

19 July 2001

Dr John Carter  
Sectional Committee Secretary  
Joint Committee of Public Accounts and Audit  
Parliament House  
CANBERRA ACT 2600

Dear Dr Carter

**REVIEW OF THE ACCRUAL BUDGET DOCUMENTATION**

I refer to your letter of 3 July in which you referred a series of follow up questions to this Office following the round table discussions held on 22 June.

I enclose our responses to these questions for the Committee. If the Committee has any further queries, please do not hesitate to contact Ms Lynne O'Brien (phone 6203 7572).

Yours sincerely

Ian McPhee  
Deputy Auditor-General

## ANAO FOLLOW UP QUESTIONS

**During the round table discussions held on the 22 June, Mr Tony Harris raised the issue of whether the budget outcome should be audited. Mr Ian McPhee responded that “it would be within the capability of the ANAO to review the budget outcome” (transcript p. 31)**

**- Would you discuss further the merits and feasibility of auditing the budget outcome?**

A decision on whether the ANAO should conduct an audit of the budget outcome is a matter for the Government and Parliament. The objectives of an audit of the budget outcome would be to enable the Auditor-General to express an opinion on whether the relevant financial report is prepared, in all material respects, in accordance with the relevant financial reporting framework. The benefits of such an audit would be the additional credibility that an independent review provides to the reported outcome.

The budget outcome is reported by the Commonwealth in its *Final Budget Outcome* (FBO) publication. Section 18(1) of *The Charter of Budget Honesty Act 1998* requires that the FBO be published within three months of the end of the financial year.

The FBO presents:

- financial information relating to the general government sector prepared in accordance with Australian Accounting Standards and 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;
- a discussion on the overall Commonwealth budget outcome which is based on analysis of the GFS statements.

The information prepared pursuant to AAS31 is effectively a subset of the Commonwealth’s Consolidated Financial Statements (CFS) and is collected during the process of preparation and audit of these statements. Given that the ANAO currently audits the CFS there would be no difficulties in extending audit coverage to this section of the FMO.

GFS information is not currently subject to audit by the ANAO. While there are some differences in the principles used in AAS and GFS reporting, the ANAO would be in a position to audit this information if requested. If considered necessary, the Office would seek expert advice on the GFS principles. Such an audit would require close liaison with Finance and other parties involved in the preparation of the FBOs so as to ensure that the audit could be finalised in a timely manner.

**Report of the Senate Finance and Public Administration Legislation Review Committee (SFPALC), *The Format of the Portfolio Budget Statements, Third Report.***

On page 41, the SFPALC raised the difficulty in using the PBS or estimates process to examine whole of government issues. Examples given were:

- the difficulty in linking ministerial cross-portfolio budget statements to the PBS;
- regarding GST information expenditure senators had to approach individual agencies; and
- consolidated information such as savings from IT outsourcing is not released by the consolidators because it “belongs” to individual agencies.

Apart from a Parliamentary committee or ANAO inquiry into whole of government activities, the SFPALC saw no immediate solution to the problem and invited comment.

**Do you see any solution to the problem identified by the SFPALC?**

*Linking ministerial cross portfolio budget statements.*

In his recent oration on the Centenary of the APS<sup>1</sup>, the Prime Minister noted that “whole of government approaches, collectively owned by several Ministers, will increasingly become a common response”. Examples quoted included the Government’s Innovation Statement and the Welfare Reform package. In this respect, the Prime Minister commented that:

*Senior Public Servants and their staff will need to find ways to minimise any limitations associated with what could be described as the ‘Silo effect’. A methodology for rapid and effective integration of work units from traditionally unrelated departments will need to be further refined to achieve broader government objectives.*

As the Committee appreciates, it can be difficult to obtain an understanding of the overall program when individual agencies report their own involvement with the program and no organisation is responsible for reporting on the overall program. Committee members involved in the inquiry into the ANAO audit of Coastwatch will be familiar with this issue. In that audit, the ANAO discussed the difficulty in obtaining an appreciation of the full resources utilised by the coastwatch function. The audit report<sup>2</sup> concluded that:

*... in order to provide a high standard of client service, Coastwatch has a responsibility to disclose funding and resource arrangements to its client agencies and the Parliament in a full and transparent manner. This includes the reporting of services (provided at no cost) to Coastwatch from all sources,*

<sup>1</sup> The Hon John Howard MP, 2001, *The Centenary of the APS Oration*, The Centenary Conference of the Institute of Public Administration Australia, 19 June

<sup>2</sup> Australian National Audit Office, Report No 38, 1999-2000 *Coastwatch Australian Customs Service*, p.103

*particularly the Defence contribution that forms the largest component of the Coastwatch program. The disclosure of the costs of Coastwatch resources should be readily accessible from the ACS Annual Report and ACS PBSs*

Similar comments were made in the ANAO's audit of the coordination of export development and promotion activities across Commonwealth agencies<sup>3</sup>. That audit concluded that there were no existing arrangements which would identify the nature and extent of all export development and promotion activities and services undertaken or provided by Commonwealth agencies.

The PBSs are not currently designed to provide such cross portfolio information as they are focussed on a single agency. One solution would be the nomination of a lead agency for each major cross portfolio program with designated responsibility for reporting.

In its 30 May submission to the Committee, this Office suggested a model whereby reporting against outcomes would be conducted by a portfolio agency with the most significant role in relation to the outcome, and that agency would include in its report how other parties, including other government entities, had contributed towards the achievement of the outcome.

#### *Reporting on GST and similar information*

As the PBSs have been designed to report by output and outcome, information on detailed input costs, which may have been available in historical budget papers, is no longer provided for within the budget model.

