

# **Monitoring and Reporting Financial and Non-financial Performance of Australian Government Organisations**

Australian National Audit Office / CPA Australia

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Performance of Australian Government Organisations**

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# Preface

This paper is part of a major project: *Corporate Governance in the Public Sector: An Evaluation of its Tensions, Gaps and Potential*. The project will provide the first comprehensive theoretical and empirical work on corporate governance in the Commonwealth public sector. It has been designed to enhance communication and participation in governance across government, industry, and the community by improving corporate governance literacy and making information publicly available.

The project is a collaborative venture between the University of Canberra; Macquarie University; and key governmental and industry partners including the Australian National Audit Office (ANAO), the Australian Government Department of Finance and Deregulation, Deloitte Touche Tohmatsu, CPA Australia, and Minter Ellison Lawyers.

This paper is the fifth in a series that is being produced by researchers and industry partners involved in the project. The aim of the series is to identify and explore key emerging public sector governance issues and encourage wider discussion and activity.

The series has been designed for public sector practitioners and corporate governance ‘enthusiasts’ across the public and private sectors. All papers will be broadly distributed and will be available online at: [www.canberra.edu.au/corpgov-aps](http://www.canberra.edu.au/corpgov-aps).

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*Corporate Governance in the Public Sector: An Evaluation of its Tensions, Gaps and Potential*  
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## **1. Background**

Measuring programme performance in the public sector has always been a challenge because results are not measured in dollars alone, and it is difficult to secure agreement on how best to determine the effectiveness of government programmes. Yet it is important that we continue efforts to improve measures of the effectiveness of government programmes, and how they may be better targeted to achieve the outcomes expected by government. Taxpayers expect their governments to deliver value for money, and governments in turn are entitled to the best advice they can get from the public service on policy and delivery options, and on programme performance.<sup>1</sup>

In this context, a common approach worldwide is for governments to express the range of programmes delivered in the context of a generic framework. For the Australian Government, this has evolved from the programme budgeting and management approach of the start of the reform era in the early 1980s to the current framework focused on outcomes and outputs, introduced in 1999–2000.

The accrual-based outcomes and outputs framework was viewed as a key component in creating a more competitive, efficient and effective public sector, and to provide a more complete picture of performance, including financial performance, for decision making and accountability. Under the framework, managers were to have better and more complete information on which they could manage their operations and be accountable to government and the Parliament on their performance.<sup>2</sup> Supporting the outcomes and outputs framework are a number of other avenues for monitoring and reporting the performance of Australian Government organisations, for example Parliamentary Committees, the Auditor-General and the Productivity Commission.

The paper provides a high-level review of major elements for monitoring and reporting financial and non-financial performance of Australian Government organisations, drawing on recent work undertaken by the author organisations, the Australian National Audit Office (ANAO) and CPA Australia, as well as broader literature.

The paper has five further sections. Section 2 provides an overview of the framework for monitoring and reporting the performance of Australian Government organisations, while Section 3 examines the implementation of the framework. Section 4 outlines the framework for monitoring the financial performance of Australian Government organisations, while Section 5 examines key issues in the operation of this framework. Section 6 provides concluding remarks.

## **2. Overview of the Framework for Monitoring and Reporting the Performance of Australian Government Organisations**

### **Introduction**

The Australian Constitution creates a framework within which the Executive Government receives and may spend money. Taken together, the requirements of section 81, section 83 and section 97 (governing accounting and audit) create a regime for the Parliament to exercise control over and require accountability for Executive Government spending. The Constitutional concepts of the Consolidated Revenue Fund (CRF) and appropriations safeguard the Parliament's ultimate control over public expenditure.

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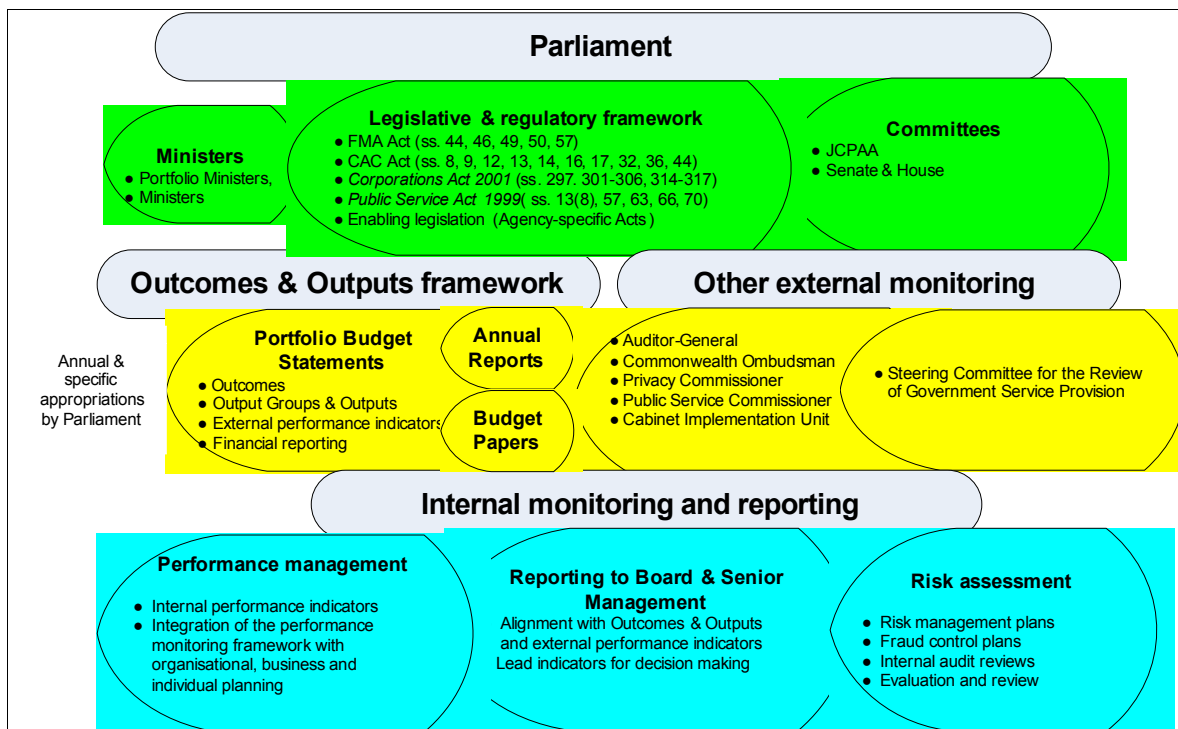
<sup>1</sup> McPhee, 2005, p.2.

