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Innovations in Government Accounting

The Case of Australia in a Westminster Context

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Introduction

The last two decades have seen some dramatic changes in the financial management practices in many countries, particularly those with a Westminster style political system. In many respects the United Kingdom has been the birth place of public management reforms based on the principles of New Public Management. During the early 1990's New Zealand made a name for itself as the most active and radical public management reformer. However, in the past decade the Australian public sector has also seen a period of significant reform.

Traditionally the Australian public sector has not been as radical in its reform practices as the U.K. and New Zealand. This point was echoed by one Australian public official in an interview with Colin Campbell where he said "we were never ideologues, we always modified and infused, recognising the dynamic between all of the parts, the interlocking elements of government".[1] However, with the election of the John Howard government in 1996 this moderate view to reform began to change.

In the period from 1996 to 2000 the Australian Commonwealth public sector underwent some of the most radical and comprehensive financial management reforms ever undertaken. In a period of four years the Howard government introduced full accrual accounting underpinned by external accounting standards, whole of government (consolidated) financial statements, and full accrual outcome and output based budgeting coupled with a budget linked performance reporting framework.

This paper takes a detailed look at the recent financial management reforms in the Australian Commonwealth public sector from three main perspectives. Firstly, Chapter 1 provides an introduction to the overall reforms being undertaken in public sector organisations with a particular focus on accrual financial management systems. Chapter 2 provides an insight into the Australian Commonwealth Public Service and the broader reforms that have taken place there.

[1] Campbell C., Juggling Inputs, Outputs, and Outcomes in the Search for Policy Competence: Recent Experience in Australia, Governance: An International Journal of Policy and Administration, Vol. 14, No. 2, April 2001, p278.

Secondly, this paper looks at the financial management framework of the Australian Commonwealth government and provides a detailed description of the practices, processes and policies making up the reform package, with little emphasis on analysing the implications of the reforms. This is contained in Chapters 3, 4 and 5.

Finally, Chapter 6 provides a critical analysis of the individual reform elements and to some extent questions the appropriateness of these in the public sector. Some of the major challenges facing the Commonwealth in relation to its financial management framework have also been briefly outlined.

The financial management reform process in the Australian Commonwealth public sector moved forward with a rapid pace in the late 1990's, allowing a comprehensive and to some extent complete framework to be implemented. However, this does not mean that the reform process itself is complete, as the new systems and processes in the Commonwealth are still in their infancy and will require continuous improvement.

Chapter 1. Financial Management Reform – Cash to Accruals

1.1 Public Management Reform

Public sector organisations have undergone significant change over the last two decades. This process of changes is commonly referred to as public management reform, which could be defined as changes to the structures and processes of public sector organisations with the objective of getting them to run better.[2] The term New Public Management (NPM) has been coined to describe the group of ideas relating to a fundamental shift in public management techniques.[3] These new techniques include:

- hands on professional management;
- explicit standards and measures of performance;
- greater emphasis on output controls;
- disaggregation of units;
- greater competition; and
- private sector styles of management.[4]

The introduction of these elements was aimed at reducing the bureaucratic and even military style management techniques which had long since disappeared from the private sector. The desired outcomes of these reforms include making savings in public expenditure, improving the quality of public services, making the operations of government more efficient and increasing the chances that the policies implemented by government will be effective.[5] Further, it was also expected that the implementation of the above listed elements would strengthen the control government has over the bureaucracy, loosen the bureaucratic constraints over public officials and enhance government's accountability to parliament and the community.[6] However, as with all reform or change processes there are many things that can go wrong which may reduce

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[2] Pollit C. & Bouckaert G., Public Management Reform: A Comparative Analysis, Oxford Press, p 8.
[3] Hood C., A Public Management for All Seasons?, Public Administration, Vol. 69, Spring 1991, p 3.
[4] Hood C., A Public Management for All Seasons?, Public Administration, Vol. 69, Spring 1991, p 4, 5.
[5] Pollit C. & Bouckaert G., Public Management Reform: A Comparative Analysis, Oxford Press, p 6.
[6] Pollit C. & Bouckaert G., Public Management Reform: A Comparative Analysis, Oxford Press, p 6.

the effectiveness of the reforms and cause the desired outcomes of the reform process to be realised only in part or in some cases not at all.

1.2 Financial Management Reform

As noted above, one of the main principles of public sector reforms undertaken under the guise of New Public Management (NPM) is the adaptation of private sector management principles and practices for use in government organisations.

Given that the profit motive is the driving force behind private sector organisations, it is natural that financial management takes a leading role in the production of information to support business decisions.

Financial management in the public sector has traditionally taken the role of recording financial transactions and allocating budgets on a cash basis (i.e. based on cash inflows and cash outflows) with the budget controlling costs by placing fixed limits on cash expenditure. This reflects the principle that no public monies should be expended except in ways or amounts expressly specified in appropriations (the legal method of assigning monies to agencies). Under this system managers were able to control and monitor receipts and payments against appropriations and justify this expenditure to parliament.[7]

This simple description of cash basis financial management in the public sector does not however represent the complexity, quality and depth of modern cash based public sector financial management systems. Over time there have been constant improvements in the capture and presentation of financial information in public sector organisations in order to provide decision makers with more detailed financial information on which to base decisions.

The evolution of financial management in the public sector has included changes such as:

- the introduction of forward estimates (in some cases up to four out years);

[7] Guthrie J., Application of Accrual Accounting in the Australian Public Sector – Rhetoric or Reality?, Financial Accountability & Management, 14(1), February 1998, p 5.

- the use of program budgeting;
- the introduction of aggregation within certain expenditure items to allow departments limited flexibility to move funds between expenditure classes;
- arrangements to allow departments to carry forward unspent funds from one reporting period to the next; and
- more detailed reports on assets held.[8]

The introduction of the above mentioned and other similar elements into the financial management systems of public sector organisations vastly improved the financial information available for decision making and monitoring expenditure. However, the push for more private sector like business practices lead governments to begin trialing full accrual based financial management systems.

1.3 Accrual Accounting – What is it?

In essence, accrual accounting changes the timing of the recording of transactions and the recognition of expenses to the period in which they are incurred rather than when they are paid, as in a cash system.[9] Accrual accounting also requires depreciation expense to be charged over the life of an asset and matched either with the original cost of purchase or with the replacement cost. In a similar fashion, future commitments to cash payments such as superannuation and other employee expenses are recorded as expenses in order to identify the future cash cost of paying them.

The definition used by the Australian Accounting Standards for accrual accounting is; that under accrual principles assets, liabilities, revenues and expenses arising from transactions or other events must be recognised in the financial statements when they have an economic impact on the reporting entity, regardless of when the associated cash flows occur.[10]

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[8] Commonwealth of Australia, 'The Australian Experience of Public Sector Reform', Australian Public Service Commission, 2003, p94.

[9] Guthrie J., Application of Accrual Accounting in the Australian Public Sector – Rhetoric or Reality?, Financial Accountability & Management, 14(1), February 1998, p6.

[10] Australian Accounting Research Foundation, Australian Accounting Standard No. 31 Financial Reporting by Governments (AAS31), June 1998, p6.

In practice however, a move to an accrual accounting system in public sector organisations means far more than just a change to when transactions are recorded. The accrual accounting frameworks which have been implemented in most Westminster political jurisdictions involve the application of private sector accounting practices and reporting formats. In most cases these practices and reporting formats are based on 'accounting standards' issued by the non government bodies responsible for setting accounting standards in the relevant countries. Such standards commonly require the preparation of three primary statements, namely:

- an operating statement (or profit and loss statement);
- a balance sheet (or statement of assets and liabilities); and
- a cash flow statement.

The Australian Accounting Standards refer to these statements as 'General Purpose Financial Reports', meaning that a large amount of financial data is condensed into a single set of reports containing meaningful information in a common format for external users. This is a significant change from the traditional array of specific reports produced under cash systems. It is also argued that traditional systems provide an incomplete picture of government finances and are based on concepts and principles only understood by a select few.[11]

Preparing and issuing financial reports based on the above three statements is only half the story. The budget process must also be adapted to follow the same format as the financial reports, as the financial statements alone would add little value.

The restructuring of the budget process in Westminster countries has also tended to involve more than just a switch to accrual principles. The United Kingdom, New Zealand and Australia have all moved toward an output and/or outcome based budget process, which is linked to a framework of objectives, and related outputs/products produced by public sector agencies. It is these products or product classes which form

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[11] Mellor T., Why Governments Should Produce Balance Sheets, Australian Journal of Public Administration, Vol. 55 Issue 1, March 1996, p79.

the basis for apportionment of government funding. In the United Kingdom this combined framework is known as 'resource accounting'.[12]

A further element, which has been implemented in Australia and New Zealand but not yet fully implemented in the U.K., is the production of 'whole of government' or consolidated financial reports. These reports combine the financial statements of all public sector organisations in a given jurisdiction, with the necessary eliminations for intra entity transactions, to form one set of financial statements for the entire jurisdiction.

The above elements form the basis of the accrual accounting reforms in most countries with a Westminster political system.

1.4 The Expected Benefits of Accrual Accounting Frameworks

The exponents of full accrual accounting and budgeting frameworks in the public sector expect them to bring vast benefits in many areas. These benefits are said to include:

- more accurate measurement of costs and revenues;
- a greater focus on outputs rather than inputs;
- a more efficient and effective use of scarce resources;
- a better indication of the sustainability of government policy;
- improved accountability by governments to their constituents;
- better financial management by public services managers;
- greater comparability of management performance between jurisdictions; and
- a complete coverage of all relevant transactions and stocks.[13]

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[12] Perrin J., From Cash to Accruals in 25 Years, Resource Accounting and Budgeting, Public Money & Management, April-June 1998, p7.
[13] Conn N., Reservations about Governments Producing Balance Sheets, Australian Journal of Public Administration, Vol. 55, Issue 1, March 1996, p82.

As identified in the previous section, the term accrual accounting refers to the time at which transaction are recorded. A change purely to the timing of when transactions are recorded will not bring about the benefits detailed above. It is more the integrated system of financial management practices that come with a switch to accrual accounting that have the potential to deliver substantial benefits in a public sector environment.

Possibly the most benefits from an accrual reporting and budgeting system will come in the following areas. (1) Accruals data is not distorted by the timing of transactions which may have no long run impact on the fiscal position of a government. For example, asset sales generally have no impact on the net worth. (2) Accrual reports provide more information on accruing costs that will require expenditures in the future, such as accruing superannuation and other employee expenses. (3) Accrual reports provide information on both financial flows (transactions) and stocks (accumulated assets and liabilities at the end of the reporting period).[14] (4) A budget process which focuses on programs, outcomes and outputs or other forms of non-input information will help to focus the attention of both public service managers and politicians on the outcomes or results they are trying to achieve.

However, it is not merely the implementation of a private sector type accounting and budgeting model that will bring advantages to the public sector. It is more the application of a commonsense mixture of financial management practices from both the private and public sectors that will best fit the needs of government organisations.

Countries which have implemented full accrual frameworks have not always generated benefits to the extent first expected. Chapter 6 critically reviews the accrual reforms undertaken in the Australian Commonwealth public sector, to provide a better understanding of some of the problems encountered in that jurisdiction.

[14] Clark-Lewis M., Government Accrual Reports: Are They Better Than Cash?, Australian Journal of Public Administration, Vol.55, Issue 1, March 1996, p86.

Chapter 2. Reform in the Australian Public Service

2.1 Demographics of the Australian Commonwealth Public Service

The Commonwealth public sector is made up of two groups of employees; those working in the Australian Public Service (employed under the Public Service Act) and those working for Commonwealth authorities and other incorporated bodies owned by the Commonwealth.

At June 2002 the Australian Public Service (APS) had a total of approximately 123,500 staff. This can be split into ongoing staff (112,123) and non-ongoing (11,371). Table 1.1 provides further details of ongoing employees represented by employment level. The number of employees working for other Commonwealth organisations not covered by the Public Service Act is approximately 150 000, which indicates the devolved nature of the Commonwealth's business strategy.

Table 2.1 – On-going Staff: Classification Group by Gender, June 2002

Class group	Males	Females	Total	% female	% by group
APS 1–2	3565	4420	7985	55.4	7.1
APS 3–4	15488	26710	42198	63.3	37.6
APS 5–6	18606	17577	36183	48.6	32.3
Executive	14580	8493	23073	36.8	20.6
SES	1262	501	1763	28.4	1.6
Trainee	403	518	921	56.2	0.8
Total	**53940**	**58219**	**112123**	**51.9**	**100.0**

Source: Commonwealth of Australia, APS Statistical Bulletin 2001-02, Australian Public Service Commission, Nov 2002, p 5.

The number of employees in the Australian Public Service has been significantly reduced over the last few decades, from its highest point in 1975 of approximately 277 500 to its current level (123 500). This dramatic reduction in size is mostly reflected in the change of many government organisations to corporatised type businesses and the privatisation of other areas.

The ten largest agencies in the Australian Public Service account for approximately 75% of the total APS workforce. The ranking of the six largest agencies has remained unchanged for the last three years. Table 1.2 provides further details of the size of the ten largest agencies.

Table 2.2 – The Ten Largest APS Agencies, June 2002

Agency	No. of staff at June 2002	% of total APS staff
Centrelink	23265	20.7
Australian Taxation Office	17818	15.9
Defence	16902	15.1
Family and Community Services	5758	5.1
Australian Customs Services	4760	4.2
DIMIA	4073	3.6
AFFA	3421	3.1
Health and Ageing	3390	3.0
Australian Bureau of Statistics	3065	2.7
Foreign Affairs and Trade	2691	2.4
Total	**85143**	**75.9**

Source: Commonwealth of Australia, APS Statistical Bulletin 2001-02, Australian Public Service Commission, Nov 2002, p 5.

APS staff are based in various locations around Australia. The largest proportion of APS staff are based in the Australian Capital Territory (33%). Table 1.3 provides further details of the locations of APS staff.

Table 2.3 – On-going Staff by Location, June 2002

State/Territory	No. of staff	% of APS staff
Australian Capital Territory	37817	33.7
New South Wales	23303	20.8
Victoria	19253	17.2
Queensland	13063	11.7
South Australia	6890	6.1
Western Australia	6529	5.8
Tasmania	2487	2.2
Northern Territory	1767	1.6
Overseas	944	0.8
Not supplied	70	0.1
Total	**112123**	**100.0**

Source: Commonwealth of Australia, APS Statistical Bulletin 2001-02, Australian Public Service Commission, Nov 2002, p 5.

2.2 Structural and other Significant Reforms in the APS

2.2.1 Structural and Operational Reforms

As with other governments around the world the Commonwealth public sector has, in the last two decades, undergone significant reforms. This reflects the view that to remain competitive in the global market, countries need to reduce rigidity in regulatory frameworks and achieve greater efficiency in taxation and expenditure arrangements.

In Australia, the push for greater public sector reform began in the mid 1970's with the handing down of a report by the Royal Commission into Australian Government Administration, which stressed the need for a clear focus on objectives and assessing performance on the basis of results.

Since the 1980s, structural reforms in the Commonwealth public sector have been undertaken in three main areas:

1. broad reforms of the public sector, which have influenced the size, composition and functions of the Australian Public Service;

2. changes at the agency level to reflect operational changes in relation to the implementation of program budgeting, flatter structures, devolution and decentralisation ; and
3. changes at the workplace level to improve ways of working.[15]

Some of the specific changes are:

- the use of strategic planning and business plans;
- commercialisation and implementation of user charges;
- increased focus on service delivery and customer service;
- introduction of competition in the delivery of public services;
- the corporatisation of government organisations;
- the outsourcing and contracting-out of government services;
- the private financing of infrastructure projects;
- the introduction of purchaser/provider arrangements;
- increasing public sector productivity; and
- a shift in the regulatory role of government.

2.2.2 Legislative reforms

Legislative changes, with regard to public management reform, began in the period from 1983 to 1996, however, since the change of Government in 1996 there have been a number of significant legislative changes with regard to the Australian Public Service.

The four main pieces of new legislation are:

- The Financial Management and Accountability Act 1997;
- Commonwealth Authorities and Companies Act 1997;
- The Workplace Relations Act 1996;

[15] Commonwealth of Australia, 'The Australian Experience of Public Sector Reform', Australian Public Service Commission, 2003, p117.

- Charter of Budget Honesty Act 1998; and
- The Public Service Act 1999.

These legislative reforms provide the framework for Government Departments to operate with significant flexibility to pursue results and to tailor their approaches to managing performance to best suit the needs of their own organisations.

Financial Management

Financial Management and Accountability (FMA) Act 1997

Possibly the most important reform in the area of budgeting and financial management was the introduction of the Financial Management and Accountability (FMA) Act 1997.

The Act sets down the financial regulatory, accountability, and accounting framework for Commonwealth bodies that have no separate legal existence, such as Departments. It also applies to monies collected on behalf of the Commonwealth by entities that have separate legal existences.

The FMA Act focuses, more than the now-repealed Audit Act 1901, on the management of the Commonwealth's financial and property resources. The Audit Act focused largely on physical handling and accounting for monies and stores. The FMA Act is intended to improve the quality and clarity of the Commonwealth's financial management framework and to sharpen accountability for financial management performance.

A key change that the FMA Act has introduced is the devolution of greater responsibility for Commonwealth financial administration to agencies, along with increased accountability measures. Most notably, under Section 45 of the FMA Act, Chief Executives will be required to promote the efficient, effective and ethical use of Commonwealth resources for which they are responsible.

The FMA Act is part of the financial environment which, while assigning the responsibility to the Chief Executive for the day-to-day management of the agency, also provides the means by which he or she is held accountable for exercising his or her management prerogatives.

Commonwealth Authorities and Companies Act 1997

The Commonwealth Authorities and Companies Act (CAC) was drafted and released at the same time as the FMA and follows similar principles. However, its application relates to incorporated Commonwealth organisations.

In general, CAC organisations have less stringent reporting requirements, in terms of their need to provide information to Government. In most circumstances CAC organisations are required to follow the same reporting and financial regulations as private sector organisations. Financial information must be provided to government on an annual basis.

Charter of Budget Honesty Act 1998

The Charter of Budget Honesty Act can be defined as financial responsibility legislation. Traditionally the requirement for governments to provide information on the financial performance of the public sector was governed by convention rather than legislation. The Charter of Budget Honesty Act details the Commonwealth Government's responsibilities in terms of preparing and publicly releasing financial information on the health of the Australian economy and on the financial position and performance of the Commonwealth public sector.

Workplace Reform

One of the major priorities of the current Australian Government is to develop employment relationships in the APS that as closely as possible resemble those that exist in the private sector. In order to achieve this goal two main pieces of legislation have been implemented, (1) The Public Service Act 1999 and (2) the Workplace Relations Act 1996.

Workplace Relations Act 1996

Through the *Workplace Relations Act 1996*, the government introduced reforms that established a new framework for the making of workplace agreements. The framework provides for the terms and conditions of employment to be negotiated between employers and employees at the agency level in Australian Workplace Agreements (AWAs) and Certified Agreements (CAs).

An AWA is an employment agreement negotiated on a one on one basis between individual employees and the employer. CA's are generally similar in structure but are negotiated with groups of employees rather than a one on one basis. In order to secure the existing rights of employees that move to either AWA's or CA's, before they come into effect the document must be reviewed by the Office of the Employment Advocate which conducts a "no disadvantage test" by comparing the employment conditions existing under the previous Award scheme with the conditions in the AWA or CA. If the employee is not disadvantaged by the new agreement the Office of the Employment Advocate approves the introduction of the agreement. This process is the same for the both the private and public sectors.

By introducing AWA's and CA's the government has attempted to simplify employment arrangements in the Australian Public Service (APS). APS Agencies have taken a leading role in pursuing the opportunities for agreement-making afforded by the workplace relations reforms.

Nearly all APS agencies have CAs in place, covering virtually all APS staff. Some APS agencies have negotiated or are close to finalising their second or third agreement. The APS has taken a leading role in introducing AWAs with over 90% of Senior Executive Service (SES) level staff having AWAs, and increasingly, AWAs are being introduced below the SES level.

The Public Service Act 1999

The previous Public Service Act was first passed by Parliament in 1922 and was based on approaches developed in the nineteenth centaury colonial public services that existed before the federation of Australia. The Act was focused on process rather than results, management actions were highly regulated, and much effort went into maintaining standard terms, conditions and classifications across the APS.

The problems with the Act were recognised by the previous government which commissioned a number of reviews on how to improve the legislation underpinning the APS. In 1994 the Report of the Public Service Act Review Group (the McLeod Report) was handed down. The report recommended wide sweeping reforms to the Public Service Act but was unfortunately never implemented.

When the current government was elected in 1996 one of its major priorities in terms of public sector reform was the drafting and implementation of a new Public Service Act. In December 1999 the Australian Commonwealth Parliament passed the new Public Service Act which provided a substantially simplified document that devolves a large amount of responsibilities to agency heads, giving them far greater power to effectively manage their staff.

The new Act makes specific improvements in areas such as:

- Public Service Legalism (common sense language and procedures);
- Recruitment and Selection; and
- Leave entitlements and applications.

2.3 The Evolution of Budgeting and Reporting in the APS

Until the late 1990's the accounting system used by the Commonwealth Government was similar to the traditional cash and modified cash accounting systems developed by most governments around the world. The system focused on cash transactions as the basis for recording and reporting of financial information. With increasing complexity in the financial dealings of the Commonwealth Government, and the call for more detailed financial information for users, the Commonwealth's accounting and budgeting systems came under pressure to reform.

The Australian Public Service (APS) has undergone significant changes, in terms of financial management techniques, over the past two decades. This evolution has seen the shift from a cash based view of government finances to a fully accrual based system, providing an alternative and more detailed picture of the Commonwealth's financial management.

Prior to 1997 the Commonwealth's accounting framework was derived from the Constitution and the Audit Act 1901. The Constitution establishes the rights and responsibilities of the Commonwealth Government in relation to financial matters. The rights and responsibilities covered by the Constitution include the power to legislate for the collection of taxes, to borrow on the public credit of the Commonwealth and to grant financial assistance to the States and Territories.[16] Section 81 of the Constitution states "*All revenues or monies 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 subject to the charges and liabilities imposed by this Constitution*".[17] Section 83 states that "*no money shall be drawn from the Treasury of the Commonwealth except under appropriation made by law*".[18] In addition, the Constitution also contains various sections dealing with the specific requirements in relation to appropriations.

The financial reporting requirements for the Commonwealth general government sector, prior to 1997, were covered by Part VII of the Audit Act 1901. The Audit Act 1901, among other things, required the preparation of financial statements covering the particulars and totals of receipts and expenditures on a year to date basis (i.e. accounts kept and prepared on a cash basis).[19]

For public authorities and certain other bodies, Part XI of the Audit Act 1901 mandated the application of accounting principles generally applied in commercial practice (i.e. accounts kept in accordance with the Australian Accounting Standards).[20]

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[16] Commonwealth of Australia, National Commission of Audit, Report to the Commonwealth Government, June 1996.
[17] Commonwealth of Australia, Commonwealth of Australia Constitution Act, p42.
[18] Commonwealth of Australia, Commonwealth of Australia Constitution Act, p42.
[19] Commonwealth of Australia, Audit Act 1901, p62.
[20] Commonwealth of Australia, Audit Act 1901, p79.

During the late 1970's the Commonwealth Government began trialing an expenditure control mechanism consisting of rolling three year forward estimates of budget outlays. These were complied and managed by the former Department of Finance, in consultation with other departments and agencies.[21]

These estimates recorded the level of expenditure proposed by the Government for future years, but did not include any provision for new policies or policy changes.

In 1983-1984 the Government began publishing these forward estimates and providing public information on the level and composition of expenditure items. These forward estimates only covered expenditure and it was not until 1996 that the forward estimates contained similar information for revenues. The integration of forward estimates into the Budget served to maintain their accuracy and also enhanced their status as an important measure of fiscal performance.

In 1987-1988 the running costs system was introduced, whereby the full current costs, plus some minor capital costs consumed by an agency in providing the government services for which it is responsible, were transferred to the agency. The key principle of the running costs system was to decentralise resource allocation and give agency managers substantial freedom to allocate resources and to adapt to changing priorities.[22]

The introduction of the running costs system focused attention on the overall costs of program delivery and enhanced accountability by placing the responsibility for running costs with the manager responsible for the program.

The addition of performance management and program evaluation practices enabled managers, government and the Parliament to more accurately measure the effectiveness of programs allowing strategic decision making to be better linked to operational practices. This encouraged agencies to define policy aims and objectives, to establish

[21] Commonwealth of Australia, Speech by Stephen Bartos, General Manager, Budget, Department of Finance and Administration, at the OECD International Symposium on Accrual Accounting and Budgeting, Paris, France, 13-14 November 2000, http://www.finance.gov.au/Media/Finance/oecd_accruals_symopsium.html , 23.08.02.

[22] Commonwealth of Australia, Speech by Stephen Bartos, General Manager, Budget, Department of Finance and Administration, at the OECD International Symposium on Accrual Accounting and Budgeting, Paris, France, 13-14 November 2000, http://www.finance.gov.au/Media/Finance/oecd_accruals_symopsium.html , 23.08.02.

program structures and to determine appropriate performance indicators. It also introduced a cultural shift towards a results and performance oriented public sector.

Over a three year period beginning in 1992, departments were required to introduce measures that would allow for the preparation of trial accrual reports from 30 June 1995. During the same time period the Commonwealth trialled whole of government reports for the 1994-95 and 1995-96 financial years.

Despite these reforms, during the 1980's and early 1990's the Joint Committee on Public Accounts and Audit (JCPAA), the National Commission of Audit and other international organisations recognised that a cash and input based resource management system was no longer adequate.

2.4 National Commission of Audit

In March 1996 the newly elected conservative government established the National Commission of Audit to report on issues associated with its financial management reform agenda. The Commission's terms of reference states that "*the Commission of Audit will investigate and report on the financial position of the Commonwealth Government with a view to advising the Government on the future management of its finances consistent with a medium to long term goal of improving the Government's fiscal position*".[23] The findings and recommendations of this report have become the backbone of the Commonwealth financial management reform process.

The issues in relation to financial management and accounting that were covered by the report are:

- the accounting framework of the Commonwealth;
- whole of government reporting;
- the Charter of Budget Honesty (i.e. fiscal responsibility legislation); and[24]

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[23] Commonwealth of Australia, National Commission of Audit, Report to the Commonwealth Government, June 1996.
[24] Commonwealth of Australia, National Commission of Audit, Report to the Commonwealth Government, June 1996.

- although not covered in detail, the budgeting framework of the Commonwealth.

2.4.1 The Accounting Framework of the Commonwealth

With regard to the accounting framework of the Commonwealth the National Commission of Audit Report made the following key findings and key recommendations.

"Key Findings

- *A full accrual accounting framework is an essential complement to the structural and cultural change the Government is seeking by way of a more competitive, efficient and effective public sector.*
- *A fundamental difference exists between financial reports for internal management and reporting for external users.*
- *The timeliness of financial reporting by Commonwealth departments, agencies and statutory authorities is less rigorous than the standards set for companies operating under the Corporations Law.*

Key Recommendations

- *The Government should formally adopt accrual principles as the basis for an integrated budgeting, resource management and financial reporting framework both at the agency level and at the aggregate budget sector level.*
- *The Commonwealth Budget should be presented in the budget papers on an accrual basis as from the 1998-99 Budget.*
- *The budget forward estimates, which have a central place in the Government's budget management and control system, should include the accrual implications of policy proposals and commitments.*
- *At the agency level, accrual budgets should form the basis of financial performance targets to be reported on in their annual reports. Such targets should be ready for implementation with the 1998-99 Budget.*

- *The budget appropriations should be made on an accrual basis.*
- *Commonwealth departments, agencies and statutory authorities should be required to arrange for their audited annual financial statements to be tabled in the Parliament by 30 September.*
- *The Department of Finance should be responsible for coordinating a strategy for the implementation of a full accrual accounting framework.*
- *Chief executive officers and senior managers should take ownership of the accrual resource management reforms in their respective departments/agencies, as they will be held accountable for their agencies' performance, which the reforms aim to make more transparent".*[25]

In substance, all of the recommendations made by the National Commission of Audit in relation to the Commonwealth's accounting framework have been implemented.

With the introduction of the Charter of Budget Honesty Act 1998, the Financial Management and Accountability Act 1997, the Commonwealth Authorities and Companies Act 1997 and other subordinate regulations (particularly the Finance Ministers' Orders), the legislative framework for the switch to a full accrual basis for financial record keeping and reporting was set in place (for a more detailed description of the relevant sections of the legislation see Chapter 4).

To facilitate the achieval of the government's goals in relation to a full accrual basis of accounting, in the Australian Public Service, the Accrual Information Management System (AIMS) was developed. AIMS is an integrated software system allowing the input, collation and management of all necessary financial information, on an accrual basis, for the production of financial reports and the budget (for further information on AIMS, see Chapter 5).

2.4.2 Whole of Government Reporting

With regard to whole of government reporting the National Commission of Audit Report made the following key findings and key recommendations.

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[25] Commonwealth of Australia, National Commission of Audit, Report to the Commonwealth Government, June 1996.

"Key Findings

- *Accumulated results and reserves (the difference between recognised assets and liabilities) do not represent the Commonwealth's net worth, nor are they an indicator of its solvency or the sustainability of its financial position.*
- *The whole of government statements show, for the first time:*
    - *the nature and composition of the Commonwealth's assets and liabilities*
    - *the effect of the (mainly) unfunded superannuation liability on the net asset position*
- *Whole of government statements require considerable care and a sophisticated understanding of the Commonwealth's business for a proper interpretation of their message; comparisons of 'bottom line' figures in the statements with those of the States or with unitary governments overseas, cannot meaningfully be made. The availability of trend data over time will enhance the analytical value of whole of government financial statements.*

Key Recommendations

- *Whole of government financial statements reporting on the financial performance and position of the Commonwealth Government for the year ended 30 June should continue to be prepared annually on a basis similar to that adopted for the 1994-95 trial.*
- *Statements prepared for audit should be signed off by the Secretary of the Department of Finance.*
- *The primary financial statements prepared for the Commonwealth Government should be a statement of revenues and expenses, a statement of assets and liabilities and a statement of cash flows for the whole of government and the three government finance statistics (GFS) sectors (general government, public trading enterprises and public financial enterprises). The statements should separately identify the budget sector.*

- *In addition to the year end statements, the Government should prepare mid year statements as of 31 December. These need not be formally audited but should be reviewed by the auditor in accordance with Australian Auditing Standard AUS 106, Explanatory Framework for Standards on Audit and Audit Related Services."*[26]

The preparation of whole of government, or consolidated, financial reports entails one of the major innovations achieved in the Australian Public Service, in relation to government accounting.

Whole of government financial reports are of particular importance in terms of achieving transparency across government operations. However, as the National Commission of Audit Report points out under its key findings, "the whole of government statements require considerable care and a sophisticated understanding of the Commonwealth's business for a proper interpretation of their message; comparisons of the 'bottom line' figures in the statements with those of the States or governments overseas, cannot be meaningfully made."[27]

Both of the external reporting requirements implemented into the Commonwealth public sector (Government Finance Statistics and Australian Accounting Standards), mandate a form of consolidation.

Under the GFS framework, sector statements are prepared with General Government, Public Non-Financial Corporations and Public Financial Corporations being consolidated, through the necessary eliminations and netting, to provide whole of government aggregates.[28]

Through the adoption of Australian Accounting Standard No. 31 - Financial Reporting by Governments (AAS 31), the requirement to consolidate the Commonwealth's financial reports has also been introduced. AAS 31 mandates the application of AAS 24

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[26] Commonwealth of Australia, National Commission of Audit, Report to the Commonwealth Government, June 1996.
[27] Commonwealth of Australia, National Commission of Audit, Report to the Commonwealth Government, June 1996.
[28] Commonwealth of Australia, Consolidated Financial Statements for the Year Ended 30 June 2001, Circulated by Senator The Honourable Nick Minchin, Minister for Finance and Administration, December 2001.

in relation to consolidation. Under AAS 24, the entities to be included in consolidated financial reports is determined by the principle of control. When an entity has the capacity to dominate decision making, directly or indirectly, in relation to the financial and operating policies of another entity, control is said to exist and the subordinate entity's financial reports must be included in the consolidated financial reports of the controlling entity.[29] Figure 2.1 details the issues used to determine if control exists.

