

## **Audit Report No. 2**

### **Use of Financial Information in Management Reports**

#### **Introduction**

- 2.1 *The Auditor-General Audit Report No. 2, 1999-2000, Use of Financial Information in Management Reports*, reviewed the effectiveness of the use of financial information for agencies' performance management framework. The report also assessed whether the financial information in management reports was appropriate for the new accrual based environment.
- 2.2 The ANAO emphasised that the 'effective use of financial information is critical to successful performance management.'<sup>1</sup> It is only through the use of both financial and non-financial data (including client feedback) that performance can be monitored and accountability discharged.<sup>2</sup>
- 2.3 The new accrual-based performance management framework being implemented in the APS is designed to focus on the full costs and benefits of activities; the services provided by government; and the desired outcomes of those services.<sup>3</sup> By identifying the full cost implications of activities and proposals, the new framework enables managers to make better informed resourcing decisions. The ultimate goal is the efficient, effective and ethical use of resources, with desired outcomes being realised by appropriate outputs.

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1 *Audit Report No. 2, 1999-2000*, p. 6.

2 *Audit Report No. 2, 1999-2000*, p. 11.

3 *Audit Report No. 2, 1999-2000*, p. 11.

- 2.4 The success of such a framework depends both on the quality of information available to managers, and how effectively that information is used. Financial information can be used to assist with:
- strategic and business planning;
  - resource management; and
  - performance monitoring.<sup>4</sup>
- 2.5 This chapter identifies the needs of agencies with respect to collecting and using financial information. It goes on to outline the findings of the ANAO report. Challenges facing the public sector in implementing the new approach are discussed, along with the Committee's views on how to meet these challenges.

## Information needs of organisations

- 2.6 In order to minimise costs, consistent with achieving organisational objectives, managers require sound information on the costs of inputs, processes and outputs. For example, in determining whether to outsource the delivery of a program, an agency needs a sound appreciation of both current costs and costs that would be incurred under the proposed arrangements, including transition costs and contract management costs.
- 2.7 The evaluation criteria used by the ANAO to assess the adequacy of financial information are outlined in Appendix 1 to *Audit Report No. 2, 1999–2000*. They include such issues as the following:
- the implementation of processes to accurately determine the information needs of managers;
  - the delivery of information consistent with managers' needs;
  - the delivery of information in an appropriate mode and format;
  - value-adding by the finance area;
  - the use of financial information in decision-making; and
  - management's level of skill in analysing and interpreting financial information.<sup>5</sup>

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4 ANAO, *Building a Better Financial Management Framework*, 1999, p. 47.

5 *Audit Report No. 2, 1999–2000*, pp. 34–5.

## Financial information in public sector agencies

### ANAO findings

2.8 The ANAO examined the use of financial information in seven Commonwealth organisations. It examined what financial information was used, who used it, and how well it was used. Also, the ANAO assessed whether current processes for defining, accumulating and producing financial information were appropriate for the new accrual based performance management framework.<sup>6</sup>

2.9 As the Auditor-General observed,

The effective use of financial information is a critical component of an organisation's performance management framework... 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.<sup>7</sup>

2.10 The following findings by the Auditor-General suggest that Commonwealth agencies have some way to go before they fulfil these requirements.

- Most organisations narrowly defined managers' financial responsibilities and associated accountabilities. Therefore, limited financial information was provided to managers, with the focus largely on accountability for compliance with budgets and managing expenditure (typically on a cash basis).
- Little evidence was found of managers using *available* financial data for day to day operations, strategic decision-making or performance management.
- Line management and finance areas demonstrated neither a strong understanding of the new accrual environment, nor the necessary skills to maximise its management benefits. Limited training constrained the ability of managers to use accrual financial information to support decision-making. Finance areas were not well equipped to fulfil their

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<sup>6</sup> *Audit Report No. 2, 1999-2000*, p. 6.

<sup>7</sup> *Audit Report No. 2, 1999-2000*, p. 11.

new role, which includes assisting managers to analyse and interpret financial information.<sup>8</sup>

## Issues discussed at the public hearing

- 2.11 At the public hearing, the Committee pursued a number of issues arising from the Auditor-General's report. These included the costing of government outputs; cultural change issues within the public sector; and the time frame for the full implementation of the accrual environment.