<sup>2</sup> Department of Finance and Administration 1998.

Within this constitutional framework, in April 1997, the Australian Government decided to implement an accrual-based outcomes and outputs framework for managing resources in the public sector. The first Budget prepared under the new accrual framework was in 1999–2000. The outcomes and outputs framework was intended to shift the focus from inputs to an orientation on results. Previously, annual appropriations were made in two parts. Running costs for each organisation were appropriated as a single amount. Appropriations for other services, in many cases individual programmes, were appropriated as individual line items. Appropriating to outcomes, which commonly amalgamated more than one programme, was expected to allow for better information for decision making by government and assist the Parliament in its scrutiny of government programmes and performance.<sup>3</sup>

While the outcomes and outputs framework is the key component for managing resources in the public sector, there are many other elements that contribute to the measurement of the performance of Australian Government operations, as Figure 1 illustrates.

Figure 1: Framework for Monitoring and Reporting the Performance of Australian Government Organisations



Source: Australian National Audit Office.

As part of parliamentary governance, a Minister provides details of planned performance in agency Portfolio Budget Statements (PBS), with results being reported later in annual reports. The Department of Finance and Deregulation (Finance) issues guidelines for all Commonwealth agencies in relation to the development of both the PBS and the definition of outcomes and outputs. The Department of the Prime Minister and Cabinet prepares and issues the requirements for the preparation of annual reports, following approval by the Joint Committee of Public Accounts and Audit (JCPAA).

The federal Parliament has a well-developed scrutiny process with an extensive range of committees, some specialising in Budget estimates, performance forecasts and achievements of particular portfolios, while others take an overall interest in the maintenance of an appropriate

<sup>3</sup> McPhee, 2005, p.3.

accountability regime. However, performance is generally monitored and reported on an agency basis. It is generally not aggregated in a systematic way to reflect achievements against the main objectives of the Australian Government.

### **Legislative and regulatory framework**

The framework for financial and non-financial performance monitoring and reporting depends on the type of Australian Government organisation, and the key legislation underpinning its administration.

The major classes of organisation are:<sup>4</sup>

- Departments of State — these are part of the Commonwealth and subject to the *Financial Management and Accountability Act 1997* (FMA Act) and the *Public Service Act 1999* (PS Act)
- Departments of the Parliament — these are part of the Commonwealth and are subject to the FMA Act and the *Parliamentary Service Act 1999*
- Prescribed agencies — these are established by an enabling Act, are subject to the FMA Act and are generally subject to the PS Act
- Commonwealth authorities — these are established by an enabling Act or by regulations under an Act, are subject to the *Commonwealth Authorities and Companies Act 1997* (CAC Act) and may also be subject to the PS Act, and
- Commonwealth companies — these are subject to the *Corporations Act 2001* and the CAC Act but are generally not subject to the PS Act.

Section 44 of the FMA Act requires that the chief executive manages the affairs of the agency in a way that promotes the efficient, effective and ethical use of Commonwealth resources. An adequate performance monitoring and reporting framework is necessary to enable the chief executive to demonstrate that he or she has used resources efficiently, effectively and ethically. Further, the FMA Act specifies key elements of performance measurement, including for annual and interim reporting, (ss. 49–50), audit of financial statements (s. 57) and the conduct of audit committees (s. 46).

The CAC Act regulates the corporate governance, financial management and reporting arrangements in relation to Commonwealth authorities and companies. The principal reporting matters covered by the CAC Act include: annual reporting by Commonwealth authorities and Commonwealth companies to a Minister, and through the responsible Minister, to the Parliament; contents of the annual report of operations of an authority; and audit of financial statements of authorities and companies by the Auditor-General. Under s. 9 of the CAC Act, Commonwealth authorities must submit an annual report to the Minister. The authority's enabling legislation may contain additional reporting requirements. Provisions concerning the general responsibilities and legal liabilities of directors of Commonwealth authorities are also in the CAC Act; equivalent duties for Commonwealth companies may be found in the *Corporations Act 2001* — duties such as acting with care and diligence and in good faith, and avoiding improper use of position and information.<sup>5</sup>

### **External bodies that monitor and report on the performance of Australian Government organisations**

There are often several external bodies to which Australian Government organisations are accountable or to which they are required to provide information on their performance and/or

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<sup>4</sup> ANAO 2003b, Guidance Paper No.1, p.1.

<sup>5</sup> *ibid.* Guidance Paper No.3, p.2.

conformance with regulatory requirements. Key external accountability institutions include:

- the Parliament, especially relevant committees such as the JCPAA, and the various Senate, House of Representatives and Joint Committees
- the Auditor-General, who is responsible to the Parliament for conducting both financial and performance audits in the Commonwealth and with whom organisations often liaise on such matters as internal audit arrangements and sound administrative practice
- the Commonwealth Ombudsman, who has the power to investigate complaints about Commonwealth or Australian Capital Territory Government organisations' actions and consider whether they are unlawful, wrong, unjust or discriminatory
- the Privacy Commissioner, who has responsibilities under the *Privacy Act 1988* and who assists citizens who have privacy complaints relating to Commonwealth or Australian Capital Territory Government agencies, consumer credit reporting activities, tax file numbers and spent convictions
- the Australian Securities and Investments Commission (ASIC), which is responsible for enforcing company and financial services laws to protect consumers, investors and creditors. Most Government Business Enterprises are subject to the *Corporations Act 2001* and thus subject to oversight by ASIC, and
- the Courts, which may be called upon to scrutinise the actions or decisions of Commonwealth bodies, for example, in reviewing a tender process on the action of an unsuccessful tenderer.