Figure 2.1 – Factors that would normally indicate control.

22 Any of the following factors would normally indicate the existence of control by one entity of another entity:

(a) the capacity to dominate the composition of the board of directors or governing board of another entity;

(b) the capacity to appoint or remove all or a majority of the directors or governing members of another entity;

(c) the capacity to control the casting of a majority of the votes cast at a meeting of the board of directors or governing board of another entity;

(d) the capacity to cast, or regulate the casting of, a majority of the votes that are likely to be cast at a general meeting of another entity, irrespective of whether the capacity is held through shares or options; and

(e) the existence of a statute, agreement, or trust deed, or any other scheme, arrangement or device, which, in substance, gives an entity the capacity to enjoy the majority of the benefits and to be exposed to the majority of the risks of that entity, notwithstanding that control may appear to be vested in another party.

Source: Australian Accounting Research Foundation, Australian Accounting Standard No. 24 Consolidated Financial Reports (AAS 24), May 1992, p12.

The use of the principle of control is important in consolidation issues because it indicates which entities are likely to have an impact on the financial performance and position of the controlling entity, in this case the Commonwealth Government.

Whole of government reports were prepared on a trial basis from the 1994-95 financial year onwards, and are now recognised as an integral part of the Commonwealth's financial reporting framework.

2.4.3 Charter of Budget Honesty

With regard to the Charter of Budget Honesty the National Commission of Audit Report made the following key findings and key recommendations.

[29] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p18.

"Key Findings

- *Fiscal policy transparency and accountability are enhanced by requiring governments to state objectives and to establish benchmarks against which fiscal policies can be assessed; and to provide more frequent comprehensive reports on the fiscal and economic outlook.*
- *Australian governments face no legislative obligation to articulate their fiscal strategy or set fiscal targets, to report on their progress in meeting their fiscal objectives or to report against specific fiscal indicators.*
- *A comprehensive report on the fiscal and economic outlook is normally published only once a year at budget time and no requirement exists for the release of such a report either before elections or mid year.*
- *No requirement exists for discretionary policies that are intended to smooth the economic cycle to be identified as such or to be accompanied by a statement explaining the process for their reversal.*
- *Current budget reporting and scrutiny of the cost of tax concessions (that is tax expenditures) is inadequate and falls short of overseas best practice.*
- *Responsibility for reports on the fiscal and economic situation lies with the relevant government Minister (usually the Treasurer or the Minister for Finance, but sometimes the Prime Minister), not the heads of the agencies that prepared them. This has the potential to impede transparency and accountability.*

Key Recommendations

- *Legislation should be introduced to require the government of the day to set and to report against a clear fiscal strategy, which would include setting targets and benchmarks.*
- *The proposed legislation should make clear that governments are responsible for setting fiscal strategy, including appropriate targets and benchmarks, while*

the Secretaries of the relevant departments are responsible for reporting on the economic and fiscal outlook.

- *The legislation should require comprehensive reports on the economic and fiscal outlook prepared by Treasury and the Department of Finance to be published at budget time, at the time of the mid year review and immediately prior to elections. The nature of this responsibility should be specified in the employment contracts of the relevant Secretaries.*
- *The proposed fiscal reporting legislation should require discretionary policies that are intended to smooth the economic cycle to be identified as such and to be accompanied by a statement explaining the process for their reversal."*[30]

The Charter of Budget Honesty falls under the realm of financial responsibility legislation. The Department of Treasury, in its submission to the Joint Committee of Public Accounts, stated that fiscal responsibility is a difficult term to define. However, appropriate fiscal policy will contain the following ingredients:

- it will seek balance in treatment across generations, that is, it will exhibit inter-generational equity and avoid excessive net expenditure on the current generation at the expense of future generations;
- it will recognise the cyclical nature of the economy and have regard to the scope for smoothing the peaks and troughs of the business cycle, even if only through the operation of the 'automatic stabilisers';
- it will make an adequate contribution to national savings needed to fund investment; and
- similarly, it will maintain government programs at levels that have regard to the burden placed on taxpayers in funding them and the unavoidable efficiency costs of taxation.[31]

In summary, fiscal responsibility needs to accommodate both short term and longer term considerations.

[30] Commonwealth of Australia, National Commission of Audit, Report to the Commonwealth Government, June 1996.
[31] Commonwealth of Australia, National Commission of Audit, Report to the Commonwealth Government, June 1996

Fiscal responsibility legislation has traditionally been the exception rather than the rule, with government reporting requirements generally regulated by convention rather than legislation.

In 1998 the Commonwealth Government enacted the 'Charter of Budget Honesty' in order to set in place legislative requirements in relation to fiscal policy and financial reporting.

In terms of the introduction of accrual accounting, the Charter of Budget Honesty Act 1998 is of particular importance as it mandates the application of external reporting standards (i.e. Government Finance Statistics and the Australian Accounting Standards).

2.4.4 The Outcomes and Outputs Framework

Although not specifically covered by the National Commission of Audit Report, a major part of the financial management reforms undertaken in the Commonwealth Government in the last decade have involved budgeting, and specifically the introduction of Accrual Outcome and Output-based Budgeting (AOOB).

AOOB is a form of performance budgeting that is conceptually related to program budgeting. However, AOOB places the entire budget mechanism in an internal market. This process sets up a situation where the government purchases products from agencies in market type transactions and agencies recognise government funding as revenue.[32]

The AOOB model is described in more detail in Chapter 3.

[32] Robinson M., Financial Control in Australian Government Budgeting, Public Budgeting & Finance, Spring 2002, p81.

Chapter 3. Budget Process and Underlying Policies

3.1 Accrual Outcome and Output-based Budgeting

One of the major innovations in relation to the Commonwealth Government's financial management has been in the area of budgeting, and specifically the introduction of Accrual Outcome and Output-based Budgeting (AOOB).

AOOB is a specific form of performance budgeting that is conceptually related to program budgeting. However, AOOB goes much further than program budgeting in that it attempts to place the entire budget mechanism in an internal market or purchaser/provider setting. In doing so the budget process becomes one where the government purchases products from departments in market type transactions and departments recognise government funding as business revenue.[33]

The main aim of the AOOB system of budgeting is to create a situation in which departments operate as quasi independent business with their financial results, and other indicators, being used for performance measurement.

The linking of performance measurement to budget estimates is also a major change from the traditional cash based budgeting systems. Under AOOB, outcomes (what the government wants to achieve) and outputs (how the government will achieve its desired outcomes) are detailed in the budget. Each outcome and its underlying outputs are allocated a price, which the government pays to the relevant agency for the delivery of that outcome or output. Simultaneously, appropriate performance indicators for each outcome and output are developed in order to determine the extent to which the outcomes and outputs have been achieved. Agencies are required to disclose the extent to which they have succeeded in achieving their outcomes and outputs, by reporting against their performance indicators in an annual report. For this reason AOOB is much more than purely a budgetary system it serves as an integrated budgetary and performance management system aimed at promoting continuous improvements in the efficiency and effectiveness of government programs.

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[33] Robinson M., Financial Control in Australian Government Budgeting, Public Budgeting & Finance, Spring 2002, p81.

Australia is not the first country to apply the principles of AOOB. Similar internal market budgeting frameworks have been implemented in the New Zealand Government and in Great Britain. One of the first public organisations to implement internal market based relationships was the British National Health System.[34]

3.2 The Outcome and Output Framework in the APS

The outcomes and outputs framework in the Australian Public Service (APS) is designed to help answer three fundamental questions:

1. What does government want to achieve? (*outcomes*);
2. How does it achieve this? (*outputs and administered items*); and
3. How does it know if it is succeeding? (*performance reporting*).[35]

Outcomes

An 'outcome' is the impact sought or expected by government in a given policy area. The focus is on change and consequences: what effect can government have on the community, economy and/or national interests? Outcome statements also perform a specific legal function by describing the purposes of appropriated funds.[36]

Outputs

Outputs are the actual deliverables – goods and services – agencies produce to generate the desired outcomes specified by government. Users of these goods and services can include members of the general public, industries or sectors, ministers, members of parliament, or other agencies or even, in some instances, interests (e.g. the national

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[34] Robinson M., Financial Control in Australian Government Budgeting, Public Budgeting & Finance, Spring 2002, p81.
[35] Commonwealth of Australia, Outcomes and Outputs Framework: Guidance Document, Department of Finance and Administration, November 2000, p3.
[36] Commonwealth of Australia, Outcomes and Outputs Framework: Guidance Document, Department of Finance and Administration, November 2000, p10.

interest). A client (user of outputs), can be anyone outside the agency who benefits from the work of the agency.[37]

Administered Items

Administered items are those resources administered by the agency on behalf of the government (such as transfer payments to the States, grants and benefits) to contribute to a specified outcome. They are identified separately from departmental items (i.e. departmental outputs) because they involve different accountability requirements.[38]

Performance Reporting

Performance reporting is undertaken through the setting of appropriate performance indicators for outcomes, outputs and administered items then comparing the actual results to the expected results.

Outcomes require indicators of effectiveness in terms of the contributions of relevant departmental outputs and administered items to the achievement of the outcome.

Outputs require indicators of the price, quantity and quality of the output.

Administered items require indicators relating to the achievement of the objectives of the grants, transfers or benefit payments (for example), as indicated in associated legislation, policy statements or inter-governmental agreements.[39]

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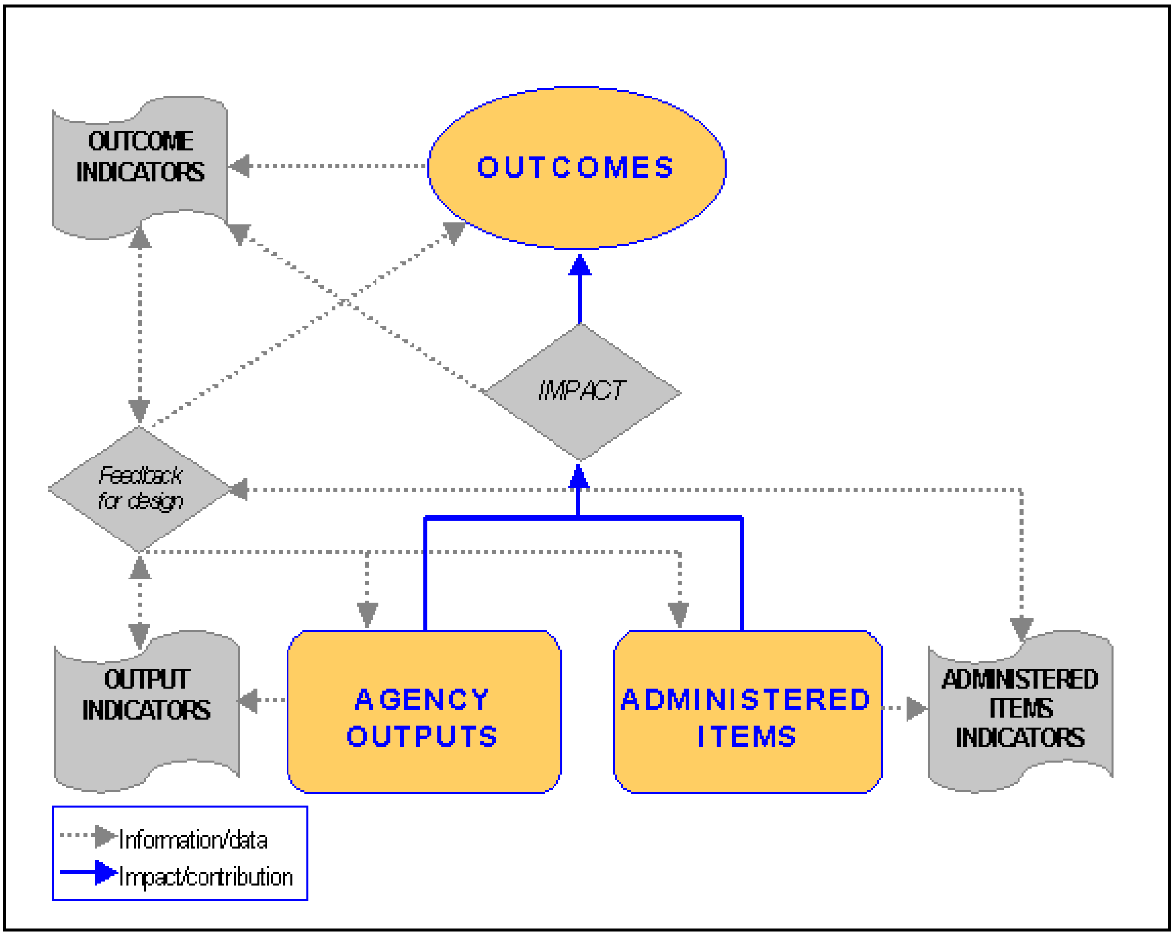
[37] Commonwealth of Australia, Outcomes and Outputs Framework: Guidance Document, Department of Finance and Administration, November 2000, p19.
[38] Commonwealth of Australia, Outcomes and Outputs Framework: Guidance Document, Department of Finance and Administration, November 2000, p16.
[39] Commonwealth of Australia, Outcomes and Outputs Framework: Guidance Document, Department of Finance and Administration, November 2000, p27.

Figure 3.1 – Basic Outcome and Output Structure



Source: Commonwealth of Australia, Outcomes and Outputs Framework: Guidance Document, Department of Finance and Administration, November 1999.

The outcomes and outputs framework applies to all Commonwealth agencies. The framework links the budgeting function with corporate governance, management arrangements and the reporting of actual performance against expected performance. Whilst the broad parameters of the framework must be adhered to by agencies, there is considerable scope for agencies to tailor the system to their specific circumstances. This inbuilt flexibility is an underlying principle of the framework and it allows considerable devolution of responsibilities away from central agencies.

The outcomes and outputs framework is aimed at achieving a number of advantages:

- Results focus: The framework requires greater emphasis by the government on the results that it wishes to achieve. Portfolio ministers must clearly define the outcomes they wish to achieve in each policy area, and all agency outputs and administered items must demonstrably contribute to those outcomes.

- Accountability: Given that the outcome statements define the purpose of all agency activities and administered items, agencies are accountable for the efficient delivery of effective outputs.
- Business-like footing: the outcomes and outputs framework introduces an internal market type environment where government purchases products and services from the public sector on a competitive basis, providing an incentive for agencies to be responsive to government and to actively manage performance.
- Transparency: The clear definition of desired outcomes and outputs and the reporting of financial and non-financial performance, on an accrual basis, provides enhanced transparency for stakeholders.[40]

Although the framework was implemented in 1999-2000, it is envisaged that full implementation will be a progressive process taking several years to complete.

The outcomes and outputs framework is in essence a seamless hierarchical system of targets or objectives which creates an unbroken audit trail that delivers advantages in transparency and accountability.

3.3 The Outcomes and Output Hierarchy

The responsibilities of the Government Ministers in the Australian Government are divided up into appropriate groupings called portfolios. Each portfolio consists of one or more departments or agencies (see Figures 3.2 and 3.3).

At the upper level, outcomes are developed for each portfolio. Some portfolios have one outcome covering all the agencies within the portfolio, for example Agriculture, Fisheries and Forestry has one outcome (see figure 3.4). Whereas other portfolios have a number of separate portfolio outcomes, for example Health and the Ageing has nine outcomes (see figure 3.5). However, given the relatively large spread of functions within Commonwealth portfolios, it is unlikely that a single outcome will be sufficient to cover all responsibilities within a portfolio. Where single outcomes have been used

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[40] Organization for Economic Cooperation and Development, OECD Journal on Budgeting, Volume 1, No. 4, OECD Publishing, Paris, 2002.

some agencies support these with intermediate outcomes that relate more closely to the work of the agency.

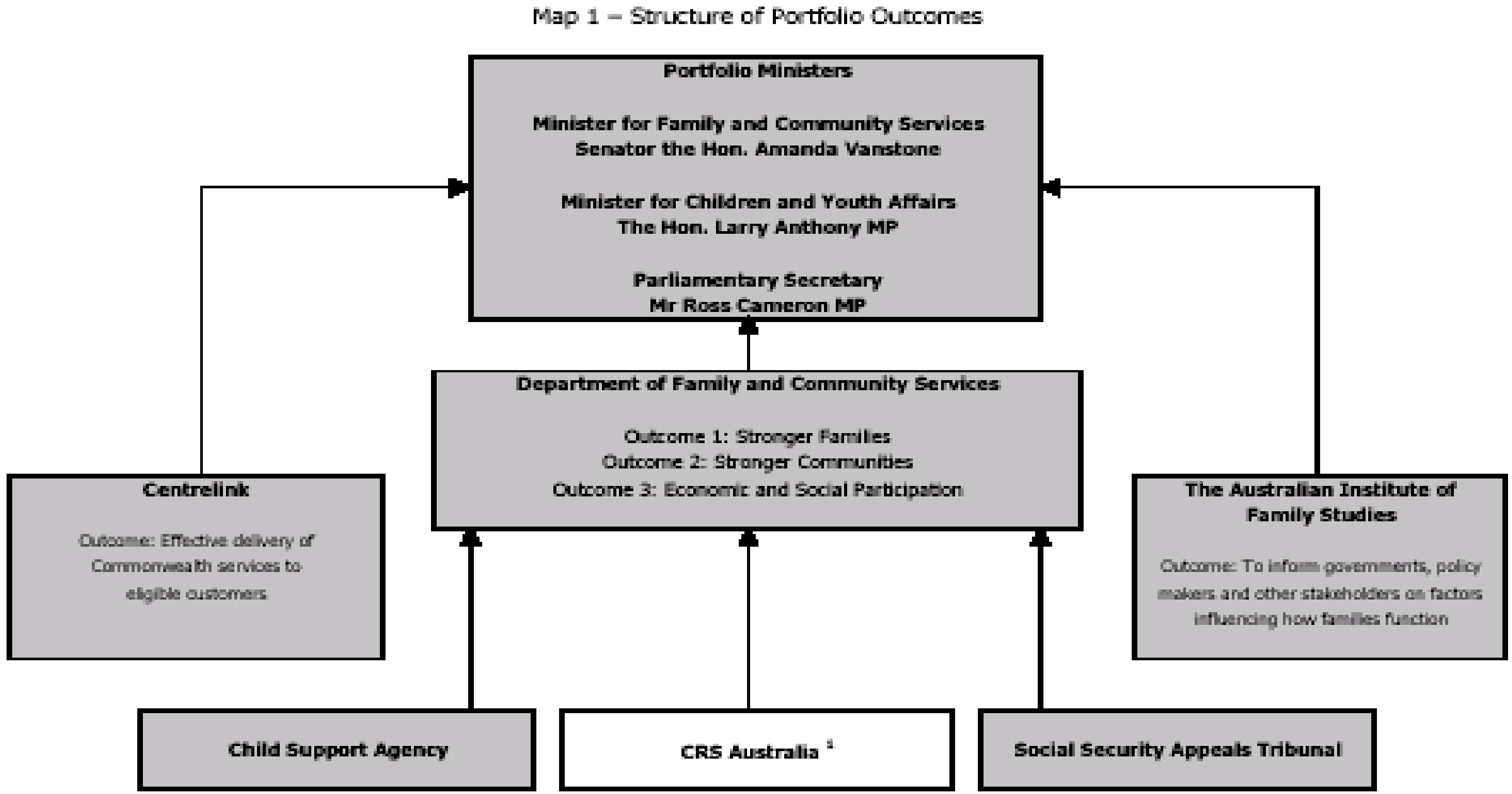
Lying below portfolio outcomes in the hierarchy, sit the agency specific outcomes. In turn each agency outcome has one or more outputs that contribute to the achievement of the outcome. These outputs may also have sub-output groups to further define the work of the agency (see Figure 3.6).

In conjunction with the departmental or agency outputs, administered items contribute to the achievement of the desired outcomes.

As an integrated part of specifying outcomes and outputs, key performance indicators (KPI's) are developed for outcomes, outputs and administered items. These KPI's are reported against in the annual report of the agency following completion of the reporting period. KPI's must deliver information on both effectiveness and efficiency.

A hierarchy of corporate goals and performance measures, similar to the hierarchy detailed above, is more or less common place in the modern business world. The innovative step taken by the Australian Commonwealth Government lies in linking the outcome and output structure to the budget function. Budget appropriations (appropriations are the only legal method of making payments/transfers of money from the consolidated revenue fund to agencies. Method of appropriation is specified in the Constitution.) are now made on the basis of outcomes, clearly defining what the government is purchasing from each agency.

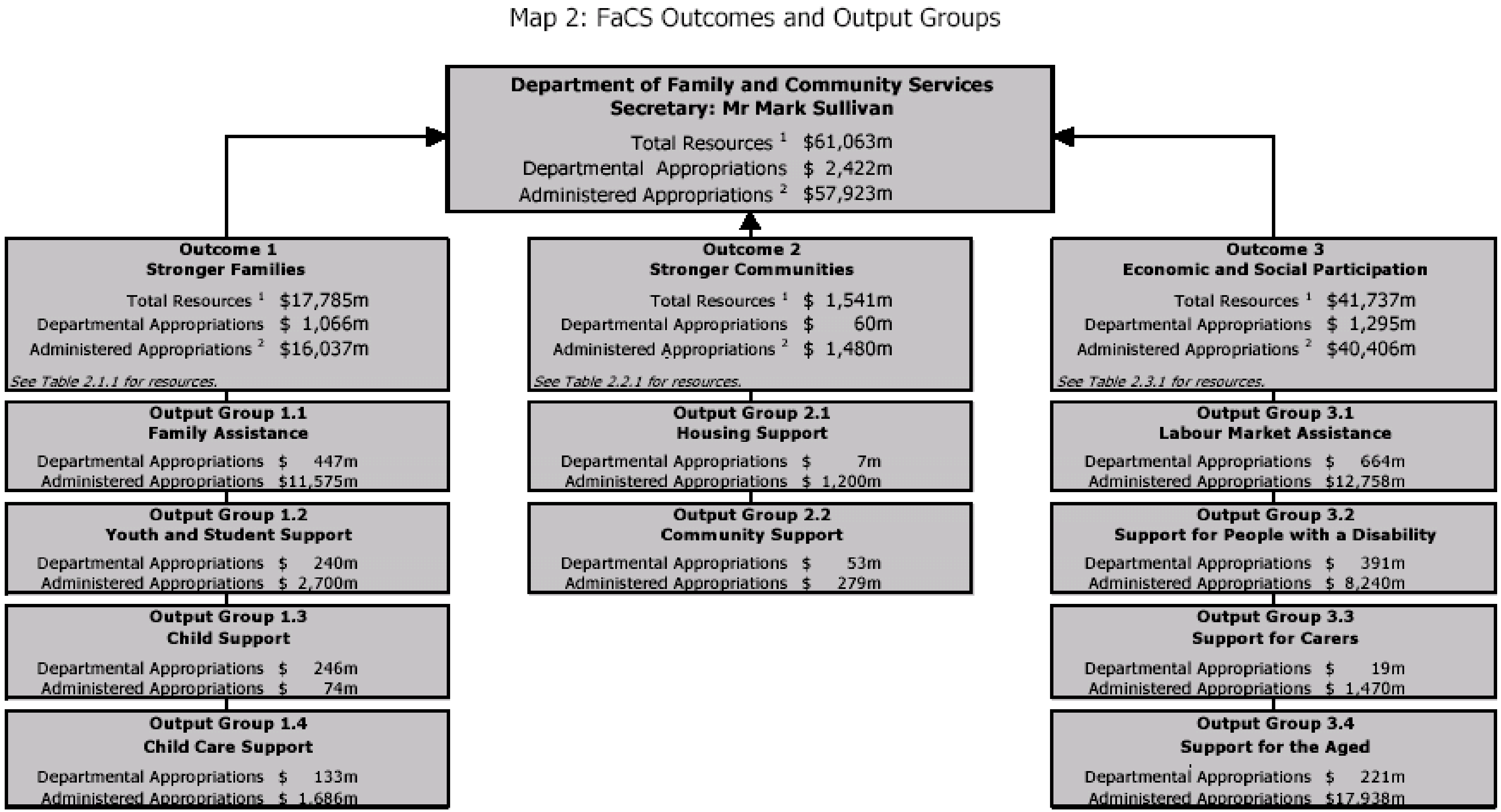
Figure 3.2 – Example of a Portfolio Structure (Family and Community Services Portfolio)



1. It is expected that from 1 July 2002 *CRS Australia* will be part of the Health and Ageing Portfolio. *CRS Australia* is included in these statements and will be included in the 2001–02 FaCS Annual Report. *CRS Australia* will be reported under the Health and Ageing Portfolio at 2002–03 Additional Estimates.

Source: Commonwealth of Australia, Department of Family and Community Services, Portfolio Budget Statements 2002-03.

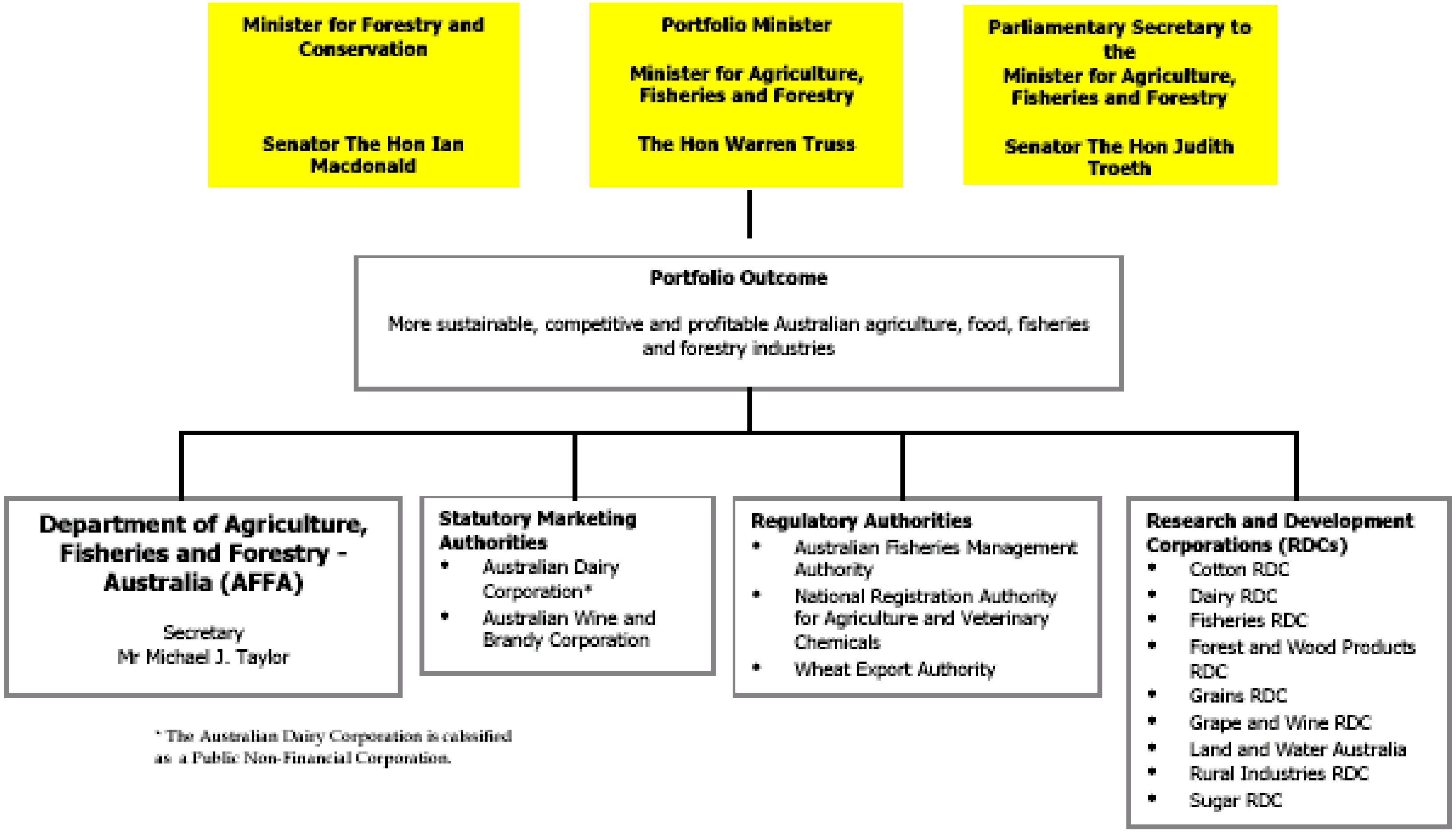
Figure 3.3 – Outcomes and Output Groups for the Department of Family and Community Services



1. 'Total Resources' includes Departmental and Administered Appropriations, Non-Directly Appropriated Expenses, and Revenue from Other Sources.
2. 'Administered Appropriations' include 'Administered Items across Outcome'.

Source: Commonwealth of Australia, Department of Family and Community Services, Portfolio Budget Statements 2002-03.

Figure 3.4 – Portfolio Outcome Structure for the Agriculture, Fisheries and Forestry Portfolio



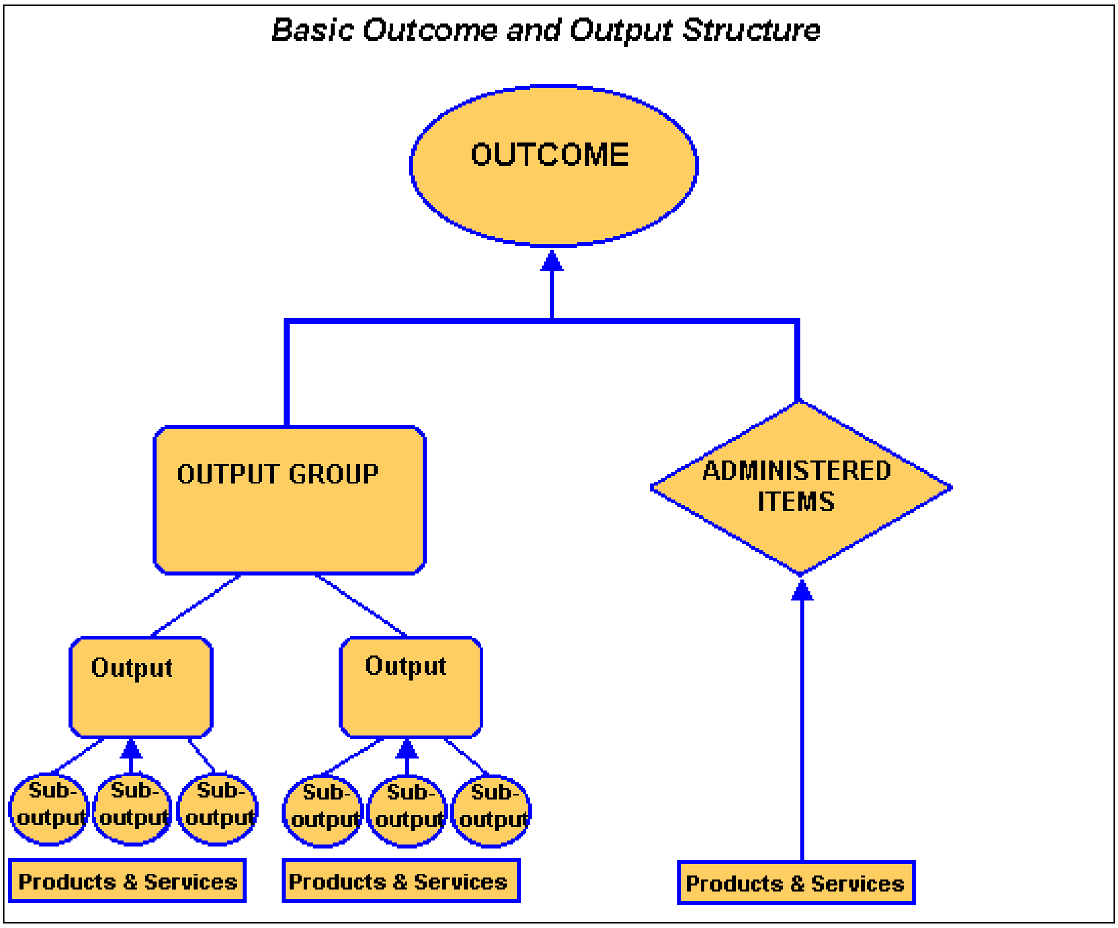
Source: Commonwealth of Australia, Department of Agriculture, Fisheries and Forestry, Portfolio Budget Statements 2002-03.

