Chapter 2

Outcome budgeting and reporting

Constitutional provisions

2.1 The Constitution of the Commonwealth of Australia adopted from Great Britain the notion of the sovereignty of parliament with regard to taxing and spending. The relevant (principal) sections of the Constitution are sections 51, 81 and 83, which read as follows:

> **51.**The Parliament shall, subject to this Constitution, have power to make laws for the peace, order, and good government of the Commonwealth with respect to: -
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> **(i.)** Trade and commerce with other countries, and among the States:
>
> **(ii.)** Taxation; but so as not to discriminate between States or parts of States:
>
> **(iii.)** Bounties on the production or export of goods, but so that such bounties shall be uniform throughout the Commonwealth:
>
> **(iv.)** Borrowing money on the public credit of the Commonwealth:
>
> **81.** All revenues or moneys raised or received by the Executive Government of the Commonwealth shall form one Consolidated Revenue Fund, to be appropriated for the purposes of the Commonwealth in the manner and subject to the charges and liabilities imposed by this Constitution.
>
> **83.** No money shall be drawn from the Treasury of the Commonwealth except under appropriation made by law.

2.2 Other relevant sections of the Constitution include Sections 53 and 54, which are discussed later in this report.

2.3 Much of the Committee's inquiry revolves around Section 83 and relates to a range of concerns about the manner in which the Commonwealth's finances are appropriated. These concerns are discussed in the Chapters that follow.

2.4 To understand the context in which these concerns have arisen it is necessary to set out the two main elements of the Government's approach to managing Commonwealth finances: accrual accounting and budgeting and the outcomes/outputs framework.

Accrual accounting and budgeting

2.5 Accrual accounting allows for the recognition and recording of economic transactions and events as they occur, regardless of when (or whether) the related cash receipt or payment takes place. For example, in the books of a business that sells goods, a sale would be recorded as 'income', even though payment from the purchaser may not yet have been received; the purchaser would be recorded under the asset heading 'Debtors'. Subsequent payment would be recorded as an increase in the asset 'Cash' and an offsetting reduction in 'Debtors'. Correspondingly, a purchaser's failure to pay would cause an increase in the expense item 'Bad Debts Written Off', with an offsetting reduction in 'Debtors'.

2.6 Cash accounting, on the other hand, would record the transaction under 'Receipts' when payment was received – or nothing at all if the purchaser defaulted. Obviously, internal records would be kept of Debtors and Bad Debt Write-offs, but, under cash accounting, they do not form part of an integrated accounting framework of the kind that would allow comprehensive financial statements to be interpreted to assess the operational performance of the entity.[1]

2.7 Accrual budgeting is budgeting on the basis of accruals.

The case for accrual accounting and budgeting

2.8 Professor Barton, School of Accounting and Business Information Systems, Australian National University, has put the case for the government's adoption of accrual accounting and budgeting as follows:

> The case for the adoption of accrual accounting and budgeting systems [AABS] is an overwhelming one. Without AABS, the government has no systematic records of its vast holdings of non-cash assets and portfolio of liabilities… There can be no effective management of such a vast portfolio of assets and liabilities without appropriate accounting records of them. Furthermore, management attention was [formerly] concentrated on fiscal policy issues, cash budget compliance and cash management, and a refocussing of management attention to encompass all the non-financial assets and liabilities of the Government required "a cultural change" … As well, accrual accounting is needed for cost control of departmental operations and of programs for delivery of services to the public. This information is necessary for determining priorities in expenditure programs, and for facilitating better management of government resources and hence efficiency of operations. In brief, accrual accounting is required for the final resource management role of government. But as well, by facilitating

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1 Maurice Kennedy, *Cheques and Balances*, Research Paper No. 17 2001-2002, Department of the Parliamentary Library, 28 May 2002, p. 33.

> greater efficiency in use of the government's own vast stock of resources, it helps to promote improved macroeconomic management of the economy.[2]

Historical context

2.9 The nature of the Commonwealth's financial transactions and the methods of accounting for those transactions have changed significantly since Federation, with changes in the size and responsibilities of government and changes in technology and accounting methods. They will no doubt continue to evolve.

2.10 For many years following Federation, the Commonwealth used cash accounting and budgeting systems (CABS). There was good reason for this:

> Historically, governments have operated on an annual cash basis because this is fundamental to the democratic constitutional safeguards which have been evolving since the days of King Charles I of England. The basic safeguard is that no monies shall be collected or spent except in ways and amounts approved by Parliament through budget appropriations.[3]

2.11 Although cash reporting and budgeting continued to be used in the budget until 1999, the presentation of the budget had changed significantly in the 1980s with the introduction of Program Management and Budgeting (PMB) and the Financial Management and Improvement Plan (FMIP).