The Productivity Commission acts as the Secretariat for the Steering Committee for the Review of Government Service Provision. The review is conducted by a joint Commonwealth/State and Territory working party, and annually publishes data that compare the efficiency and effectiveness of Commonwealth and State government services. The review also assesses service provision reforms that have been implemented or are under consideration by Commonwealth and State governments.

The Office of Best Practice Regulation, which is part of the Department of Finance and Deregulation has a central role in assisting departments and agencies to meet the Australian Government's regulatory impact analysis requirements and in monitoring and reporting on their performance. It also serves a similar role for the Council of Australian Governments (COAG) in relation to national regulatory proposals.

The Cabinet Implementation Unit was established late in 2003 to work with agencies to ensure timely and effective implementation of government decisions. The Unit, located in the Department of the Prime Minister and Cabinet, identifies policy proposals that should include an implementation plan; examines systemic issues that determine the effectiveness of implementation; and identifies and supports best practice in project management and programme implementation. The Unit monitors and reports to government on the timeliness of the delivery of key programmes and services, but does not evaluate programme outcomes against policy objectives.

The media, both electronic and print, has a major role in reporting the performance of Australian Government organisations. Public sector managers and politicians are often sensitive to media coverage of public sector administration as it impacts on public perceptions of them. The media has been taking an increasingly prominent role in recent years in the accountability of the public sector.

### 3. Implementation of the Framework for Monitoring and Reporting Non-financial Performance of Australian Government Organisations

#### The outcomes and outputs framework

The essential purpose of the outcomes and outputs framework is to answer four questions: what does government want to achieve (these are the outcomes); how does it want to reach those achievements (outputs and administered items); how does it know if it is succeeding (performance reporting); and how can results be improved. Outcomes are the key results the government seeks to achieve. Outputs are discrete products or services produced or performed by an organisation in order to contribute to outcomes. In order to measure performance, a range of qualitative and quantitative indicators should be developed. Indicators should incorporate a number of better practice characteristics, including having targets and benchmarks.

Outcomes, and the supporting administered and departmental outputs, form the basis of an agency's operating budget and external reporting framework. As Parliament appropriates annual administered monies by outcome, the nature and purpose of the outcome must be sufficiently clear in a legal sense to form a valid appropriation. However, unlike outcomes, the formal and detailed specification of outputs is not part of the legislative requirements for the annual Appropriation Acts — their inclusion for Commonwealth budgeting purposes enables closer links to be established between PBS and agencies' annual reports. This assists the Parliament, Ministers and external stakeholders to scrutinise how appropriated monies will be spent, and to judge how expenditure was used.

Australia has been committed to performance management and budgeting over the past two decades. During this time Australian Government agencies have refined their measurement and performance framework and increased their capacity to monitor performance. Yet practice falls short of aspirations even under these benign conditions for cultivating performance management.<sup>6</sup>

With respect to Australian Government organisations, there have been several reports over the last five years from Parliamentary committees, the ANAO and Finance that have identified aspects of the implementation of the outcomes and outputs framework needing improvement, particularly in the specification and measurement of outcomes.<sup>7</sup> In February 2007 the ANAO concluded in its audit of the implementation of the outcomes and outputs framework that: 'although the application of the outcomes and outputs framework in each of the audited agencies' incorporated some better practice characteristics, each agency had aspects that required improvement'.<sup>8</sup>

In March 2007 the SSCFPA concluded that:

the broad formulation of outcomes has accompanied a loss of program detail and specificity in the appropriation process of the Parliament. This poses challenges for parliamentary scrutiny. Outcomes must be more precisely and meaningfully specified in the appropriations bills and in all other budget documentation.<sup>9</sup>

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<sup>6</sup> Halligan, 2008.

<sup>7</sup> Scrutiny of the outcomes and outputs framework has included: three reports from the then Senate Finance and Public Administration Legislation Committee on the format and content of Portfolio Budget Statements, November 2000; the Joint Committee of Public Accounts and Audit (JCPAA) Report No.388, *Review of Accrual Budget Documentation*, June 2002; the Government's Budget Estimates Framework Review (BEFR) in 2002; and the SSCFPA report *Transparency and Accountability of Commonwealth Public Funding and Expenditure*, March 2007.

<sup>8</sup> ANAO 2007a.

<sup>9</sup> SSCFPA 2007, p.74.

The Committee recommended that outcomes be expressed in clear, simple and measurable terms.<sup>10</sup> In 2002, the JCPAA's recommendation in this area was very similar: 'Agency outcomes statements should be written in clear simple English language to allow for greater transparency'.<sup>11</sup>

Where outcomes statements are at a high level, this can contribute to agencies experiencing difficulties in demonstrating the link between their outputs and the outcomes to which they contribute and can provide limited information for decision-making.<sup>12</sup> While it is difficult in some circumstances to design indicators that effectively measure outcomes, it may be possible to establish second-level indicators (for example, intermediate outcomes) that provide a useful start in linking outputs and outcomes in a meaningful fashion.

While information on outputs tends to be much better than for outcomes, the recent ANAO audit found that:

the development of a comprehensive, relevant and informative regime of performance indicators, as well as having cost-effective systems and processes to capture, monitor and report complete, accurate and relevant agency performance, continued to be challenging for many agencies. In particular, the audit identified that many performance indicators did not enable an assessment to be made on whether desired results were achieved, as the indicators did not incorporate targets, benchmarks or other details of the extent of achievement expected.<sup>13</sup>

In a public sector environment, the development of a relevant and informative performance budgeting and management regime characterised by multiple objectives and stakeholders is inherently a difficult task. The regime required by the framework involves establishing and measuring performance relating to both the effectiveness of an agency's contribution to outcomes and the efficiency of its activities. Agencies often find it challenging to implement all the required elements of such a regime in a manner that reports on effectiveness and efficiency.

