6

Accounting issues

Introduction

6.1 This chapter discusses accounting issues relating to the suitability, operation and reporting of the accrual based outcomes and outputs framework in the public sector. In particular, the Committee has considered:

- the appropriateness of accounting standards for the public sector;
- accrual-based appropriations and cash management;
- the appropriation process;
- the use of ‘price’ in the resource management framework;
- the implementation of the Capital User Charge (CUC);
- the explanation of operating surpluses; and
- the reporting of the Final Budget Outcome (FBO).

Use of accrual accounting in the public sector

6.2 In general, witnesses appearing before the Committee endorsed the Commonwealth’s adoption of the accrual based outcomes and outputs framework. CPA Australia commented that overall 'the CPA's position is very positive towards the accrual shift at the Commonwealth level.'[1]

6.3 Emeritus Professor Allan Barton, appearing in a private capacity, noted advantages including the provision of relevant information for the control of resources and costs of departments and programs, and for the management of government assets and liabilities.[2]

Appropriateness of accounting standards for the public sector

6.4 Professor Barton argued that the accrual accounting system used by business needed significant modification before being used by the public sector. This was because of a fundamental difference in the nature of the two sectors:

> The accrual accounting systems used by business are designed to suit the specific market environment of business operations which are profit seeking, self-funding and very much concerned with solvency, et cetera. Businesses sell goods with several technical characteristics; that is, the goods are rival and excludable … Public goods are non-rival and non-excludable. The typical examples of public goods are defence, law and order—and good government, … public broadcasting and so on.[3]

6.5 Professor Barton added there were also problems in accounting for cultural and heritage assets, and he concluded:

> The present business accounting standards do not readily cover these types of situations because they were never intended for application to them, so we need accrual accounting—but it has to be modified.[4]

6.6 The ANAO responded by stating:

> … I can say with some authority that the accounting bodies did seek to take into account the differences between the public sector and the private sector, so we have a specific series of accounting standards dealing with public sector matters: we have standards on local government reporting, departmental reporting and whole of government reporting, which do seek to address the public sector. That said, I think people would probably accept that it is

1 Mr Adam Awty, CPA Australia, *Transcript*, p. 16.
2 Emeritus Professor Allan Barton, *Transcript*, p. 13.
3 Emeritus Professor Allan Barton, *Transcript*, p. 13.
4 Emeritus Professor Allan Barton, *Transcript*, p. 14.

> probably time that the Australian Accounting Standards Board has another look at that particular series of standards. Recent discussions I had with the chairman of that board suggest that they are likely to look at that downstream.[5]

6.7 The Committee notes the ANAO's comment that the Australian Accounting Standards Board was likely to be revisiting the issue in the future, and considers such a move would be timely.

Accrual-based appropriations and cash management

Accrual based appropriations

6.8 In 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 considered two options for appropriations:

- Option 1, appropriating accrual based amounts; and
- Option 2, appropriating only the cash amount required based on the cash flow budget.[6]

6.9 While the Commission favoured Option 2, in the event the Government decided to adopt the other option. However, Mr Anthony Harris, appearing in a private capacity, considered appropriations should be on a cash needs basis. He told the Committee:

> … it is probably better that the appropriations be cash based, which can be deduced from the accrual accounts, rather than paying for expenses that are not going to require any expenditure in the year ahead, for example. The department will have very considerable expenses that will be accrual based not cash based, but you are funding them as if they were cash based, as I understand it, in the current year.[7]

6.10 The ANAO took a contrary view:

> I am sure that that would have been one of the models that Finance contemplated at the time. But, like many things in life, there is always a downside to every model that you choose. One of the downsides of that model is that you would not necessarily