Figure 3.5 – Portfolio Outcome Structure for the Portfolio Health and the Ageing

Outcome	Agencies or Divisions Responsible	Outcome	Agencies or Divisions Responsible
1. Population Health And Safety Promotion and protection of the health of all Australians and minimising the incidence of preventable mortality, illness, injury and disability.	Population Health Division, Therapeutic Goods Administration, Portfolio Strategies Division, Australia New Zealand Food Authority, Australian Radiation Protection and Nuclear Safety Agency, Health Insurance Commission*	*6. Hearing Services* Reduced consequences of hearing loss for eligible clients and a reduced incidence of hearing loss in the broader community	Aged and Community Care Division (Office of Hearing Services), Australian Hearing Services*, Health Insurance Commission*
2. *Access to Medicare* Access through Medicare to cost-effective medical services, medicines and acute health care for all Australians.	Health Access and Financing Division, Health Insurance Commission*, Professional Services Review	*7. Aboriginal and Torres Strait Islander Health* Improved health status for Aboriginal and Torres Strait Islander peoples	Office of Aboriginal and Torres Strait Islander Health
3. Enhanced Quality of Life for Older Australians Support for healthy ageing for older Australians and quality and cost effective care for frail older people and support for their carers.	Aged and Community Care Division, Aged Care Standards and Accreditation, Agency*	*8. Choice through Private Health* A viable private health industry to improve the choice of health services for Australians.	Health Industry and Investment Division, Private Health Insurance Administration Council, Private Health Insurance Ombudsman, Health Insurance Commission*
4. Quality Health Care Improved quality, integration and effectiveness of health care.	Health Services Division	*9. Health Investment* Knowledge, information and training for developing better strategies to improve the health of Australians.	Health Industry and Investment Division, National Health and Medical Research, Council Portfolio Strategies Division, Corporate Services Division, Australian Institute of Health and Welfare
5. Rural Health Improved health outcomes for Australians living in regional, rural and remote locations.	Health Services Division		

*These agencies contribute to the outcome through service agreements with the Department.

Figure 3.6 – Outcome and Output Hierarchy



Source: Commonwealth of Australia, Outcomes and Outputs Framework: Guidance Document, Department of Finance and Administration, November 2000.

3.4 Outcomes

As defined earlier, outcomes are the expected or sought impacts in a particular policy area. These expected or sought impacts are defined in the outcome statements, as part of the budget.

Outcome statements serve several purposes. They:

- define the impacts the government expects from the work of a given agency as well as the administered items it manages;
- articulate the purpose of the relevant appropriations under the Appropriation Acts of the Commonwealth Budget; and

- delineate the parameters for departmental outputs.[41]

All departmental outputs must contribute, directly or indirectly, to the realisation of a specified outcome, including under purchaser/provider arrangements whereby the provider is delivering to the purchaser's outcome(s). They must provide the Parliament, external accountability bodies, agency clients, interest groups and the general public with a clear statement of the broad goals of government and its agencies.[42]

In order to satisfy these various objectives, outcome statements must be well drafted and undergo extensive consultation within the agency and with external stakeholders. Further, due to the fact that appropriations are made on the basis of outcome statements, they must be drafted in a manner so as to meet the requirements of sections 81 and 83 of the Constitution (which deal with the nature and purpose of appropriations from the consolidated revenue fund).

To meet the Constitutional requirements for a legally valid appropriation, the following factors should be considered:

- an outcome should specify the state of affairs towards which an agency's activity is directed, not the activity itself;
- outcomes must be specific enough to determine authorisation of expenditure. However, the Appropriation Bills can be read in conjunction with the Portfolio Budget Statements and the Portfolio Additional Estimates Statements to clarify the purpose of the appropriation; and
- the Appropriation Bills include general provisions making it clear appropriations will be for department or agency services to help achieve the specified outcome.[43]

[41] Commonwealth of Australia, Outcomes and Outputs Framework: Guidance Document, Department of Finance and Administration, November 2000, p10.
[42] Commonwealth of Australia, Outcomes and Outputs Framework: Guidance Document, Department of Finance and Administration, November 2000, p10.
[43] Commonwealth of Australia, Outcomes and Outputs Framework: Guidance Document, Department of Finance and Administration, November 2000, p12.

3.4.1 Design

In order to comply with legal, management and accountability issues, outcome statements should be designed to appropriately match the government objectives they are addressing and allow for the measurement of effectiveness.

Outcomes are set in a similar manner to organisational mission or vision statements (in the context of business/corporate planning), but should avoid the value-laden language that is common (and appropriate) in mission or vision statements.

Outcome statements should be:

- focussed on the end result the government is seeking, not on the means of achieving it;
- succinct;
- specific as to the area being addressed;
- able to be read in conjunction with the Portfolio Budget Statements and the Portfolio Additional Estimates Statements to constitute a clear purpose for the relevant appropriation;
- stated in such away as to allow the relevant target group(s) to be identified;
- enable the formulation of sound effectiveness indicators to measure the impact of departmental outputs on the desired outcome.[44]

In drafting outcome statements it is important not to over specify. Over specification can occur when the same issue is expressed with various qualifications and extensions of the core issue or objective. This problem was expressly noted by the Senate Finance and Public Administration Committee in its report on the format of Portfolio Budget Statements.

In cases where desired outcomes are to be delivered through interagency cooperation it may be appropriate for these agencies to agree on a single outcome statement, even if

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[44] Commonwealth of Australia, Outcomes and Outputs Framework: Guidance Document, Department of Finance and Administration, November 2000, p11.

they are in different portfolios. Alternatively, it is possible for a purchaser/provider relationship between agencies to be established, whereby the 'lead' agency is funded for the whole outcome, and purchases outputs from other provider agencies.

3.4.2 Facilitation of Effectiveness Indicators

One of the more difficult aspects of specifying outcomes lies in ensuring that they are able to be measured, especially in terms of the effectiveness of the relevant administered items and/or departmental outputs in contributing to the outcome.

Almost all Commonwealth outcomes are likely to be influenced by factors that are beyond the control of the agency and/or influenced by outputs across a range of portfolios. Isolating the relationship that administered items and departmental outputs have on a particular outcome is therefore often an issue of judgement and may sometimes require the use of proxy or parallel effectiveness indicators. These proxy indicators represent conditions in Australia's manufacturing, resources and service industries, but are heavily influenced by factors other than the outputs of agencies. An example of linking the measurement of effectiveness through economic indicators could be; changes in Australia's per capita gross domestic product relative to its major international trading partners and trading competitors, at purchasing power parities.[45]

3.4.3 Entities governed by the Commonwealth Authorities and Companies Act

Agencies governed by the Commonwealth Authorities and Companies Act 1997 (CAC Act) are generally required to adhere to the outcomes and outputs framework, with two main variations from departments and agencies governed by the Financial Management and Accountability Act 1997 (FMA Act):

1. where a CAC Act body receives budget appropriations (as is often the case), their outcome statements are not subject to the same level of detail needed to satisfy the legal requirements for appropriations under the Constitution; and

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[45] Commonwealth of Australia, Outcomes and Outputs Framework: Guidance Document, Department of Finance and Administration, November 2000, p14.

2. CAC Act bodies need not necessarily make express distinctions between administered items and departmental outcomes.

3.5 Outputs

As detailed earlier, outputs are the actual deliverables or goods and services that agencies produce in order to generate the desired outcomes specified by government. The users of these goods and services include members of the general public, industries or sectors, ministers, members of parliament, other agencies or even, in some cases, interests such as the national interest.[46]

Unlike outcomes, outputs do not form part of the legislative requirements in relation to appropriation of monies from the Consolidated Revenue Fund. They are however required to be included in the Portfolio Budget Statements and the Annual Reports of agencies. In setting outputs, agencies should consult with all major stakeholders and then have the outputs and relevant performance indicators officially approved by the Portfolio Minister.

The Department of Finance and Administration (DOFA) has issued a summary of output specification requirements. According to DOFA, outputs should:

- describe a good or service provided to individuals or organisations external to the agency;
- be effective in terms of their contribution to the specified outcome;
- be expressed in terms of what it is rather than how it is performed;
- be within the control of the agency, whether through direct delivery or contractual arrangements with third parties;
- identify what government is paying for, including being measurable in terms of price, quantity and quality;
- be amenable to comparison between actual or potential suppliers (especially through price analysis);

[46] Commonwealth of Australia, Outcomes and Outputs Framework: Guidance Document, Department of Finance and Administration, November 2000, p19.

- collectively cover all of the agency's activities, including overheads or shared resources allocated across outputs or output groups; and
- be specified so that the agency's organisational structure and management systems can be mapped to its outputs (in practice this may be achieved over time).[47]

3.5.1 Design

In general, the output structure developed by agencies should include business specific output groups backed up with more generic outputs able to be compared across agencies and/or potential competitors. The use of generic outputs for comparative purposes across agencies gives rise to the need for ongoing reviews, undertaken by DOFA, in order to insure that such generic outputs are and continue to be comparable.

The impact departmental outputs have on outcomes is not always clear. Where outside factors impact on the overall result in a given outcome area this should be made clear in the relevant budget documentation and in annual reports.

3.5.2 Relationship between Outputs and Outcomes

In some areas it may not always be possible to establish a clear link between an agency's outputs and its specified outcomes. This is particularly relevant in areas such as regulation, fiscal or other policy settings and coordinating efforts with other levels of government, foreign or international bodies.

Situations also exist in which the Commonwealth participates as a minor player in a large system. In these cases the relevant agency or department may find it difficult to quantify the contributions its outputs have on the specified outcome. It may also be the case that factors outside the control of the agency affect the outcome area (positively or negatively).[48]

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[47] Commonwealth of Australia, Outcomes and Outputs Framework: Guidance Document, Department of Finance and Administration, November 2000, p20.
[48] Commonwealth of Australia, Outcomes and Outputs Framework: Guidance Document, Department of Finance and Administration, November 2000, p22.

Where external factors impinge heavily on an agency's ability to deliver positive change in its outcome areas, these should be detailed in the Portfolio Budget Statements and Annual Reports.

3.5.3 Outputs and Sub-Outputs Vs. Activities and Processes

In many areas the output information published in Portfolio Budget Statements is not specific enough to serve for internal control and management purposes, even where outputs are broken down into sub-outputs. However, items that do not meet the test of an output (i.e. that it is a good or service delivered to someone outside the agency) should be classed as activities or processes and need not be specified in official documents for external circulation.

3.5.4 Outputs and the Organisational Structures of Agencies

Over time it is expected that agencies will structure or restructure their organisational form to broadly reflect their output structure. The advantages of such restructuring will be obvious in the areas of reporting and financial control, but will also highlight managerial responsibility in terms of the outcomes, output groups, outputs, sub-outputs, processes and activities structure.[49]

3.5.5 Policy Advice

Virtually all departments have an output class policy advice. Policy advice can be defined as a service delivered to a client outside the department or agency, including the minister. Where policy development work relates to internal issues it should be classed as an overhead item and should not be included under the output 'policy development'.

3.6 Administered Items

As defined earlier, administered items are those resources administered by an agency on behalf of the government (such as transfer payments to the States, grants and benefits) to contribute to a specified outcome.

[49] Commonwealth of Australia, Outcomes and Outputs Framework: Guidance Document, Department of Finance and Administration, November 2000, p24.

Approximately 80 per cent of the Commonwealth Budget is made up of administered items with departmental outputs making up the difference. Therefore, administered items are of vital importance in relation to the achievement of the government's desired outcomes.

The most common administered items comprise the following:

- expenses from subsidies, grants and benefit payments;
- revenues from taxes, fees, fines and excise;
- liabilities relating to public debt and employee superannuation; and
- assets relating to tax receivables, loans to other governments and investments in controlled entities.[50]

Many factors in relation to administered items (for example, legislation, government policy or agreements with other governments) are outside the control of agencies. However, it is none the less important for the effectiveness and efficiency of administered items to be measured and reported on, given their role in achieving the government's specified outcomes.

The reporting of performance in relation to administered items differs from that for departmental outputs in that it is not required to specifically measure quantity, quality and price issues. However, where possible the measurement of these items (quantity, quality and price) is desirable. An example of the measurement of administered items based on the above criteria is provided at figure 3.7.

[50] Commonwealth of Australia, Outcomes and Outputs Framework: Guidance Document, Department of Finance and Administration, November 2000, p16.

Figure 3.7 – Example of Performance Measures for Administered Items

The Department of Family and Community Services (FACS) is responsible for managing some $60 billion in administered items. The Department has developed a structured approach to managing and reporting on administered items where each is subject to specific performance indicators. These include effectiveness measures as well as quality and quantity indicators. Under 'Grants to Family Relationship Support Organisations', for example, the Department has identified the following indicators in its 2000-2001 Portfolio Budget Statement:
Cost - average cost per session and per customer by service delivery type (estimate $175 per session and $350 per customer).
Effectiveness - capacity (proportion of customers with positive outcomes);
take-up/coverage (number of service requests not accepted);
targeting (proportion of services delivered to areas of identified high need.
Quality - assurance (proportion of service providers meeting Family Quality Information Strategy Tier 1 standards).
Quantity - number of sessions provided and number of customers.
For the most part, the Department has not identified targets for these performance indicators. The use of targets is expected to increase as data on current performance is gathered and analysed.

Source: Commonwealth of Australia, Outcomes and Outputs Framework: Guidance Document, Department of Finance and Administration, November 2000, p17.

3.7 Performance Reporting Framework Under Outcomes and Outputs

3.7.1 Overview

Performance information can be defined as evidence about performance that is collected and used systematically. It can be collected at many different levels depending on the purpose and on the structure of each agency.

All Commonwealth agencies are required to publish performance information through their Portfolio Budget Statements and their Annual Reports. Performance information is required for all components of the outcome and output framework.

Outcomes require indicators of effectiveness in terms of the contributions departmental outputs and administered items make towards the achievement of the relevant outcomes.

Outputs require indicators of the price, quantity and quality of the output.

Administered items require indicators relating to the achievement of the objectives of the grants, transfers or benefit payments etc.[51]

3.7.2 Underlying Principles

Performance management information is collected and analysed in order to provide a better understanding of performance to both internal and external stakeholders.

Internal stakeholders require timely performance information in order to make adjustments that will ensure that the government's expectations will be met. In cases where performance measures are aligned with organisational structures, performance information will provide staff with feedback on their contribution to the management of outputs and administered items.

External stakeholders require performance information to allow informed decision making processes. External performance reporting is generally less frequent and less detailed than internal performance reporting and is publicised in the Portfolio Budget Statements and Annual Reports.

The Commonwealth government has based its performance management framework on two interconnecting systems; (1) the performance management cycle and (2) the performance improvement cycle.

The performance management cycle consists of six stages (shown graphically in Figure 3.8):

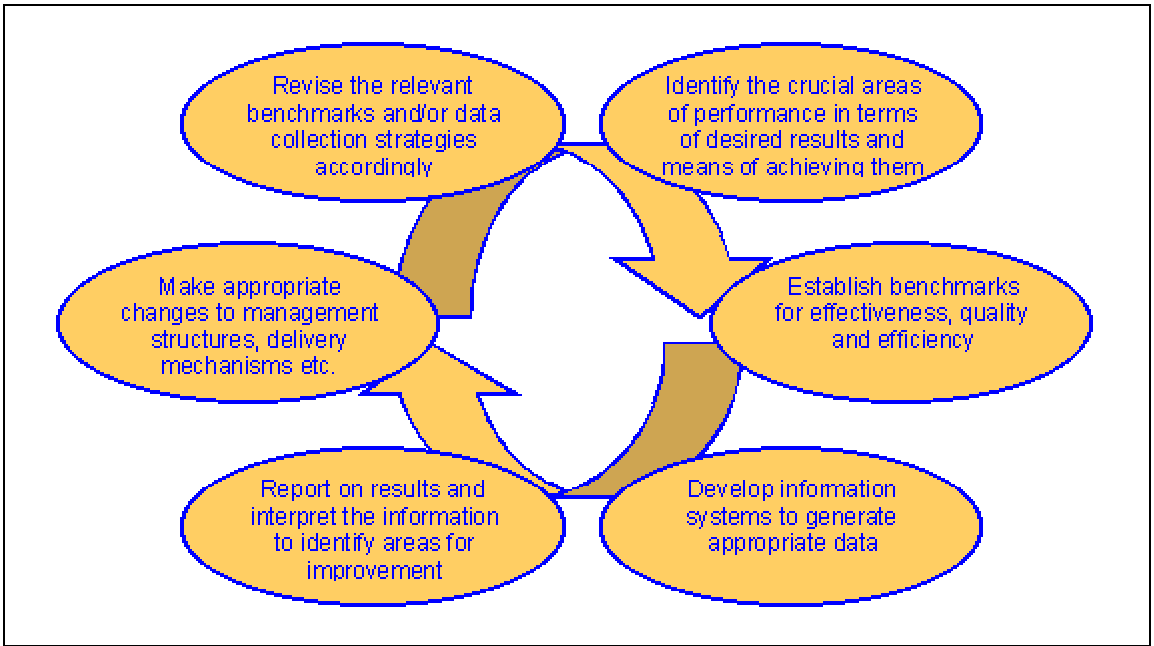
- identify the crucial areas of performance;
- establish benchmarks for achieving the specified outcomes as effectively and efficiently as possible;
- develop information systems to generate the appropriate data;
- report on results and interpret the information to identify areas for improvement;

[51] Commonwealth of Australia, Outcomes and Outputs Framework: Guidance Document, Department of Finance and Administration, November 2000, p27.

- make appropriate changes to management and operations; and
- revise the relevant benchmarks accordingly (taking into account the need for continuity of indicators over time).[52]

The performance management cycle interconnects with the Department of Finance and Administration's performance improvement cycle. The performance improvement cycle is a case-by-case approach to management review and improvement. It aims to encourage managers to actively question the relevance of particular activities and the need to continue with a given set of responsibilities or modes of operating. The performance improvement cycle has four stages (shown graphically in Figure 3.9).

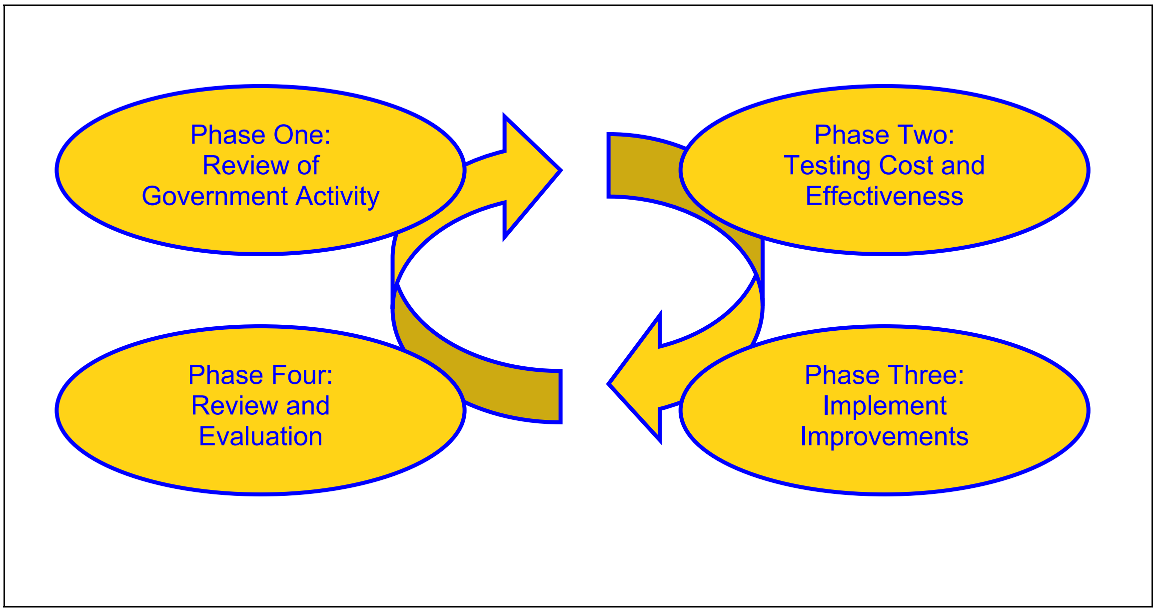
Figure 3.8 – Performance Management Cycle



Source: Commonwealth of Australia, Outcomes and Outputs Framework: Guidance Document, Department of Finance and Administration, November 2000, p30.

[52] Commonwealth of Australia, Outcomes and Outputs Framework: Guidance Document, Department of Finance and Administration, November 2000, p29.

Figure 3.9 – Performance Improvement Cycle



Source: From Author

Phase One: Review Government Activity

- Should the Commonwealth be involved in the activity?
- Should the activity be devolved to another level of government, privatised or discontinued?

Phase Two: Testing Cost and Effectiveness

- What is the most efficient way for the Commonwealth to be involved in the activity - competitive tendering and contracting, benchmarking, partnering re-engineering, contracting with another agency etc?

Phase Three: Implement Improvements

- How will improvements be implemented most efficiently?

Phase Four: Review and Evaluation

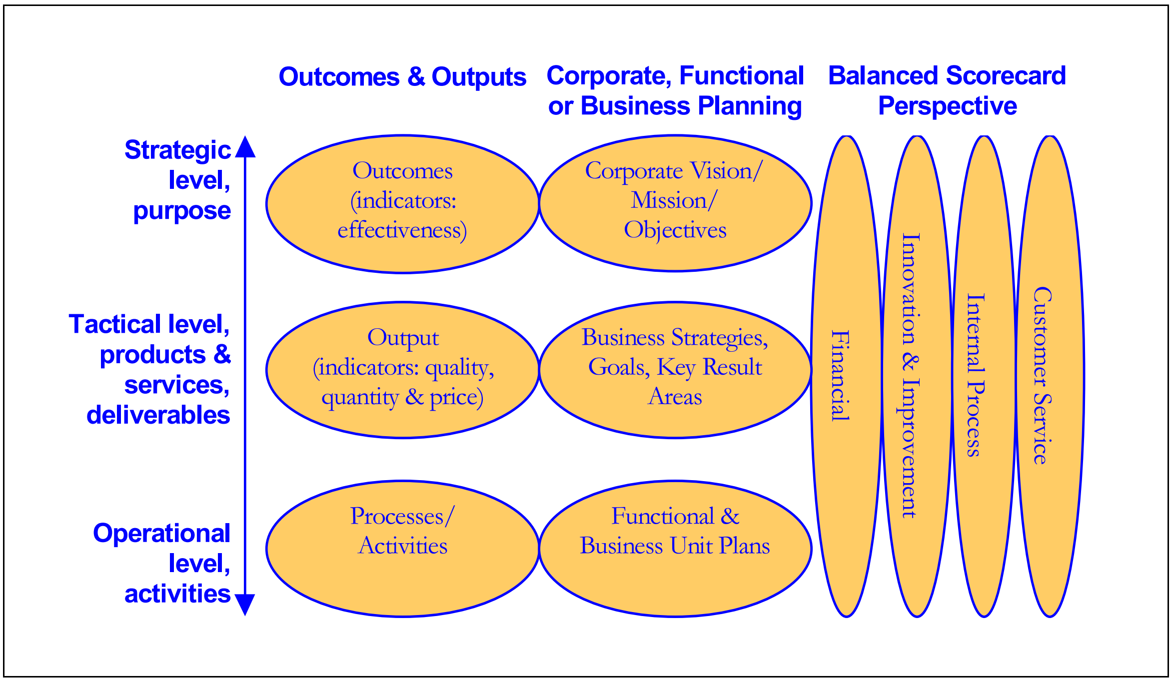
- How well did the improvement strategy work and is it still relevant to the current environment? (Repeat phases one and two)

3.7.3 Performance Management under Outcomes and Outputs Vs. Business Planning and the Balanced Scorecard

The performance management framework under outcomes and outputs is constructed in a similar fashion to other well known management tools such as business planning and the balanced scorecard. The underlying principle of all these management tools is to align the strategy and operations of an organisation so they are consistent with its overall purpose.

The outcomes and outputs framework focuses on performance measurement, particularly in terms of the effectiveness of outcomes. Business planning assists organisations in identifying their key result areas and ensuring that their strengths, weaknesses, opportunities and threats are identified and dealt with within the organisation's strategies. The balanced scorecard uses a matrix to compare performance information from all levels of the organisation within the four perspectives of customers, internal processes, innovation and financial performance. Figure 3.10 graphically compares these three management tools.

Figure 3.10 – Comparison of Outcomes & Outputs, Business Planning and the Balanced Scorecard



Source: Commonwealth of Australia, Outcomes and Outputs Framework: Guidance Document, Department of Finance and Administration, November 2000, p31.

3.7.4 Outcome Information

Performance information in relation to outcomes is reported in two ways: (1) information on the overall outcome performance and (2) information on the government's contribution to the outcome through its administered items and outputs (effectiveness indicators).

Overall outcome performance measures provide information on the trends in the specified outcome area. For example, the Department of Industry, Science and Resources measures trends in business expenditure on research and development, trends in international science and technology collaboration and the uptake of new and leading edge technology and trends in the IR&D Board programs (amongst others), in relation to its outcome two (Enhanced economic and social benefits through a strengthened national system of science and innovation). Such trends provide evidence of performance in the overall sector of research and development, which is useful in describing the broad environment in which the agency is operating and in developing and communicating policies.[53]

Effectiveness indicators measure the extent to which agency outputs and/or administered items make positive contributions to the specified outcome. From this it can be assumed that effectiveness is directly related to the output(s) and administered item(s) being both appropriate and well performing. It is theoretically possible to have an effective output or administered item that is highly inefficient. However, in practice it would be rare for an output that is of a high per unit cost and low quality to also be effective in realising the desired outcome.[54]

Indicators of effectiveness will generally be derived from characteristics of the outcome and should as clearly as possible identify the casual relationship between the outputs and/or administered items and the outcome. These indicators are not as easily definable as those for outputs and administered items and the application of generic indicators is more difficult. However, for long term planning and policy purposes it is important that

[53] Commonwealth of Australia, Outcomes and Outputs Framework: Guidance Document, Department of Finance and Administration, November 2000, p32.
[54] Commonwealth of Australia, Outcomes and Outputs Framework: Guidance Document, Department of Finance and Administration, November 2000, p32.

the best available efficiency indicators are identified and reported against. Further, the process of designing indicators of effectiveness can also be a useful tool for checking the overall framework of a given outcome and the outputs and administered items designed to achieve it.[55]

Effectiveness indicators should reflect the terms of the outcome as much as possible so as to allow for the combined effects of outputs and administered items to be measured and reported.

As a general rule, the effectiveness indicators should cover the major areas covered by the outcome. However, some outcomes are of such a broad nature that it will not be possible to cover all issues without having an unworkable number of indicators. As a guide, less than two indicators will not provide interested parties enough information to make judgements on the contributions of the outputs and administered items. More than six, however, is likely to confuse users by providing information on issues of little relevance to the outcomes objectives.[56]

3.7.5 Output Information

Output indicators should provide information on the performance of an output in terms of the combined and interdependent effects of its price, quality and quantity. From a theoretical perspective, there is an optimal mix of each of these factors at which the best performance will be achieved. On this basis, indicators for outputs should be equally spread between price, quality and quantity measures (see figure 3.11 for graphical representation).

Quality

A common misconception is that quality indicators are the same as effectiveness indicators. The quality relates to specific, immediate characteristics of an output that are not covered by price or quantity indicators, where as effectiveness relates to the

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[55] Commonwealth of Australia, Outcomes and Outputs Framework: Guidance Document, Department of Finance and Administration, November 2000, p32.
[56] Commonwealth of Australia, Outcomes and Outputs Framework: Guidance Document, Department of Finance and Administration, November 2000, p35.

contribution of output's and/or administered item's to the specified outcome. This distinction has been made because the immediate impacts of an output (quality, quantity and price) are not the same as its impact on the specified outcome (effectiveness). It is possible that an output may be well performing in terms of price, quality and quantity but is not the best method of achieving the maximal contribution to the outcome.[57]

The qualitative aspects of an output are often the most difficult to define, measure and interpret. Quality indicators are made up of both tangible, objective criteria (such as timeliness, coverage, accuracy and conformity to specifications) and less tangible, interpretive data (such as client satisfaction, peer review or public perception/profile).

Appropriate quality measures should:

- measure those aspects of the output that are most pertinent to clients, customers or stakeholders;
- include both tangible, objective indicators as well as subjective, qualitative information; and
- be kept to a minimum number, as it is possible to overload both the user of the information and the agency's capacity to gather and interpret relevant data (i.e. between two and five indicators of quality).[58]

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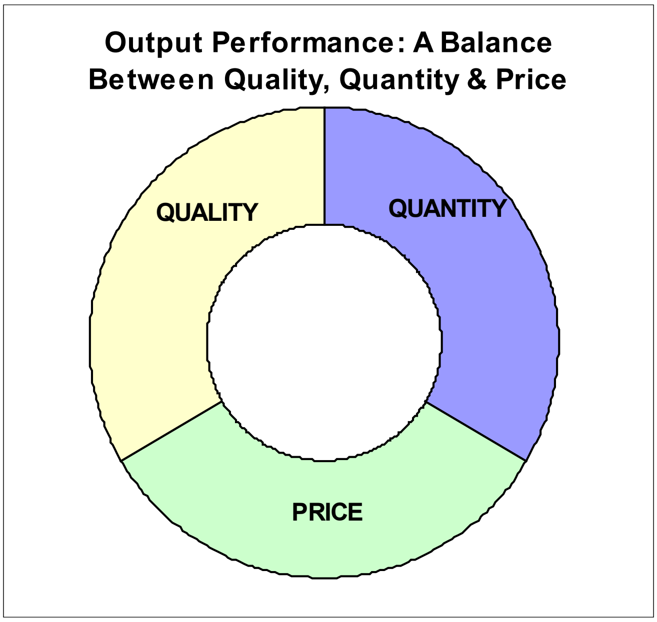
[57] Commonwealth of Australia, Outcomes and Outputs Framework: Guidance Document, Department of Finance and Administration, November 2000, p36.
[58] Commonwealth of Australia, Outcomes and Outputs Framework: Guidance Document, Department of Finance and Administration, November 2000, p37.

Figure 3.11 – Output Performance Indicator Balance



Source: Commonwealth of Australia, Outcomes and Outputs Framework: Guidance Document, Department of Finance and Administration, November 2000, p36.

Quantity

The measurement of quantity, where the activity in question is a relatively homogeneous administrative or service function, is relatively straightforward (for example, number of benefit claims of number of grant applications). However, as is often the case, the outputs generated by public organisations are not so homogeneous (for example, policy advice).

Where there is a lack of homogeneity, it is important to select a quantity indicator that will make sense when read in conjunction with the price and quality indicators. Using the example of policy advice, the number of policy briefs prepared may not be seen as an efficient indicator of quantity. In this case the number of officer hours applied to policy work could be a better measure of quantity.

Price

Price can be defined as the market value of a good or product. On one hand it is influenced by the cost of production, distribution and supply (i.e. inputs), and on the other hand it is also influenced by demand and alternative supply.

On this basis, the price of an output is the agreed amount negotiated between an agency and the government for a particular output or output group.[59]

3.7.6 Administered Items

In terms of administered items, performance information generally arises from the specific circumstances and characteristics of the items themselves. The relevant legislation or policy documentation often make clear what the key performance information should consist of.

As for output performance information, administered items should be measured in terms of price, quality and quantity, where possible and meaningful.

3.8 Financial Control and Appropriation of Monies Under Outcomes and Outputs

The switch to Accrual Outcome and Output-based Budgeting (AOOB) brought with it a fundamental change in the way the Legislature allocates and controls the monies applied by agencies in delivering services. Under traditional cash based arrangements, the annual budget formed the backbone of the financial control process by setting limits on agency expenditure. The budget appropriations were divided into those for current expenditure and those for capital expenditure, with departments forbidden to use funds from one appropriation type for expenditure of the other type.