### Costing of Government outputs

- 2.12 One of the objectives of accrual budgeting is to provide more meaningful data on the cost of providing government services. An example of this would be for a relevant agency to identify the cost of delivering one dollar of transfer payments to a client. This point was highlighted by the following example:

If I were CEO of a department I would like to know what it costs per dollar of benefit to deliver an unemployment benefit versus a single parent benefit versus an age pension benefit versus a Department of Veterans' Affairs benefit.<sup>9</sup>

- 2.13 Such information would enable agencies to compare costs and to implement efficiency mechanisms to ensure that they were competitive.

### Cultural change issues

- 2.14 The new framework's successful implementation will require significant cultural change at all levels. At the public hearing, Centrelink remarked that they had experienced 'significant cultural changes moving from a cash mentality to a full accrual mentality'.<sup>10</sup> However, they went on to state that 'it will take a while to get into the role of a full accrual accounting mentality'.<sup>11</sup>
- 2.15 During the hearing, Defence referred to the difficulty of securing commitment to change from staff near the end of their careers, particularly those at more junior levels.<sup>12</sup> Another Defence representative, Dr Ian Williams, noted that 'Probably the mass of people in the middle are the

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8 *Audit Report No. 2, 1999-2000*, pp. 6-7, 13-14.

9 *Transcript*, p.18.

10 Mr Allan Guakroger, Centrelink, *Transcript*, p. 22.

11 Mr Allan Guakroger, Centrelink, *Transcript*, p. 22.

12 Claude Neumann, Defence, *Transcript*, p. 29.

area we need to try and push'<sup>13</sup> and also that '...there is a challenge to get the senior managers thinking in accrual terms.'<sup>14</sup>

- 2.16 The Committee takes the view that senior executives require a more robust and detailed knowledge of their organisational culture if they are to effect meaningful change. This includes a thorough understanding of the obstacles to the full implementation of the new framework.

### Implementation of the new framework

- 2.17 The Committee is conscious of the practical difficulties facing the public sector as it attempts to implement the new framework. These include the need for cultural change, resource constraints and the lack of appropriate off-the-shelf support systems. Precisely because of these barriers, agencies need to accord implementation a high priority. However, at the hearing, the Committee was alarmed by agencies' lack of confidence in their ability to meet deadlines for the implementation of their new financial systems.

- 2.18 The agencies did not indicate any sense of urgency to fully implement their financial systems. For example, Defence observed that:

In hindsight, I suspect we have probably started a bit more slowly than we should have done and perhaps that was just a bit of optimism on how quickly one could implement change.<sup>15</sup>

- 2.19 Similarly, a representative from Treasury tentatively nominated a possible timeframe with the reservation that he '...would not like to be pinned to it...'<sup>16</sup>

- 2.20 It will be the responsibility of senior management to adopt a broader view of their financial management responsibilities. In doing so, they will be able to generate a cultural change by infiltrating the benefits of effective financial information throughout their agency. The implementation of accrual budgeting constitutes a project of significant scope and complexity. While the time frame for each agency needs to be realistic, it also needs to be followed through. This matter is discussed further in the following section.

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13 Ian Williams, Defence, *Transcript*, p. 30.

14 Ian Williams, Defence, *Transcript*, p. 19.

15 Ian Williams, Defence, *Transcript*, p. 18.

16 Tony Preston Stanley, Treasury, *Transcript*, p. 45.

## Financial information—the way ahead

- 2.21 The Committee identified several key components to collecting and using accrual-based information effectively. These are:
- responsibility (ie accountability for the implementation of the new approach);
  - commitment (ie ownership of the new approach);
  - ability (ie the technical skills to implement the new approach);
  - experience (ie background in applying such an approach); and
  - literacy (ie common and confident use of new terminology).
- 2.22 In the Committee's view, the heart of the issue is responsibility. Unlike the private sector, the Australian public sector has not had an imperative to operate according to full cost information. If change is to be achieved in years rather than decades, this imperative needs to be created. The most practical way to achieve this is to make public sector employees directly responsible for implementing the new approach. From such responsibility will come cultural change, including commitment to the new environment. This commitment will, in turn, cause agencies and individuals to ensure that they have the experience and technical skills required. As the new approach is implemented and becomes the status quo, a greater level of facility will be achieved.
- 2.23 The appropriate collection and use of financial information requires staff at all levels of the Australian Public Service to perceive the utility of the new approach. While education of managers is critical, the progress made so far suggests that motivation is also required. For example, discussions with agency representatives indicate that training has generally been made available. However, this has been insufficiently translated into appropriate behavioural change.
- 2.24 The following comments and recommendations are intended to encourage managers at all levels to take responsibility for the full implementation of accrual budgeting. The Committee is confident that a sense of ownership will ensure that the other key requirements are met.

