Pty Ltd:

...we believe that DoFA must set the pace of development and provide goal posts for all agencies to achieve. Some uniformity of methodology and approach is vital if any meaningful comparisons are going to be possible between one agency and another, and with potential external providers.<sup>17</sup>

### Committee comments

- 4.22 The Committee notes that the Australian National Audit Office intends to conduct an audit on the costing approach of the Australian Quarantine Inspection Service.
- 4.23 The Committee considers that DoFA has an important role to play in promoting and facilitating effective costing. This may entail:
- emphasising the links between effective costing and the efficient management of resources in an accrual framework; and
  - providing expertise to agencies on an individual basis.

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### Recommendation 3

- 4.24 **The Committee recommends that the Department of Finance and Administration actively facilitate the development of appropriate costing methodologies.**

Bob Charles  
Chairman  
29 September 1999

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17 Martin A Cocker and Associates Pty Ltd, *Submission No 5*, p. 3.