The legislature's control over the funds consumed by public sector agencies is implemented through two types of control mechanisms: (1) *legislative controls* known as appropriations and (2) *administrative controls* where for example agencies must seek

[59] Commonwealth of Australia, Outcomes and Outputs Framework: Guidance Document, Department of Finance and Administration, November 2000, p39.

the Treasurer's approval before entering into certain financial arrangements. A successful financial control system consists of both types of controls.[60]

The pre AOOB system of appropriations performed well in terms of legislative controls as expenditure was tightly restricted. However, a purely cash based system leaves scope for agencies to evade financial controls through committing to transactions beyond the reporting period. Modifications to the pre- AOOB financial management arrangements in the Australian Commonwealth took this into account and required goods and services to be accounted for in the period they were received, regardless of whether they were paid for in that period or not. This increased the scope of the legislative financial controls.[61]

The switch to AOOB increased the detail of the financial information available to the legislature through the recording and presentation of financial information on an accrual basis, but reduced the level of control exerted by appropriations. Under AOOB agencies have significantly more scope in accessing funds not subject to appropriations, such as funded depreciation reserves, accumulated profits and asset sales receipts. However, as a general rule agencies must seek the Treasurer's approval to access these funds, meaning they are subject to administrative rather than legislative controls.[62]

The appropriations process under AOOB was, in theory, expected to reduce the complexity and increase the transparency of agencies financial operations. In reality, the linking of appropriations to outcomes and outputs is not so simple and issues such as the funding of depreciation and agencies' abilities to use these funds have not yet been completely resolved.

Further, the number of special appropriations have not been significantly reduced. These appropriations generally relate to specific programs, not outcomes or outputs and comprise approximately 70% of the Commonwealth budget.[63]

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[60] Robinson M., Financial Control in Australian Government Budgeting, Public Budgeting & Finance, Spring 2002, p83.

[61] Robinson M., Financial Control in Australian Government Budgeting, Public Budgeting & Finance, Spring 2002, p82.

[62] Robinson M., Financial Control in Australian Government Budgeting, Public Budgeting & Finance, Spring 2002, p85.

[63] Commonwealth of Australia, 2003-03 Budget Paper No. 4, Agency Resourcing, Circulated by Senator the Honourable Nick Minchin Minister for Finance and Administration, 14 May 2002, p 2.

Given these issues, one could argue that the switch to AOOB did not bring enhanced financial control, however, AOOB should be looked at as a complete system and as with all systems it has its strengths and weaknesses. There are still many unanswered questions in relation to the application of the market model of budgeting to the whole of the public budget sector and it is reasonable to expect that the AOOB model in Australia will undergo continuous development to improve its weak points.

3.9 Structure of the Budget Papers

The Commonwealth Budget consists of five main parts plus a number of ancillary documents to be used in conjunction with the Budget Papers.[64]

Budget Paper No. 1

Budget Paper No. 1 provides information on the budget strategy and outlook. Topics covered include:

- an overview of budget and economic forecasts;
- discussion of the Government's medium-term fiscal strategy;
- the Government's key budget priorities;
- changes to the budget estimates since the Mid-Year Economic and Fiscal Outlook (MYEFO);
- summary of revenue, expenses, net debt and net worth estimates;
- budget financial statements;
- economic developments since the MYEFO;
- the outlook for the domestic and international economies;
- revised economic parameter forecasts;
- terms of trade and current account deficit issues;
- taxation and other revenue issues;

[64] All budget papers are available via the internet at www.budget.gov.au.

- expenditure and net capital investment issues;
- details of the Government's budget funding program;
- debt issue and conversion programs;
- trends in the finances at the Commonwealth, State and Local levels;
- size and structure of the Australian public sector;
- sensitivity analysis of the budget estimates to changes in key economic parameters;
- statement of financial risks;
- discussion of budget accounting standards;
- explanation of major budget aggregates;
- Government Finance Statistics financial statements;
- Australian Accounting Standards financial statements; and
- historical data for key fiscal aggregates.

Budget Paper No. 2

Budget Paper No. 2 provides information on budget measures. Budget measures can be defined as all new revenue, expense and capital issues being introduced for the first time.

Budget Paper No. 3

Budget Paper No. 3 provides information on the Commonwealth's financial relations with State, Territory and Local Governments.

Budget Paper No. 4

Budget Paper No. 4 contains information on the resourcing of Commonwealth agencies. Particularly the Appropriation Bills 1 and 2 (annual appropriations to agencies) and the Appropriation Bill for Parliamentary Departments.

Budget Paper No. 5

Budget Paper No. 5 contains the Intergenerational Report. Which provides information on the long-term sustainability of government finances over the next 40 years.

Ancillary Documents

The most important ancillary documents are the Portfolio Budget Statements, which contain the detailed financial information (including all outcomes, outputs and administered items) for every Commonwealth agency.

Other ancillary documents include the Treasurer's Budget Speech, a budget overview, and other brief reports.

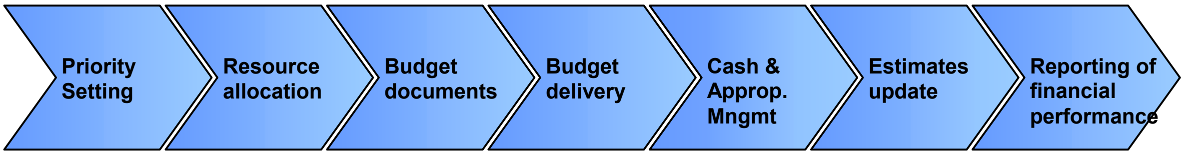
3.10 Budget Process and Timetable

The Budget process is undertaken each year to produce the Commonwealth Budget. A complete Budget process begins in September of year 1 and ends in December of year 3. The tabling of the Budget in Parliament usually occurs on the second Tuesday in May.

Stages of the Budget Process

In general terms the Budget process can be divided into seven key stages. These seven stages combined equal one budget cycle. Figure 3.12 diagrammatically illustrates these stages.

Figure 3.12 – The Seven Stages of the Budget Process



Source: Commonwealth of Australia, 'The Commonwealth Budget Process', Department of Finance and Administration (internal document), p 2.

The seven stages of the Budget process run sequentially. However, some activities overlap due to the fact that the beginning and end phases of previous and upcoming Budgets run concurrently with the current Budget process. In fact, for three months of the year there are three separate Budget process running.

Priority Setting

The priority setting phase of the Budget process is divided into two parts: (1) the Budget process operating rules, which occurs around September when Cabinet meets to set the operational rules and timing for the upcoming Budget; and (2) the Senior Ministers' review, which begins with portfolio Ministers writing to the Prime Minister in October, outlining their policy proposals for the upcoming budget and culminates with a meeting of the Prime Minister, the Deputy Prime Minister, the Treasurer and the Minister for Finance and Administration to decide on the strategy and policy priorities for the upcoming Budget.[65]

Resource Allocation

In order to obtain funds for new policy proposals, portfolio departments must submit Portfolio Budget Submissions (PBS) by late January or early February to Budget Group so that the costs of the new proposals can be agreed. Information in relation to savings measures are also provided at this time. Budget proposals contained in the PBS are divided into major proposals (over $5 million per year) and minor proposals (less than $5 million per year).

[65] Commonwealth of Australia, 'The Commonwealth Budget Process', Department of Finance and Administration (internal document), p3.

The Expenditure Review Committee (ERC) of Cabinet meets in March to consider the major new policy and savings proposals. The ERC then recommends to Cabinet which proposals should be included in the Budget. The ERC bases its decisions on information from the PBSs and special briefs from the Department of Finance and Administration called ‘green briefs’. The green briefs summarise information on new proposals and provide Finance’s perspective. Finance also provides the ERC with ‘daily briefs’ that contain up to date information on issues effecting the Government’s financial position. In addition to written briefs, senior Finance officers attend the ERC meeting to provide the Minister with assistance.[66]

During the weeks when the ERC is sitting, minor new policy and minor savings proposals are considered by the Minister for Finance and Administration. The Minister’s recommendations on which proposals should be included in the Budget are presented in a submission to the ERC for its endorsement.

In late March and early April the Minister for Finance and Administration considers requests by agencies to rollover unexpensed funds into the next financial year. Prior to the pre-Budget update of estimates the Minister advises agencies of the decision regarding the ‘movement of funds between years’. Agencies requests to the Minister of Finance and Administration to run an operating loss in the upcoming Budget period are also considered at this time.

After the ERC rounds are completed the Ad Hoc Revenue Committee meets to consider new revenue proposals. Given that taxation is the responsibility of Treasury, its officers provide most of the support to this committee.

The final stage of the resource allocation process occurs in late April with the sitting of Budget Cabinet (a special meeting of Cabinet). Budget Cabinet considers all proposals recommended by the ERC and the Ad Hoc Revenue Committee. Additional information on the impact of the new proposals is provided to Budget Cabinet by the Department of Finance and Administration.

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[66] Commonwealth of Australia, ‘The Commonwealth Budget Process’, Department of Finance and Administration (internal document), p4.

Budget Documentation

Each Commonwealth Budget is supported by the Budget documentation, which is released on Budget night.

Between the end of the ERC decision making process and Budget night, the Department of Finance and Administration's main output is the preparation of the Budget papers. The Departments of Treasury and Finance and Administration jointly prepare the Budget papers.[67] Further details about the structure of the Budget papers are provided above.

Budget Delivery

The Treasurer delivers the Budget in a speech in Parliament on Budget night. This speech is also the second reading for the Appropriation Bill No. 1.

The media is given a chance to review the Budget papers and prepare their stories on the day the Budget is presented. This process is called the Budget 'lockup' because the media representatives are confined to a certain area and not allowed to leave until the Treasurer begins his speech. This is to ensure that the Budget details are kept secret.

In the weeks following the Treasurer's presentation of the Budget the Appropriation Bills are considered in Parliament. The Bills must be passed by both Houses of Parliament.

Prior to the vote on the Appropriation Bills, the Senate Legislation Committees (SLCs) meet to review all financial information in the Portfolio Budget Statements and other related documents. These meetings are known as the Senate Estimates hearings. The SLCs seek explanations from Ministers and Agency representatives about expenses and

[67] Commonwealth of Australia, 'The Commonwealth Budget Process', Department of Finance and Administration (internal document), p7.

revenues. The SLCs split the hearings along portfolio lines so all issues can be to be covered in time for a vote on the Appropriation Bills before the end of June.[68]

Cash and Appropriation Management

The Budget year begins on 1 July and on this date agencies can begin drawing funds approved under the Appropriations Acts. In accordance with the Outcomes and Outputs framework the amounts are appropriated as either departmental or administered funds. Departmental funds are required to be drawn down from the Consolidated Revenue Fund on a fortnightly basis (usually in equal instalments). Administered funds are drawn down on an as required basis.

Appropriation draw downs, as well as approved urgent and unforeseen expenditure amounts and savings amounts are managed by the Department of Finance and Administration through the Cash and Appropriation Management Module (CAMM) of the Accrual Information Management System (AIMS).[69] Further information on AIMS is provided in chapter 5.

Budget Estimates Update

During the course of a Budget year there are typically many issues that will effect the current Budget and forward estimates. Some of the issues which may cause a need to revise estimates are:

- new Government decisions;
- revisions to the level of unexpensed funds moved into the next or future years;
- the creation of estimates for the new third out year;
- changes in parameters (e.g. a change in the estimate for economic growth); and
- other factors, such as program delays.[70]

[68] Commonwealth of Australia, 'The Commonwealth Budget Process', Department of Finance and Administration (internal document), p8.
[69] Commonwealth of Australia, 'The Commonwealth Budget Process', Department of Finance and Administration (internal document), p9.
[70] Commonwealth of Australia, 'The Commonwealth Budget Process', Department of Finance and Administration (internal document), p10.

To ensure that estimates are as accurate as possible they are updated in full three times a year. Agencies directly upload their changes into AIMS for approval by the Department of Finance and Administration.

The updates are performed at the:

- pre-ERC Review (February / March);
- pre-Budget Review (April); and
- Mid-Year Economic and Fiscal Outlook (usually September to November).[71]

In order to provide a legal footing for the revised estimates Additional Estimates (AE) Appropriation Bills are prepared and tabled in Parliament after the Mid-Year Economic and Fiscal Outlook (MYEFO). The additional estimates proposals are available for use by agencies only after the AE Appropriation Bills have been passed by Parliament and have received Royal Assent.

The Mid-Year Economic and Fiscal Outlook (MYEFO) report is a publicly released document that updates the economic and fiscal outlook and the budgetary position. The preparation and release of the MYEFO is mandated by the Charter of Budget Honesty Act 1998.

Reporting of Financial Performance

For accountability purposes, it is important not only to set estimates of future spending but also to report on actual spending. The Government does this through three main documents. The requirement to provide these documents is set in the various financial legislation.

As soon as practicable after the end of each month, the Minister for Finance and Administration is required to publish monthly financial statements. These contain monthly and cumulative data including the fiscal balance, the underlying cash balance

[71] Commonwealth of Australia, 'The Commonwealth Budget Process', Department of Finance and Administration (internal document), p10.

and the net operating result for the Commonwealth general government sector. Information provided in the monthly financial statements is derived from AIMS.

The last phase of each Budget process is the tabling in Parliament of the Final Budget Outcome and the Consolidated Financial Statements. The Treasurer must release publicly and table the Final Budget Outcome no later than three months after the end of the financial year and the Minister for Finance and Administration must release publicly and table the Consolidated Financial Statements as prescribed in the Financial Management and Accountability Act.

At the agency level, annual reports containing financial statements and performance information in relation the achievement the agency's specified outcomes must be provided to the portfolio minister and tabled in each House of Parliament on or before 31 October each year.

Chapter 4. Financial Reporting Standards

4.1 Background

The majority of private sector financial reporting systems are based on some form of externally set requirements as to how they must be structured. In many European countries this is governed by legislation. In Australia and other Westminster countries (also the US) the requirements are set down in accounting standards produced by non government organisations, typically Accounting Standards Boards. These standards have not generally been applied to the public sector. Recant reforms in the Australian Commonwealth public sector financial management have seen a change to this tradition.

Division 3, clause 19, section 2 of the Commonwealth Charter of Budget Honesty Act 1998 stipulates that the Australian Government's final budget outcome report must be based on external reporting standards. Under the terms of the Act, external reporting standards are defined as "(a) the concepts and classifications set out in Government Finance Statistics (GFS) Australia; and (b) public sector accounting standards developed by the Public Sector Accounting Standards Board"[72]. The government produces its financial reports according to both of these external reporting standards, due to the differing requirements of the end users. The GFS reports are developed in an internationally standardised form that facilitates economic analysis between countries. The Australian public sector accounting standards are however based on, and used in conjunction with, the private sector accounting standards already in place in Australia, allowing easier comparison with Australian private sector organisations. The Commonwealth Financial Management and Accountability Act 1997 (Part 4, Division 1, Section 19 and Part 7, Section 48) requires that accounts and records of the Commonwealth government are kept in accordance with the Finance Ministers' Orders (FMO's). The FMO's (Requirements and Guidance for the Preparation of Financial Statements of the Commonwealth Agencies and Authorities) state that the financial statements of agencies and authorities must be prepared in accordance with the

[72] Commonwealth of Australia, Charter of Budget Honesty Act 1998, No.22, 1998, p5.

accounting standards prepared by the Australian Accounting Standards Board[73]. As such, the Australian Accounting Standards have become the primary basis for the keeping of records and preparation of financial reports in the Commonwealth government.

4.2 Government Finance Statistics Framework (GFS)

The GFS reporting framework is a specialised statistical system designed to support economic analysis of the public sector. It allows comprehensive assessments to be made of the economic impact of government policies and is consistent with international statistical standards such as the System of National Accounts 1993 (SNA93) and the International Monetary Fund's (IMF) Government Finance Statistics Manual 2001.[74] The GFS data is provided to the Australian Bureau of Statistics (ABS), which uses the data for various analysis projects and international distribution.

An internationally standardised system of financial reporting, for statistical analysis between countries, has existed for many years. From 1993 until 2000 the System of National Accounts (SNA93), produced jointly by the United Nations, IMF, World Bank, Commission of the European Union and the Organisation for Economic Co-operation and Development was used as the basis for the development of the Australian System of National Accounts (ASNA), the cash based forerunner to the GFS framework. Since the mid 1990's the push for the Commonwealth Government to move to an accrual based reporting structure has been growing (see for example National Commission of Audit 1996[75]).

The primary reporting framework introduced into the Australian public sector, for accrual based financial statements, is based on the Australian Accounting Standards. The three most important standards in relation to government are:

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[73] Commonwealth of Australia, Department of Finance and Administration, Requirements and Guidance for the Preparation of Financial Statements of the Commonwealth Agencies and Authorities, Finance Ministers' Orders 2001-2002.

[74] Commonwealth of Australia, Statement 10: External Reporting Standards and Budget Concepts, Commonwealth Budget 2003-03, Budget Paper No.1.

[75] Commonwealth of Australia, National Commission of Audit, Report to the Commonwealth Government, June 1996.

- Australian Accounting Standard 27 (AAS27): Financial Reporting by Local Governments;
- Australian Accounting Standard 29 (AAS29): Financial Reporting by Government Departments; and
- Australian Accounting Standard 31 (AAS31): Financial Reporting by Governments.

The adoption of these standards by the various levels of government in Australia has been one of the main driving forces for the reform of the ABS financial statistics framework.[76] However, since the accrual basis for reporting has been introduced into the Australian system, the IMF has also revised its GFS framework in line with accrual principles, through the Government Finance Statistics Manual 2001. Although the IMF has revised its policies with regard to accrual presentation, it also acknowledged that there would be a limited number of countries able to provide financial information in this form.[77] Australia is one of the few countries with the ability to meet the requirements of the IMF standards.

One of the other major changes to government financial reporting, since the adoption of accrual principles, is the preparation of whole of government accounts, also known as consolidated financial statements. Consolidated financial statements eliminate all within-sector asset-liability positions and all transactions between two units in the same sector. Consolidation requirements have also been introduced into the GFS system and are one of the major changes from the System of National Accounts framework.[78]

The GFS framework is based on an integrated recording of flows and stocks. Flows reflect the creation, transformation, exchange, transfer or extinction of economic value. They involve changes in the volume, composition or value of a unit's assets, liabilities and net worth. Stocks refer to a unit's holdings of assets, liabilities and net worth at a point in time.

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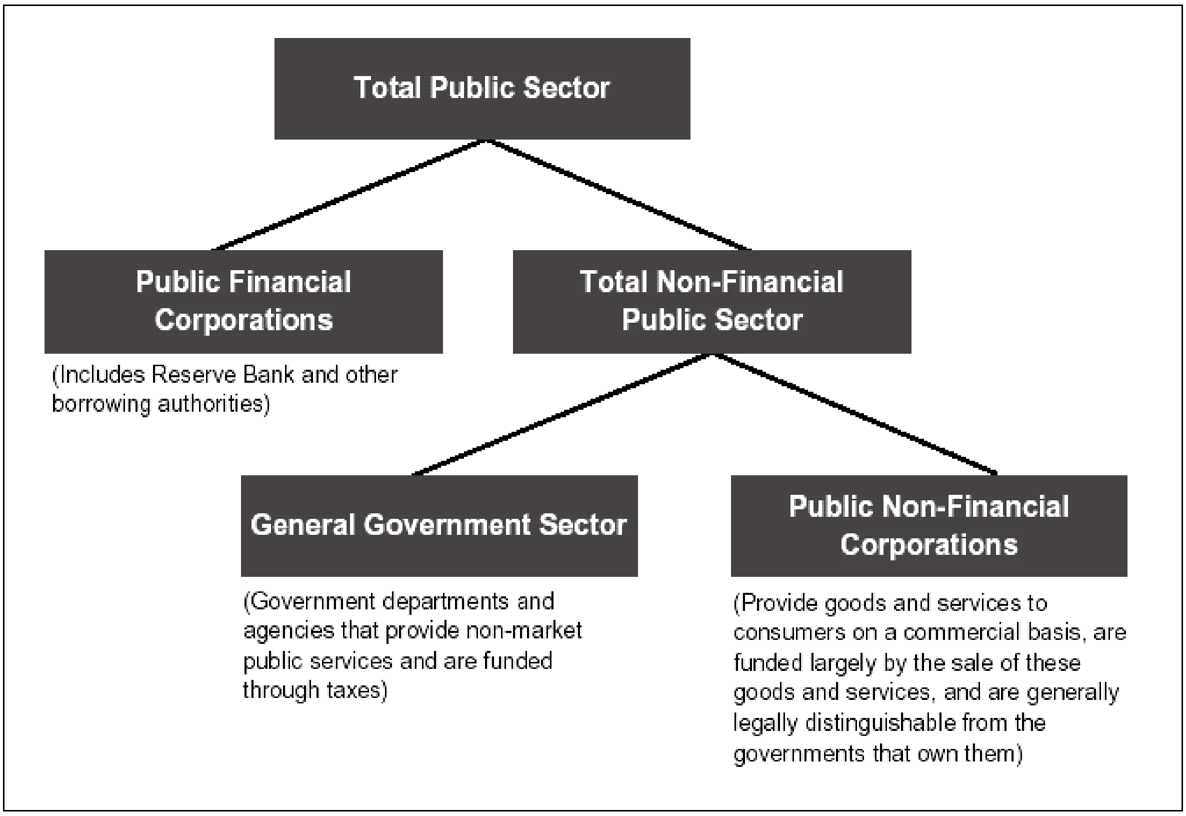
[76] Commonwealth of Australia, 5517.0 Information Paper: Accruals-based Government Finance Statistics, Australian Bureau of Statistics, 13 March 2000, p5.
[77] International Monetary Fund, Government Finance Statistics Manual 2001, Statistics Department, International Monetary Fund, 2001, p vii.
[78] International Monetary Fund, Government Finance Statistics Manual 2001, Statistics Department, International Monetary Fund, 2001, p164.

4.2.1 GFS Institutional Structure

To allow for different government sectors to be viewed in isolation, the GFS framework splits the public sector into five sections: (1) Total Public Sector; (2) Public Financial Corporations; (3) Total Non-Financial Public Sector; (4) General Government Sector; and (5) Public Non Financial Corporations. Figure 4.1 illustrates the division.

All government departments, offices and some other bodies comprise the general government sector and as such are the major focus of budget reporting. The general government sector provides public services that are mainly non-market in nature, and for the collective consumption of the general public.

Figure 4.1 - Institutional structure of the Public Sector



Source: Commonwealth of Australia, Statement 10: External Reporting Standards and Budget Concepts, Commonwealth Budget 2003-03, Budget Paper No.1.

The transfer or redistribution of income also falls under this sector. The general government sector is financed through the collection of taxes and levies and more recently user charging and external funding have also contributed to the funding of this sector.[79]

Public non-financial corporations are organisations that provide mainly market, non-regulatory and non-financial goods and services that are financed largely through sales to consumers. In addition public non-financial corporations are legally separated from the governments that own them.[80]

Some examples of Commonwealth non-financial corporations are :

- Australian Rail and Track Corporation;
- Employment National;
- Telstra Corporation Limited; and
- Australian Postal Commission.

When combined, the general public sector and the non-financial public sector comprise the non-financial public sector.

The GFS framework separately identifies public financial corporations, such as the Reserve Bank of Australia, the Export Finance and Insurance Corporation and Medibank Private. Public financial corporations engage in intermediation and auxiliary financial services and are able to incur financial liabilities on their own account. Public financial corporations are involved in financial intermediation and are therefore distinct from other public sector entities. Accordingly, information on these entities is not included in the budget papers, but is reported in budget outcome statements.[81]

All sectors combined (i.e. general government, public non-financial corporations and public financial corporations) make up the total public sector.

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[79] Commonwealth of Australia, Statement 10: External Reporting Standards and Budget Concepts, Commonwealth Budget 2003-03, Budget Paper No.1.
[80] Commonwealth of Australia, Statement 10: External Reporting Standards and Budget Concepts, Commonwealth Budget 2003-03, Budget Paper No.1.
[81] Commonwealth of Australia, Statement 10: External Reporting Standards and Budget Concepts, Commonwealth Budget 2003-03, Budget Paper No.1.

4.2.2 GFS Conceptual Framework

Stocks and Flows

The GFS framework is based on the recording of stocks and flows. Stocks are holdings of assets and liabilities, valued at market prices at a particular point in time. Flows relate to economic events and other occurrences that change the value of stocks through the creation, transformation, exchange, transfer or extinction of value. Flows are recorded in the relevant period on an accrual basis. The flows that have taken place in a given period affect the stock of assets and liabilities and therefore result in a new value for stocks at the end of the period.[82]

Recording of Flows on an Accrual Basis

Under the GFS framework, as opposed to the System of National Accounts (SNA), flows are recorded on an accrual basis. This change means that flows are recorded at the point in time when economic value is created, transformed, exchanged, transferred or extinguished irrespective of whether associated cash flows took place in the same period.[83]

Classification of Stocks

As previously mentioned, stocks represent the government's holdings of assets and liabilities. Both assets and liabilities are further classified into various sub-categories according to their detailed nature and type. Assets are classified into financial and non-financial, with non-financial assets being further classified into produced assets (assets that have been created through production, and as a result have impacted on Gross Domestic Product) and non-produced assets. Liabilities are classified into deposits held, advances received, borrowing, superannuation, other employee liabilities and

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[82] Commonwealth of Australia, 5517.0 Information Paper: Accruals-based Government Finance Statistics, Australian Bureau of Statistics, 13 March 2000, p8.
[83] Commonwealth of Australia, 5517.0 Information Paper: Accruals-based Government Finance Statistics, Australian Bureau of Statistics, 13 March 2000, p8.

other liabilities. The GFS framework also groups shares and contributed capital of public corporations together with liabilities.[84]

Classification of Flows

Flows are also further classified into sub-categories according to their nature and type. The two main categories are transaction flows and other flows. Other flows are broken down into two further categories, revaluations and other changes in the volume of assets.[85]

Transactions can be described as changes to stocks that occur through mutually agreed interactions between institutional units (i.e. the sale of goods or services by one unit and the purchase of those goods or services by another unit). Transactions such as depreciation that do not involve interactions with other units are also recorded under the framework. This is because it is recognised that entities can be both the owner of a fixed asset and the consumer of the services provided by that asset, therefore meeting the requirements for classification as a transaction.[86]

Although taxes and levies are compulsory, the GFS framework deems them to be by mutual agreement and therefore are classified as transactions.

Changes to stocks that do not come about as a result of transactions are defined as other flows. As previously mentioned, other flows are split into two categories; (1) revaluations, which represent changes to the level of stocks through price movements, including movements in exchange rates; and (2) other changes in the volume of assets, which relate to changes in stocks occurring form such things as the discovery of new assets and the depletion or destruction of existing assets.[87]

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[84] Commonwealth of Australia, 5517.0 Information Paper: Accruals-based Government Finance Statistics, Australian Bureau of Statistics, 13 March 2000, p9.
[85] Commonwealth of Australia, 5517.0 Information Paper: Accruals-based Government Finance Statistics, Australian Bureau of Statistics, 13 March 2000, p9.
[86] Commonwealth of Australia, 5517.0 Information Paper: Accruals-based Government Finance Statistics, Australian Bureau of Statistics, 13 March 2000, p9.
[87] Commonwealth of Australia, 5517.0 Information Paper: Accruals-based Government Finance Statistics, Australian Bureau of Statistics, 13 March 2000, p9.

4.2.3 Main Statements and Balances

Under the GFS framework there are four statements produced. They are:

- the operating statement;
- the balance sheet;
- the cash flow statement; and
- the statement of other economic flows.

Operating Statement

Transactions in revenues (increases in net worth), expenses (decreases in net worth) and the net acquisition of non-financial assets (net capital investment) are recorded in the operating statement. See figure 4.2 for an overview of the GFS operating statement.

The two main balances detailed in the operating statement are the GFS net operating balance and the GFS net lending / borrowing or fiscal balance. The GFS net operating balance is equal to GFS revenues less GFS expenses and measures government saving plus capital transfers. The GFS net lending / borrowing is equal to the GFS net operating balance less net acquisition of non-financial assets, where the net acquisition of non-financial assets (net capital investment) represents the changes in the volume of non-financial assets owned by the government due to transactions.

Figure 4.2 – Overview of the GFS Operating Statement

		Transactions only (excludes Revaluations and Other Changes in volume of Assets)
   less	GFS Revenues . . . . GFS Expenses	
equals	GFS Net Operating Balance	
less	Net acquisition of non-financial assets	
equals	GFS Net lending (+) / Borrowing (-)	

Source: Commonwealth of Australia, 5517.0 Information Paper: Accruals-based Government Finance Statistics, Australian Bureau of Statistics, 13 March 2000, p12.

The net acquisition of non-financial assets is made up of gross fixed capital formation, less depreciation, plus changes in inventories, plus other transactions in non-financial assets.[88] In order to better understand the elements that make up net acquisition of non-financial assets they are described in further detail below.

Gross fixed capital formation – is made up of purchases less sales of fixed assets and net acquisitions of fixed assets by way of finance leases.

Depreciation – consists of the consumption of fixed assets during the process of production.

Changes in inventories – represents investments in new inventories less the use of current inventories.

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[88] Commonwealth of Australia, Statement 10: External Reporting Standards and Budget Concepts, Commonwealth Budget 2003-03, Budget Paper No.1.

Other transactions in non-financial assets – is for the Commonwealth general government sector mainly made up of changes in the value of work-in-progress and software assets and transactions in non-reproducible, intangible assets.[89]

The GFS net lending / borrowing balance, as described above, comprises the net operating balance less net capital investment. The purpose of this balance is to measures the gap between the government's savings plus net capital transfers and investment in non-financial assets and show the Commonwealth general government sector's contribution to the balance of payments current account.

A surplus balance in the net lending / borrowing line indicates that the Commonwealth government is lending to other sectors, whereas a deficit balance indicates that the Commonwealth is using financial resources from other sectors. Given this, it can be seen that the net lending / borrowing balance can be used as an indicator of the impact government operations are having on the financial state of the rest of the economy.[90]

Balance Sheet

The balance sheet provides details of stocks of assets, liabilities and shows the GFS net worth balance. Two additional balances are also reported in the balance sheet, net financial worth and net debt.

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[89] Commonwealth of Australia, Statement 10: External Reporting Standards and Budget Concepts, Commonwealth Budget 2003-03, Budget Paper No.1.

[90] Commonwealth of Australia, Statement 10: External Reporting Standards and Budget Concepts, Commonwealth Budget 2003-03, Budget Paper No.1.

Figure 4.3 – Outline of the GFS Balance Sheet

	Stocks
Assets Non- financial Assets . . . . Financial Assets . . . . less Liabilities . . . . less Shares and other contributed capital (for the general government sector this item is zero)	
GFS Net Worth	

Source: Commonwealth of Australia, 5517.0 Information Paper: Accruals-based Government Finance Statistics, Australian Bureau of Statistics, 13 March 2000, p13.

Assets are defined as instruments or entities over which ownership rights are enforced by institutional units and from which economic benefits may be derived by holding or using them, over a period of time. In the balance sheet they are split into non-financial and financial assets.[91] Liabilities represent obligations to provide economic value to other institutions.[92]

The bottom line in the balance sheet is represented by GFS net worth and is defined as assets less liabilities. The statements for the public financial corporations and public non-financial corporations sectors include a shares and other contributed capital section, making the GFS net worth formula; assets less liabilities less shares and other contributed capital. Where public corporations are listed the shares and other contributed capital are recorded at market value and for those public corporations that are not listed the value is equal to asset less liabilities. The value of the GFS net worth balance shows the contribution of the Commonwealth government to the wealth of Australia.[93]

[91] Commonwealth of Australia, 5517.0 Information Paper: Accruals-based Government Finance Statistics, Australian Bureau of Statistics, 13 March 2000, p13.
[92] Commonwealth of Australia, Statement 10: External Reporting Standards and Budget Concepts, Commonwealth Budget 2003-03, Budget Paper No.1.
[93] Commonwealth of Australia, 5517.0 Information Paper: Accruals-based Government Finance Statistics, Australian Bureau of Statistics, 13 March 2000, p14.