5 Mr Ian McPhee, ANAO, *Transcript*, p. 18.

6 National Commission of Audit, *Report to the Commonwealth Government*, AGPS, Canberra 1996, pp. 235–6.

7 Mr Anthony Harris, *Transcript*, p. 15.

> have the read-through. Also, you do not necessarily signal to public sector managers that they have to take into account the full resource costs of decisions. I suspect that, if you went from an accrual based budget to cash appropriations, the whole system would still drive off cash, because that was a clear control point.[8]

Cash management

6.11 Prior to the introduction of the accrual-based framework, financial resources were managed on a cash accounting basis. The introduction of full accrual accounting has not diminished the need to effectively manage cash within the budget context. As Professor Barton explained:

> … because of the nature of the role of government, cash budgeting and cash accounting are still absolutely vital to its information needs—and there is no problem in theory and in practice about running cash accounting budgets and reports alongside full accrual accounting reports. Cash accounting is merely a subset of full accrual accounting.[9]

6.12 He added that he believed, however, that when accrual accounting was adopted the decision to drop the cash accounting statements was a basic mistake.[10]

6.13 Finance responded to Professor Barton's comment:

> I should reassure the committee that we have a very good handle on cash. We know the Commonwealth's total cash balance and the cash balance for each agency. I am told that within a few minutes after midnight … all of that information is available.[11]

6.14 However, Finance did agree with Professor Barton on the issue of managing agencies' cash positions:

> I agree entirely with Professor Barton that you cannot manage unless you have a good handle on both what your cash position is and what your likely cash requirements are going to be.[12]

6.15 Treasury supported the comments from Finance:

> There is a full cash flow statement produced at the whole of government level which enables the underlying cash and headline

8 Mr Ian McPhee, ANAO, *Transcript*, pp. 17–18.

9 Emeritus Professor Allan Barton, *Transcript*, p. 14.

10 Emeritus Professor Allan Barton, *Transcript*, p. 14.

11 Mr Stephen Bartos, Finance, *Transcript*, p. 22.

12 Mr Stephen Bartos, Finance, *Transcript*, p. 22.

> cash balances to be tracked so they can be tracked on a consistent basis over a number of years. We think that is very important. Cash will continue to be a very key focus both of government policy makers and financial markets.[13]

6.16 Finance also drew attention to the monthly financial statements prepared by Finance. Finance commented they were available on its web site and were valuable documents used by the financial markets.[14]

Conclusion

6.17 The Committee considers there is no compelling reason to discontinue the present system of appropriations on a full accrual basis. The Committee is also satisfied in relation to cash management, that Finance monitors and reports on the Commonwealth's cash position in a timely manner. However, the Committee considers it would be useful if commentary in the form of explanatory notes from Finance were provided to support its monthly financial statements.

The appropriation process

Background

6.18 For the current Budget for 2002–03, Appropriation Act No.1 authorises the Finance Minister to issue out of the Consolidated Revenue Fund (CRF) the sum of $43 445 965 000 in accordance with the Schedule to the Act.[15] The Committee considered an alternative whereby each portfolio Minister was authorised to issue from the CRF.

6.19 The potential benefits of this more devolved arrangement may include:

- highlighting of Portfolio Ministers' accountability for appropriations provided for the delivery of departmental outputs and administered items to achieve Government outcomes; and
- achieving greater efficiencies in the Commonwealth's cash management as compared to the current centralised arrangement.

6.20 Finance advised the Committee that while agency chief executives were responsible for managing the cash resources coming within agency control, the Finance Minister, in collaboration with the Treasurer, was

13 Dr Paul Grimes, Treasury, *Transcript*, p. 23.

14 Mr Stephen Bartos, Finance, *Transcript*, pp. 28-9.

15 *Agency Resourcing 2002–03, Budget Paper No. 4,* p. 34.

responsible for managing the Commonwealth's overall cash position. One of the key objectives of Commonwealth central cash management policy was to minimise the overall cost of Commonwealth borrowing, that is, public debt interest costs.[16]