2.12 The framework for presenting the budget prior to the 1980s and the changes which resulted from PMB and the FMIP have been described as follows:

> Since Federation, appropriations for departmental administrative expenses had been presented in highly dissected form, with separate line-items for each type of expense – salaries; overtime; travel; postage and telephone; office equipment; repairs and maintenance; etc. [The early years of Federation even had the salaries appropriations identifying, separately, staff positions and classifications.] Such line-item appropriations meant that there was no flexibility available to managers to re-arrange their resources to meet changing needs. By aggregating all of the separate departmental administrative expenses into a separate single line-item appropriation titled 'running costs', managers were given greater freedom to make rational operational decisions, such as employing more staff rather than paying overtime, or purchasing computers rather than employing additional people

2 Professor Allan Barton, *Accrual Accounting and Budgeting Systems Issues in Australian Governments*, Paper presented to the Annual Congress of the European Accounting Association, Dublin, March 2005, pp 11-12.

3 Commonwealth Department of Finance, *The New Financial Reports of Agencies*, Commonwealth of Australia, Canberra, July 1994, p. 9, quoted in Professor Allan Barton, *Accrual Accounting and Budgeting Systems Issues in Australian Governments*, Paper presented to the Annual Congress of the European Accounting Association, Dublin, March 2005, p. 7.

– decisions that were formerly made difficult by the existence of line-item appropriation limits.[4]

2.13 Other major changes that were made prior to the adoption of the current system included the enactment of the *Financial Management and Accountability Act 1997*, the *Auditor-General Act 1997* and the *Commonwealth Authorities and Companies Act 1997*.

2.14 With the enactment of the *Financial Management and Accountability Act 1997* the Trust Fund that had been established by the Audit Act of 1901 was abolished and was replaced by two funds, the Reserved Money Fund and the Commercial Activities Fund. In his Second Reading Speech, the then Minister for Finance stated:

> Apart from components of the Reserved Money Fund that may be established pursuant to other enactments, the components of these two funds will be established or varied by Finance Minister's determinations. The effect of such determinations will be to specify the kinds of money that may be drawn from the CRF [Consolidated Revenue Fund] or Loan Fund and credited to a particular component and the purposes on which that money may then be spent. Since the spending of money from such a fund is, in all respects, an appropriation, the proposed Act will require that these determinations by the Finance Minister be tabled as disallowable instruments that do not take effect until the period of disallowance has passed. This procedure is more visible and provides a greater measure of Parliamentary control that has traditionally been the case in the establishment of Trust Accounts under the *Audit Act 1901*.[5] [6]

2.15 In the event, the Government abolished the Reserved Money Fund, the Commercial Activities funds and the Loan Fund in 1999. This was done by the enactment of the *Financial Management Legislation Amendment Act 1999* which amended the FMA Act so as to abolish fund accounting.

2.16 The current system of budgeting, which was first implemented in the 1999-2000 Budget, involved major changes, including:

- a move to accrual budgeting;
- a shift in the focus of agency reporting from programs to planned outcomes;

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4 Maurice Kennedy, *Cheques and Balances*, Research Paper No. 17 2001-02, Department of the Parliamentary Library, 28 May 2002, p. 30.

5 The Hon John Fahey, *House of Representatives Hansard*, 12 December 1996, pp 8345-8346, quoted in Maurice Kennedy, *Cheques and Balances*, Research Paper No. 17 2001-02, Department of the Parliamentary Library, 28 May 2002, p. 31.

6 An element that continues under the new legislative regime is that the determinations made by the Finance Minister under the amended Financial Management and Accountability Act that establish, vary or abolish Special Accounts are disallowable instruments.

- the presentation of general government financial statements in accordance with two accounting standards;
- the presentation of performance information to allow assessment of agency performance; and
- the reporting and other requirements of the *Financial Management and Accountability Act 1997* and the *Charter of Budget Honesty Act 1998* at the whole-of- government level.