However, depending upon their chart of accounts, individual agencies are likely to maintain this information within their financial management systems and should, therefore, be able to provide it to Committees, upon request. A possible solution to this issue would be for committee members to advise agencies early in the parliamentary proceedings as to the types of such information required. The practice of pre-hearing budget estimates briefings, discussed by the F&PAL Committee in its 1999 report on the format of the PBS<sup>4</sup>, would seem to be one avenue for such exchanges to occur.

*Consolidated information such as savings from IT outsourcing not released by the consolidators because it 'belongs' to individual agencies.*

The first point to note is that information on 'savings' will not be reported in accrual financial statements as financial statements report on actual transactions and not savings or opportunity costs.

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<sup>3</sup> Australian National Audit Office, Report No 39, 1999-2000 *Coordination of Export Development and Promotion Activities Across Commonwealth Agencies*

<sup>4</sup> The Parliament of the Commonwealth of Australia. Senate Finance and Public Administration Legislation Committee, *The Format of the Portfolio Budget Statements, Second Report*, October 1999

One way of obtaining such information would be to place greater emphasis on the use of program evaluations<sup>5</sup> across the public service. In the late 1980s and early 1990s, the Government had a policy of requiring all major programs to be evaluated on a regular basis. The results of these evaluations were generally required to be made available publicly and were utilised in budget and Cabinet deliberations. During the mid to late 1990's, requirements in relation to evaluations were changed, and it is now left to individual agencies to determine what evaluations to undertake and when to undertake them.

Such evaluations would be one way to obtain and publish consolidated information on cross agency programs.

**The main aim of the CUC was to encourage agencies to recognise their assets and promote good asset management.**

**Would you discuss in practice whether the CUC has been beneficial?**

The ANAO has been advised that Finance has recently reviewed the CUC and its application to public sector agencies.

The ANAO understands that the aim of the CUC was actually to place public sector entities on par with their private sector counterparts by requiring that the price of outputs incorporate an appropriate return to owners.

Accordingly the CUC is applied on the net departmental assets of an agency. Net assets is a measure of the difference between total assets less total liabilities.

In order to minimise the CUC payable, agencies will seek to minimise their net assets. This can be achieved by a number of mechanisms such as deferring the recognition of revenues, advancing the recognition of liabilities or reclassifying assets from departmental to administered. Since implementation of the CUC, the ANAO has observed a greater focus on such "balance sheet management" by agencies.

For example, a number of agencies have expressed a desire to defer recognition of appropriation revenue until the associated output delivery occurs. This treatment has the effect of reducing the net assets in the year the appropriation is made available to the agency and thereby reducing the CUC. Similar results can be achieved by reducing the valuation of fixed assets or reclassifying such assets from 'departmental' to 'administered'. It is important to note that some of these treatments will not be consistent with the standards and current reporting requirements, and therefore not acceptable.

While there may be a positive effect on asset management, in the ANAO's opinion, the major impact of the CUC has been to provide public sector managers with an incentive to manage financial results so as to minimise the CUC payable. Whether, in practice, this has resulted in improved management at the program level is not clear.

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<sup>5</sup> Program evaluation is the systematic assessment of the appropriateness, effectiveness and/or efficiency of a program or part of a program.

The review undertaken by Finance (referred to above) may be able to shed more light on this matter.

**From time to time agencies can achieve a significant operating surplus separate from the Capital Usage Charge. There appears merit in requiring agencies to specifically identify the details of any surplus to output level with explanations in the agency annual report which can be matched to the audited financial statements.**

**Would you discuss the merits and feasibility of this proposal.**

The reporting of surpluses against outputs requires that revenues and costs of an agency be attributed to an output level. Given the large number of outputs that some agencies have, the ANAO would suggest that such reporting is more likely to be feasible at an output group level.

Financial reporting requirements are imposed on government agencies by way of the *Finance Minister's Orders (FMOs)* as well as accounting standards. The accounting standards require that agencies report on the revenues and costs associated with major activities where such revenues and costs can be reliably attributed to activities. The FMOs applying to financial statements for the year ended 30 June 2001 suggest that it would be appropriate to report on outputs as activities. The ANAO understands that the 30 June 2002 will require such reporting by output group.

There are two matters to be noted in such reporting which would place the relevance and reliability of any reported output surplus/deficit at question.

#### *Reporting of revenues*

The major revenue associated with most agency outputs is appropriation funding. Under the current system of appropriations, agencies are provided with one appropriation for all outputs at the 'departmental item' level. Agency chief executives have the authority to move funding between outputs as and when required.

Thus 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.

#### *Reporting of expenses*

The reporting of expenses by output requires that all agency costs be attributed to outputs. Where organisational structures are aligned with output groups, this is not too difficult, although it does require a method of attributing 'enabling services' such as corporate support divisions, to output groups. Where organisational structures are not aligned, this becomes more difficult with all costs such as staff time, rent, needing to be directly charged or attributed to, outputs.

At this time, not all agencies are able to accurately attribute all costs to outputs/output groups. This matter is being considered further during our current audits of agencies'

30 June 2001 financial statements and will be reported on in the ANAO's report to Parliament on the results of these audits.

In its May 30 submission to the Committee, this Office discussed the accounting treatment adopted for the CUC. In particular, we noted that the current treatment, whereby funding for the charge is disclosed as revenue but the imposition of the charge is not shown as a corresponding expense, directly increases the operating result by the amount of the funding. This would need to be taken into account in any interpretation of operating results attributed to outputs.

#### *Analysis of results*

Given that the actual revenue is able to be determined by the chief executives, the ANAO considers that an alternative reporting model may be 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.

Such reporting, however, would not be reliable until agencies have in place systems which will allow them to monitor and measure the delivery and cost of outputs.