There have been a number of developments in recent years that have had a direct or indirect bearing on the way that agencies comply with the requirements of the framework and the extent to which information that is reported in accordance with the framework is utilised by stakeholders. These developments include the reporting to government of programme and cash information and an increasing emphasis on whole of government service delivery.

While information required to be publicly reported under the outcomes and outputs framework will not meet all the information needs of all stakeholders, many agencies have established mechanisms to produce special-purpose reports to better meet particular stakeholder needs. As the PBS and annual report are the two common documents through which agencies discharge their accountability obligations, these documents should provide stakeholders with sufficient, relevant and reliable information so as to facilitate communication and effective decision making. The 'clear read' principle between these two documents (one forecasting outcomes and outputs and associated performance indicators, and the other reporting at the end of the corresponding year against the same outcomes, outputs and indicators) is one of the features of the outcomes and outputs framework that has yet to reach its full potential.

It is not surprising that performance monitoring and reporting comprises a significant proportion of the ANAO's performance audit recommendations and suggestions for improvement. Table 1 shows that the ANAO continues to recommend improvements in agencies' performance information in the majority of its performance audits. However, problems with performance

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<sup>10</sup> *ibid.* p.74. Recommendation 12.

<sup>11</sup> JCPAA 2002, p.37. Recommendation 3.

<sup>12</sup> ANAO 2007a, p.22.

<sup>13</sup> *ibid.* p.23.

information may be abating slightly over time, as 53 percent of audits made recommendations regarding performance information in 2006–07 and 52 percent in 2004–05, compared to 70 and 69 percent in 2000–01 and 1996–97 respectively. The majority of these recommendations have been to improve the quality of data used for performance measures. In addition, a number of recommendations have been made regarding the need to improve outcome and effectiveness indicators.

Table 1: Progress of Australian Government Agencies in Implementing Effective Performance Measurement, ANAO Audit Findings, Selected Years

Indicators	1996–97	2000–01	2004–05	2006–07
Number of performance audits	35	46	48	51
Number of audits with performance information recommendations	24	32	25	27
Percentage of audits with performance information recommendations	69%	70%	52%	53%
Proportion of recommendations agreed or agreed with qualification	All	All	All	All
Percentage of follow-up performance information recommendations that were fully or partly implemented	66%	50%	100%	84%
Type of recommendation (number):				
- outcome	9	9	6	3
- effectiveness	10	11	4	17
- quality of data	28	41	32	23
- for internal management (for example, cost)	14	1	4	4

Source: ANAO performance audit reports, 1996–97 to 2004–05.

The ANAO considers that implementation of the outcomes and outputs framework is ‘work in progress’ and agencies, as part of a continual improvement process, need to improve the measuring and reporting on their performance. In addition, there is scope to adopt a more consistent approach to the reporting of whole of government budget and performance reporting arrangements. The ANAO’s audit of the implementation of the outcomes and outputs framework found that the concept of cross-agency outcomes had not been adopted by agencies.<sup>14</sup>

### Internal monitoring

Internal accountability arrangements should be closely aligned with external requirements. This is both efficient — by reducing reworking of similar material — and effective — by establishing internal arrangements on the basis of broader standards and expectations. This applies to performance planning and monitoring arrangements. To facilitate such coordination, agencies must integrate performance monitoring with business planning processes. This will help ensure that performance information is embedded in the culture of decision making — at both government and agency levels.

As set out in the joint ANAO and Finance publication *Better Practice in Annual Performance Reporting*:

Organisations that have reliable performance information for both external requirements and internal management and review have achieved good performance reporting through some, or all, of the following strategies:

<sup>14</sup> *ibid* p.88.

- establishing a robust performance culture based on public sector values
- maintaining strong links between reporting, planning and management, and
- ensuring strong links between external and internal reporting.<sup>15</sup>

According to Halligan:

The Australian outcomes policy provides for agencies to use performance information in budget decision making, but the potential has not been achieved because of the variable influence of this information on decisions and resource allocation during the process. The Finance Department is exploring means for improving the use of performance information by revising the information required for new policy proposals and making greater use of reviews, regarded as an instrument through which performance information can best feed into budget decision making.<sup>16</sup>

The ANAO has also identified the limited use of the reported performance information by decision-makers for policy development, refinement and resource allocation. The ANAO audit of the *Application of the Outcomes and Outputs Framework* found that:

The majority of surveyed agencies indicated that they used, to varying degrees, outcomes and outputs information in agency decision-making. Nevertheless, the survey results and the review of audited agencies identified that further attention should be given to including outcomes and outputs budget and performance information in regular management reports.<sup>17</sup>

This audit also highlighted that, in many agencies with administered items, programme information was seen as being more relevant to the day-to-day management of agencies, with outcomes and outputs information being viewed as being necessary to obtain annual appropriations and to meet external accountability requirements.

One tool that agencies have used to enhance their performance reporting frameworks is the balanced scorecard. This approach is concerned with aligning strategy and operations so that they are consistent with the overall purpose of the organisation. The balanced scorecard provides a set of performance indicators covering the major aspects of an organisation's operations, within the typical four perspectives of customers, internal processes, innovation and financial performance.<sup>18</sup>

## **Performance management**

The term performance management refers to the use of performance information to manage an organisation. According to Bouckaert and Halligan<sup>19</sup>, performance management exists where an agency: *measures* through the collecting and processing of performance data into information; *incorporates* this information into documents, procedures, and stakeholder discourses; and *uses* it within a strategy of improving decision making, results, and accountability.

