

## Introduction

### Background to the inquiry

- 1.1 In 1999–2000 the Commonwealth Government completed its move to full accrual accounting with the release of its first accruals based Budget.
- 1.2 The accruals system of accounting differs from the previous cash based system in that it recognises revenue and expenses in the accounting period in which they occur, irrespective of when cash is paid or received. It aims to match the costs incurred during a particular reporting period with the benefits earned in that period.
- 1.3 'Revenues' and 'expenses' under accrual accounting include items which are not usually covered in 'receipts' and 'payments' under cash accounting, such as:
  - the cost of consuming assets—for example, depreciation;
  - the cost of accruing employee entitlements such as long service leave; and
  - the value of goods and services received free of charge from other bodies.
- 1.4 Accrual information is useful because it provides information about total resource allocation, and enables managers to discharge their accountability responsibilities for overall resource management.

- 1.5 It is important to note that cash accounting and accrual accounting are not alternative systems. Rather, cash accounting is a subset of the more comprehensive full accrual accounting system. This is because one of the accruals based financial statements is a Statement of Cash Flows.
- 1.6 The Budget papers are but one set of accruals based documents provided to Parliament to allow it to scrutinise expenditure and performance by the Executive. Other documents are:
- the associated portfolio budget statements (PBSs) which expand on the Budget papers;
  - the portfolio additional estimates statements (PAESs) which provide, at a later time in the financial year, information about variations in proposed expenditure; and
  - agency annual reports which provide audited financial statements and information about the agency's performance in spending the money appropriated by the Parliament.

## The Committee's interest

- 1.7 The Committee has been a long time supporter of the move towards full accrual financial management by Commonwealth agencies. In its report into accrual accounting, tabled in August 1995, the then Joint Committee of Public Accounts recommended that the Government commission a review to consider the merits or otherwise of a move to accrual budgets and appropriations.<sup>1</sup>
- 1.8 The Committee's view was confirmed in November 1995 when it recommended, in its report on financial reporting for the Commonwealth, that 'the first accrual budget for the Commonwealth be introduced into Parliament for the 1999–2000 financial year.'<sup>2</sup>
- 1.9 In March 1996, the newly elected Government established the National Commission of Audit to investigate and report on the financial position of the Commonwealth Government. The Commission found that:

A full accrual accounting framework [was] an essential complement to the structural and cultural change the Government

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1 JCPA, *Report 338, Accrual Accounting—A Cultural Change*, APS, Canberra, 1995, Recommendation 9, p. 72.

2 JCPA, *Report 341, Financial Reporting for the Commonwealth: Towards Greater Transparency and Accountability*, Canberra, 1995, Recommendation 15, p. 137.

[was] seeking by way of a more competitive, efficient and effective public sector.<sup>3</sup>

- 1.10 The Commission recommended that the Government should adopt 'accrual principles as the basis for an integrated budgeting, resource management and financial reporting framework'.<sup>4</sup>
- 1.11 The Government subsequently decided in 1997 to move to an accruals-based framework with the first accrual Budget being for the 1999–2000 financial year. Appropriations would be based on the total financial resources needed to contribute to Government outcomes,<sup>5</sup> with funds being allocated for departmental items, administered items, and for equity injections.
- 1.12 The Committee has retained its interest in accrual matters. In March 2000, the Committee commented in its *Report 374* that it had noted some concern among members of Parliament concerning the impact of the new budget format on their ability to scrutinise proposed government expenditure.<sup>6</sup>
- 1.13 Further, during its review of Coastwatch, the Committee reviewed the funds expended on Coastwatch during 1999–2000 and 2000–01. The Committee concluded that while Coastwatch information had largely been separated out from other Customs information, there was still some way to go in providing clear and unambiguous information.<sup>7</sup>

### Interest by other parliamentary committees

- 1.14 Since 1997, the Senate Finance and Public Administration Legislation Committee (SFPALC) has tabled three reports on the format and contents of the PBS.
- 1.15 The SFPALC's first report in 1997 presented general principles for PBS preparation but did not recommend specific changes due to the anticipated move to the accrual budget and outcomes/outputs reporting framework.<sup>8</sup>

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3 National Commission of Audit, *Report to the Commonwealth Government*, Canberra, 1996, p. 211.

