Senate Committee on Finance and Public Administration.

Inquiry into the Transparency and Accountability to the Parliament of Commonwealth Public Funding and Expenditure.

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1. Reintroduction of the Cash Accounting and Budgeting System (CABS)
CABS is necessary for fiscal policy determination and management purposes and for cash management purposes, for the reasons given in my paper (pp. 7-10). However, it is important that the system is integrated into an accrual accounting system but be reported on separately as a subset of the AABS system so that the advantages of both cash and accrual systems can be obtained. CABS should not be a stand-alone system.

2. Choice between the AAS and the GFS Accrual Accounting and Budgeting Systems (AABS).
The use of two financial measurement and reporting systems (FMIRS) which report substantially different results for most key items in the budget statements and outcome statements is clearly nonsense. Both cannot be correct, the two sets of reports are very confusing to Parliament, and expensive to produce. Hopefully the harmonisation project will soon be completed and only one set of financial statements will be prepared. But if agreement is not reached shortly by the Australian Accounting Standards Board, then I recommend that the GFS system, as modified according to the recommendations of the HOTARAC Committee, be adopted. This will require an amendment to the Charter of Budget Honesty Act, 1998.

The reasons for my preference for the GFS system (as modified) are covered on pp 10-22 of my article. Briefly, they are that the GFS system is:

- a financial measurement system designed specifically for the use of governments, and hence it provides relevant information for them;
- a much more rigorous financial measurement system with respect to the definitions of key items such as revenues, expenses, budget balance, assets, liabilities, net worth, and capital maintenance.
- a much more rigorous system with respect to the valuation basis of assets and liabilities. This in turn affects asset consumption charges

and capital maintenance measures, as well as those for all assets and liabilities.

The major reasons given by the Australia Accounting Standards Board for their preference for the AAS system is their desire for “sector neutral” standards which are applicable to all sectors of the economy. However I believe that this approach exhibits a lack of understanding of how and why the basic features of governments differ fundamentally from those of business activities undertaken in the pursuit of profit. Three reasons have been given for the “sector neutral” principle:

a) enable greater efficiency in standard setting as only one set of standards is required;
b) facilitate comparability of public and private sector financial statements; and
c) facilitate the access of government departments to the expertise of private sector accountants.

However, they are weak justifications lacking substance; and most importantly, they are not consistent with the accounting standards requirement (SAC3, 1990, para5) that the information reported from the accounting system be relevant to the needs of users. Counter arguments concerning each are that:

a) The greater efficiency principle has unnecessarily complicated those accounting standards unique to the public sector, eg:
    - AAS objectives of government purpose financial reporting have limited relevance for governments,
    - Non-recognition of the General Accounting Sector as a financial reporting entity yet it is probably the one of most interest to citizens of the nation,
    - Difficulties in recognising taxation as a revenue because it does not result from an exchange transaction,
    - Problems in accounting for those public sector assets which do not generate cash flows to the government and whose benefits accrue to the public.

    All the above problems and many others could have been readily solved had it not been for the sector neutral principle.
b) Facilitate comparability. This is like mixing apples and oranges together and calling all the fruit as apples. It results in the provision of irrelevant and misleading information.
c) Access to business accounting expertise. This can be overcome through a modest amount of retraining for the different characteristics and information needs of the public sector. The same problem occurs when accountants move between different business sectors, eg from banking to mining.

3. Administered Items
Budgeting and financial reporting of ‘administered items’ over which departments have management responsibility would be simplified if they were reported on a cash basis. They are normally cash transfers and they would be more easily understood as such.

4. Funding of Depreciation Charges.
Depreciation charges should not be directly funded in the budget. While they are necessary accounting charges for the use of physical assets in the outcome statements, funding them directly creates confusion and complications with respect to the accountability for the expenditure of budget appropriations. Rather, gross capital expenditure should be separately reported and budgeted for as required, with a subdivision of expenditures between asset replacement (i.e., the depreciation component), and asset expansion. This methodology has the effect of funding depreciation charges each year only as required for replacement purposes in that year. This is useful information for Parliament and management. As well, it would avoid the questionable practice of departments building up internal cash balances for future asset replacement or whatever other purpose they may use to spend the funds on. Also in practice, the lifespans over which costs are allocated for long life assets may bear little relationship to reality, and the annual depreciation charges can be, ‘soft’ figures. Lifespans are greatly affected by obsolescence, repair and maintenance, and general management of the asset. These matters are not given much consideration in determining asset lifespans for depreciation purposes.

5. Use of a Centralised FMIRS System.
The Government must use a centralised FMIRS so that Treasury and Finance and Administration can regularly monitor budgets throughout the year to assist in the coordination of activities on a whole-of-government basis. It is also required for efficient cash management along with the management of Treasury Note issues and redemptions. Use of separate departmental FMIRS is a recipe for weak central management of operations, as well as being an unnecessarily expensive mode of operations. Departments are not separate economic entities but the administrative arms of government. Devolution of substantial budget allocation and management responsibilities to departments can continue under a centralised FMIRS system. Coordination and monitoring activities only require that they report their budget allocations, and that their transactions and relevant accounting events are reported to the central authority.