6.21 Finance continued by stating that:

> In recognition of the time value of money, an important element of the Commonwealth's central cash management framework was the Finance Minister's capacity to manage the timing of funding to Commonwealth agencies. Under the arrangements in place since 1 July 1999, the Finance Minister's delegate negotiates and agrees the timing of the cash to be transferred to agencies in respect of, *inter alia*: outputs; departmental equity injections; departmental loan drawdowns; departmental special appropriations, administered capital injections; administered grants, benefits and subsidies; specific purpose payments to the States and Territories; payments to be made from special accounts; GST funding; and refunds of taxes, excise, fees and charges.[17]

6.22 Finance added that the agreed timing of the funding flows to agencies was based upon agencies' business needs. By carefully managing the timing of funding to agencies, the central pool of cash available to fund the emergent needs of all Government programs was optimised, with minimal borrowing costs. Less than optimal cash management in this area could significantly impact on public debt interest cost.[18]

6.23 Finance concluded that central management afforded the Government an important degree of flexibility in the reprioritisation of Government programs throughout the year, within clear accounting and budgeting rules.[19]

Conclusion

6.24 The Committee agrees that sound cash management is necessary to reduce any impact on public debt interest cost. However, this does not of itself preclude portfolios from being responsible for managing cash. Portfolios could for instance, manage cash with clearly specified statutory rules (*Finance Minister's Orders*) and appropriate incentives for sound management and sanctions for poor management. With an appropriate

16 Finance, *Submission No. 13*, p. 109.
17 Finance, *Submission No. 13*, p. 109.
18 Finance, *Submission No. 13*, p. 109.
19 Finance, *Submission No. 13*, p. 109.

governance structure for the management of this function, it may be possible to achieve greater efficiencies for the Commonwealth's cash management in a devolved environment with elements of competition, rather than in a centralised, totally controlled environment. For instance, Finance could set the optimal governance structure, cash management and public interest cost reduction performance targets, and portfolios could manage the function accordingly.

6.25 The Committee acknowledges that Government priorities may change through the budget year. The renegotiation of Government priorities should take place within the established governance structure of Cabinet Government, and Parliamentary approved appropriations. As with the management of cash, with the appropriate governance structure, incentives and sanctions and guidance from Finance, the ongoing process of priority review can proceed. With clear accounting and budgeting rules, better outcomes may be achieved than perhaps is possible through central control.

6.26 Finally, the Committee notes the trend towards 'letting the managers manage'. To this end there has been increasing responsibility placed on agency CEOs and the devolution of functions from central agencies such as banking, purchasing, central pay and accounting systems. Trends in public administration often conform to 'the pendulum rule', and the Committee conjectures whether with Finance wishing to retain control of cash management, the pendulum has reached the limit of its current swing.

Recommendation 8

6.27 **The Department of Finance and Administration should identify and report to the Minister on the risks and benefits of allowing Portfolio Ministers authority to issue amounts out of the Consolidated Revenue Fund directly rather than through the authority of the Minister for Finance. The Department should advise its Minister on the appropriateness of allowing Portfolio Ministers to exercise such an authority.**

Use of 'price' in the resource management framework

6.28 Under the accrual based outcomes and outputs framework, agencies nominate in their PBS, the 'price' of outputs for purchase by the Government. Such arrangements pre-suppose the existence of a functioning market for the outputs. However, most public sector expenditure occurs in the general government sector which provides 'public services which are mainly non-market in nature.'[20]

6.29 The Committee sought advice from Finance and the ANAO about the appropriateness of using the 'price' concept within the accrual based outcomes and outputs framework given that there may be no market.