The outcomes/outputs framework

2.17 In a 'Guidance Document' issued to other agencies in November 2000, the Department of Finance and Administration (Finance) provided the following description of the framework introduced in the 1999-2000 Budget:

> - government (through its ministers and with the assistance of relevant agencies) specifies the outcomes it is seeking in a given area;
> - these outcomes are specified in terms of the impact government is aiming to have on some aspect of society (e.g. education), the economy (e.g. exports) or the national interest (e.g. defence);
> - Parliament appropriates funds to allow the government to achieve these outcomes through administered items and departmental outputs;
> - items such as grants, transfers and benefit payments are administered on the government's behalf by agencies, with a view to maximising their contribution to the specified outcomes;
> - agencies specify and manage their outputs to maximise their contribution to the achievement of the Government's desired outcomes;
> - performance indicators are developed to allow scrutiny of effectiveness (i.e., the impact of the outputs and administered items on outcomes) and efficiency (especially in terms of the application of administered items and the price, quality and quantity of outputs) and to enable the system to be further developed to improve performance and accountability for results.[7]

2.18 Finance claimed that the outcomes and outputs framework would help answer three fundamental questions:

- What does government want to achieve?

  (outcomes)
- How does it achieve this?

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7 Department of Finance and Administration, *The Outcomes and Outputs Framework Guidance Document*, November 2000, p. 5.

(outputs and administered items)

- How does it know if it is succeeding?

  (performance reporting)[8]

2.19 Finance asserted that the framework has two basic objectives: to improve agencies' corporate governance and to enhance public accountability. The department elaborated on these objectives as follows:

> Managing through outcomes and outputs helps improve decision making and performance by focussing attention on the fundamental questions outlined above. It can also improve the understanding and knowledge of those outside the agency who have an interest in its performance, including ministers, parliament and external accountability bodies such as the Auditor General.
>
> Agencies apply inputs (eg finances, human resources, capital equipment) to the activities and processes that generate the products and services that constitute their outputs. These inputs include the funds appropriated to them from the budget or received through purchaser/provider arrangements, as well as revenue raised through other means, such as sales, levies and industry contributions.[9]

2.20 Finance also stated that 'Outcome statements define the purpose of appropriations in the Budget Bills, while administered items and departmental outputs are detailed in the Portfolio Budget Statements, which form part of the Budget Papers'.[10]

2.21 There is no necessary correlation between accrual budgeting and the outcomes/outputs framework.

> The changes involved were massive – not only was the financial reporting basis for the budget to change from cash to accruals, but its structure was changing from inputs to outcomes and outputs. There is no necessary relationship between the two changes: it would have been possible to have accrual budgeting based on inputs, or moved to outcomes/outputs on a cash basis.[11]

2.22 Nevertheless, accrual budgeting and the outcomes/outputs framework are effectively complementary.

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8 Department of Finance and Administration, *The Outcomes and Outputs Framework Guidance Document*, November 2000, pp 3-4.

9 Department of Finance and Administration, *The Outcomes and Outputs Framework Guidance Document*, November 2000, pp 4-5.

10 Department of Finance and Administration, *The Outcomes and Outputs Framework Guidance Document*, November 2000, p. 5.

11 Professor Stephen Bartos, Director, National Institute for Governance, University of Canberra, *Submission 5*, p.15.

Application of the framework

2.23 The application of the outcomes and outputs framework was the subject of a recent performance audit conducted by the Australian National Audit Office (ANAO).[12] The objective of the audit was to assess the application of the framework in Australian Government agencies.

2.24 The report on the audit, which was tabled on 6 February 2007, includes a detailed description of the framework and is recommended to readers who may wish to gain a more complete understanding of the way in which Commonwealth public moneys are appropriated and spent.

2.25 The report's recommendations cover matters such the specification of outputs, the appropriateness of performance indicators and the integration of outcomes and outputs cost and performance information into regular management reports. ANAO also proposed six matters for the consideration of the department of finance. These included better integration of programs into the outcomes and outputs framework and enhanced reporting of expenditure and performance against specified new budget measures.[13]

Some significant changes

Cash accounting and budgeting

2.26 Cash accounting is an essential management tool in the private and in the public sectors. Professor Barton has identified the need for cash information in the public sector as follows:

- Cash is central to all government fiscal policies because it funds the resources required to provide all the goods and services to the community.
- Cash budgets provide Parliament with information on the *new resources* required for allocation to departments and programs to citizens in the form of goods and services and how they are to be funded through taxation and other measures. (Provision of new resources involves government policy decisions and parliamentary approval.)
- Cash is central to macro-economic management of the economy.
- Long term cash budgets extending over the economic cycle are needed to determine whether current policies are compatible with the objective of intergenerational equity. A long term cash deficit indicates that, on current expectations, taxation receipts are inadequate to fund the budgeted provision of services.