In the Australian Public Service, the term performance management is typically considered to involve the use of performance information to improve performance, but often focuses on monitoring individual and team performance to support an organisation achieve its goals. The Management Advisory Committee (MAC) has provided guidance about performance management in the APS, and defined performance management as 'the use of interrelated strategies and activities to improve the performance of individuals, teams and organisations'.<sup>20</sup>

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<sup>15</sup> ANAO and Department of Finance and Administration 2004, p.4.

<sup>16</sup> Halligan, p.352.

<sup>17</sup> ANAO 2007a, p.23.

<sup>18</sup> ANAO 2002.

<sup>19</sup> Bouckaert and Halligan 2006.

<sup>20</sup> MAC 2001.

The ANAO's 2004 *Performance Management in the Australian Public Service* audit<sup>21</sup> found that the alignment of performance management systems with agencies' goals and organisational priorities was variable across the APS. Many agencies did not have established systems that related to, and supported, their performance management systems. As well, little attempt had been made by agencies to assess the organisational impact of their performance management system. These are contributing factors in making it difficult for agencies to establish a strong link between the conduct of their performance management systems and improved performance of their organisations. However, that audit also found that agencies were making progress in the integration of the performance management systems with the overall corporate management structure and in providing a clearer link for staff between their work and the goals of the organisation.<sup>22</sup>

## Evaluation and review

Another tool that organisations can use to supplement performance monitoring is evaluation. Finance defines programme evaluation to be an assessment of a programme, or part of it, in order to aid judgments about its appropriateness, efficiency and effectiveness. Programme evaluations encompass policy/programme reviews, efficiency (or process) and effectiveness (or impact) evaluations, post-implementation reviews, major enquiries and some audits.<sup>23</sup>

Prior to 1997, Finance oversighted an APS-wide evaluation strategy, which was linked to the budget process. This approach required agencies to submit formal portfolio evaluation plans each year, assessing all programmes within their area of responsibility over a five-year period. With the reforms of the late 1990s seeking to hold agency heads responsible for performance, and placing greater emphasis on the development of precise, measurable performance information, the requirements for central controls on comprehensive evaluation plans were relaxed.

Since 1997, individual agencies have had ongoing responsibility for undertaking evaluations of their own programmes. In this regard, the Government expects agencies to evaluate key policies and programmes as part of normal internal management practice. The outcomes and outputs policy requires agencies to report on any major evaluations in their portfolio budget statements and in annual reports. Over this period, Finance has provided information to support agencies to undertake effective evaluations.

As with other elements of the Australian Government's performance information framework, the approach to evaluation has been a long-term, iterative process. The iterative approach to improvement has allowed Australia to proceed with care, making refinements as unanticipated or unintended effects occur, and keeping to a long-term path of management for results.<sup>24</sup> At stages in this process there has been some criticism that there is scope for evaluation in the APS to be given a higher profile. For example, in 2004 Mackay drew the conclusion that:

...the genesis of evaluation in the first generation reforms was a response to the difficulties encountered with a simple 'let the managers manage' approach, with the realisation that this devolutionary philosophy needed to be balanced with tighter information requirements to demonstrate performance to support resource allocation decision making in the budget process and for reasons of accountability. The second generation reforms have applied the devolutionary approach to evaluation itself with the unfortunate result that the quality and depth of the information available concerning government performance has actually declined.<sup>25</sup>

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<sup>21</sup> ANAO 2004, p.14.

<sup>22</sup> *ibid.* p.14.

<sup>23</sup> Department of Finance and Administration, 2006a, p.6.

<sup>24</sup> OECD 2007, p.101.

<sup>25</sup> Mackay, 2004.

In this regard, Halligan (2008) noted that there is an understanding by Australian central agencies that review and evaluation is required on a more systematic basis. Emphasising the role of evaluation as an integral element of programme management would raise awareness of its benefits for better outcomes and administration.

The Australian Government has introduced initiatives in recent years to encourage organisations to improve the level of evaluations of policies and programmes. In 2003, the Government instituted a process whereby organisations seeking further funding for lapsing or terminating programs needed to evaluate their appropriateness, effectiveness and efficiency and report in the budget process in tandem with any proposal for continuation. The onus was on organisations to conduct these evaluations to address Terms of Reference agreed by the relevant Minister with the Minister for Finance and Deregulation. Ongoing programmes were not subject to these evaluation requirements.

In the 2007–08 Budget, a more centralised, higher-level approach has been initiated, no longer focused on lapsing or terminating programmes. The Australian Government announced that it would provide \$19.8 million over four years ‘to establish an enhanced framework for the strategic review of government programmes’.<sup>26</sup> The Budget measure provided funding for a team within Finance, together with funding to undertake approximately 14 reviews per year. The funding is directed to Finance’s Output 1.2.1, which includes the following activity: ‘conducting reviews of selected government programmes to determine appropriateness, effectiveness and efficiency.’

## **Review**

Expenditure and programme reviews are a central feature of the Australian budget process, and the area where performance information is used to inform budget decision making. The Australian Government revised review arrangements in October 2006 to achieve a more co-ordinated, strategic process better linked to budget planning and resource allocation. Under these new arrangements, Finance established a Strategic Review Unit that provides advice to senior ministers on matters warranting major review as part of the budget process.

The Strategic Review Unit is responsible for coordinating and managing the strategic review framework and reviews in consultation with central agencies and other relevant agencies. A small number of strategic reviews will be undertaken each year on major policy and spending areas across programmes and/or portfolios and significant government initiatives including entitlements, service delivery, tax expenditures and those with intergenerational considerations. Strategic reviews will assess significant government initiatives including tax expenditures to ensure they remain aligned with government priorities; assess that expenditure is managed effectively and efficiently; and identify gaps and/or areas of duplication. The focus of strategic review is to provide information to assist the government when making decisions on policy strategies and resource allocations. Reviews will be generally considered by government in the context of the following Budget, but timing is at the discretion of the government.