Although not structurally part of the balance sheet, two further balances (net financial worth and net debt) are included for analytical purposes. Net financial worth represents total financial assets less total liabilities. Net debt consists of the sum of deposits held; advances received; government securities; loans; and other borrowings less the sum of cash and deposits; advances paid; and investments, loans and placements. Net debt is a common measure of the strength of a government's financial position and was also reported under the previous cash framework, even though full balance sheets were not produced.[94]

Cash Flow Statement

The cash flow statement identifies how cash is generated and applied. Cash is determined to arise from operating, investing and financing activities of government. Figure 4.4 provides an outline of the cash flow statement.

Cash held refers to cash on hand and cash equivalents. Cash on hand refers to notes and coins held, and deposits held at call with a bank or financial institution. Cash equivalents are deemed to be highly liquid investments which can readily be converted to cash and overdrafts considered integral to the cash management function.[95]

The cash flow statement is based on a cash rather than an accrual approach, however, the information contained in the cash flow statement is derived from movements in accrual accounts. These cash transactions are monitored because cash management is considered to be an integral part of accrual accounting.[96]

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[94] Commonwealth of Australia, Statement 10: External Reporting Standards and Budget Concepts, Commonwealth Budget 2003-03, Budget Paper No.1.
[95] Commonwealth of Australia, 5517.0 Information Paper: Accruals-based Government Finance Statistics, Australian Bureau of Statistics, 13 March 2000, p14.
[96] Commonwealth of Australia, Statement 10: External Reporting Standards and Budget Concepts, Commonwealth Budget 2003-03, Budget Paper No.1.

Figure 4.4 – Outline of the Cash Flow Statement

	$
Net cash flows from operating activities Net cash flows from investing activities Net cash flows from investments in financial assets for policy purposes Net cash flows from investments in financial assets for liquidity purposes Net cash flows from financing activities Net increase / decrease in cash held	
Surplus (+) / Deficit (-) (The Surplus / Deficit is not structurally part of the Cash Flow Statement, but has been included for analytical purposes)	

Source: Commonwealth of Australia, 5517.0 Information Paper: Accruals-based Government Finance Statistics, Australian Bureau of Statistics, 13 March 2000, p14.

The two main balances shown in the cash flow statement are the net increase / decrease in cash held and the surplus (+) / deficit (-). The net increase / decrease in cash held is represented by the total of net cash from operating, investing and financing activities. The surplus (+) / deficit (-) is calculated as follows:

Net cash flows from operating activities

plus Net cash flows from investments in non-financial assets

less Distributions paid

less Acquisitions of assets acquired under finance leases and similar arrangements

equals Surplus (+) / Deficit (-)

The surplus (+) / deficit (-) balance is not structurally part of the cash flow statement, but is included for analytical purposes.[97]

[97] Commonwealth of Australia, 5517.0 Information Paper: Accruals-based Government Finance Statistics, Australian Bureau of Statistics, 13 March 2000, p15.

Statement of Other Economic Flows

As mentioned earlier, all changes in GFS net worth are the result of either transactions or other economic flows. Although it is not required by the Accrual Uniform Presentation Framework (an agreement between all Australian jurisdictions to provide financial information in a common format) the Commonwealth government also publishes the statement of other economic flows for the general government sector. Changes in net worth that occur from transactions (changes to stocks that occur through mutually agreed interactions between institutional units) are recorded in the operating statement. Other economic flows (changes to stocks through price movements or volume changes) are not detailed in the GFS operating statement and as such it has been deemed appropriate to detail them elsewhere.

The most common price movements and volume changes giving rise to other economic flows are:

- valuation changes due to movements in exchange rates;
- increases in the value of assets since purchase, leading to a profit on sale;
- changes in the value of investments in commercial entities, including through changes in share prices;
- write-downs in the value of assets, such as through greater allowances for bad and doubtful debts; and
- changes in the valuation of superannuation liabilities due to economic and demographic changes.[98]

Changes in the volume of stocks that occur through the recognition of assets for the first time and from reclassifications and accounting policy changes are also recognised in the statement of other economic flows.

[98] Commonwealth of Australia, Statement 10: External Reporting Standards and Budget Concepts, Commonwealth Budget 2003-03, Budget Paper No.1.

4.3 Uniform Presentation Framework

In order to provide one common platform for the presentation of financial information, between jurisdictions, the Commonwealth and all other State and Territory Governments have agreed to provide financial information under a Uniform Presentation Framework (UPF). The UPF is based on the Australian Bureau of Statistics (ABS) Government Finance Statistics framework. As a result, the financial information from all jurisdictions is in a comparable format and allows statistical analysis across governments.[99]

4.4 Australian Accounting Standards

As mentioned earlier, through the application of the Commonwealth Financial Management and Accountability Act 1997 (FMA) and the Finance Ministers' Orders (FMO's), that are required under the FMA, the Australian Accounting Standards have become the primary basis for record keeping and the preparation of financial reports in the Commonwealth government.

The FMO's are detailed guidance documents that assist agencies in providing relevant and reliable information for users of financial reports. They also enable chief executives and directors of Commonwealth agencies and authorities to discharge their accountability under the FMA (Section 49) to provide financial statements that give a true and fair view of the matters required under the Commonwealth's financial reporting framework.

The introduction of the Australian Accounting Standards into the Australian public sector has been facilitated through the development of three main accounting standards specifically for governments. The three most important standards are:

- Australian Accounting Standard 27 (AAS27): Financial Reporting by Local Governments;

[99] Commonwealth of Australia, Accrual Uniform Presentation Framework, The Australian Loan Council, 2000.

- Australian Accounting Standard 29 (AAS29): Financial Reporting by Government Departments; and
- Australian Accounting Standard 31 (AAS31): Financial Reporting by Governments.

In December 1993 the Public Sector Accounting Standards Board released Australian Accounting Standard 29 (AAS 29). In June 1998 it was reissued.

While the standard provides a broad reporting framework for departments, the requirements of the standard are applied to reflect local administrative arrangements and conditions. The standard encourages governments across Australia to adopt a consistent reporting model to enhance the information base on which management and resource allocation decisions are made.[100] Whole of government consolidated financial statements as required under Australian Accounting Standard 31 are also prepared on a similar basis.

One of the main features of the standards is that they require governments to adopt all other Australian Accounting Standards, except those standards specifically identified as not applying to governments. The Australian Accounting Standards that do not apply are detailed in AAS 27, AAS 29 and AAS 31.

There are approximately 29 Australian Accounting Standards that potentially apply to governments. Table 4.1 provides a list of these standards, split into two groups according to their relevance.

Table 4.1 – Australian Accounting Standards likely to be relevant to Government entities

Standard Number	Standard Name
Australian Accounting Standards likely to be relevant to most Government entities	
AAS 1	Statement of Financial Performance
AAS 2	Inventories

[100] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p4.

AAS 4	Depreciation
AAS 5	Materiality
AAS 6	Accounting Policies
AAS 8	Events Occurring After Reporting Date
AAS 10	Recoverable Amounts of Non-Current Assets
AAS 11	Construction Contracts
AAS 15	Revenue
AAS 17	Accounting for Leases
AAS 21	Accounting for the Acquisition of Assets (including Business Entities)
AAS 24	Consolidated Financial Reports
AAS 28	Statement of Cash Flows
AAS 29	Financial Reporting by Government Departments
AAS 30	Accounting for Employee Entitlements
AAS 31	Financial Reporting by Governments
AAS 32	Specific Disclosures by Financial Institutions
AAS 33	Presentation and Disclosure of Financial Instruments
AAS 34	Borrowing Costs
AAS 36	Statement of Financial Position
AAS 37	Financial Report Presentation and Disclosures
AAS 38	Revaluation of Non-Current Assets

Standard Number	**Standard Name**
Australian Accounting Standards likely to be relevant to a small number of Government entities	
AAS 13	Accounting for Research and Development Costs
AAS 14	Accounting for Investments in Associates

AAS 18	Accounting for Goodwill
AAS 19	Accounting for Interests in Joint Ventures
AAS 20A	Foreign Currency Translation
AAS 23	Set-off and Extinguishing of Debt
AAS 35	Self-Generating and Regenerating Assets

4.4.1 Australian Accounting Standards likely to be relevant to most Government entities

AAS 1 – Statement of Financial Performance

AAS 1 requires the inclusion of all items of revenue and expense, including adjustments relating to prior reporting periods in the determination of the result for the reporting period. Items of revenue and expense that are outside of the ordinary operations of the entity are considered to be "extraordinary items" and must be disclosed in the statement of financial performance.

AAS 1 also requires the disclosure of:

- any revenues or expenses from ordinary operating activities that are of such a size, nature or incidence that disclosure is relevant in explaining the financial performance of the entity for the period;
- any adjustments made to equity as required or permitted by another standard; and
- the disclosure of any material prior year adjustments that are discovered during a later financial year, to be called fundamental errors.[101]

[101] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p8.

AAS 2 – Inventories

Inventories are defined as goods, other property and services:

- held for sale in the ordinary course of business; or
- in the process of production, preparation or conversion for such sale; or
- in the form of materials or supplies to be consumed in the production of goods and services available for sale, but does not include depreciable assets (such as plant and office equipment).

The main principle defined in the standard is that inventory is valued at the lower of cost and net realisable value on an item-by-item basis. Cost of inventories and net realisable value are defined in the standard.

The standard does not apply to:

- forests, livestock or similar regenerative natural resources;
- work in progress under long term contracts; and
- marketable securities.

These items are covered by other standards or accounting practices.[102]

AAS 4 – Depreciation

AAS 4 stipulates that physical assets with useful lives longer than one reporting period are to be depreciated over their useful life in recognition of the consumption, and the resulting depreciation charges reported in the statement of financial performance.

The standard does not apply to:

- forests, livestock or similar regenerative natural resources; or

[102] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p8-9.

- investment properties (as defined in the standard).[103]

AAS 5 – Materiality in Financial Statements

AAS 5 covers the notion of materiality and how it should be applied in relation to financial information.

"Information is considered to be material if its omission, non-disclosure or misstatement would mislead users of that information when making evaluations or decisions, or result in management or the governing body of the entity failing to discharge their accountability requirements. The concept of materiality can apply to an individual transaction or a group of transactions."[104]

Annual financial statement disclosures that are required by legislation must be included regardless of the amount involved.

AAS 6 – Accounting Policies

Accounting policy is a term used to describe the accounting method or treatment applied to a transaction or set of financial statements. A clear picture of the accounting policies used by an entity is vital to understanding its financial statements.

AAS 6 requires:

- all material accounting policies to be detailed in the notes accompanying the financial statements; and
- a note detailing the extent to which Australian Accounting Standards or other relevant requirements have been complied with.

Under AAS 6, changes to accounting policy are permitted but must be disclosed in the notes.[105]

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[103] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p9.
[104] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p10.
[105] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p11.

AAS 8 – Events Occurring After Reporting Date

Some events that occur after reporting date may have a significant impact on an entity's accounts. Accordingly, these material events must be disclosed and some may require an adjustment to the financial statements.

Three categories of post-reporting date events are identified in AAS 8:

1. events which provide additional information regarding a condition existing at reporting date, which could only be estimated at reporting date;
2. events which reveal, for the first time, a condition which existed at reporting date; and
3. events which occurred after reporting date, which have a material impact on the accounts of an entity.

In general, events falling into the first two categories require an adjustment to the accounts and those events falling into the third category require disclosure in the notes.

For events occurring after reporting date which do not relate to conditions existing at reporting date but do have a material impact on the financial statements should be disclosed in the notes and if possible their financial effect.[106]

AAS 9 – Expenditure Carried Forward to Subsequent Accounting Periods

Although this standard has been replaced by the principles in Statement of Accounting Concepts (SAC 4) the explanation of the matching principle contained in the standard is still relevant.

One of the main principles of accounting is matching. Costs should be matched with the revenues they generate. Costs in one period are often associated with revenue in following period and the underlying principles of accrual accounting are designed to deal with this.

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[106] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p12.

Costs that relate to revenues which will be derived over a number of future accounting periods may be capitalised and amortised over the revenue period.

Expenditure should only be carried forward into future accounting periods when it satisfies the following tests:

- it is material in amount;
- it does not relate solely to revenue which has already been brought to account;
- it can be clearly identified as contributing to revenue earning capability in the future; and
- it is reasonably expected that future revenue will absorb the expense carried forward; or
- the expenditure has given rise to an asset which may be reasonably expected to realise at least its book value.[107]

AAS 10 – Recoverable amount of Non-Current Assets

AAS 10 requires that non-current assets must be written down to their recoverable amounts when those recoverable amounts are less than their carrying amounts. The decrease in value must be recognised as an expense in the statement of financial performance in the period when the write off occurs.

This statement will however, have limited application in government because it does not apply to:

- non-current assets of non-profit entities where the future economic benefits from those assets are not dependent on their ability to generate cash flow; or
- non-current assets measured at fair value or net fair value under another AAS (i.e. AAS 38 – Revaluation of Non-Current Assets).[108]

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[107] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p12.
[108] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p13.

AAS 11 – Accounting for Construction Contracts

The standard AAS 11 sets out the methods for accounting for all construction contracts.

A loss on a construction contract, whether completed or not must be recognised as soon as possible.

The standard requires detailed disclosure of the method used to determine revenues, stage of completion and amounts due, and receivable from, customers as an asset and liability respectively.

Other relevant requirements contained in AAS 11 include the following:

- the substance and not the legal form of the transaction must be considered. For example, a number of contracts should be combined to form a construction contract or a contract that covers a number of construction items should be split into its parts;
- a change in contract revenue, costs or outcome should be recognised in the period of the change and future periods if the change affects both. However, the change cannot be retrospectively recognised through a change to the statement of financial performance or accumulated results;
- additional disclosures are required, including the method used to determine the stage of completion of contracts in progress and the method used to determine the amount of revenue recognised in the period; and
- where construction contract outcomes cannot be reliably estimated, contract costs must be recognised as expenses when incurred and revenues are recognised to the extent that it is probable that expenses incurred are recoverable.[109]

[109] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p14.

AAS 15 – Revenue

AAS 15 details the accounting treatment of revenues arising from various transactions. Revenues must be recognised at fair values. Revenue derived from the sale of goods or the disposal of assets must only be disclosed when:

- the entity has passed control of the goods or other assets to the buyer;
- it is probable that the economic benefits from the consideration will flow to the entity; and
- the amount of revenue can be reliably measured.[110]

For the rendering of services, revenue arising from a contract must be recognised when:

- the entity controls a right to be compensated for services rendered;
- it is probable that the economic benefits will flow to the entity;
- the amount of revenue can be reliably measured; and
- the stage of completion of the transaction can be reliably measured.[111]

AAS 17 – Accounting for Leases

For accounting purposes, leases are divided into two types:

1. operating leases; and
2. finance leases.

An operating lease is said to exist when the lessor effectively retains all risks and benefits of ownership of the leased asset. Such a situation exists under hiring arrangements, for example short term car hire and renting furnished property.

A finance lease exists where the lessee is more like the owner of the asset and the lease is a means of financing what is effectively a purchase of the asset, rather than a contract

[110] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p15.
[111] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p15.

of hire. Under a finance lease the risks and benefits associated with ownership of an asset fall to the lessee, while legal ownership remains with the lessor.

The accounting treatment of a lease depends on whether it is a finance or operating lease.[112]

Finance Lease

Finance leases are capitalised as assets of the entity. This means that the leased asset is treated as if it were purchased with borrowed funds. Accordingly, both an asset and the corresponding liability are recorded in the balance sheet of the lessee's financial statements. The debt is reduced by a notional repayment amount and the asset is amortised to reflect the years repayments and usage.

The notional finance charges on the debt and the amortisation of the asset are reflected in the statement of financial performance. Due to this accounting treatment it is often the case that the cash repayments in relation to the finance lease are different from the figures shown in the financial statements, but by the end of the lease they will have equalised.[113]

The following items are used to determine if a lease transfers the risks and benefits of ownership to the lessee:

- the lease is not cancellable; and
- ownership is transferred at the end of the lease term; or
- the lease contains a nominal purchase option; or
- the lease term is for 75% or more of the useful life of the leased property; or
- the present value of minimum lease payments is equal to or greater than 90% of the fair value of the leased property.

[112] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p15.
[113] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p16.

Operating Lease

In the case of an operating lease, the asset is treated as being owned by the lessor and as such the lease does not affect the balance sheet of the lessee. There is no capitalisation of the asset under an operating lease, instead the minimum payments due under the lease are reported in the statement of financial performance.

The commitments under both operating and finance leases must be disclosed and analysed according to the following categories:

- commitments payable not later than one year;
- later than one but not later than two years;
- later than two but not later than five years; and
- after five years.[114]

AAS 21 – Accounting for the Acquisition of Assets (including Business Entities)

AAS 21 requires that all acquisitions of assets be initially recorded at the cost of acquisition. This cost is made up of the purchase price plus any incidental costs. The purchase price may take the form of cash, other monetary assets, non-monetary assets, securities issued or liabilities undertaken; or a combination of any of these.

Where the purchase price of an asset comprises cash, other monetary assets or liabilities undertaken it is relatively simple to determine the value of the transaction. However, if the purchase involves the transfer of non-monetary assets, including shares or other securities, the value should be determined with reference to the fair value of the assets involved in the transaction. Fair value is defined as the amount for which assets could be exchanged between knowledgeable and willing buyers and sellers, in arms length transactions.[115]

Assets acquired at no or nominal cost are not covered by AAS 21. In relation to government entities, such transactions are covered by AAS 29. It stipulates that

[114] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p17.
[115] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p17.

government entities may recognise assets, transferred at nominal or no cost, at the amount they were recognised by the transferring entity immediately prior to the transfer.[116]

AAS 24 – Consolidated Financial Reports

AAS 29 and AAS 31 require that the general purpose financial reports of Government Departments and the Government itself be prepared in accordance with AAS 24.

AAS 24 requires that parent entities prepare consolidated financial reports comprising information from all other entities that it controls. The requirement to include information from other entities in consolidated financial reports stems from the notion of control rather than ownership.

Control is defined as the capacity of an entity to dominate decision making, directly or indirectly, in relation to the financial and operating policies of another entity.

The requirement to prepare one set of consolidated financial reports applies even if:

- control is temporary;
- dissimilar activities are conducted by member entities; or
- the parent entity holds only a minority ownership interest in the controlled entity.

AAS 24 stipulates the method to be applied and the information to be included in the preparation of consolidated financial statements.[117]

AAS 28 – Statement of Cash Flows

A statement of cash flows provides information on the cash inflows and outflows and shows the net change in the cash position for the period. Cash equivalents are also

[116] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p18.
[117] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p18.

reported in the cash flow statement and can be defined as items that can be converted to cash with little risk of change in the value of the asset when converted.

Cash flow statements are considered to be an integral part of the accrual accounting process because they provide an understanding of:

- how much cash has been generated in operating activities;
- how much cash has been invested (or divested) from investing activities; and
- the net cash flows from financing activities. In the case of government departments, the cash flow statements also contribute to the understanding of the cash requirements of the overall budget sector; and
- the ability of an entity to meet financial commitments as they fall due.[118]

AAS 28 also requires that a reconciliation of cash flows from operating activities to the operating result in the statement of financial performance be prepared.

AAS 30 – Accounting for Employee Entitlements

Employee entitlements include wages and salaries, annual leave, long service leave and (in certain cases) sick leave. Superannuation liabilities are specifically excluded by the standard.

The standard requires that:

- employees' entitlements to wages and salaries, annual leave, long service leave, sick leave, non-monetary benefits, medical benefits, retirement, termination, retrenchment and redundancy payments be recognised as liabilities in an employer's financial statements in respect of the services rendered by the employees up to the reporting date;
- wages and salaries, annual leave and sick leave (irrespective of whether they are expected to be settled within twelve months of the reporting date) and other employee entitlements expected to be settled within twelve months of the

[118] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p19.

reporting date be measured at their nominal amounts (based on current remuneration rates and undiscounted cash flows; and

- other (long term) employee entitlement liabilities to be measured at their present value.

The present value of the employer's liability relating to employee entitlements is calculated by discounting the future payments at the Commonwealth Government Guaranteed Securities rate, with matching terms to maturity.[119]

AAS 31 – Financial Reporting by Governments

AAS 31 stipulates that each of the Commonwealth, State and Territory Governments are reporting entities and are therefore required to prepare general purpose financial reports. Given this, the general purpose financial reports need to include the financial information of controlled entities by way of consolidation in accordance with AAS 24 "Consolidated Financial Reports".

The standard requires each government to prepare, at least annually, a general purpose financial report which includes:

- a statement of financial position, displaying information about its assets and liabilities as at the reporting date;
- a statement of financial performance, which provides information on the entity's revenue and expenses for the reporting period;
- a statement of cash flows, and other necessary information to allow informed assessments of its financial position, financial performance, and financing and investing activities; and
- appropriate disclosures by way of notes, which report disaggregated information relating to the financial performance and financial position of the entity.[120]

[119] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p20.
[120] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p21.

AAS 31 also requires governments to:

- adopt the full accrual basis of accounting;
- recognise all assets that can be measured reliably (including infrastructure, restricted, heritage and community assets) to be recognised as appropriate;
- to comply with other Australian Accounting Standards, except:
    - AAS 16 Financial Reporting by Segments and AAS 22 Related Party Disclosures; or
    - where they have been expressly excluded from applying some standards that are issued in the future.[121]

AAS 31 applies to reporting periods ending on or after 30 June 1999.

AAS 32 – Specific Disclosures by Financial Institutions

AAS 32 requires specific disclosures in the financial reports of financial institutions.

In particular, the standard:

- prescribes limited disclosures for parent-entity financial institutions in some circumstances;
- allows the presentation of certain revenues and expenses in the statement of financial performance;
- clarifies impaired loans as non-accrual loans or restructured loans;
- prescribes specific disclosures additional to those required by other Accounting Standards, including:
    - particular revenues and expenses;
    - analysis of interest revenue and interest expense, including average interest rates;

[121] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p21.

- presentation of assets and liabilities in the statement of financial position in order of relative liquidity;
- particular assets and liabilities;
- maturity analysis of specified assets and liabilities;
- concentrations of deposits and borrowings;
- commitments and contingent liabilities;
- impaired loans, assets acquired through the enforcement of security and past-due loans;
- general and specific provisions for impairment; and
- fiduciary activities.[122]

AAS 33 – Presentation and Disclosure of Financial Instruments

AAS 33 includes the following major features:

- the term financial instrument and the associated asset, liability and equity terms are defined. They cover a wide range of items from cash and trade receivables to derivative instruments like interest rate swaps;
- the issuer of a financial instrument must:
  - classify an instrument as a liability or equity according to its substance on initial recognition (an instrument may have a component of each);
  - account separately for liability and equity components; and
  - not reclassify components unless certain conditions are met;
- the standard sets out disclosure requirements in relation to the following issues:
  - the terms and conditions of financial instruments and the associated accounting policies adopted;
  - interest rate risk, by class of recognised and unrecognised financial asset and financial liability;

[122] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p22.

  - credit rate risk, by class of recognised and unrecognised financial asset;
  - net fair value by class of recognised and unrecognised financial asset and financial liability; and
  - financial assets recognised at amounts exceeding their net fair value;

- with regard to derivatives, the objectives of having them, the context in which the objectives were set out and the strategy for meeting the objectives;
- hedges and anticipated future transactions; and
- the standard also encourages other disclosures (eg. policies for controlling the risks associated with financial instruments).[123]

AAS 34 - Borrowing Costs

AAS 34 has an operative date for periods ending on or after 31 December 1998.

The main features of the standard are:

- borrowing costs must be expensed in the reporting period incurred except to the extent that they are directly related to the acquisition, construction or production of a qualifying asset (an asset that takes more than 12 months to get ready for its intended use or sale);
- borrowing costs capitalised during a reporting period must not exceed borrowing costs incurred during the period by the entity;
- the standard also prescribes:
  - the methods for allocating costs between assets;
  - when capitalisation must cease or be suspended; and
  - specific disclosures; and
- the standard also notes that situations may arise in which the treatment of borrowing costs differ between entities within an economic entity. For example if a parent entity borrows funds which are then transferred to a subsidiary to

[123] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p23.

construct a qualifying asset, the borrowing costs would only be capitalised in the economic entity's financial report.[124]

AAS 36 – Statement of Financial Position

This standard sets out the format and classification criteria to be used in the preparation of statements of financial position. AAS 36 applies to reporting periods on or after 30 June 2001.

The main issues covered by the standard are:

- classes of items to be disclosed separately on the face of the statement of financial position are prescribed;
- current assets and current liabilities are to be presented separately from non-current assets and non-current liabilities, unless the items are presented on the basis of liquidity (the latter classification method is appropriate for financial institutions);
- note disclosures in relation to assets are to be classified according to their nature or function, while for liabilities and equity items they are to be classified according to their nature; and
- if an entity has a single clearly identifiable operating cycle exceeding twelve months, that period must be used as the basis for identifying current and non-current assets and liabilities.[125]

AAS 37 – Financial Report Presentation and Disclosure

AAS 37 stipulates the disclosure and presentation requirements for the preparation of financial reports. It applies to all accounting periods on or after 30 June 2001.

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[124] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p24.
[125] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p25.

The standard requires the following:

- disclosures regarding the entity's operations, audit arrangements, economic dependence, and dividends; and
- period to period consistency in the presentation and classification of items in the financial reports unless there is a significant change in the nature of the entity's operations, a change in the presentation required by an applicable accounting standard, or a more relevant presentation or classification will be achieved.[126]

AAS 38 – Revaluation of Non-Current Assets

The standard provides the method by which non-current assets should be valued subsequent to their initial recognition. It applies to accounting periods ending on or after 30 June 2000.

AAS 38 requires that after their initial recognition, each class of non-current assets must be measured on either the cost or fair value basis. As detailed earlier, fair value is the amount for which assets could be exchanged between knowledgeable willing parties in an arm's length transaction. Where the fair value method is used, revaluations must be carried out with sufficient regularity to ensure that the carrying amount does not materially differ from the fair value.[127]

Revaluation increment and decrements must be offset against one another within a particular class of non-current assets, but must not be offset in respect of different classes of non-current assets.

When classes of assets are revalued:

- revaluation increments must be credited to an asset revaluation reserve, except to the extent that the increment reverses a revaluation decrement previously recognised as an expense in respect of the same class of non-current assets. In such cases increments must be recognised as revenue;

[126] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p25.
[127] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p25.

- revaluation decrements must be recognised immediately as an expense in the net result, except to the extent that a credit balance exists in the asset revaluation reserve relating to that class of asset. In these cases the decrement, grossed up for any related recognised current tax and deferred tax, must be debited directly to the asset revaluation reserve.

In cases where the fair value method of valuation is used the following must be disclosed:

- the method used in determining asset values; and
- whether the revalued carrying amount has been determined in accordance with an independent valuation.

Generally, accumulated depreciation is to be credited to asset accounts and those accounts then increased or decreased by the relevant revaluation decrement or increment. An exception to this is in the case where an entity revalues assets by reference to current prices for assets newer than those being valued and then adjusts the prices according to the present condition of the assets on hand.[128]

There are transitional arrangements in place for public sector entities in relation to this standard as some valuation methods used in the public sector are not compatible with the standard. These issues are being reviewed by the standard setting bodies.

4.4.2 Australian Accounting Standards likely to be relevant to a small number of Government entities

AAS 13 – Accounting for Research and Development Costs

Research is defined as investigation procedures aimed at gaining new knowledge which will be useful in the development of a new product or process or significant improvement in an existing product or process.

[128] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p26.

Some examples are:

- new knowledge search;
- search for new research findings;
- search for new or improved products and processes; and
- testing of alternatives.[129]

Development is defined as the translation of research into a plan.

Some examples are:

- evaluation of alternatives;
- testing of models, prototypes, pilots, etc.;
- design of tools, etc. using new technology; and
- market research.[130]

AAS 14 – Accounting for Investments in Associates

Under AAS 14 an associate means an investee, not:

- a subsidiary (an entity controlled by a parent company);
- a partnership of the investor; or
- an investment acquired and held exclusively with a view to its disposal in the near future, over which the investor has significant influence.[131]

The standard prescribes:

- the circumstances in which investors must apply the equity method in accounting for investments in associates;

[129] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p27.
[130] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p27.
[131] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p27.

- the rules for implementation of the equity method of accounting; and
- the disclosure requirements in respect of investments in associates, including those for which the equity method of accounting is not required.

AAS 18 – Accounting for Goodwill

In the standard goodwill is described as the future benefits derived from unidentifiable assets. Unidentifiable assets are those assets which are not capable of being individually identified and specifically recognised in the financial statements. AAS 18 stipulates the way in which entities must account for goodwill and discount on acquisition following the acquisition of an entity.

The reporting of goodwill is required because it provides users of general purpose reports with an additional insight into the financial position and performance of the reporting entity.[132]

AAS 19 – Accounting for Interests in Joint Ventures

AAS 19 defines a joint venture as a contractual arrangement whereby two or more parties undertake an economic activity which is subject to joint control. Joint control exists when two or more parties must consent to all major decisions.

The concept of control is important in many areas of the of the standards, in particular it is often substituted for the concept of ownership.[133]

The standard requires a venturer to:

- recognise the assets, liabilities and expenses arising from its interest in a joint venture operation and revenues from sale or use of its share of the output of a joint venture operation;

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[132] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p28.
[133] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p28.

- measure its interest in a joint venture entity that is a partnership by applying the equity method of accounting in its own financial report and its consolidated financial report; and
- make specific disclosures about its interests in joint ventures.[134]

AAS 20A – Accounting for Foreign Currency Translation

The standard details the way in which foreign currency transactions and the translation of foreign currency financial statements must be accounted for as well as the disclosure requirements for information relating to foreign currency transactions.

Generally, each asset, liability, revenue and expense arising from a foreign currency transaction is initially recognised and measured using the appropriate domestic exchange rates. Monetary assets and liabilities are measured at the spot rate current at that time. Separate rules are in place where hedging is involved.[135]

Under AAS 20A the following disclosures are required:

- the method used for translating foreign currency transactions and foreign currency financial statements;
- the resultant net exchange gains or losses, with separate disclosures of gains and losses resulting form speculative dealings;
- details of the nature and amount of movements in the foreign currency translation reserve; and
- a reconciliation of opening and closing balances.[136]

AAS 23 – Set-off and Extinguishment of Debt

For the purposes of AAS 23 set-off means the reduction of an asset by a liability or a liability by an asset in the presentation of financial position so that only the net amount

[134] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p29.
[135] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p29.
[136] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p30.

is recognised. The standard also requires that debt be accounted for as extinguished when settled through repayment or replacement by another liability.

AAS 23 further prescribes:

- the conditions to be met before a debt can be accounted for as extinguished;
- the accounting requirements when conditions for extinguishment cease to be met;
- the accounting requirements for partial extinguishments;
- the accounting for the costs of voiding the debt and the gains and losses on voiding the debt;
- the specific disclosure requirements; and
- the set-off of assets and liabilities when there is a legal right to set off, and settlement is intended to be on a net basis or simultaneously.[137]

AAS 35 – Self-Generating and Regenerating Assets

Under AAS 35 self-generating and regenerating assets are defined as non-human living assets. Further, a living asset is deemed to become a non-living asset when biological change can no longer take place. The standard applies to all self-generating and regenerating assets other than those held for non-commercial purposes and states that the cost of non-living self-generating and regenerating assets is equal to the net market value of the produce immediately after it becomes non-living.[138]

The standard requires self-generating and regenerating assets:

- to be measured at net market value;
- to be presented separately in the statement of financial position;
- other specific disclosures in relation to self-generating and regenerating assets; and

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[137] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p30.
[138] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p31.