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12 Australian National Audit Office (ANAO), *Application of the Outcomes and Outputs Framework*, Audit Report No. 23 2006-2007.

13 Australian National Audit Office (ANAO), *Application of the Outcomes and Outputs Framework*, Audit Report No. 23 2006-2007, pp 31-33.

- CABS is also necessary for efficient cash management by government to ensure adequate liquidity throughout the year and to minimise borrowing costs.[14]

2.27 Professor Barton concluded that 'for fiscal policy purposes, efficient cash management, and budget legal compliance and accountability purposes, CABS is necessary and the information must be available on a timely basis such as daily for cash management'.[15]

2.28 It is important to note, as did a senior Finance officer, Ms Campbell, and Mr McPhee, the Commonwealth Auditor-General, in their evidence, that cash information is still reported in the budget papers and within accruals accounting.[16] Additionally, within the new Central Budget Management System, departments and agencies are responsible for providing monthly forecasts of cash requirements and reporting monthly on financial performance and trends.[17]

Annual appropriations?

2.29 The FMA Act of 1997 classified money that was en route to or from a fund as Received Money or Drawn Money. The Act provided that Drawn Money held by agencies as unused/uncommitted advances that had been drawn against an appropriation which had lapsed at a particular time would lose its status as Drawn Money and be dealt with as Received Money. It would thus be paid promptly into the CRF. This was to prevent the accumulation of 'hollow logs'.[18]

2.30 Changes to the financial framework in the 1999-2000 Budget ensured that the annual Appropriation Acts do not lapse at the end of the year, with the result that funds may be carried over from year to year. The Committee considers the issues that arise from the existence of 'carryovers' in Chapter 3.

Role of the Department of Finance and Administration

2.31 ANAO provided information on the changes that have occurred within the Commonwealth Public Service in the control of government finances.

> Under the *Audit Act 1901* (Audit Act), Finance had a central role in maintaining a reasonably detailed and prescriptive financial framework, including the provision of central accounting and payment systems. This

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14 Professor Barton, *Submission 8*, pp 8-9.

15 Professor Barton, *Submission 8*, p. 9.

16 Ms Campbell, *Committee Hansard*, 8 September 2006, pp 21-22; Mr McPhee, *Committee Hansard*, 27 November 2006, p. 12.

17 Department of Finance and Administration, *Supplementary Submission 6b*, [p. 3.]

18 Maurice Kennedy, *Cheques and Balances*, Research Paper No. 17 2001-02, Department of the Parliamentary Library, 28 May 2002, p. 32.

latter role included the centralised reporting of estimated and actual appropriations expenditure.

With the devolution of greater authority to agencies and the repeal of the Audit Act, and the commencement on January 1998 of the *Financial Management and Accountability Act 1997* (FMA Act) and related Acts, there were important changes in appropriation management roles and responsibilities. In particular, agencies have the following responsibilities:

Maintaining records of all appropriations, including any adjustments that occur over the course of the financial year;

Maintaining records that link, or are able to link, transactions to appropriations;

Recording amounts debited from appropriations prior to or as payments are made; ensuring that appropriations are not exceeded and are expended for the purpose appropriated; and

Implementing adequate controls over appropriations.

For its part, Finance remains responsible for developing and maintaining the financial framework, and the provision of guidance on the operation of that framework. Finance also prepares the Annual Appropriation Acts and analyses the estimates that are prepared by the agencies during the Budget and Additional Estimates processes. In addition, following the introduction of agency transactional banking on 1 July 1999, Finance provides the mechanism for agencies to draw down appropriated funds into agency bank accounts.[19]

2.32 It was suggested during the inquiry that Finance should take a more interventionist role in the budget process especially in relation to the definition of outcomes and in determining the items that should be included in the different annual Appropriation Acts. These matters are discussed later, in Chapter 3.

Conclusions

2.33 The Committee agrees with Professor Barton that the case for the adoption of accrual accounting and budgeting is overwhelming. In the Committee's opinion, their adoption has significantly enhanced the management of the Commonwealth's finances and has led to improvements in certain aspects of transparency and accountability. However, the accounting and budgeting processes, and particularly the adoption of the outputs/outcomes framework, have also resulted in new challenges in accountability and transparency for the Parliament, for the public and even for ministers of the executive government. The most significant of these challenges are discussed in the following chapters of this report.

19 ANAO, *Submission 4*, pp 5-6.