The new arrangements supplement rather than replace agency performance measurement and evaluation activities. Wider independent review and evaluation activity relating to government policies and programmes also continues, for example through parliamentary inquiries, independent commissions, eminent persons and non-government organisations.<sup>27</sup>

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<sup>26</sup> Australian Government 2007.

<sup>27</sup> OECD 2007, p.98.

## **Audit committees**

An audit committee plays a pivotal role in the governance framework of organisations in both the public and private sectors. The responsibilities of a better practice audit committee would generally encompass all areas of risk management, the organisation's control framework, its external accountability responsibilities, the organisation's compliance with legislation, and its internal and external audit activities, in particular the implementation of audit recommendations.<sup>28</sup>

As such, public sector audit committees typically have responsibilities for elements of performance monitoring and reporting, including to:<sup>29</sup>

- review the financial statements included in the organisation's annual report. The acceptance of the financial report by the Chief Executive/Board being the culmination of one of the Audit Committee's key responsibilities
- oversight the organisation's performance framework to ensure that the organisation's performance reporting frameworks link directly with organisational objectives and outcomes, and
- monitor management's consideration, and where appropriate, implementation of, relevant internal and external audit reports and recommendations and Parliamentary Committee reports and recommendations.

In the Australian Public Sector, an internal audit unit typically provides assurance about key elements of an organisation's control environment and advice to improve business performance, by reporting to the audit committee.

In June 2007, the ANAO issued an audit report dealing with the interim phase of its audit of financial statements of General Government Sector agencies for the year ending 30 June 2007.<sup>30</sup> This report noted that audit committees continue to have a positive influence on the effectiveness of agencies' control environment particularly in the areas of risk assessment, legislative compliance and financial system controls. The report also noted that agency internal audit coverage is generally based on a work plan that includes a combination of audits that address assurance, compliance, performance improvements and is aligned with agencies' risk management plans.

There has been little analysis, however, of the extent to which audit committees support the CEO or Board to help ensure that the Australian Government organisation's performance monitoring regime is effective, and links directly with organisational objectives and outcomes. There appears scope for further research into this topic, to support audit committees to help strengthen organisations' performance monitoring frameworks.

## **4. Framework for Monitoring Financial Performance: Accrual Budgeting**

The introduction of a full accrual budget in 1999–2000 was an integral part of an accrual-based outcome and output-focused, resource management framework for the Commonwealth government. The Government's decision and timetable for accrual budgeting formed part of its public service reform agenda and was made in April 1997. The National Commission of Audit, which conducted a review in the early days of the first Howard Government, had recommended the adoption of 'accrual principles as the basis for an integrated budgeting, resource management and financial reporting framework (which would include cash flow reports), both at the agency

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<sup>28</sup> ANAO 2005, p.6.

<sup>29</sup> *ibid.* pp.11–12.

<sup>30</sup> ANAO 2007b, p.20.

level and at the aggregate budget sector level.<sup>31</sup> This initiative followed, and built upon, the measured but extensive introduction of accrual financial reporting.

### **Accrual reporting followed by accrual budgeting**

Accrual annual financial reporting was introduced generally in the Australian federal public sector from 1994–95 onwards with audited statements based on Australian Accounting Standards. Accruals-based budgeting was introduced in the 1999–2000 Commonwealth Budget using both the Australian Accounting Standards (AAS) and the accrual-based Government Finance Statistics (GFS) Standard of the International Monetary Fund. The Consolidated Financial Statements for the Commonwealth have also been reported on an accrual basis since 1994–95 (initially on a trial and unaudited basis until 1996–97 when audited statements were introduced).

Accrual accounting and budgeting in the public sector has therefore come a long way in a relatively short period of time. It was less than 15 years ago — in November 1992 — that Australian Government public sector departments and agencies moved to adopt accrual accounting. Prior to that, they had presented modified cash accounts. All statutory authorities have reported on an accrual basis since 1986, although some reported on this basis prior to this time.

The adoption of accrual reporting for agencies was a big decision at the time, because it marked a recognition that the traditional approach to accounting and reporting had its limitations. At the time, budget accounting ruled supreme and the emergence of accrual accounting concepts was not universally warmly embraced.

Accrual accounting, and then accrual budgeting, were important elements in a suite of public sector reforms directed at improving the efficiency and responsiveness of government services, and enhancing the accountability for the use of public resources.

There were then, as there are today, discussions around the application of the accrual concepts to the public sector. Governments have fundamentally different roles to enterprises in the private sector, and so direct translation of the private sector model was not then, and is not now, the right answer. For example, governments have different objectives to private sector organisations, generally acquire assets to provide service potential rather than to generate future cash flows, and have a range of social obligations beyond those of private sector organisations.

So some of the traditional accounting concepts need additional consideration, and, in some cases, modification, for application in the public sector environment. Current issues in this area are discussed later in this paper. The presentation of information to meet the needs of public sector users, including the Parliament, continues to be an important consideration.

In the early years of accrual reporting, recognising there were unresolved issues and less than full acceptance of the benefits of accrual accounting, the then Department of Finance adopted an incremental approach to the expansion of disclosure requirements relating to assets and liabilities in agency financial statements. In this way, Finance conditioned public sector agencies to a more comprehensive basis of reporting. Even when it was decided by the Finance Minister in 1992 to adopt full accrual reporting, agencies were allowed several years to produce their first set of accounts on this basis. As it turned out, 10 agencies reported on an accrual basis in 1992–93, approximately 20 in 1993–94 and the remaining agencies in 1994–95. The first accrual-based whole of government statements that were audited were for the 1996–97 financial year, and followed a two-year trial period when unaudited financial statements were published.

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<sup>31</sup> Officer, 1996.