- increments / decrements in net market values to be recognised as revenues / expenses in the reporting period in which the increments / decrements occur, and the net market value of non-living produce determined immediately after it becomes non-living to be recognised as revenues in the reporting period in which extraction occurs.[139]

4.5 Comparison and Reconciliation of Government Finance Statistics and the Australian Accounting Standards

As described earlier, the Government Finance Statistics (GFS) and the Australian Accounting Standards (through AAS 29 and AAS 31) have been developed to serve the information needs of different user groups. The GFS framework is designed to facilitate macro-economic analysis whereas the Australian Accounting Standards are for the preparation of general purpose financial reports.[140]

Given the different intentions of these two financial reporting frameworks, it is understandable that there are different treatments of certain transactions and that the main balances are not always comparable.

The Finance Ministers' Orders (Requirements and Guidance for the Preparation of Financial statements of Commercial Agencies and Authorities) mandate the application of the Australian Accounting Standards with regard to the recording and reporting of financial information.[141] As a result, the base information held and managed by the Commonwealth government is in AAS form and this base information is then used by the Australian Bureau of Statistics to compile the GFS financial statements. In order to insure the integrity of, and user confidence in, both GFS and AAS reports, a method for reconciling the two sets of data has been developed. The following section provides an analysis of the main differences between the two reporting frameworks.

[139] Australian Capital Territory Government, ACT Accounting Policy Manual, 03 July 2001, s2-p31.
[140] Commonwealth of Australia, 5517.0 Information Paper: Accruals-based Government Finance Statistics, Australian Bureau of Statistics, 13 March 2000, p22.
[141] Commonwealth of Australia, Department of Finance and Administration, Requirements and Guidance for the Preparation of Financial Statements of the Commonwealth Agencies and Authorities, Finance Ministers' Orders 2001-2002, p-vi.

Table 4.2 – Major differences between AAS 31 and Accrual GFS Operating Statements

Issue	AAS31 Treatment	GFS Treatment
Asset writedowns	Treated as part of operating expenses.	Treated as revaluations (other economic flows), except for mutually agreed writedowns, and therefore removed from expenses.
Gains and losses on assets	Treated as part of operating revenues/expenses.	Treated as revaluations (other economic flows) and therefore removed from revenues/expenses.
Provisions for bad and doubtful debts	Treated as part of operating expenses and included in the balance sheet as an offset to assets.	Act of creating provisions is not considered an economic event and is therefore not considered an expense or included in the balance sheet. * Commonwealth does not comply with this latter requirement.
Interest flows related to swaps and other financial derivatives	Treated as operating revenues and expenses.	Treated as financing transactions and so not included in revenues and expenses.
Acquisition of defence weapons platforms	Treated as capital expenditure. Defence weapons platforms appear as an asset on the balance sheet. Depreciation expense on assets is recorded in the operating statement.	Treated as an expense. Defence weapons platforms do not appear as an asset on the balance sheet and no depreciation is recorded in the operating statement.
Commonwealth general government sector investments in public corporations	Investments in public corporations are valued at historic cost in the balance sheet.	Investments in public corporations are valued at current market value. For publicly listed corporations, the share price is used to calculate market value. For non-listed corporations, the current value of net assets is used.
Public debt net interest	Premiums and discounts on the repurchase of debt are included in public debt net interest expenses at the time of repurchase, regardless of whether the stock is cancelled at that time. Issue premiums and discounts are amortised over the life of the stock.	Repurchase premiums and discounts are treated as economic revaluations at the time the debt is repurchased (provided it is valued at historical cost). The GFS cash flow statement includes repurchase premiums or discounts in the year that the repurchased stock is cancelled or matures.

Finance leases	Treats finance leases as if an asset were purchased from borrowings. That is, the lease payment is split into an interest component (which is shown as an operating expense) and a principal component. The asset and the liability are recorded on the balance sheet. This convention does not apply to the cash flow statement, which does not record the acquisition of the asset or the liability.	As per the accounting standard, except that the GFS cash flow statement includes the acquisition of the asset as a supplementary item for the calculation of the surplus/deficit (underlying cash balance).

Source: Commonwealth of Australia, Statement 10: External Reporting Standards and Budget Concepts, Commonwealth Budget 2003-03, Budget Paper No.1.

4.5.1 Reconciliation of GFS Net Operating Balance and AAS 31 Operating Surplus

The two main operating aggregates or balances are, in GFS statements, the Net Operating Balance, and in AAS 31 statements, the Operating Surplus (Deficit), also known as the Operating Result. There are items that are included in the GFS statements that are not included in the AAS 31 statements, and vice versa. The following details these differences and illustrates the method for reconciliation.

Provisions for doubtful debts

Provisions or allowances for doubtful debts relate to expected writedowns in debtor balances for the period. The GFS framework excludes these provisions from the operating statement as they do not meet the definition of transactions (see GFS Conceptual Framework for definition of transactions). The GFS framework treats bad debts written off as capital transfers if mutually agreed between debtor and creditor, and as other changes in the volume of assets if unilaterally written off by the creditor.[142]

Bad debts written off from provisions and treated as capital transfers

[142] Commonwealth of Australia, 5517.0 Information Paper: Accruals-based Government Finance Statistics, Australian Bureau of Statistics, 13 March 2000, p22.

In order to reconcile the AAS 31 operating surplus (deficit) with the GFS net operating balance an adjustment for the bad debts written off from provisions and treated as capital transfers is needed.[143]

Gains and losses on assets

The GFS net operating balance does not include gains and losses on assets. However, the AAS 31 operating surplus (deficit) includes such things as profit and loss on the sale of assets, realised and unrealised gains and losses on derivative financial instruments, and realised and unrealised gains and losses on securities valued at historic cost. These items are not included in the net operating balance under the GFS framework and are instead treated as revaluations in GFS output.[144]

Abnormal items

The AAS 31 operating surplus (deficit) includes all abnormal items for that period. However, under the GFS framework the only abnormal items included are those that represent revenue and expense transactions for that period. Abnormal items that relate to asset revaluations or economic transactions for other periods are not included in the GFS net operating balance.[145]

Distributions to owners

In order to generate the savings plus capital transfers aggregate, distributions to owners in the form of dividends, transfers of profits or other similar distributions are regarded as expenses in the GFS net operating balance. Under AAS 31 distributions are not considered to be operating expenses.[146]

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[143] Commonwealth of Australia, 5517.0 Information Paper: Accruals-based Government Finance Statistics, Australian Bureau of Statistics, 13 March 2000, p23.
[144] Commonwealth of Australia, 5517.0 Information Paper: Accruals-based Government Finance Statistics, Australian Bureau of Statistics, 13 March 2000, p23.
[145] Commonwealth of Australia, 5517.0 Information Paper: Accruals-based Government Finance Statistics, Australian Bureau of Statistics, 13 March 2000, p23.
[146] Commonwealth of Australia, 5517.0 Information Paper: Accruals-based Government Finance Statistics, Australian Bureau of Statistics, 13 March 2000, p23.

Capitalised interest

The AAS 31 operating surplus (deficit) does not include capitalised interest as it is considered to form part of capital expenditure. Under the GFS framework capitalised interest is treated as an interest expense and thus included in the net operating balance.[147]

Figure 4.6 – Reconciliation of GFS Net Operating Balance with AAS 31 Operating Surplus (Deficit)

Movement	*Item*
	GFS Net Operating Balance
minus	Provisions for doubtful debts
plus	Bad debts written off from provisions and treated as capital transfers
plus / minus	Gains and losses on assets, including derivatives
plus / minus	Adjustment for abnormal / extraordinary items
plus	Distributions to owners (dividends)
plus	Capitalised interest
plus / minus	Other adjustments
equals	AAS31 Operating Surplus (Deficit)

Source: Commonwealth of Australia, 5517.0 Information Paper: Accruals-based Government Finance Statistics, Australian Bureau of Statistics, 13 March 2000, p23.

4.5.2 Reconciliation of GFS Net Worth and AAS 31 Net Assets

For the major part GFS Net Worth and AAS 31 Net Assets are equivalent. The GFS Net Worth measure represents total assets less liabilities less shares and other contributed capital. Whereas the AAS 31 Net Assets measure represents Total Net Assets (total assets less total liabilities) less outside equity interests.[148]

In order to reconcile GFS Net Worth and AAS 31 Net Assets a number of adjustments need to be made in the areas of capitalised interest, provision for bad debts, superannuation, coverage, valuation and other unidentified differences. The reconciliation is calculated on a residual basis.

[147] Commonwealth of Australia, 5517.0 Information Paper: Accruals-based Government Finance Statistics, Australian Bureau of Statistics, 13 March 2000, p23.
[148] Commonwealth of Australia, 5517.0 Information Paper: Accruals-based Government Finance Statistics, Australian Bureau of Statistics, 13 March 2000, p25.

Figure 4.7 – Reconciliation of GFS Net Worth with AAS 31 Net Assets

Movement	*Item*
	GFS Net Worth
plus / minus	Capitalised interest
plus / minus	Provision for bad debts
plus / minus	Superannuation
plus / minus	Coverage
plus / minus	Valuations
plus / minus	Residual adjustments
equals	AAS31 Net Assets

Source: Commonwealth of Australia, 5517.0 Information Paper: Accruals-based Government Finance Statistics, Australian Bureau of Statistics, 13 March 2000, p25.

4.6 Summary

The Commonwealth Government of Australia, through the introduction of the Charter of Budget Honesty Act 1998 and the Financial Management and Accountability Act 1997 (FMA), has set in legislation the requirement for its financial reporting to be based on external reporting standards. The FMA, through Sections 48 and 49, also provides the legal basis for holding the Chief Executives of Commonwealth departments and agencies accountable for the accuracy of their department's financial statements.

By requiring the financial reporting and record keeping of government departments and agencies to be in accordance with external reporting standards, and audited by the Auditor-General, Chief Executives are able to discharge their responsibility of providing financial statements that give a true and fair view of the financial performance and financial position of the department or agency.

Further, external reporting standards assist in creating an environment in which users of government financial information can have confidence in the comparability and accuracy of that financial information.

This chapter has provided an overview of the two external reporting requirements that exist in relation to the Commonwealth Government. They are: the Australian Bureau of Statistics Government Finance Statistics framework and the Australian Accounting Standards framework (through the introduction of AAS 29 and AAS 31).

The GFS framework is a specialised statistical system designed to support economic analysis of the public sector and is consistent with international statistical standards, thus allowing international comparisons. The GFS framework has also been adopted as the common reporting framework for all public sector jurisdictions within Australia.

The Australian Accounting Standards form the basis for financial reporting in the Australian private sector and as such are the most commonly used and readily understood reporting requirements in Australia. The Australian Accounting Standards have been introduced into the Commonwealth Government through the development of Australian Accounting Standard No.29 (Financial Reporting by Government Departments) and Australian Accounting Standard No.31 (Financial Reporting by Governments). These standards require the application of all other Australian Accounting Standards, except those standards specifically identified as not applying to governments.

Through the Finance Ministers' Orders, the government has imposed the requirement for all government departments and agencies to keep records and prepare financial statements in accordance with the Australian Accounting Standards. As a result, the AAS framework has become the principal reporting framework for the Commonwealth Government.

Of particular interest from an international perspective, is the fact that AAS 31 requires the preparation of consolidated financial statements, therefore introducing whole-of-government financial reports.

Chapter 5. Financial Reporting Processes and Underlying Policies

5.1 Agency Level Accounting Processes

In line with one of the main goals of the financial management reform process undertaken in the Commonwealth government sector, a large degree of autonomy has been delegated to agencies. This delegation of authority includes decisions relating to the accounting systems and processes applied in agencies. Certain parameters are naturally prescribed centrally to allow for consistency across government operations.

As detailed in Chapter 4, the broad framework for accounting in Commonwealth agencies is prescribed through the Financial Management and Accountability Act 1997 (FMA). The FMA requires the application of the Finance Minister's Orders (FMO's), which provide the government's policy on the preparation and management of financial information. One of the main principles contained in the FMO's is the application of the Australian Accounting Standards, particularly Australian Accounting Standard 29 (AAS29) Financial Reporting by Government Departments. However, in certain areas the FMO's override the Accounting Standards. These areas are clearly detailed in the FMO's.

5.1.1 Accounting Processes

Given the devolved accounting environment in the Commonwealth government, the choice of accounting software used by agencies is not centrally prescribed and is an issue for the senior management and Chief Financial Officer of each agency to select the particular accounting software.

The accounting software and processes used by agencies must be capable of preparing and holding the financial information in a form compatible with the Accrual Information Management System (AIMS), which is the Commonwealth's central accounting and budgeting software.

5.1.2 Chart of Accounts

As a general rule, agencies' charts of accounts are set up using three main dimensions: (1) natural account, (2) cost centre and (3) activity code.

The natural account represents types of transactions (e.g. salaries, postage etc.). See Figure 5.1 for an example of natural account codes.

Figure 5.1 – Natural Account Codes for Australian Sports Commission (extract)

AUSTRALIAN SPORTS COMMISSION
Chart of Accounts 2002 - 2003
Account Code Listing
Account No. date 02/04/03

REVENUE				
	Government Appropriations			
			11111	Parliamentary Funding
	Other Revenue			
		Other Revenue from Government		
			11113	Federal Govt Depts/ Agencies
			11211	State Gov Depts / Agencies
		Sponsorship		
			12111	Cash Sponsorship
			12113	Endorsements
			12117	Signage
			12119	Royalties
			12121	Copyright
			12125	Cash Sponsorship T/fer In
			12127	Cash Sponsorship T/fer Out
		General Revenue		
			12713	Contributions Rec'd - Vehicles
			12715	Contributions Received - Other
			12717	Donations Received
			12719	Sundry Revenue
			12721	Bad Debts Recovered
	Revaluation Increments			
			12881	Reval Inc - Land
			12882	Reval Inc - Buildings
			12883	Reval Inc - Leasehold improvem
			12884	Reval Inc - Carparks, roads
			12885	Reval Inc - Furn and equipment
			12886	Reval Inc - Computer hardware
			12887	Reval Inc - Marine fleet
			12888	Reval Inc - Motor Vehicles
			12889	Reval Inc - Computer software
	Revenue from Sale of Goods and Services			
		Income from Services Provided		
			13101	Research
			13102	Video Club Membership
			13103	Video Loans
			13104	Inter Library Loans

EXPENSES				
	Employee Expenses			
		Gross Salaries		
			21111	Salaries and Allowances
			21113	Casual Staff
			21115	Athletes
			21117	Board/Directors Fees
			21119	Scholars SSSM
			21120	Scholarship Coaches (was equip hire 98/99)
		Leave Entitlements Accrued		
			21121	Annual Leave entitlements
			21123	Long Service Leave entitlement
		Salary Sacrifice Expenses		
			21131	Sal Sacrifice - Vehicles
			21133	Sal Sacrifice - Child Care
			21135	Sal Sacrifice - Superannuation
			21137	Sal Sacrifice - Other
		Salary On Costs		
			21141	Superannuation
			21143	Superannuation 3% Productivity
			21145	Workers Compensation
			21147	Compo Salaries Recoveries
		Terminations		
			21151	Redundancy
		Non Payroll Staff		
			21171	Contractors
			21172	Temp Agency Staff
			21181	Salary Transfers - In
			21182	Salary Transfers - Out
	Depreciation Expenses			
			22132	Depreciation Buildings
			22133	Amortisation Leasehold Improve
			22134	Depreciation Land Improvements
			22135	Depreciation Furn & Equipment
			22136	Depreciation Computer Hardware
			22137	Depreciation Marine Fleet
			22138	Depreciation Motor Vehicles

Source: Commonwealth of Australia, Australian Sports Commission Chart of Accounts 2002-2003, Account Code Listing, Australian Sports Commission, p 29.

The second dimension included in the chart of accounts relates to the cost centre or organisational area to which the transaction relates. Figure 5.2 gives an example of cost centres.

Figure 5.2 – Cost Centres for the Australian Sports Commission (extract)

AUSTRALIAN SPORTS COMMISSION COST CENTRE LISTING 2002/2003 Web update 02/04/03	Cost Centre 2002/2003	Cost Centre Name
AUSTRALIAN INSTITUTE OF SPORT		
Director AIS (Michael Scott)	100100	DIRECTOR - AIS
	100102	AIS RESERVE
	100103	AIS CARRYFORWARD
	100104	IOC SOLIDARITY SCHOLARSHIPS
AIS Business Development (Melissa Clough)	100200	AIS BUSINESS DEVELOPMENT
Planning & Evaluation		
Assistant Director (Bob Murphy)	110100	ASST DIR - PLANNING & EVALUATION
	110202	AIS PROFESSIONAL DEVELOPMENT
	110289	C'WEALTH GAMES S/SHIP PROGRAM
	110291	PLANNING & EVALUATION ADMIN
	110299	AIS ATHLETES COMMISSION/ALUMNI
	110301	ADELAIDE RESIDENCE
	110303	INTERNAL CHARGES AIS RESI'S
Scholarship Sports	113103	AIS ARCHERY
	113105	AIS ATHLETICS
	113106	AIS AUSTRALIAN RULES
	113111	AIS BASKETBALL
	113118	AIS BOXING
	113123	AIS CANOEING - SLALOM
	113124	AIS CANOEING - SPRINT
	113127	AIS CRICKET - MEN
	113128	AIS CRICKET - WOMEN
BUSINESS OPERATIONS		
General Manager (Lois Fordham)	200100	GENERAL MGR-BUSINESS OPERATIONS
Senior Mgr Commercial Ops (Amber Fox)	220100	SNR MGR-COMMERCIAL OPERATIONS
Finance Section (Simon Kidman)	221101	FINANCE SECTION
Strategic Planning (Gabrielle Duschner)	221200	STRATEGIC PLANNING
Research		
Research (Ian Ford)	330401	RESEARCH SALS & ADMIN
	330402	PARTICIPATION DATA
	330403	MISC SPORT PROJECTS
Business Development Unit (Paul Stapleton)	221400	BUSINESS DEVELOPMENT UNIT

Source: Commonwealth of Australia, Australian Sports Commission Chart of Accounts 2002-2003, Cost Centre Listing, Australian Sports Commission, p 4.

The third dimension held in the chart of accounts relates to activity codes. Activity codes allow for the classification of transactions for project/program management across cost centres, or within a single cost centre. Figure 5.3 gives an example of activity codes.

Figure 5.3 – Activity Codes for the Australian Sports Commission (extract)

Australian Sports Commission

Chart of Accounts

Web updated 02/04/03

ACTIVITIES

nnnnnn BUILDINGS/VENUES

First three digits	Building	
Fourth digit	Component	("0" for general)
Last two digits	01-49=MNW, 51-99=LAR	

Building	Componei	Project Description	Code	
AIS (Indoor) Arena				
	Arena		1010nn	
		general		101000
		gantry safety restraints		101001
		replace roof membrane		101003
		bldg mgt system		101030
		replace sports floor		101050
		replace gantry mesh floor		101051
		repaint staunchions		101052
		repair/repaint changerooms		101053
		lighting system replacement		101054
		overhaul fire exit door		101055
		repair expansion joints		101056
		overhaul sewer ejectors		101057
		pneumatics replacement		101058
				101059
		repaint/recarpet offices		101060
		refurbish changerooms		101061
	Arena: Function Room		1011nn	
		general		101100
		refurbish function room		101101
Track and Field				
	Track and Field		1020nn	
		general		102000
		replace lights		102050
		repair concrete entry slab		102051
	Running Track		1021nn	
		general		102100
		synthetic track replacement		102101
		replace running rail		102150

Source: Commonwealth of Australia, Australian Sports Commission Chart of Accounts 2002-2003, Activity Code Listing, Australian Sports Commission, p 10.

A further dimension may be added to deal with outcome and output splits, however, it is also possible to determine outcome/output results by loading periodic financial statements into spreadsheets with predetermined splits within each cost centre. Outcome and output splits are developed by senior management in conjunction with the finance sections. The percentage splits can be based on staff time, dollars spent, floor space and combinations of these. Actual methods for splitting costs and revenues between outcomes and outputs varies between agencies.

An accounting system of this nature is generally adequate to satisfy all internal financial information needs of the relevant agency. For central Commonwealth information purposes the summary data, held in the agency Financial Information Management System (FIMS), is uploaded into AIMS.

5.2 Centralised Accounting Systems and Processes

5.2.1 Accrual Information Management System (AIMS)

AIMS is a group of interlinked software systems to provide for the recording and management of the Commonwealth's central budgeting and reporting needs. It was introduced in 1998, prior to the first full accrual budgeting and reporting cycle in 1999-2000.

AIMS provides and stores data for the Budget and forward estimates. It holds information for the central appropriation of funds and supports the cash management function. It is also the main system through which the Whole of Government and General Government Sector financial statements are produced.[149]

AIMS Functions

There are two main user groups of AIMS: (1) the Department of Finance and Administration (Finance); and (2) agencies of the Commonwealth.

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[149] Commonwealth of Australia, Department of Finance and Administration, Accrual Information Management System (AIMS) User Manual, March 2001, s2 p4.

Finance is the central Commonwealth agency responsible for AIMS. It uses AIMS to:

- develop the budget, including consolidation and reporting;
- report on potential and agreed adjustments to the budget and their overall impact on financial targets;
- produce the budget documentation;
- perform central appropriation management; and
- prepare Whole of Government and General Government Sector financial reports.[150]

Agencies are also required to use AIMS for various processes. AIMS requirements are not the same for all agencies, they have been divided into requirements for material agencies and small agencies. Material agencies are those, when ranked in order by dollar value, that make up 99% of either total assets, total liabilities, total expenses or total revenue for the sector.

AIMS is used by agencies to:

- submit budget estimates and revised budget forecasts to Finance;
- report actual results against budget;
- advise Finance of estimate adjustment details, including costings of policy proposals;
- drawdown cash from the Official Public Account (OPA) to agency bank accounts; and
- download information circulars and other policy advice.[151]

For further details of agencies' responsibilities in AIMS see table 5.1.

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[150] Commonwealth of Australia, Department of Finance and Administration, Accrual Information Management System (AIMS) User Manual, March 2001, s2 p6.
[151] Commonwealth of Australia, Department of Finance and Administration, Accrual Information Management System (AIMS) User Manual, March 2001, s2 p6.

Agencies access AIMS using Netscape browser and a ‘Kyberpass’ secure encryption system.

System Structure

AIMS is made up of three separate databases: (1) Financial Statements or Baseline Module (Essbase); (2) Adjustment Tracking Module (ATM); and (3) QSP Financials.

The Essbase database holds the financial statements for budgeted estimates and monthly reporting. The statements held in Essbase are stored on a totals basis and are updated from time to time (replaced) rather than being derived from transaction data.

Table 5.1 – Agencies' Responsibilities in AIMS

	General Government Sector (GGS)		**PTE/PFE Sectors**
	Material Agencies	**Small Agencies**	**Companies**
Estimates	Provide updated budgeted financial statements (baselines) for current budget, next budget and three forward years as required. In between baseline updates: • Input estimates adjustments to explain the changes in estimates • Input pressures and policy variations.	Input Appropriation and receipts information prior to Budget and Additional Estimates.	Input Appropriation information, where relevant, prior to Budget and Additional Estimates.
Financial reporting of actual results	**From 1 July 1999**, Provide monthly financial statements as input to the consolidated GGS Statements **For 1999-2000 and on**, Provide annual financial statements as input to the Whole of Government Statements.	**For 1999-2000 and on**, Provide annual financial statements as input to the Whole of Government Statements. This data will be at a high level only.	**For 1999-2000 and on**, Provide annual financial statements as input to the Whole of Government Statements.
Appropriation and cash management	• When agencies need funding to make administered payments, they will request a drawdown of administered appropriations via an AIMS screen, entering appropriation information. • Agencies will transfer administered receipts from their bank accounts to Finance's bank account and enter the remittance information via an AIMS screen.		

Notes:

1. Most agencies are likely to receive appropriations for departmental outputs, equity injection and loans in accordance with a drawdown schedule agreed with Finance before the start of the year.
2. If agencies pay dividends, loan repayments and capital use charges electronically to Finance, they can enter the remittance information via an AIMS screen.

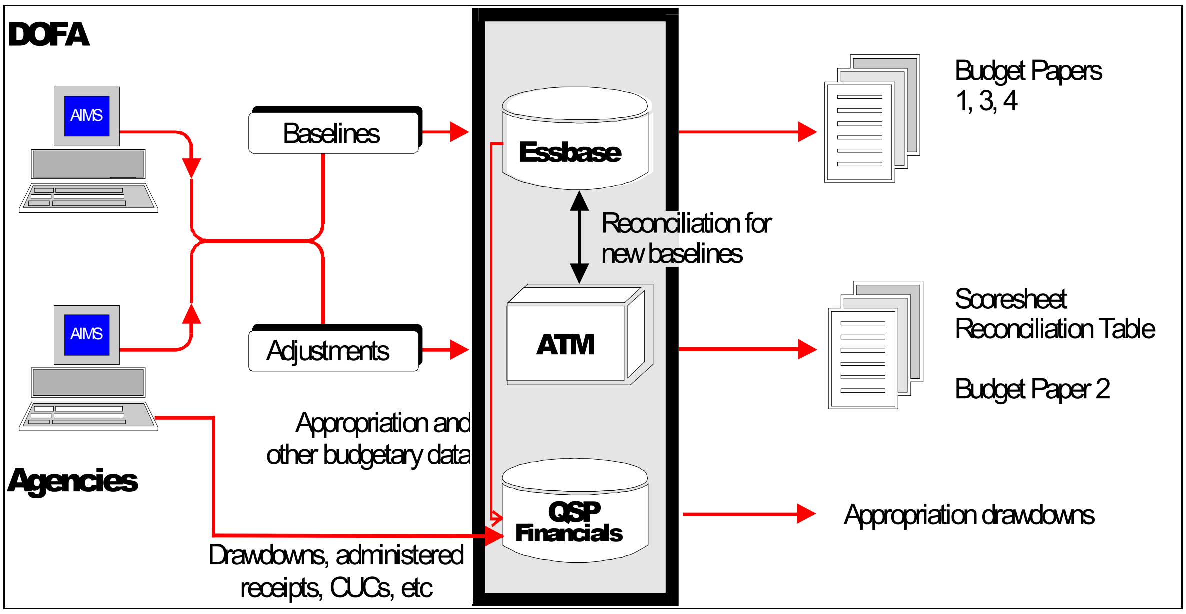
Source: Commonwealth of Australia, Department of Finance and Administration, Accrual Information Management System (AIMS) User Manual, March 2001, s2 p8.

The ATM database holds potential and agreed adjustments to the budgeted financial statements. The adjustments are made between updates of the budgeted financial statements. The updated financial statements must be equal to the previous set of financial statements plus the agreed adjustments held in the ATM.

The QSP Financials database holds appropriations and other budgetary data, drawdown schedules, drawdowns against appropriations, administered and departmental receipts and dividends, loan repayments and, prior to its discontinuation, information on the Capital Use Charge.

Figure 5.4 illustrates the relationship between the components of AIMS.

Figure 5.4 – The Components of AIMS



Source: Commonwealth of Australia, Department of Finance and Administration, Accrual Information Management System (AIMS) User Manual, March 2001, s 2 p 9.

5.2.2 AIMS Chart of Accounts

The chart of accounts in AIMS has been designed to accommodate both the budgeting and reporting requirements of the Commonwealth Government. It is a generic chart of accounts and is therefore not as detailed as the charts of accounts used by individual agencies.

The AIMS chart of accounts is divided into seven sections: (1) Accounts; (2) Entity; (3) Version; (4) Time; (5) Function and Outcomes; (6) Reporting; and (7) Inter Entity Transactions.

Accounts

In line with the structure of the primary financial statements, the major classes of accounts are:

- Assets, which can be defined as future economic benefits controlled by the entity as a result of past transactions or other past events;
- Liabilities, which can be defined as the future sacrifices of economic benefits that the entity is presently obliged to make to other entities as a result of past transactions or other past events;
- Equity, which can be defined as the residual interest in the assets of the entity after the deduction of its liabilities;
- Revenue, which can be defined as the inflows or other enhancements, or savings in outflows, for future economic benefits in the form of increases in assets or reductions in liabilities of the entity, other than those relating to contributions by owners, that result in an increase in equity during the reporting period;
- Expenses, which can be defined as the consumption or loss of future economic benefits in the form of reductions in assets or increases in liabilities of the entity, other than those relating to distributions to owners, that result in a decrease in equity during the reporting period; and
- Cash flows, which can be defined as cash movements resulting from transactions with parties external to the entity.[152]

Other Schedules (financial reporting purposes only)

- Commitments, can be defined as obligations or undertakings to make future payments to other entities, which exist at the end of the reporting period but

[152] Commonwealth of Australia, Department of Finance and Administration, Accrual Information Management System (AIMS) User Manual, March 2001, s2 p37.

have not been recognised as liabilities in the Statement of Assets and Liabilities; and

- Contingencies, which can be defined as conditions, situations or circumstances that exist at the end of the reporting period, create uncertainty as to the possible gain or loss to an entity and will only be confirmed after the occurrence or non-occurrence of one or more uncertain events.[153]

Entity

The entity segment identifies the agency to which the financial information relates. A separate entity code exists for Departmental and Administered items and for the break up of these by appropriation source.[154]

Version

The version segment identifies to which version of data the financial information belongs (e.g. Budget Estimates, Final Budget Outcome) and separates the data into financial periods (e.g. Revised Budget, Next Budget, Forward Year 1, Forward Year 2 etc.).

Time

The time segment identifies to which period the financial information belongs (e.g. 1998-99 Revised Budget, 1999-2000 Next Budget, 2000-2001 Forward Year etc.). For actual results, the time identifies the reporting period (e.g. financial year or month being reported).

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[153] Commonwealth of Australia, Department of Finance and Administration, Accrual Information Management System (AIMS) User Manual, March 2001, s2 p38.
[154] Commonwealth of Australia, Department of Finance and Administration, Accrual Information Management System (AIMS) User Manual, March 2001, s2 p39.

Function

The function segment identifies the purpose of expenses. Agencies are required to identify a function for Administered expenses, however, Departmental expenses are allocated a function by Finance.[155]

Outcomes

The outcome segment identifies to which agency or intermediate outcome the financial information belongs.

Reporting

The reporting segment allows the separate identification of original data entered into AIMS by agencies and the adjustments made to that data.

Inter Entity

The inter entity segment identifies the transactions and balances of an inter-entity nature to allow for their elimination in the consolidation process.

5.2.3 Essbase (Baseline Estimates)

Estimates and actual results are prepared by Commonwealth General Government Sector (GGS) agencies, in consultation with Finance and then uploaded into AIMS.

As described earlier, Commonwealth agencies have been divided into different classes with varying information requirements.

Material agencies are required to enter detailed estimates and monthly financial statements for both departmental and administered items. Whereas, small agencies are only required to input high level estimates for their administered and departmental items.

[155] Commonwealth of Australia, Department of Finance and Administration, Accrual Information Management System (AIMS) User Manual, March 2001, s2 p39.

All agencies are required to provide financial reports on annual results as part of the whole of government reporting process.