## Performance agreements

- 2.25 In order to secure responsibility for implementation, the Committee supports the inclusion of appropriate knowledge and behaviour requirements in the performance agreements of Chief Executive Officers

and Senior Executive Service employees as a matter of urgency. Appropriate requirements should be included in the performance agreements of other managers as support systems become sufficiently effective.

### Recommendation 1

- 2.26 **The Committee recommends that knowledge of, and appropriate use of, financial information be identified in all managers' performance agreements.**

### Better practice guides

- 2.27 In an effort to assist organisations to collect and use financial information effectively, the ANAO has published two better practice guides. *Building a Better Financial Management Framework* covers defining, presenting and using financial information. *Building Better Financial Management Support* covers functions, systems and activities for producing financial information.
- 2.28 In view of the difficulties faced by Commonwealth organisations in harnessing financial information, the Committee strongly encourages all managers to familiarise themselves with these publications. Further, the Committee takes the view that it would be beneficial for all Commonwealth agencies to complete the questionnaire included in *Building a Better Financial Management Framework*.

### Recommendation 2

- 2.29 **The Committee recommends that Chief Executive Officers support the use of financial information by:**
- **requiring managers to use the diagnostic questionnaire provided in *Building a Better Financial Management Framework*; and**
  - **providing targeted assistance to managers on the basis of their responses to the questionnaire.**
- 2.30 The Committee draws the attention of agencies to the section on costing in *Building Better Financial Management Support*.

## Planning

- 2.31 At the hearing, the Committee observed a lack of certainty regarding the time frame in which agencies expected to fully implement accrual budgeting. In view of the slow progress to date, the Committee believes that agencies would benefit from outlining a time frame for full implementation.

## Parliamentary scrutiny

- 2.32 The Committee would be interested to follow the progress of agencies with respect to their estimates for implementation of accrual budgeting.
- 2.33 In particular, the Committee intends to become increasingly focused on the issues of costing and achieving value. The Committee encourages other parliamentary committees to emphasise these issues as well as scrutinising expenditure.
- 2.34 The Committee is also concerned that some Parliamentarians experienced difficulty in obtaining details of transactions of Budget and financial statements from agencies and departments without requesting supplementary questions. Members of the Committee have found explanatory accounts of such statements to be insufficient. The Committee urges all agencies and departments to adequately document transaction details in their Budget and financial statements.

## Support from DoFA

- 2.35 The Department of Finance and Administration has a critical role to play in guiding the implementation of the new framework. The Committee concurs with Dr Michael Vertigan, who observed:

As well as through direct staff support, DOFA should seek a variety of means of satisfying this requirement, such as the issue of best practice advice, development of manuals covering matters of common concern, and establishing forums for specific professional groups such as Chief Financial Officers, senior budget officers, and the like, where experience and best practice solutions can be shared. Attention should be paid during this process to ensuring that consistent advice is received by departments who encounter similar issues.<sup>17</sup>

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17 Michael Vertigan, *Review of Budget Estimates Production Arrangements*, July 1999, p. 18.



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## Chief financial officers

- 2.36 The Committee recognises that program managers are responsible for resourcing decisions, and that it is critical that they develop a sound understanding of the new framework. However, it is also important that the finance function be managed with appropriate expertise and experience.
- 2.37 The Committee encourages all agencies that have not done so to employ a chief financial officer. It is important that such a person be employed at a sufficiently senior level. Chief financial officers from private sector backgrounds could be expected to face a steep learning curve with respect to their understanding of the public sector and its accountability requirements. Therefore, it would be advisable to make such appointments a priority.