In 1993, the Organisation for Economic Co-operation and Development (OECD) completed a study of the use of accrual accounting in the public sector at the time, and referred to the benefits which accrual accounting can provide to public sector organisations, including the ability to:

- reflect and provide the basis for accountability for the additional flexibility provided to public sector managers
- underpin objectives for a more competitive approach to public sector provision
- facilitate more efficient and effective resource management
- improve accountability by extending the notion of performance beyond the use and application of cash, and
- provide a longer-term focus on the effect of government and management decisions.

The introduction of accrual budgeting was a very substantial change, not without complications, but a major achievement in linking financial reporting to the Budget, which was the engine of financial management reform. The Budget is, and has always been, such a powerful driver for change in the Australian Government public sector that accrual accounting would always have been a ‘backroom’ exercise without accrual budgeting.

It was significant also that the two most influential committees of the Parliament in terms of financial management, namely the JCPAA and the SSCFPA (and their predecessors), were and continue to be, supportive of the adoption of accrual concepts in government accounting and budgeting.

In the context of the current-day accrual budgeting and accounting model, and as envisaged by the National Commission of Audit, information on cash is still very important, particularly in terms of government decision making. There is no denying the budget surplus/deficit line of the Budget Papers and financial reports is still the most quoted measure as an indicator of government financial performance. At election time the major political parties committed in 2004 and 2007 to running budget surpluses (underlying cash) — this was the key measure.

At the hearings held by the SSCFPA as part of its recent inquiry into the transparency and accountability of Commonwealth public funding and expenditure, both Finance and the Auditor-General noted that cash information is still reported in the Budget Papers and within accrual accounting. Additionally, Finance advised that within the newly-introduced Central Budget Management System (CBMS), departments and agencies are responsible for providing monthly forecasts of cash requirements and reporting monthly on financial performance and trends.<sup>32</sup>

### **The contribution of accrual accounting and budgeting to enhanced governance and accountability**

Both the ANAO and CPA Australia are in no doubt that accrual information provides better information for decision making and accountability purposes than earlier financial information available to managers, government and the Parliament.

In the Commonwealth’s devolved system of public administration, many of the practical benefits from accrual budgeting and reporting have been derived. By identifying the real costs of operations and resources tied up or committed, agencies are better placed to manage programmes efficiently and effectively. This information may also contribute to policy and strategy development.

By analysing prospective transactions in the light of the accounting framework, accountants in agencies are able to contribute to a more informed understanding of the transactions. This may

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<sup>32</sup> SSCFPA 2007, p.12.

include understanding the level of risk being taken by the Commonwealth or being more focused on the probability that future economic benefits will flow to or from an agency as a result of transactions or events. Accounting advice can inform decisions across the spectrum, including in relation to revenue or expense recognition, grant administration, and asset and liability management. For example, changes in the carrying value of key assets and liabilities due to impairment or revaluation, can provide important information to management, which may, in turn, influence strategies being adopted by an agency.

In this light, accrual budgeting and accounting is not just about recording the debits and credits — it is a discipline which aids management to better understand and govern their programme and organisation. It is a means to an end.

In 2006, the Auditor-General indicated that while there was always room for debate at the margin of the merits of particular accounting standards or disclosures, he was in no doubt that public administration is better informed as a result of the accrual accounting and budgeting reforms. He noted that viewing accounting information as performance information to be interpreted with other key performance indicators, establishes the right tone and context for any organisation, and for government as a whole.<sup>33</sup>

Some public sector agencies still have work to do in better integrating their business and accounting systems, and streamlining their financial statement preparation processes. For some of the Australian Government's major agencies, ANAO reports have raised issues relating to:

- having appropriations or authorisations in place to cover planned expenditure
- performing key reconciliations to provide assurance around the integrity of information being reported
- paying close attention to material and unusual transactions
- addressing access security within FMIS's (Financial Management Information Systems) and HRMIS's (Human Resource Management Information Systems), and
- underpinning the financial statement preparation process with effective project management arrangements, including aligning monthly financial reporting processes with year-end processes to the extent practicable.<sup>34</sup>

In April 2006, the ANAO issued a Better Practice Guide on the *Preparation of Financial Statements by Public Sector Entities*<sup>35</sup> to assist agencies and their audit committees to enhance their preparation and accountability processes for agency financial statements.

And as previously mentioned, in June 2007, the ANAO issued an audit report dealing with the interim phase of its audit of financial statements of General Government Sector agencies for the year ending 30 June 2007.<sup>36</sup> It noted that properly functioning internal controls are fundamental for agencies in meeting their respective strategic, operational and financial responsibilities. The results of the interim phase indicated that controls over business and accounting processes have generally been effective, with an overall decrease in the total number and significance of audit findings from 2005–06. However, it noted that a continuous occurrence of control weaknesses identified in relation to information systems suggests a need for increased management attention.

These findings were reinforced in December 2007, in the ANAO audit report dealing with the final phase of its audit of financial statements of General Government Sector agencies for the

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<sup>33</sup> McPhee, 2006, p.4.

<sup>34</sup> In this context, the work done by Finance and agencies generally on the implementation of the Australian Equivalents to the International Financial Reporting Standards (AEIFRS) is seen by the ANAO as beneficial because significant issues that have arisen to date have been resolved without impacting on reporting timetables.

<sup>35</sup> ANAO 2006b.

<sup>36</sup> ANAO 2007b, p.75.

year ending 30 June 2007. This report also found that most agencies enabled their Chief Executive to issue a Certificate of Compliance in respect of 2006–07, by 15 October 2007. This is an annual government requirement designed to reinforce the importance of legislative and policy compliance with the financial management framework. While the actions taken by agencies revealed a significant number of breaches of various legislative requirements, these breaches did not have any material impact on entities' financial statements. The audit found that entities devoted considerable resources to enable completion of the Certificate of Compliance process and generally found that it had been beneficial in raising the awareness of staff to the requirements of the financial management framework.