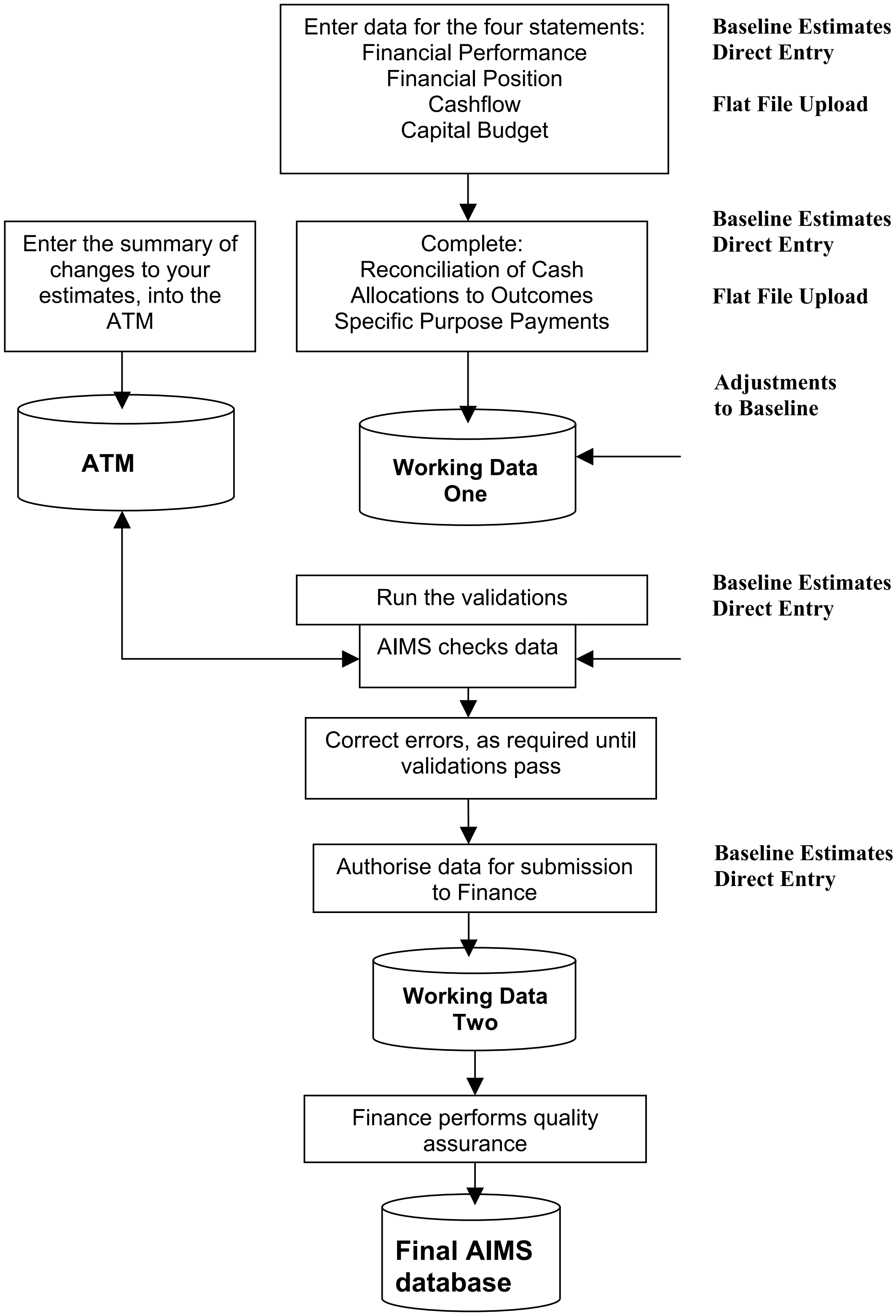
Agencies outside the GGS sector such as Public Non-Financial Corporations (PNFC) and Public Financial Corporations (PFC) are only required to provide annual accrual financial reports.[156]

Agencies are able to input data into AIMS in two ways: (1) direct entry into the working area of AIMS via the web browser interface; and (2) via a flat file which is uploaded into the working area of AIMS.

Figure 5.6 provides an overview of the AIMS data entry process.

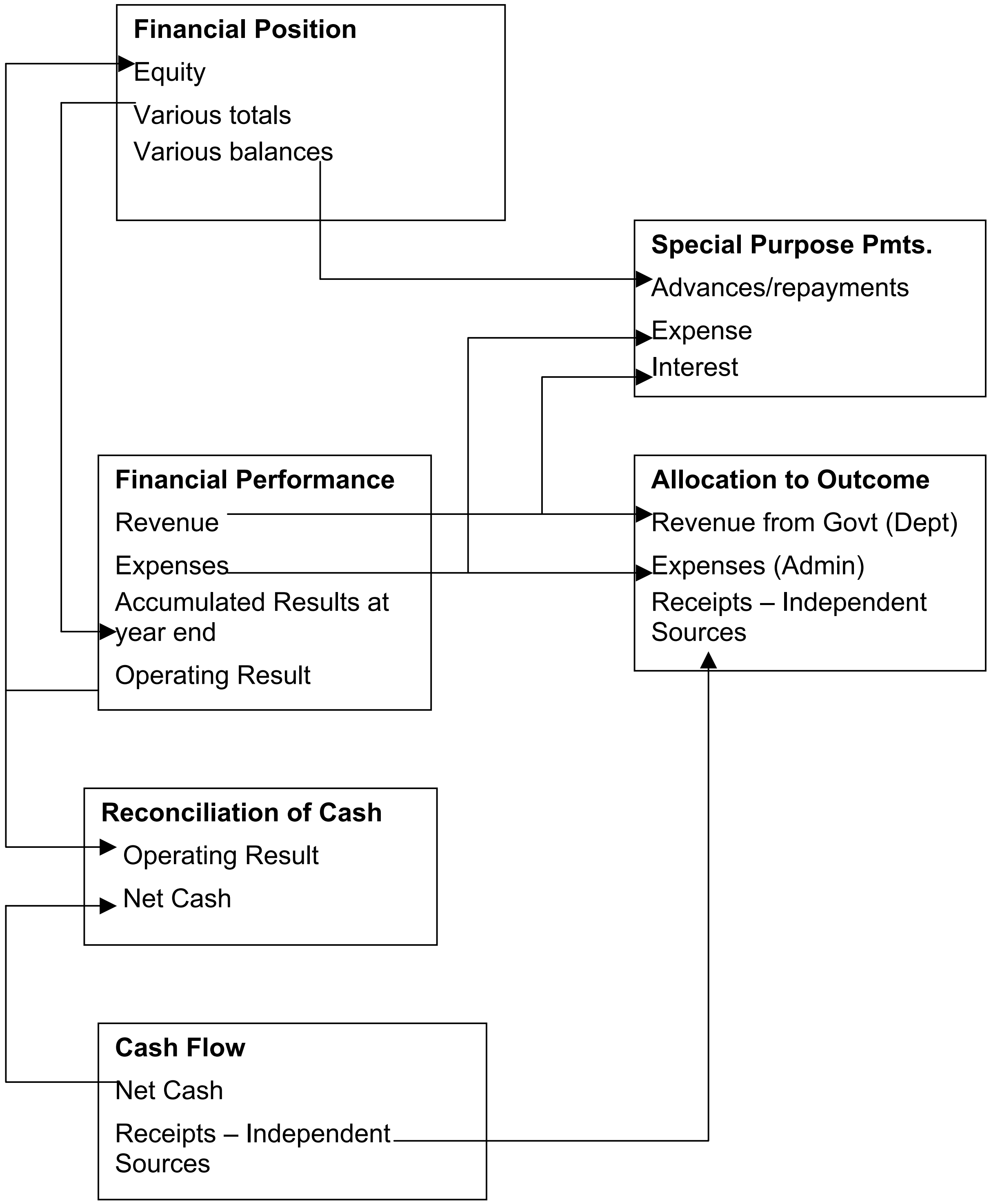
[156] Commonwealth of Australia, Department of Finance and Administration, Accrual Information Management System (AIMS) User Manual, March 2001, s3 p7.

Figure 5.6 – AIMS Data Entry Process



Source: Commonwealth of Australia, Department of Finance and Administration, Accrual Information Management System (AIMS) User Manual, March 2001, s3 p23.

Figure 5.7 – Movements of AIMS Totals Between Statements



Source: Commonwealth of Australia, Department of Finance and Administration, Accrual Information Management System (AIMS) User Manual, March 2001, s3 p24.

5.2.4 Input of Estimates Data

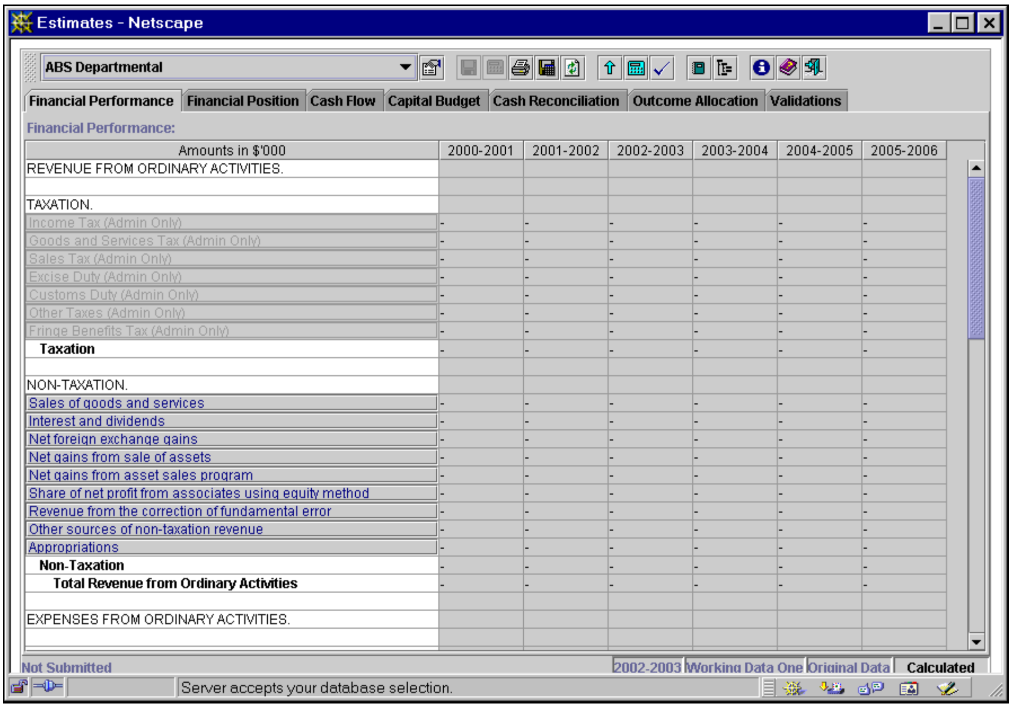
Estimates data is entered into AIMS following the form of the Commonwealth's main financial statements (i.e. Statement of Financial Performance, Statement of Financial Position, Cashflow Statement, and Capital Budget Statement).

The first step for all AIMS data entry processes is to log on to the AIMS homepage using the secure dialup facilities supplied to all Commonwealth agencies.

Statement of Financial Performance

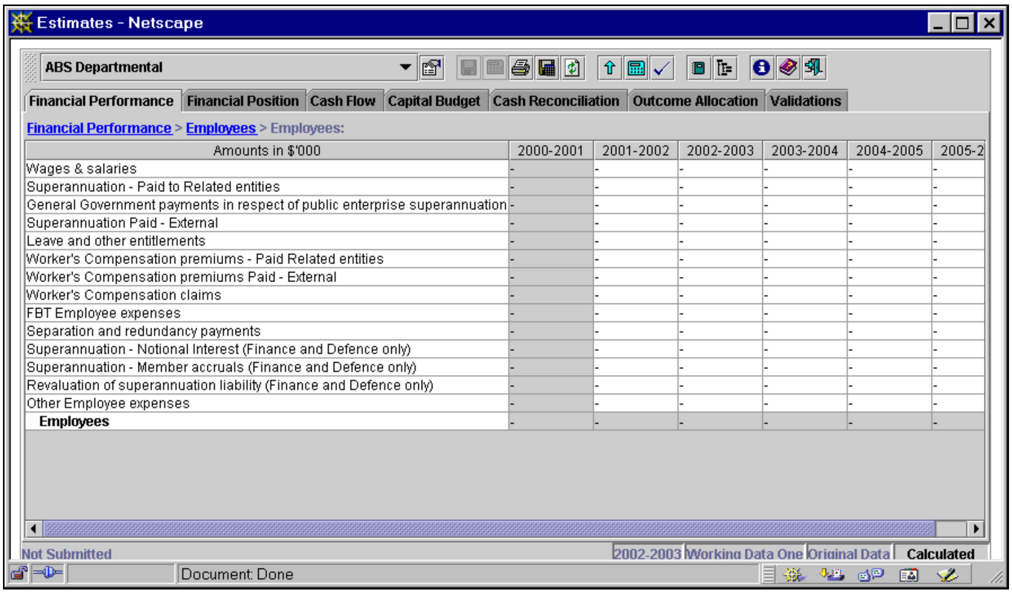
Once logged on to the AIMS home page, the user must select the Baseline Estimates screen and select either the Departmental or Administered items entry screen. Figure 5.8 shows the Financial Performance summary screen. However, the actual data entry screen is accessed by clicking on the desired field to move through to the next, more detailed, screen (see Figure 5.9).

Figure 5.8 – Financial Performance Summary Screen (example)



Source: Commonwealth of Australia, Department of Finance and Administration, Accrual Information Management System (AIMS) User Manual, March 2001, s3 p41.

Figure 5.9 – Detailed Data Entry Screen for Financial Performance (example)



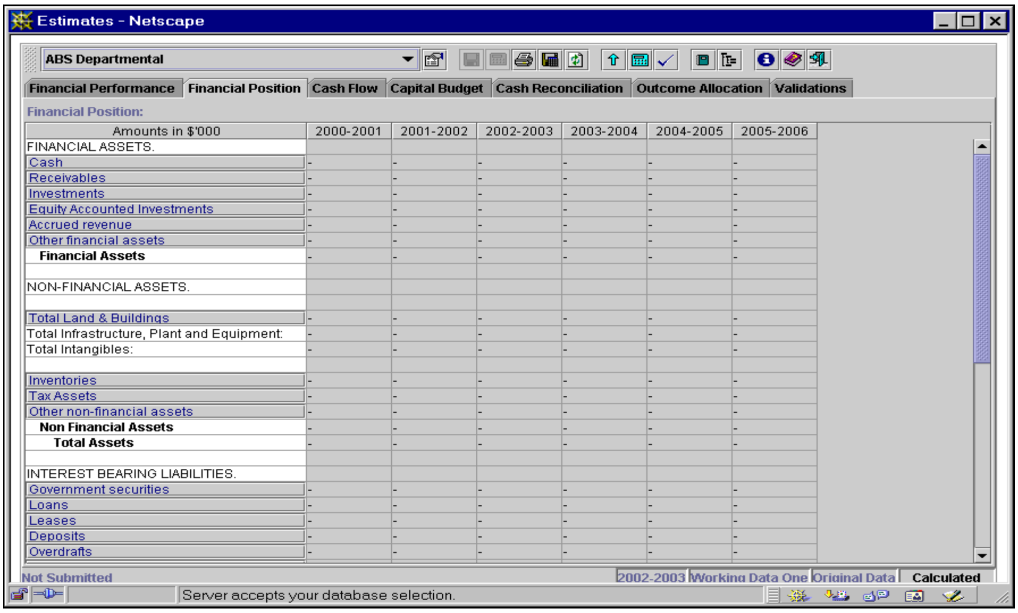
Source: Commonwealth of Australia, Department of Finance and Administration, Accrual Information Management System (AIMS) User Manual, March 2001, s3 p43.

Once all figures have been entered the user selects 'save and calculate' to complete the entry of financial performance information.

Statement of Financial Position

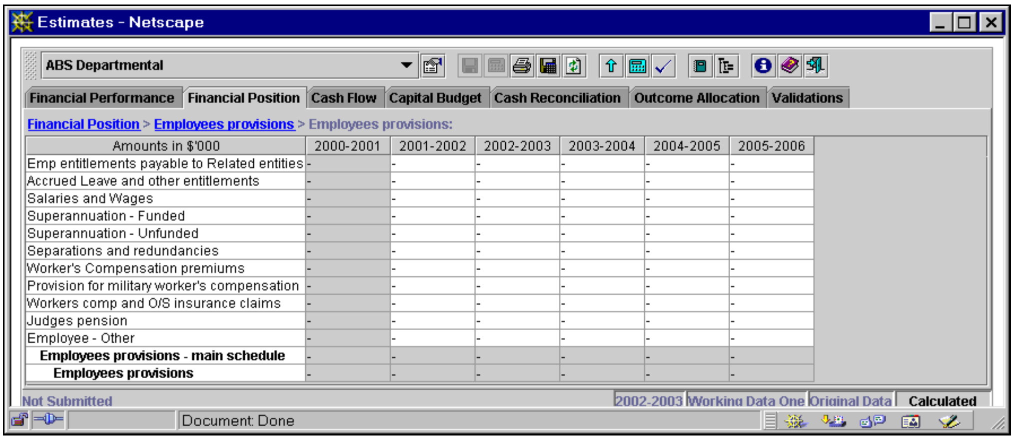
The process for data entry into the financial position screen follows the same process as above. Figure 5.10 shows the summary screen for financial performance. Actual data entry is done through the sub screens accessed by clicking on the desired field in the summary screen (see Figure 5.11).

Figure 5.10 - Financial Position Summary Screen (example)



Source: Commonwealth of Australia, Department of Finance and Administration, Accrual Information Management System (AIMS) User Manual, March 2001, s3 p45.

Figure 5.11 – Detailed Data Entry Screen for Financial Position (example)



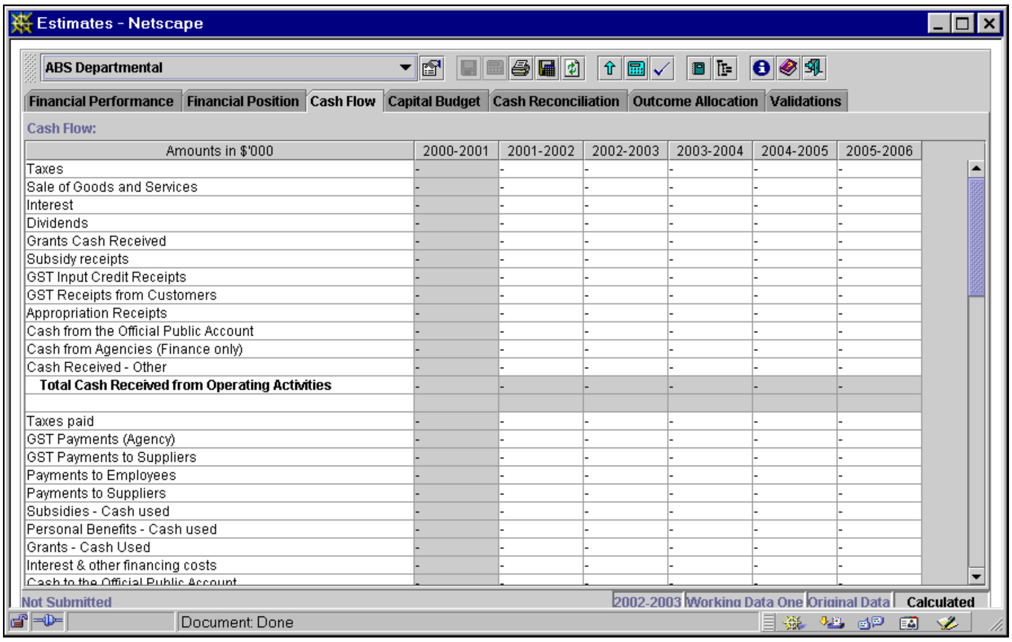
Source: Commonwealth of Australia, Department of Finance and Administration, Accrual Information Management System (AIMS) User Manual, March 2001, s3 p46.

Following the entry of data for each of the five financial years the user must click 'save and calculate' and then exit the financial position area.

Cash Flow Statement

In the cash flow data entry section of AIMS some fields all entry directly from the summary screen (see Figure 5.12).

Figure 5.12 – Cash Flow Summary Screen (example)



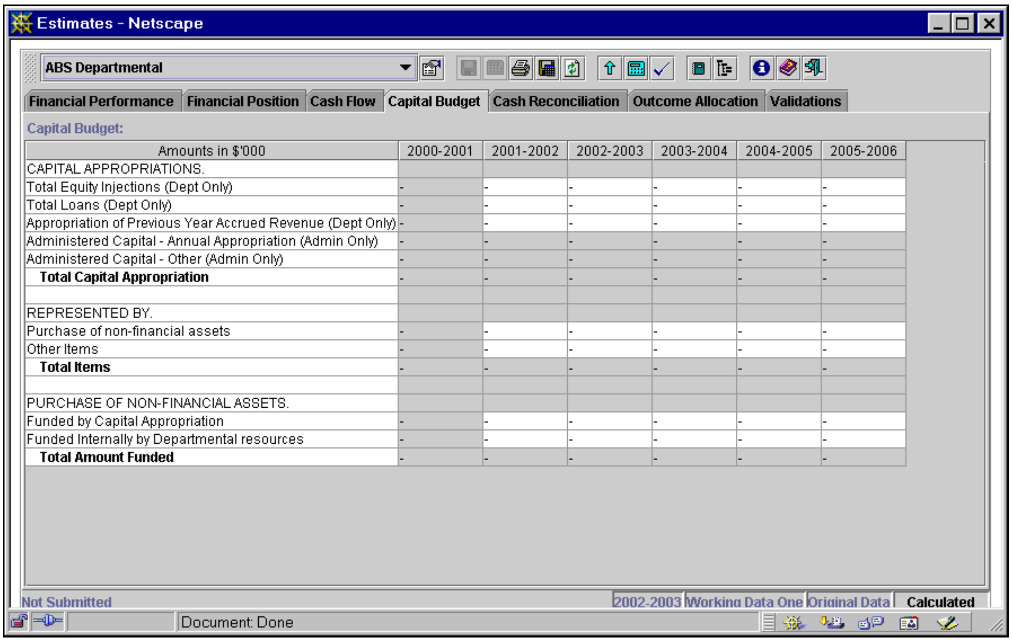
Source: Commonwealth of Australia, Department of Finance and Administration, Accrual Information Management System (AIMS) User Manual, March 2001, s3 p48.

To complete the cash flow data entry process the user clicks the 'save and calculate' button and exits the cash flow area.

Capital Budget Statement

Again, the user enters the capital budget screen by selecting 'capital budget' from the drop-down list to move to the summary screen. The capital budget also allows for data entry in the summary screen (see Figure 5.13).

Figure 5.13 – Capital Budget Summary Screen (example)



Estimates - Netscape

ABS Departmental

Financial Performance | Financial Position | Cash Flow | Capital Budget | Cash Reconciliation | Outcome Allocation | Validations

Capital Budget:

Amounts in $'000	2000-2001	2001-2002	2002-2003	2003-2004	2004-2005	2005-2006
CAPITAL APPROPRIATIONS.						
Total Equity Injections (Dept Only)	-	-	-	-	-	-
Total Loans (Dept Only)	-	-	-	-	-	-
Appropriation of Previous Year Accrued Revenue (Dept Only)	-	-	-	-	-	-
Administered Capital - Annual Appropriation (Admin Only)	-	-	-	-	-	-
Administered Capital - Other (Admin Only)	-	-	-	-	-	-
Total Capital Appropriation	-	-	-	-	-	-
REPRESENTED BY.						
Purchase of non-financial assets	-	-	-	-	-	-
Other Items	-	-	-	-	-	-
Total Items	-	-	-	-	-	-
PURCHASE OF NON-FINANCIAL ASSETS.						
Funded by Capital Appropriation	-	-	-	-	-	-
Funded Internally by Departmental resources	-	-	-	-	-	-
Total Amount Funded	-	-	-	-	-	-

Not Submitted | 2002-2003 | Working Data One | Original Data | Calculated

Document: Done

Source: Commonwealth of Australia, Department of Finance and Administration, Accrual Information Management System (AIMS) User Manual, March 2001, s3 p48.

To complete the data entry in the capital budget the user clicks on the 'save and calculate' button and exits the capital budget area.

5.2.5 Data Validation

Following the input of data, a number of validations and other processes that need to take place before the data can sent to Finance for its final quality assurance.

Reconciliation of Cash

The reconciliation of cash schedule reconciles the operating result with the net cash increase / decrease. The formula for the reconciliation of cash is:

Operating Result

\+ non cash operating expenses (e.g. depreciation)

\- non cash operating revenues (e.g. revenue earned but not yet received)

\+ total cash provided by working capital items (e.g. decrease in assets)

\- total cash used by working capital items (e.g. increase in assets)

= net cash from operating activities

\+ net cash from investing activities

\+ net cash from financing activities

= Net cash increase / decrease[157]

Allocation to Outcomes

There are certain accounts which must be allocated to outcomes. Totals from the Statement of Financial Performance and the Cash Flow Statement are copied by AIMS into the Allocation to Outcomes schedule.

Allocations to Specific Purpose Payments

Agencies which are involved in transfer payments to States and Territories must allocate these transfers into individual Special Purpose Payments (SPP) items for input into documentation for budget and Premiers' conferences.

Validations

There are a number of validations that must be performed on baseline data in AIMS before it can be authorised by the agency authorising officer, and submitted to Finance for final quality assurance. Validations must be performed on both departmental and administered items.

Some examples of the typical validations that are performed are:

- accounting validations (e.g. balance sheet balances);
- reconciliations (e.g. that amounts have been correctly allocated); and
- new baseline figures must equal the previous baseline figures plus Finance validated estimates adjustments.[158]

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[157] Commonwealth of Australia, Department of Finance and Administration, Accrual Information Management System (AIMS) User Manual, March 2001, s3 p55.
[158] Commonwealth of Australia, Department of Finance and Administration, Accrual Information Management System (AIMS) User Manual, March 2001, s3 p63.

Agency Authorisation

Before data can be sent to the Working Data Two area of AIMS (see Figure 5.6 for details) for final quality assurance by Finance, the agency authorising officer is required to authorise the submission of the data. Data can only be submitted to Working Data Two by someone with authorise access. This is to ensure the accuracy of the data and that the data reflects the true intentions of the agency.[159]

Finance Quality Assurance

Given the decentralised nature of estimates data entry, Finance has been charged with the responsibility for assuring Cabinet of the accuracy of the estimates data.

Finance Budget Officers test the figures entered by agencies for consistency and sense.

5.2.6 The Adjustment Tracking Module (ATM)

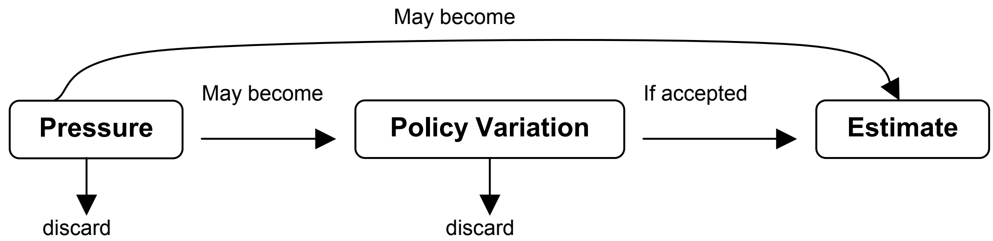
The Adjustment Tracking Module (ATM) stores adjustment data on pressures, policy variations and estimates. Adjustment data can originate from agencies or Finance.

The ATM monitors movements in the budget and forward estimates, between updates of the baseline data. Any update in the baseline data in Essbase must be consistent with Finance validated estimate adjustments in the ATM.

Adjustments entered into the ATM move through a cycle before becoming accepted and able to be entered into the baseline estimates. Figure 5.18 illustrates this cycle.

[159] Commonwealth of Australia, Department of Finance and Administration, Accrual Information Management System (AIMS) User Manual, March 2001, s3 p69.

Figure 5.18 – Adjustment Life Cycle



Source: Commonwealth of Australia, Department of Finance and Administration, Accrual Information Management System (AIMS) User Manual, March 2001, s3 p74.

The ATM is designed to be continuously updated (i.e. estimates updates entered as agencies become aware of issues). This could be as often as daily, and assists agencies and Finance to reduce the workload around update times.

Estimates adjustments need to be authorised by agencies and validated by Finance before they are reflected in the bottom line. After and adjustment has been validated by Finance it can not be changed or deleted.[160]

5.2.7 The Cash and Appropriation Management Module (CAMM) in QSP Financials

With the switch to accrual accounting and outcome and output based budgets, devolved banking arrangements for agencies were also introduced. From 1 July 1999 all Commonwealth agencies were required to operate their own bank accounts.[161]

Agencies were required to set up a departmental account for drawing down departmental appropriations and where agencies have administered expenses, or collect administered receipts, they were required to set up accounts for each of these. Appropriations are drawn down from the Official Public Account (OPA), the Commonwealth's central bank account, which reflects the operations of the Consolidated Revenue Fund.

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[160] Commonwealth of Australia, Department of Finance and Administration, Accrual Information Management System (AIMS) User Manual, March 2001, s3 p78.
[161] Commonwealth of Australia, Department of Finance and Administration, Accrual Information Management System (AIMS) User Manual, March 2001, s5 p7.

The Cash and Appropriation Management Module (CAMM) is a component of AIMS and is designed to allow agencies to draw down their appropriation monies into their devolved bank accounts and to record transfers to the OPA.

Agencies use CAMM to:

- amend schedules for their departmental appropriations;
- draw down funds against administered appropriations;
- record the return of unspent administered appropriations to Finance;
- record any administered receipts collected and returned to Finance; and
- record any other transfers to Finance.[162]

CAMM provides a record of (annual appropriations):

- amounts passed by Parliament for the purchase of departmental outputs, for equity injections and for the provision of loans to agencies;
- appropriations for administered items passed by Parliament through the annual appropriation bills for specified outcomes, in the form of specific purpose payments or other administered expenses and for administered capital; and
- amounts that have been transferred to agencies over time against each of these items.[163]

All payments from the OPA to agency bank accounts are in the form of electronic funds transfers. There are three types of transfers which can be used in CAMM:

- government direct entry system (GDES), which consist of regular transfers to agency bank accounts at 9am each day;

[162] Commonwealth of Australia, Department of Finance and Administration, Accrual Information Management System (AIMS) User Manual, March 2001, s5 p8.
[163] Commonwealth of Australia, Department of Finance and Administration, Accrual Information Management System (AIMS) User Manual, March 2001, s5 p11.

- real time gross settlement (RTGS), which are for individual payments exceeding $100 million and are transferred to an agency's bank account 15 minutes before the time required; and
- emergency RTGS, which are processed on the day the request is made, and are only used in cases where RTGS transfers have been underestimated.[164]

[164] Commonwealth of Australia, Department of Finance and Administration, Accrual Information Management System (AIMS) User Manual, March 2001, s5 p14.

Chapter 6. Financial Management Reform in the Australian Commonwealth – Problem Areas and Future Challenges

6.1 The Accrual Switch in the Australian Commonwealth Public Sector – A Critical Analysis

The major difference between the traditional cash accounting systems and the new accrual systems is that accrual accounting changes the timing of the recording of transactions and the recognition of expenses to the period in which they are incurred rather than when they are paid, as in a cash system.[165] Accrual accounting also requires the inclusion of items such as depreciation expense and future commitments to cash payments, for example, superannuation and other employee expenses. Further, accrual principles mandate the preparation of a detailed statement on assets and liabilities.

Government business enterprises and public corporations have been required to prepare financial reports on an accrual basis for many years. However, it was not until 1995 that the Commonwealth government began trialing accrual reports for core public sector agencies (i.e. agencies that are fully budget funded). Although prior to this time, modifications to the traditional cash accounting systems introduced measures intended to include many transactions not of a purely cash nature.

One of the central arguments for the application of accrual accounting to core public sector agencies is that it provides the best method to measure the sustainability and intergenerational equity of government fiscal policy at the whole of government level.[166] But has this really occurred? Even prior to the implementation of accrual accounting in the Commonwealth public sector the National Commission of Audit Report in 1996 noted that whole of government accrual statements require considerable care and a sophisticated understanding of the Commonwealth's business for a proper

[165] Guthrie J., Application of Accrual Accounting in the Australian Public Sector – Rhetoric or Reality?, Financial Accountability & Management, 14(1), February 1998, p6.
[166] Robinson M., Accrual Accounting and the Efficiency of the Core Public Sector, Financial Accountability & Management, 14(1), February 1998, p21.

interpretation of their meaning.[167] Given this, are the General Purpose Financial Reports, as the Australian Accounting Standards define them, that are produced by Commonwealth public sector organisations really general purpose?

A further argument for the application of accrual accounting is that it has an invaluable role to play in providing information on which managerial decisions can be based and in monitoring managerial performance at the agency level.[168] But could this be achieved by a modified cash system? The answer is probably yes, but is it useful to have an individually tailored accounting system for use only in the public sector? Or should public sector financial reform also be about trying to harmonise practices with those used in the private sector?

Following various reports into possible reforms for the Australian Commonwealth public sector, the newly elected conservative government embarked in 1996 on a reform process that has significantly reshaped the Commonwealth financial management framework.