6.30 Finance acknowledged in a supplementary submission that there were a large number of Commonwealth activities, such as grants, transfers and benefits payments, which were not delivered in a competitive market. These constituted some 80 per cent of the Budget and were classified as administered items. However, the concept of 'price' was generally not applied to administered items.[21]

6.31 The term 'price' was applied only to departmental outputs which were generally contestable in nature and thus open to price comparison. Some outputs, such as corporate services or other administrative activities, were increasingly exposed to direct competition.[22]

6.32 The Finance submission continued:

> In other cases even where governments have taken a decision to source an activity solely from a public sector agency, a clear comparison with other providers can generally be made. For example, in relation to policy advice, a number of private policy advisers exist, or in relation to assessing and administering grants programs, comparisons can be drawn with private sector assessment processes or indeed between different Commonwealth agencies with similar processes. In these cases the concept of price

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20 Consolidated Financial Statements, Commonwealth Government of Australia, circulated by the Honourable John Fahey, M.P. Minister for Finance and Administration, for the information of Honourable members, October 2000, Glossary, p. 136.

21 Finance, *Submission No. 21*, p. 159.

22 Finance, *Submission No. 21*, p. 159.

> remains applicable as a guide to whether the Commonwealth is paying the right amount for the output delivered.[23]

6.33 Finance also advised that the use of benchmarking comparisons was one way to evaluate whether the price for an output was reasonable. A range of benchmarking diagnostics was available to agencies to use.[24]

6.34 The supplementary submission from the ANAO noted that:

> … a market pricing model is only one of a number of ways in which pricing structures can be set. The absence of an active market can make it difficult to determine market prices: it does not, in itself, mean that market prices cannot be estimated or that other pricing models are not appropriate.[25]

6.35 The submission also commented that a more significant issue was the question of how to deal with the difference between prices and costs. Government agencies were established to deliver services on behalf of the Government, so eventually these variations have to be funded (if costs exceeded prices) or returned (if prices exceeded costs). This raised the question, therefore, as to what was the benefit in differentiating between price and cost.[26]

6.36 The ANAO suggested that funding agencies for the 'market price' of services delivered would drive efficiencies and lead to lower costs—if market prices were below existing government cost levels, then efficiencies would follow when agencies are funded at these lower levels. The concept of price had been introduced to provide an important message to agencies that funding would not always be given on the basis of costs.[27]

Conclusion

6.37 The Committee notes that although many departmental outputs are generally contestable in nature and thus open to comparison on the basis of price, not all departmental outputs readily lend themselves to benchmarking comparisons for the purpose of contestability.

6.38 For example, in the audit of the Australian Taxation Office's (ATO's) management of tax debt collection, the Auditor-General identified the

23 Finance, *Submission No. 21*, p. 159.
24 Finance, *Submission No. 21*, p. 159.
25 ANAO, *Submission No. 20*, p. 156.
26 ANAO, *Submission No. 20*, p. 156.
27 ANAO, *Submission No. 20*, pp. 156–7.

relationship between the Government and the ATO as one between a monopsony purchaser[28] and a monopoly provider—'the Government can only 'purchase' this output from the ATO, and the ATO can only 'sell' this output to the Government.'[29]

6.39 The Committee notes that Finance has a pricing agreement in place with the ATO for the delivery of its departmental outputs.

6.40 The Committee considers that while such agreements provide the agency with a degree of certainty over its future funding, they may have limited value in cases of a monopsony relationship between the Government and the agency, or where agency outputs are not readily able to be fairly and accurately benchmarked for the purpose of contestability. In some cases therefore there may be difficulties in establishing the appropriate market price for the agency's outputs.

6.41 The Committee concludes that, as with the comments concerning the transferability of the accrual accounting model from the private to public sector, the use of price may not always be appropriate in relation to expenditure in the general government sector.

6.42 The Committee notes the ANAO's suggestion that if there was concern with the reference to 'price' in the PBS, the term could be replaced with 'funding' or a similar term.[30]

6.43 The Committee considers it would be worthwhile to identify in the PBS the pricing model used to derive the price of agency outputs, for example, whether the price simply represents the cost of output delivery or is based on 'cost plus', or on some other model. This would assist Parliament's understanding of the basis on which funding is sought and indicate the extent to which it is considered that a market exists for the output.