4 National Commission of Audit, *Report to the Commonwealth Government*, p. 211.

5 This includes salaries and operational expenses including depreciation and accruing employee entitlements such as long service leave.

6 JCPAA, *Review of the Financial Management and Accountability Act 1997 and the Commonwealth Authorities and Companies Act 1997*, Canberra 2000, p. 34.

7 JCPAA, *Review of Coastwatch*, Canberra 2001, pp. 37–9.

8 SFPALC, *The Format of Portfolio Budget Statements*, Canberra 1997, pp. 31–6.

- 1.16 The SFPALC's second report in 1999 found difficulties associated with the mechanics of accrual budgeting and with the new reporting framework. It noted in particular that Senators wanted:
- less aggregated financial information;
  - more standardisation across the PBSs; and
  - forward estimates for outcomes and outputs.<sup>9</sup>
- 1.17 Although it did not agree to the publication of more detailed forward estimates, the Government agreed to:
- publish a best practice outcomes and outputs guide;
  - disaggregate appropriations to output level in the PBS;
  - itemise administered expenses;
  - disclose variations from budget predictions to actual expenses; and
  - include explanations of the capital user charge.<sup>10</sup>
- 1.18 The SFPALC's third report was tabled in 2000. The call was repeated for greater consistency and comparability of the pricing and performance information contained in the PBS. The SFPALC also sought the provision of forward estimates information and noted that, in relation to performance information, the time between the setting of indicators in the PBS and reporting against them in the annual report was too long. The committee suggested that agencies provide part-year performance information in the PBS for those quantifiable indicators for which the information was readily available.<sup>11</sup>
- 1.19 The SFPALC also noted that reporting on progress towards outcomes was a weakness of the new system. In particular, few of the 'effectiveness indicators' used were particularly robust and many agencies had indicated that work needed to be done in this area.<sup>12</sup>

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9 SFPALC, *The Format of Portfolio Budget Statements—Second Report*, Canberra 1999, pp. 50–1.

10 SFPALC, *The Format of Portfolio Budget Statements—Third Report*, Canberra 2000, p. 1.

11 SFPALC, *The Format of Portfolio Budget Statements—Third Report*, Canberra 2000, pp. 39–42.

12 SFPALC, *The Format of Portfolio Budget Statements—Third Report*, Canberra 2000, p. 41.

## **The Committee's inquiry**

- 1.20 The inquiry was advertised in the national press on 4 April 2001, at which time submissions were invited from the public. In addition, selected agencies, and other interested people were invited to contribute to the inquiry. The Committee received 20 submissions and 1 exhibit. A list of the submissions received by the Committee can be found at Appendix A and details of the exhibit can be found at Appendix B.
- 1.21 The Committee subsequently held a public hearing using a round table format on 22 June 2001. A list of participants at the hearing can be found at Appendix C.

## **The structure of this report**

- 1.22 Chapter 2 of this report continues with a discussion of the structure of the outcomes and outputs framework. The Committee examines the links between the various components of the framework, including the links between agencies.
- 1.23 Chapter 3 addresses the degree of continuity of financial and performance information. Two aspects are discussed: the timeliness of the provision of information, specifically the delay between the portfolio budget statements (PBSs) and the annual reports; and the year by year continuity of information provided by agencies.
- 1.24 Chapter 4 discusses the level of detail in the PBS, namely the level of aggregation of outcomes and outputs and the reporting of forward estimates for outputs.
- 1.25 Chapter 5 discusses performance information, in particular: performance indicators, performance measurement and reporting, and the guidance provided to agencies.
- 1.26 The final chapter, Chapter 6 covers various accounting issues: the use of accrual accounting in the public sector; the implementation of the capital use charge; the explanation of operating surpluses; and the reporting of the final budget outcome.