The implementation of accrual principles shaped the overall nature of the reforms, however, the process consisted of a number of significant interlocking elements. The major elements are:

- the implementation of accrual financial reporting with external accounting standards;
- the introduction of whole of government reporting;
- the implementation of accrual based outcome and output budgets in a devolved budgetary environment;
- a split between the purchasers of services and the providers of services;
- appropriation of monies based on outcomes and outputs; and
- the linking of performance measurement to the budget process.

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[167] Commonwealth of Australia, National Commission of Audit, Report to the Commonwealth Government, June 1996.

[168] Robinson M., Accrual Accounting and the Efficiency of the Core Public Sector, Financial Accountability & Management, 14(1), February 1998, p21.

6.1.1 Accrual Financial Reporting

Accrual financial reporting relates to the preparation of annual audited financial statements based on accrual information. Financial statements prepared in this manner contain accounting information that was not previously captured or presented under the traditional cash based system.[169]

The statements produced under the accrual form more closely represent the financial statements prepared by private sector organisations. The financial statements now include an operating statement, a statement of assets and liabilities, a statement of cash flows and related notes to the financial statements.

The question of how well these private sector style statements fit to the public sector is becoming a core focus point of much public sector academic research. As Guthrie J. writes “commercial / business accounting is rife with problems which have, in the past, caused major misallocation in the private sector. What is it about the public sector that will remove the choices and ambiguities in accrual accounting?”[170] This is of course true but, accounting practices and methods are often far less objective than is traditionally believed to be the case, and subjective decisions that can change the financial picture being presented are likely to occur under any system.

Another one of the main drivers for reform in government financial management came from the serious financial problems experienced in a number of Australian States and the failure of two State banks during the 1980’s and early 1990’s. This notion overlooks the fact that the government owned enterprises that were at the centre of these problems were accounting on a fully commercial basis. So commercial, in fact, that that the governments that controlled them were not able to easily see what risks were being taken by these organisations.[171]

Given that virtually all Australian public sector organisations have now adopted accrual accounting principles, there is little point discussing if accrual accounting should or

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[169] Guthrie J., Application of Accrual Accounting in the Australian Public Sector – Rhetoric or Reality?, Financial Accountability & Management, 14(1), February 1998, p2.
[170] Guthrie J., Application of Accrual Accounting in the Australian Public Sector – Rhetoric or Reality?, Financial Accountability & Management, 14(1), February 1998, p6.
[171] Conn N., Reservations about Governments Producing Balance Sheets, Australian Journal of Public Administration, Vol. 55, Issue 1, March 1996, p2.

should not be applied in the public sector. Far more important are questions of the format and detail of accrual financial reports, and how to make them fit the needs of the public sector.

One of the most problematic aspects involved in the application of accrual financial reporting to the public sector arises in the area of preparing statements of assets and liabilities or balance sheets, as they are known in the private sector.

Commercial organisations have commercial objectives and hold financial resources in order to pursue these objectives. In line with this situation, the financial reports of private sector organisations are focused on financial performance and wealth maximisation. For many public sector organisations the focus on financial performance is relevant but not the primary driver for their existence. For institutions such as libraries, art galleries, parks and recreations departments, educational institutions and museums the primary focus is far more one of a social / benefit to the community type than for organisations driven by profit motive.[172]

The application of accrual reporting to socially orientated organisations in Australia has brought with it a range of problematic issues, particularly with regards to asset valuation and the interpretation of those values. The difficulties being experienced by Australian public sector organisations, in relation to assets, indicate that applying commercial valuation practices in the public sector can often be misleading.

Within commercial, profit driven organisations everything is ultimately available for sale if the situation requires it. For this reason, the concept of an asset is purely financial in nature. In contrast, public sector organisations hold assets that could not conceivably be converted to cash and are therefore not financial in nature. So how can it be appropriate to assign values to them for inclusion in a balance sheet? Balance sheets are designed to indicate the net worth of an entity. But does the full market value of the art works held by a public art gallery or the historical artefacts in a museum indicate the organisation's true value? This is especially pertinent when one considers that such items are often unique, priceless, irreplaceable, not for sale and never intended to be sold.

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[172] Carnegie G. and West B, How Well Does Accrual Accounting Fit the Public Sector?, Australian Journal of Public Administration, 62(2):83-86, June 2003, p84.

A further consideration in relation to assigning balance sheet values to such items lies in the fact that, once valued and included in the financial statements, these arbitrary figures may be viewed in a way never intended and leading to unsatisfactory consequences. For example, if the market values of art works or other heritage assets are used in determining capital use charge transfer payments, the holding of these items may become financially impossible and they could possibly be transferred to the private sector.[173]

Such issues have not been thoroughly considered in the rush to implement accrual reporting in the Australian public sector and need to be thoroughly reviewed to provide an appropriate long term solution.

Another issue in relation to accrual financial reporting is the treatment of depreciation expense. The current situation in the Commonwealth public sector is that depreciation is fully funded. That is, the depreciation expense calculated to match the life cycle of the relevant asset are paid in cash to the responsible agency as part of its annual appropriations. Thus requiring agencies to become experts in the management of large amounts of cash that may not be needed for many years. There are many obvious risks in such a strategy and it assigns duties to agencies in areas in which they have no or little experience. Further, poor management techniques coupled with the temptation to use funded depreciation reserves for operational needs sets the scene for possible serious financial problems in the years to come.

A capital use charge is a cash payment from agencies to central government in recognition of the cost of capital assets which the agency controls and uses in delivering services. The capital use charge in the Commonwealth has been levied at a rate of 12 percent. In some cases this charge can amount to millions of dollars. This in another perfect example of how accrual accounting principles can complicate rather than simplify government financial management processes. The capital charge is, however, in the process of being discontinued in the Australian Commonwealth public sector.

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[173] Carnegie G. and West B, How Well Does Accrual Accounting Fit the Public Sector?, Australian Journal of Public Administration, 62(2):83-86, June 2003, p85.

The above section has attempted to highlight some of the specific areas, in relation to accrual reporting in the public sector, that need further consideration to achieve the transparency and efficiency benefits said to stem from a switch to accrual accounting. This is not the say that accrual accounting in its self is not appropriate in the public sector. But more that the public sector has special needs not considered in accounting systems designed for application in the private sector, and therefore a direct transfer of private sector principles can not be meaningfully made.

6.1.2 Whole of Government Reporting

The Australian Commonwealth Government is made up of various sectors. The division made by the Government Finance Statistics (GFS) framework separates the Commonwealth public sector into Public Financial Corporations, Non-Financial Public Sector, General Government Sector and Public Non-Financial Corporations. All of these combined make up the Total Public Sector (for further information see Financial Reporting Standards).

Whole of government reporting refers to a view of the overall financial position of government and is prepared by consolidating the financial statements and transactions of all controlled entities.[174] Control is determined in accordance with Australian Accounting Standard 24 "Consolidated Financial Reports" (see Financial Reporting Standards for further details) and is generally said to exist when the government has the ability to dominate the financial and operating policies of the entity.

The Commonwealth began trialing whole of government or consolidated financial reports in the mid 1990's. The first official consolidated financial statements for the Commonwealth public sector were prepared for the 1999/2000 financial year.

Even in government issued documents, questions have been raised as to the meaningfulness and comparability of Commonwealth whole of government financial reports.[175] This is not to say that there is no point in producing them, as whole of government financial statements provide a more detailed picture of the government's

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[174] Guthrie J., Application of Accrual Accounting in the Australian Public Sector – Rhetoric or Reality?, Financial Accountability & Management, 14(1), February 1998, p2.
[175] Commonwealth of Australia, National Commission of Audit, Report to the Commonwealth Government, June 1996.

overall financial position than the traditional cash reports, but rather that care must be taken in interpreting the information contained in them. This is especially important in comparisons with other jurisdictions of government in Australia or overseas jurisdictions.

The issues discussed above under the heading of Accrual Financial Reports apply also to the whole of government reports, given that they are merely a consolidation of the individual accrual financial statements.

6.1.3 Accrual Outcome and Output Budgeting

Traditional cash budget frameworks of the public sector served the purpose of controlling departmental expenditure by limiting spending to the amounts published in the budget and appropriated to agencies. One public official in Australia has referred to this as the 'Jam-jar' approach, that is, 'This is your jar of money, don't spend more than that'.[176] Exponents of performance budgets, a group to which outcome and output budgets belong, argue that public sector budgets should be concerned with more than pure cost control. It is argued that public sector budgeting should also serve as a key instrument for maximising efficiency and effectiveness in the delivery of government services, by focusing on the results or outcomes achieved with a given amount of resources, not solely with the amount of resources consumed.[177]

There are many variants on the performance budget model, and even within Australia the budget frameworks of the state governments vary from one state to another. The model applied in the Commonwealth public sector is again a unique system purpose built for application in that jurisdiction.

Robinson M., in his 2002 paper Output-Purchase Funding and Budgeting Systems in the Public Sector, describes an output funding budget system in its pure form. According to Robinson, a pure output funding budget system possesses two core properties. Firstly, the funding, or payments to agencies are a function exclusively of the quantities of

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[176] Campbell C., Juggling Inputs, Outputs, and Outcomes in the Search for Policy Competence: Recent Experience in Australia, Governance: An International Journal of Policy and Administration, Vol. 14, No. 2, April 2001, p277.

[177] Robinson M., Financial Control in Australian Government Budgeting, Public Budgeting & Finance, Spring 2002, p81.

outputs (of a defined quality) delivered by the agency. Where outputs are goods or services delivered by an agency to external parties. The simplest form of output funding is where a fixed per unit price is paid for each type of output delivered by an agency.[178] Further, payments are made on a results basis, therefore, if the output quantity is less than expected the payment is reduced accordingly.

Secondly, the fixed unit price described above is based on the efficient cost of production or best practice, rather than the actual costs incurred by the agency in producing the output. Under this system, agencies that are producing inefficient outputs will incur a financial loss. This has been one of the main reasons for the drive to introduce business style accrual operating statements alongside an output funding budget system, so as to allow the bottom line profit or loss to be used as a measure of efficiency.[179]

The theoretical pure output funding framework described above is useful from an analytical or academic perspective, however, its application in the real world would be near to impossible. Even output funding systems that are currently in operation include significant elements of activity based and even input based funding.[180]

The Australian Commonwealth government, in comparison to the various State governments, has made a serious effort to apply the principles of output based funding. One element through which this has been done is the use of purchase agreements between each agency and the Department of Finance and Administration. Under these agreements, a significant portion of funding to agencies is provided in association with per unit prices paid for a range of outputs.[181] To assist in this area agencies are encouraged to develop generic outputs which are comparable across the Commonwealth public sector. However, by no means is all funding provided based on per unit prices. A large proportion of funding for fixed and variable costs associated with outputs are effectively included in agencies base funding. Further, the application of funding on the

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[178] Robinson M., Output Purchase Funding and Budgeting Systems in the Public Sector, Public Budgeting & Finance, Winter 2002, p19.
[179] Robinson M., Output Purchase Funding and Budgeting Systems in the Public Sector, Public Budgeting & Finance, Winter 2002, p20.
[180] Robinson M., Output Purchase Funding and Budgeting Systems in the Public Sector, Public Budgeting & Finance, Winter 2002, p23.
[181] Robinson M., Output Purchase Funding and Budgeting Systems in the Public Sector, Public Budgeting & Finance, Winter 2002, p24.

basis of efficient or best practice costs has also shown little take up in the Australian public sector, either at the Commonwealth or State levels.

The budgeting framework implemented in the Commonwealth public sector in recent years boasts that it has a stronger focus on outcomes than budgeting models implemented in other jurisdictions.[182] However, although the appropriation of monies to agencies occurs officially, and from a legal perspective in relation to the Constitution, under the guise of outcome appropriations, these represent a notional split of outputs across those outcomes.

A further problem in the Commonwealth public sector arises in the area of clear and meaningful outcome and output specifications. One can appreciate this situation given the inexperience of public officials with the new system. This was noted in the Senate Finance and Public Administration Legislation Committee's Report, The Format of the Portfolio Budget Statements – Second Report (October 1999). The report states that the committee is not unduly concerned with the lack of consistency in the level of specificity in the outcomes and outputs framework. For example, many agencies detailed as outputs items that would be better defined as processes in delivering outputs.[183] This is interesting particularly given the Commonwealth's desire to move away from the New Zealand framework, where it was considered that many outputs were actually processes or groups of inputs, rather than something delivered to customers.[184] The committee went on to say that over time, and with experience, it is probable that a greater level of consistency will evolve.[185]

Not only specification issues are causing problems in the Commonwealth outcomes and outputs framework, the fact that ministers and other members of parliament (especially members of the Senate Estimates Committees) are having difficulties understanding the

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[182] Campbell C., Juggling Inputs, Outputs, and Outcomes in the Search for Policy Competence: Recent Experience in Australia, Governance: An International Journal of Policy and Administration, Vol. 14, No. 2, April 2001, p277.
[183] Commonwealth of Australia, The Format of the Portfolio Budget Statements – Second Report, Senate Finance and Public Administration Legislation Committee, October 1999, c 3.
[184] Campbell C., Juggling Inputs, Outputs, and Outcomes in the Search for Policy Competence: Recent Experience in Australia, Governance: An International Journal of Policy and Administration, Vol. 14, No. 2, April 2001, p277.
[185] Commonwealth of Australia, The Format of the Portfolio Budget Statements – Second Report, Senate Finance and Public Administration Legislation Committee, October 1999, c3.

system is not helping things.[186] Discussions with Commonwealth officials have indicated that agencies may, in the future, be required to supply information on a broad program basis as well as the current outcomes and outputs information to make the system more understandable and manageable for parliamentarians.

A closer look at the budget documentation prepared under many outcomes and output frameworks reveals that there are significant similarities to the documentation produced under the previous input based systems. Given this, one could question the extent to which internal management processes have fundamentally changed as a result of accrual outcome and output budgeting.[187]

The issues identified here do show that accrual outcome and output budgeting, as it exists in practice, will not fulfil all of the expectations with regards to improved accountability, efficiency and effectiveness which have been promoted by its exponents. This is not to say that it can not make significant contributions to public sector management, but rather that there is still a divide between outcome and output budgeting theory and its application in the real world.

6.1.4 The Purchaser / Provider Split

Private sector market based theories have been the main inspiration for many of the reforms that have been working their way into the public sector over the last two decades. One of these is agency theory, where the general proposition is that those in control of resources will serve their own interests rather than the interests of those who own the resources.[188] In the case of the public sector, the government and its ministers are considered to be the owners of the resources and the agencies that deliver services those in control of the resources.

The purchaser / provider model is based on applying the principle of conducting dealings between the government and service delivery agencies on a contract basis, in

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[186] Campbell C., Juggling Inputs, Outputs, and Outcomes in the Search for Policy Competence: Recent Experience in Australia, Governance: An International Journal of Policy and Administration, Vol. 14, No. 2, April 2001, p278.

[187] Carlin T. and Guthrie J., Lessons from Australian and New Zealand Experiences with Accrual Output-Based Budgeting, Learning from International Public Management Reform, Vol. 11, p89-100, 2001, p 98.

[188] Stewart J., Research Note: Purchaser Provider – Are the Purchasers Ready for It?, Australian Journal of Public Administration, Vol.58, Issue 4, December 1999, p105.

which the purchaser of services (the government) specifies the services or products it wishes to purchase from the providers (agencies) and these are detailed in contracts or agreements between the two parties.

The proponents of purchaser / provider arrangements claim that by splitting the hierarchical organisations of the public sector and introducing contract based relationships, purchasers will be able to obtain more accurate information about costs by:

- subjecting providers to competition, or at least the threat of it;
- benchmarking providers against each other; and
- forcing providers to specify the exact nature of the goods and services they will supply for a specified price.[189]

Such purchaser / provider agreements are not restricted to relationships between government and agencies. Various forms of market type contract specified relationships can and do exist where agencies contract with each other and agencies or government contract with private sector organisations.

Market type relationships have much to offer the public sector in terms of providing clearer information about the expectations of both parties and providing a framework through which these expectations can be measured, both during and after the contract period. However, given the heterogeneity of many government services and the difficulty in measuring performance, coupled with the fact that it would be near to impossible to provide many services except through in-house methods, the classical contracting model can not be widely applied[190]. When one takes a look at real world business relationships in the private sector it is obvious that this strict adversarial type relationship is often replaced by partnershipping and cooperative arrangements. And

[189] Stewart J., Research Note: Purchaser Provider – Are the Purchasers Ready for It?, Australian Journal of Public Administration, Vol.58, Issue 4, December 1999, p105.
[190] Robinson M., Output Purchase Funding and Budgeting Systems in the Public Sector, Public Budgeting & Finance, Winter 2002, p31.

this is probably where the public sector can learn most from the market in terms of contracting arrangements.[191]

This sentiment was echoed by one Commonwealth Department of Finance official interviewed by Colin Campbell in 1998, who said "we are trying to focus on partnerships rather than a purchaser / provider arrangement. In order to achieve the sort of outcome / impacts that the government wants to achieve, they need to have support from the professionals and experienced agencies to give them guidance on how to best shape the outcomes they want".[192] However, there are numerous cases of purchaser / provider arrangements in the Commonwealth, for example, the relationship between Family and Community Services and Centerlink. Further, the accrual outcome and output budgeting arrangements implement what is essentially, although not formally, a purchaser / provider management and reporting framework.[193]

When implementing a purchaser / provider model it is often assumed that many of the technical and financial functions can be easily contracted out. The rational for doing so lies in the belief that competition between providers will offer more cost effective services than can be supplied in-house and that competition will flush out the hidden costs that exist in traditional hierarchical organisations.[194]

These advantages are not automatically present, and the conditions needed to make efficiency gains through competition require an environment where competition will function. It is this environment that is often difficult, or in some cases impossible, to construct in a public sector context.

Further, the efficiency gains offered by purchasing services from organisations operating in a competitive environment may be outweighed by the additional costs associated with the drafting of tenders and the management and enforcement of contracts.

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[191] Robinson M., Output Purchase Funding and Budgeting Systems in the Public Sector, Public Budgeting & Finance, Winter 2002, p32.

[192] Campbell C., Juggling Inputs, Outputs, and Outcomes in the Search for Policy Competence: Recent Experience in Australia, Governance: An International Journal of Policy and Administration, Vol. 14, No. 2, April 2001, p278.

[193] Stewart J., Research Note: Purchaser Provider – Are the Purchasers Ready for It?, Australian Journal of Public Administration, Vol.58, Issue 4, December 1999, p105.

[194] Stewart J., Research Note: Purchaser Provider – Are the Purchasers Ready for It?, Australian Journal of Public Administration, Vol.58, Issue 4, December 1999, p108.

The implementation of purchaser / provider arrangements also assumes that public sector staff, who have traditionally undertaken clerical functions in a strict hierarchical system, can suddenly and without adequate training become effective contract negotiators and managers.[195] In addition, the public sector staff who have detailed technical experience in the provision of services often leave the public sector and move to the private provider organisations, leaving an information void in the areas which now must be up to the task of negotiating, managing and enforcing complicated and detailed contracts in a market environment.

Not withstanding these weaknesses, properly managed purchaser / provider frameworks offer a substantial increase in the information available about government services. In doing so this requires politicians to more closely consider long term and interrelated policy issues, match them against political and commercial risks and prioritise the use of resources to support policies or deliver services.[196]

It may be the case that significant cost savings are not made in all cases where purchaser / provider arrangements are applied, but the information and transparency aspects can not be overlooked. This is not to say that the purchaser / provider model is suitable in all situations, and there is enough evidence that in many jurisdictions agencies are bringing some outsourced operations back in-house, but with selective rather than across the board application there are significant gains to be achieved through purchaser / provider arrangements in the delivery of government services.

6.1.5 Appropriation of Monies under Accrual Budgeting

The term ‘appropriations’ refers to the method by which Parliament allocates funds to agencies. The appropriations process is of significant importance in terms of Parliament’s control over agency expenditure. The appropriations process between jurisdictions can vary significantly, as it is a system that has evolved over many years and is to some extent a product of the budgeting and financial control frameworks applicable in each jurisdiction.

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[195] Baxter K., A Response to the Research Note: Purchaser Provider – Are the Purchasers Ready for It?, Australian Journal of Public Administration, Vol.58, Issue 4, December 1999, p111.

[196] Baxter K., A Response to the Research Note: Purchaser Provider – Are the Purchasers Ready for It?, Australian Journal of Public Administration, Vol.58, Issue 4, December 1999, p111.

In the Australian Commonwealth public sector the Constitution requires that for any monies to be drawn from the Treasury of the Commonwealth it must be done so under an appropriation made by law. This effectively means that all appropriations are laws passed by Parliament. Such a requirement secures the ability for Parliament to scrutinise agency expenditure, and can be described as legislative financial controls.[197]

In the Australian Commonwealth context there are two main types of appropriations; annual appropriations and special (or standing) appropriations. Annual appropriations are separated into those relating to ordinary annual services of government (Appropriation Bill No. 1) and those for purposes other than ordinary annual services of government (Appropriation Bill No. 2). Appropriation Bill No. 1 sets out agency appropriations by outcome and distinguishes between departmental and administered expenses. The data in Appropriation Bill No. 1 is highly aggregated and in order to make sense of that data it must be read in conjunction with the Portfolio Budget Statements.[198] Appropriation Bill No. 2 covers items such as; expenses in relation to grants to the States and capital injections.

Probably one of the most significant problems associated with the Commonwealth appropriations process lies in the fact that annual appropriations account for approximately only 25 percent of agency expenses, with special (or standing) appropriations making up the bulk of the remaining 75 percent. The legal footing for special (or standing) appropriations usually lies in other Commonwealth legislation. For example, spending on roads is authorised through the Australian Land Transport Act 1998, the Roads to Recovery Act 2000 and the Local Government (Financial Assistance) Act 1995.[199] Unlike annual appropriations, special (or standing) appropriations are not subject to annual review by parliament and are of a distinct program nature. It is this program nature of special (or standing) appropriations that is causing difficulties for parliamentary spending review committees, such as the Senate Estimates Committees, to make meaningful comparisons between the outcome and

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[197] Robinson M., Financial Control in Australian Government Budgeting, Public Budgeting & Finance, Spring 2002, p82.
[198] Commonwealth of Australia, Commonwealth Budget: Process and Presentation (April 2003), IRS Publications, 2003, p16.
[199] Commonwealth of Australia, Commonwealth Budget: Process and Presentation (April 2003), IRS Publications, 2003, p16

output information presented in the Portfolio Budget Statements and the specific appropriation acts approved by Parliament. For this reason, there are currently proposals that Commonwealth agencies should prepare an additional tier of information on a program basis that more closely represents the underlying appropriations.

This would, to some extent, indicate that the move to budgeting and reporting on an outcome and output basis has complicated rather than simplified the expenditure control process entrusted to parliament. This is not to say that budgeting and reporting on an outcome and output basis does not have advantages but that the underlying appropriation process must also be reformed to more closely represent the information being prepared by agencies.

6.1.6 Performance Reporting

Performance reporting and the linking of it to the budget process has often been used as one of the major justifications for the implementation of accrual outcome and output budgeting. Australian Commonwealth public sector agencies, in their Portfolio Budget Statements, are required to set out the indicators they will use to measure performance in terms of efficiency and effectiveness against planned outcomes. Actual results against these indicators are reported on in the annual reports of agencies.

The usefulness of performance information currently supplied by Commonwealth agencies has been the subject of significant criticism. Of these criticisms, the following will discuss three specific issues. Firstly, the introduction of reporting against outcomes, which can be described as the impact sought or expected by the government in a particular policy area, is complicated by the fact that external forces impact on outcome results making it difficult if not impossible to measure the contribution of an agency to a particular outcome in isolation from other influences.[200]

Secondly, to be able to make sense of specific performance information an adequate knowledge base is required. The primary arena for scrutiny of performance information should be the Senate Estimates Committees, however, as noted in official government reports the vagaries of political life frequently work against the acquisition of such a

[200] Commonwealth of Australia, Commonwealth Budget: Process and Presentation (April 2003), IRS Publications, 2003, p37.

knowledge base. There are naturally individual senators who develop expertise in a given subject area but this is largely a random process.[201]

Thirdly, many of the performance indicators included in Portfolio Budget Statements and annual reports were developed by agencies for internal operational purposes without adequate consideration of the purpose of performance information in the broader whole of government accountability context.[202]

Whilst indicating that there are difficulties in managing a performance information system that reports against outcomes, it should not be said that performance reporting itself can not advance significant improvements in the public sector management.

6.2 Future Challenges

The last five or so years has seen the Australian Commonwealth public sector undergo rapid and extensive reform of its financial management framework. This process of rapid change has brought both advantages and problems with it. It is recognised both from within and from outside the Commonwealth that the reforms will need continuous refining in order to derive the full benefits from them.

In terms of financial reporting, the core challenges lie in the way that assets and liabilities are valued and treated in the statements, how capital assets are depreciated and how to deal with cost of capital issues. It can be seen that these issues relate more to balance sheet items than to the operating statement. There may be some contentious issues in terms of the treatment certain revenue and expense items, but the main issues for the Commonwealth public sector, and indeed all public organisations, are the special issues relating to the assets and liabilities of government. This is where the greatest challenges exist for public sector accrual financial reporting.

On the budgeting side, the Commonwealth selected a budgeting system focused strongly on outcomes. These outcomes are linked to underlying outputs, but the actual parliamentary appropriations are made on the basis of outcomes, giving these more

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[201] Commonwealth of Australia, The Format of the Portfolio Budget Statements – Second Report, Senate Finance and Public Administration Legislation Committee, October 1999, c5.
[202] Commonwealth of Australia, Performance Information in Portfolio Budget Statements, Australian National Audit Office, Audit Report 18, 2001-02, November 2001, p14.

weight than in any other national public sector. One of the greatest problems with managing and appropriating on the basis of outcomes is that they are difficult to accurately define and measure. Should the Commonwealth wish to continue with a strong focus on outcomes there are great challenges in dealing with the inaccuracies and vagaries of outcome based information. Further, there are significant challenges for the Commonwealth public sector in coming to terms with the contractual type relationships that are accompanied by a move to a purchaser / provider model.

However, on balance there are significant benefits, and not only challenges, for the Commonwealth in refining and improving the financial management framework that has been implemented in recent years.

Conclusion

As this paper has shown, the financial management reforms undertaken in the Australian Commonwealth public sector since the mid 1990's have brought deep and fundamental change.

The introduction of private sector based accrual accounting principles to both the financial reporting and budgetary processes has set the general tone of the reform package.

The financial reporting framework is based on external reporting standards, with the strongest emphasis on the Australian Accounting Standards. These are the same requirements as for private sector organisations in Australia and there are only limited areas in which special provisions have been made for public sector organisations.

The responsibility for financial record keeping and accounting processes have to a large extent been devolved to agencies. The central accounting software package of the Commonwealth holds fairly high level information, which is periodically updated by agencies.

The budget process was simultaneously, with the reporting framework, moved to an accrual footing and is based on a system of outcomes and outputs. The introduction of the outcomes and output based budgetary framework brought with it a system of performance reporting which is linked to the budget and the principles of a purchaser / provider split.

As detailed in Chapter 6, these radical reforms have not always brought the synergies and improvements in performance that were expected by their proponents. There are a number of reasons for this. Including:

- the general difficulties of applying accrual accounting systems, developed in the private sector, to public organisations without adequate consideration of their special needs;

- the difficulties involved in the specification of outcomes and outputs, particularly when they will be used as the basis for government funding;
- the problems associated with measuring the contributions made by agencies towards outcomes, especially where significant external factors can influence the outcome area;
- the lack of experience by public sector staff in managing the complex market based issues associated with purchaser / provider arrangements; and
- that parliamentarians and other users of the information generated by the new framework are finding it difficult to understand.

Whilst these and other issues may have reduced the level of the benefits expected through the reforms, it would be incorrect to say that no benefits have been achieved. There is no question that the level of financial information captured by the new system is in excess of that captured under the previous cash arrangements. Further, the cultural changes towards a more outcome or results focused public sector is assisted by the outcomes and output based budgeting framework. On balance the benefits of the reform process do outweigh the problems. However, significant improvements are still needed if the framework is to deliver all benefits expected prior to its implementation.

Definitions

accrual accounting means that assets, liabilities, revenues and expenses arising from transactions or other events must be recognised in the financial statements when they have an economic impact, regardless of when the associated cash flows occur

actual outcomes are the results or impacts actually achieved.

administered items are those areas controlled by the government and administered by agencies on its behalf. Annual appropriations for administered items are classified and made on the basis of their intended outcomes.

agencies are Departments of State, Parliamentary Departments, and other agencies prescribed under the financial management legislation

appropriations are the formal and only constitutional method of transferring funds to agencies. The Constitution states: 'no money shall be drawn from the Treasury of the Commonwealth except under appropriation made by law'

assets means the future economic benefits controlled by the entity as a result of past transactions or other events

controlled entity means an entity over which the government has the capacity to dominate financial and operating policies so as to enable that other entity to operate with it in pursuing its own objectives

departmental items are items over which the agency has control. They are appropriated as a single amount for each agency and represent the price to be paid for the outputs delivered by the agency

depreciable asset means a non-current asset having a limited useful life

entity means any legal, administrative, or fiduciary arrangement, organisational structure or other party (including a person) having the capacity to deploy scarce resources in order to achieve objectives

equity injections and loans are the means by which the government can introduce new capital into an agency. Equity injections will be approved when a significant and permanent increase in an agency's operating capacity is warranted

equity means the residual interest in the assets of the entity after deduction of its liabilities

expenses means consumptions or losses of future economic benefits in the form of reductions in assets or increases in liabilities of the entity, other than those relating to distributions to owners, that result in a decrease in equity during the period

fair value means the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arms length transaction

financial statements means an operating statement a statement of financial position and a statement of cash flows, including accompanying notes containing detailed information relating to the financial performance and financial position of the entity

general purpose financial report means a financial report intended to meet the information needs common to users who are unable to command the preparation of reports tailored so as to satisfy, specifically, all of their information needs

liabilities means the future sacrifices of economic benefits that the entity is presently obliged to make to other entities as a result of past transactions

non-reciprocal transfer means a transfer in which the entity receives assets or services or has the liabilities extinguished without directly giving approximately equal value in exchange to the other party or parties to the transfer

outcomes are the results, impacts or consequences of actions by the government on the community.

outputs are the goods and services produced by agencies on behalf of the Government for external organisations or individuals. Outputs include goods and services produced for other areas of government external to the agency

output budgets are a form of program budgeting with government funding based on the price of outputs delivered

planned outcomes are the results or impacts that the government intends to achieve.

purchaser / provider is a split in the hierarchical structures of government organisations between those areas that purchase services and those areas that provide services

reciprocal transfer means a transfer in which the entity receives assets or services or has liabilities extinguished and directly gives approximately equal value in exchange to the other party or parties to the transfer

reporting entity means an entity (including and economic entity) in respect of which it is reasonable to expect the existence of users dependent on general purpose financial reports for information which will be useful to them for making and evaluating decisions about the allocation of scarce resources

revenues means inflows or other enhancements, or savings in outflows, of future economic benefits in the form of increases in assets or reductions in liabilities of the entity, other than those relating to contributions by owners, that result in an increase in equity during the period

the going concern means that an entity is viewed as an ongoing operation. It assumes that the entity will continue to use its resources or assets to produce goods and services.

whole of government accounts means financial statements prepared in a consolidated format, encompassing all assets, liabilities, expanses and revenues, regardless of whether they arise directly or through its controlled entities.

Abbreviations

AAS – Australian Accounting Standard

ABS – Australian Bureau of Statistics

AIMS – Accrual Information Management System

AOOB – Accrual Outcomes and Output-based Budget

APS – Australian Public Service

ATM – Adjustment Tracking Module

CAMM – Cash and Appropriation Management Module

ERC – Expenditure Review Committee

FMO – Finance Ministers' Orders

GFS – Government Finance Statistics

IMF – International Monetary Fund

MYEFO – Mid Year Economic and Fiscal Outlook

OPA – Official Public Account

PBS – Portfolio Budget Statements

SLC – Senate Legislation Committee

SNA – System of National Accounts

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Attachments

Attachment 1 – Government Finance Statistics Statements 2002-03

Attachment 2 – Australian Accounting Standard No. 31 Financial Statements 2002-03