Recommendation 9

6.44 **The Department of Finance and Administration should amend its guidelines to agencies so that information describing the model used for pricing outputs is included in the agency PBS.**

28 A monopsony purchaser refers to a situation where there is only one possible purchaser for a good.

29 ANAO, *Audit Report No. 23, 1999-2000, The Management of Tax Debt Collection, Australian Taxation Office*, pp. 66-7.

30 ANAO, *Submission No. 20*, p. 157.

Implementation of the Capital Use Charge

Background

6.45 The Capital Use Charge (CUC) was introduced as part of the Government's intention that agencies operate on a more commercial basis. There is a cost related to the use of capital resources and the CUC is a mechanism whereby this cost is recognised. The net assets (equity) charging basis has been adopted as the way to include a cost of capital in the price of agency outputs.

6.46 With the introduction of accrual budgeting, the CUC was imposed upon the 'departmental' net assets of budget funded agencies.[31] Agencies are funded for the CUC at the beginning of the year by Budget appropriation, and the CUC is imposed at the end of the year on the net assets of the agency at that time. The CUC is disclosed as a 'below the line' adjustment on operating statements.[32]

Relevance and effectiveness of the CUC

6.47 Professor Barton, while acknowledging that capital funds have an opportunity cost, questioned the relevance of the CUC for government operations. He argued that the rate which is set is not the actual cost to Government but was roughly the cost of capital to the private industry, which was significantly higher. He suggested a specific financial charge was unnecessary if managers recognised resources always have an internal opportunity cost.[33] He continued:

> In economics, all these things are developed initially as internal opportunity costs. You can only use a resource at one time for one purpose, and you cannot use it for something else, so you always have those choices. I doubt whether you would get any extra benefits from having this fictitious and notional charge imposed on top of that. I think it complicates your accounting system no end and … it is paid up front and then it is recalled back. It does not really make very much sense to many people.[34]

31 Departmental assets are those the agency controls on its own behalf. They can be distinguished from 'administered' assets which are assets an agency administers on behalf of the Government.

32 ANAO, *Submission No. 7*, p. 50.

33 Professor Alan Barton, *Transcript*, p. 43.

34 Professor Alan Barton, *Transcript*, p. 44.

6.48 A Finance supplementary submission advised that it was important for the cost of capital used by an agency to be included in the price of its outputs to allow comparison with both public and private sector providers.[35]

6.49 Another use of the CUC was identified by Finance when it told the Committee that the underlying precept of the CUC was 'to foster greater asset management, not just in the accounting sense, but in the actual life cycle management of the net asset base of each organisation.'[36]

6.50 Finance added that it had considered a variety of available models, but eventually settled on a charge on net assets.[37]

6.51 The submission from CPA Australia questioned the net assets basis for application of the CUC:

> By using the net assets base, the agency is being charged CUC on movements in the operating result, so if an agency makes a surplus (the expected) they are penalised. However, if the agency were to be charged on the controlled, non-current physical assets, the agency is being measured fairly on the assets within their management control.[38]

6.52 Finance responded:

> To the extent that assets grow, then the CUC is rather like a dividend. It is a concept of saying to the organisation: you have made a surplus, the owner would expect to have a proportion of that surplus returned as a dividend. … if you have the model that a business is there to make a profit for owners—given that was part of the emulation model—then when an agency makes a surplus it is not a penalty, it is a sharing process.[39]

6.53 Finance indicated that there were other issues related to the CUC:

- the different risk profiles of organisations and within organisations and the possibility of considering the use of differential CUC rates based on risk weightings, currently used by the New Zealand Government; and
- the complexities introduced through many agencies having negative net assets.[40]

35 Finance, *Submission No. 13*, p. 117.
36 Mr Brett Kauffman, *Transcript*, p. 42.
37 Mr Phillip Prior, Finance, *Transcript*, p. 42.
38 CPA Australia, *Submission No. 5*, p. 38.
39 Mr Phillip Prior, Finance, *Transcript*, p. 42.
40 Mr Phillip Prior, Finance, *Transcript*, p. 42.

6.54 Finance concluded in its supplementary submission that while the experience in other jurisdictions is that improvements have been limited in asset management practices as a result of capital charges, 'together with other reforms, such as the publication of capital budget statements, early signs are that Commonwealth agencies are placing greater emphasis on balance sheet management.'[41]

Accounting treatment of the capital use charge

6.55 As previously discussed, the CUC is imposed on the net assets of the agency at the end of the year and is disclosed as a 'below the line' adjustment on operating statements. This means that the CUC is effectively treated as a dividend to the Commonwealth.

6.56 In its submission, the ANAO commented that the Corporations Law stated that dividends may only be paid out of profits. Consequently, it was usual for dividends to represent a distribution of operating surpluses. Imposing the CUC on the net assets of agencies meant it was possible that the charge could be paid out of capital contributions or unrealised asset revaluation reserves. In such circumstances, it would not represent a return of surpluses to the owner.[42]

6.57 The submission commented further that currently the funding for the CUC was disclosed as revenue, and directly increased the operating result by the amount of the CUC. This was because the CUC when levied was not recorded as a corresponding expense. By way of example, the ANAO commented that the Defence financial statement for 1999–2000 revealed an operating surplus of $5.3 billion. (This compared to the $3.6 billion surplus of Telstra, one of Australia's largest corporate entities.) However, $4.6 billion of the Defence 'surplus' was subsequently remitted to the Commonwealth by way of the CUC.[43]

6.58 The ANAO advised it had raised this matter with Finance, by asking whether the CUC should more accurately be reflected as a financing cost or charge imposed on agencies. If this was the case it would more appropriately be disclosed as an expense.[44]

6.59 During the hearing the ANAO referred to the Defence example noting that it ran a very large surplus, but a large component was the funding provided to pay for the CUC. The ANAO questioned whether this

41 Finance, *Submission No. 13*, p. 117.

42 ANAO, *Submission No. 7*, p. 50.

43 ANAO, *Submission No. 7*, p. 50.

44 ANAO, *Submission No. 7*, p. 50.

obscured from Parliamentarians the underlying performance of some agencies as revealed by their accounts.[45]

6.60 Finance responded in a supplementary submission advising that it had reviewed whether the CUC should be recognised above the operating result line as an expense, or below the operating result line as a dividend. The review had endorsed the current approach of treating the CUC as a dividend because it matched the view that the CUC was a return on the Commonwealth's investment in an agency.[46]

Conclusion

6.61 The Committee has considered the introduction of a CUC when it reviewed asset management in the Commonwealth. The Committee noted that such a charge 'would encourage agencies to accurately value their assets and moderate any tendency … to over value assets to gain advantage of funding to meet asset depreciation'.[47] The Committee reasserts its support for a mechanism which recognises the opportunity cost of capital in agency financial statements.

6.62 The Committee recognises, however, that the current CUC arrangement has been in place for a relatively short period of time, and is but one of a range of tools used by the Government to ensure improved financial practices within agencies. As with all new initiatives, refinement may be needed from time to time to maximise potential effectiveness.

Explanation of operating surpluses

6.63 The Committee notes that from time to time agencies can achieve a significant operating surplus which is separate from the CUC. The Committee sought comment on the merit of requiring agencies to include in their annual reports the details of any such surplus to output level. Such details would be supported by explanations which could be matched to the audited financial statements.

6.64 Finance responded in a supplementary submission that it supported the 'separate disclosure of the "true" operating position, net of any surpluses achieved in order to pay the CUC dividend.' The submission also advised that the *Finance Minister's Orders* for 2001–02 relating to financial reporting

45 Mr Ian McPhee, ANAO, *Transcript*, p. 44.

46 Finance, *Submission No. 13*, p. 117.

47 JCPAA, *Report 363, Asset Management by Commonwealth Agencies*, Canberra, 1998, p. 38.

'will require the major revenue and expense items at the output (output group) level to be disclosed in the notes of agencies' financial reports.'[48]

6.65 The ANAO commented that because of the large number of outputs of some agencies, the reporting of surpluses would be more feasible at the output group level. Also, agencies are currently provided with a single appropriation for departmental items, and have the authority to move funding between outputs as and when required. Consequently:

> … the chief executive is able to determine the revenue attributable to any output and thus the consequential 'surplus' or 'deficit'. Under these arrangements, it would be unlikely to see excessive surpluses or deficits recorded against any output group.[49]

6.66 The ANAO provided an alternative model for consideration, which was:

> … to report on budgeted against actual expenses at an output level. Consistent with the way such reporting occurs within the private sector, such reporting could disclose not only the budget variance, but an analysis of the cause of the budget variance in terms of:
>
> - the quantity of outputs delivered; and
> - the cost of outputs delivered.[50]

6.67 The ANAO, however, cautioned that such reporting would not be reliable until agency systems were able to accurately attribute all costs to output/output groups.[51]

Conclusion

6.68 The Committee considers there is merit in agencies identifying in their annual reports any operating surplus to output level or output group level. The Committee is unsure, given the comments from the ANAO, as to how this might be best achieved.

48 Finance, *Submission No. 13*, p. 118.
49 ANAO, *Submission No. 11*, p. 94.
50 ANAO, *Submission No. 11*, p. 95.
51 ANAO, *Submission No. 11*, pp. 94–5.

Recommendation 10

6.69 **The Department of Finance and Administration, in consultation with the Australian National Audit Office, should review ways in which agencies should disclose details of any operating surplus to output or output group level. These details should be able to be matched to the agency's audited financial statements. The *Finance Minister's Orders* should be amended to put into effect such a reporting requirement.**

Reporting of the Commonwealth Final Budget Outcome

Introduction

6.70 In addition to financial reporting at agency and whole of government levels, the *Charter of Budget Honesty Act 1998* requires the Government to publish a Final Budget Outcome (FBO) report within three months of the end of the financial year. The information contained in the FBO is obtained from the annual process of compilation of the Consolidated Financial Statements (CFS), and presents:

- financial information relating to the general government sector prepared in accordance with Australian Accounting Standards (AAS), in particular AAS31;
- financial information prepared using Government Finance Statistics (GFS) concepts;
- discussion and reconciliations of differences between the above two sets of information;
- information on federal financial relations; and
- a discussion on the overall Commonwealth budget outcome which is based on analysis of the GFS statements.[52]

Accounting standards for the Final Budget Outcome

6.71 Using two accounting standards—the AAS and the GFS—results in two different sets of financial reports being produced for scrutiny by Parliament and other stakeholders. The Committee notes that it is also

52 ANAO, *Submission No. 11*, p. 90.

possible for governments to depart from these standards provided any departures from the standards are clearly identified.[53]

6.72 Nevertheless, the presentation of two differently based reports can lead to difficulties in interpretation. Mr Anthony Harris told the Committee that while the two accrual reports can be linked, they can provoke confusion and difficulties when moving between them. He continued:

> The cost of that was most evident in the treatment of a loan provided under ANTS—the new tax system—to the states interest free and repayable from a grant in the subsequent year. Under the [GFS] system it was treated as a loan and under Australian Accounting Standards it was treated as a grant. That is a problem …[54]

6.73 In discussing the issue of the two standards, the Australian Bureau of Statistics (ABS) witness told the Committee that efforts at harmonisation were limited because the statistical standards were really 'a subset of wider national accounting standards and, in some areas of significance, there is a difference between the AAS31 approach and the statistical approach.'[55] He continued:

> Our solution to that was that, whenever we publish accruals based government finance statistics, we will provide a reconciliation to get from our presentation of the data to the accounting presentation. Having said that, there are, in my view, some needless differences between the accounting presentation and the statistical presentation. We would be very keen to see whether we can remove those differences.[56]

6.74 Finance agreed that ideally there should be 'no difference between the GFS and AAS presentations.' He advised the Committee that Finance currently had a longer term project aimed at harmonising the two standards. However, the difficulty was that the GFS originated from the International Monetary Fund system of national accounts, so achieving change would require international liaison.[57] Treasury expressed similar sentiments.[58]

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53 Dr Paul Grimes, Treasury, *Transcript*, p. 21.
54 Mr Anthony Harris, *Transcript*, p. 15.
55 Mr Robert Edwards, ABS, *Transcript*, p. 32.
56 Mr Robert Edwards, ABS, *Transcript*, p. 32.
57 Mr Stephen Bartos, Finance, *Transcript*, p. 22.
58 Dr Paul Grimes, Treasury, *Transcript*, p. 23.

6.75 Finance noted that it was important that when new standards were developed or existing standards revised, 'the uniqueness of public sector transactions is taken into account'. He added that Finance was dissatisfied with the current public sector minority representation on the Australian Accounting Standards Board (AASB). He noted that although greater public sector representation had recently been achieved, it still amounted to only three out of the ten AASB members.[59]

Conclusion

6.76 The Committee supports greater harmonisation between the GFS and AAS standards and encourages Finance to maintain its efforts to achieve this goal.

6.77 The Committee also believes there would be benefit in greater public sector representation on the AASB as this would assist in the development of accounting standards as they relate to the public sector.

Auditing the Final Budget Outcome

6.78 During the public hearing Mr Harris drew the Committee's attention to the fact that the FBO was not audited.[60] The Committee subsequently sought advice from Finance and the ANAO on whether the FBO should be audited.

6.79 Finance responded that the FBO performed a different function to agency financial statements and the Consolidated Financial Statements (CFS) which were audited and released in September/October each year. The emphasis of the FBO was on 'timely, indeed speedy, issue of this information, to an acceptable degree of accuracy.' The issue was that auditing the FBO would 'compromise its timeliness and end-year utility, pending release of the CFS.'[61]

6.80 An additional issue was the level of assurance that could be provided by an audit. Specifically, whether the auditor should provide the traditional positive assurance audit report requiring a full scope audit approach, or whether a negative assurance report should be provided based on a review only.[62]

59 Mr Brett Kauffman, Finance, *Transcript*, pp. 23–4.
60 Mr Anthony Harris, *Transcript*, p. 15.
61 Finance, *Submission No. 13*, p. 107.
62 Finance, *Submission No. 13*, p. 107.

6.81 The ANAO responded by advising that the information in the FBO which was prepared under the AAS requirements was effectively a subset of the CFS which was audited by the ANAO. Thus there would be no difficulty in extending audit coverage to this component of the FBO. Concerning the unaudited GFS information, the ANAO advised the Committee that it 'would be in a position to audit this information if requested.' Because there were some differences in the principles underlying AAS and GFS reporting, expert advice could be sought if necessary.[63]

6.82 The ANAO considered that the benefits of auditing the FBO would be the additional credibility provided by an independent review.[64]

Conclusion

6.83 The Committee concludes that given the importance of the information contained in the FBO for decision-making and accountability purposes, there is merit in seeking the additional assurance which an audit of the FBO would provide. Finance should consult with the ANAO to determine the most suitable form of the audit to ensure a balance between an appropriate level of assurance and the provision of timely information.

Recommendation 11

6.84 **The Final Budget Outcome should be audited by the Australian National Audit Office.**

Bob Charles MP
Chairman
5 June 2002

63 ANAO, *Submission No. 11,* p. 90.

64 ANAO, *Submission No. 11,* p. 90.