The use of performance information for budgeting and resource management depends crucially on the quality of cost attribution in plans and accounts. ANAO's 2003 audit of annual performance reporting<sup>37</sup> found that there was a wide range of approaches to cost attribution. In some audited agencies there were different systems for preparing financial and non-financial reports, and non-financial reports were not part of the regular internal management financial reporting process. In the ANAO's 2007 audit of the application of the outcomes and outputs framework,<sup>38</sup> agencies reported that overhead allocation is the main area for improvement in cost attribution. For example, the ANAO noted that for one audited agency, over 80 percent of costs within one outcome were treated as indirect, requiring allocation across a number of outputs. If outcome and output information is to be used more effectively by agencies for management and resource allocation, the quality and accuracy of cost information, that is meaningful within agency management structures, is likely to need improvement.

## **5. Current Framework Issues in Monitoring and Reporting Financial Performance of Australian Government Organisations**

Earlier it was observed that both the JCPAA and SSCFPA have consistently supported the introduction of accrual accounting and reporting by the Australian Government. In both cases, the committees have identified a number of common areas of the accrual-based outcomes and outputs framework as requiring further attention.

The SSCFPA's 2007 report concluded:

The Committee agrees with Professor Barton that the case for the adoption of accrual accounting and budgeting is overwhelming. In the Committee's opinion, their adoption has significantly enhanced the management of the Commonwealth's finances and has led to improvements in certain aspects of transparency and accountability. However, the accounting and budgeting processes, and particularly the adoption of the outputs/outcomes framework, have also resulted in new challenges in accountability and transparency for the Parliament, for the public and even for ministers of the executive government.<sup>39</sup>

The report focused its comments and grouped its recommendations in four general areas:

- the proliferation of funding sources<sup>40</sup>
- tax expenditures, the Advance to the Finance Minister (AFM), the GST, and ordinary annual services<sup>41</sup>

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<sup>37</sup> ANAO 2003a, p.43.

<sup>38</sup> ANAO 2007a, p.70.

<sup>39</sup> SSCFPA 2007, p.13.

<sup>40</sup> Main areas of concern were: annual appropriations subject to parliamentary scrutiny account for less than 20 percent of the Budget — most are special or standing appropriations. There are also special accounts, net appropriations (section 31 agreements), and annual agency carryovers of unspent departmental (not administered) funds that the Committee considered were inadequately reported and scrutinised.

- improving the transparency of and specificity of the Budget documents,<sup>42</sup> and
- improving parliamentary oversight.<sup>43</sup>

At the time this paper was finalised, the government had not presented its response to the report. There are some matters raised in the report that relate particularly to accrual budgeting and reporting, which merit comment in this paper not least because some recent progress can be reported. These are discussed below.

### Accounting standards

As outlined in the previous section, there are two financial models currently in use to present government financial information for both Budget estimates and reports of actual activity. They are the Government Finance Statistics (GFS) framework of the Australian Bureau of Statistics (ABS GFS) and the Australian Accounting Standards (AAS), being the Australian equivalents to the International Financial Reporting Standards (AIFRS) and other standards, including AAS 31 *Financial Reporting by Governments* (the AAS are sometimes also referred to as GAAP — Generally Accepted Accounting Principles).

Both are accrual-based models, where the financial effects of economic events are recorded, not merely cash receipts and expenditures. The *Charter of Budget Honesty Act 1998* mandates neither of these. That Act does require annual government reporting to be based on external reporting standards, which is consistent with the purpose of the Charter — to facilitate public scrutiny of fiscal policy and performance; but the government of the day determines what method(s) to use and whether to require any departure from the reporting standards adopted. In practice, because it is not feasible to maintain a separate set of standards, the ABS GFS and GAAP systems are used for annual government financial reporting.

The ABS GFS reporting framework is a specialised tool designed to support economic analysis, particularly macroeconomic, of the impact of government in total. It is closely based on the GFS framework used by the International Monetary Fund (IMF) which, in turn, is consistent to the extent possible with the international statistical standard *The System of National Accounts 1993*.<sup>44</sup>

The AAS apply to reporting entities and are intended to report the financial performance and financial position of the reporting entity, within the definitions of performance and position in the model. The application of the generalised AAS model, which has its origins in commercial activities, to the government and agencies in the public sector, does require attention to interpretation of results. It is possible that a performance indicator seen as useful and informative

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<sup>41</sup> In terms of ordinary annual services, the Committee expressed concern that the Compact of 1965 as amended in 1999 required further clarification from the government as to what should be included in the various appropriation bills (principal issue being the split between ordinary annual services and new services/capital expenditure).

<sup>42</sup> Main areas of concern were: more information in the PBS on programmes; forward estimates; outcomes to be expressed in clear terms; and that the terms ‘administered’ and ‘departmental’ be defined in the appropriation bills.

<sup>43</sup> Discussion of the focus of Committee consideration of estimates, a possible role for the Auditor-General in assisting Committee scrutiny, and increased assertion of the parliamentary process of approval of appropriations and their purposes.

<sup>44</sup> The *1993 System of National Accounts* (1993 SNA) is a conceptual framework that sets the international statistical standard for the measurement of the market economy. It consists of an integrated set of macroeconomic accounts, balance sheets and tables based on internationally agreed concepts, definitions, classifications and accounting rules. Together, these principles provide a comprehensive accounting framework within which economic data can be compiled and presented in a format that is designed for purposes of economic analysis, decision taking and policy making. Despite harmonisation of the GFS system with the 1993 SNA, there are differences between the two statistical systems. The most important difference is that the focus of the GFS system is on financial transactions — taxing, spending, borrowing, and lending — while the 1993 SNA also focuses on the production and consumption of goods and services. As a result, the treatment of government productive activities in the GFS system differs substantially from the treatment of those activities in the 1993 SNA. Significant differences relate to the treatment of own-account capital formation, retirement schemes for government employees, and the degree of consolidation.

in a commercial organisation does not have similar utility and information value in a budget-funded organisation.

Neither model diminishes the value of cash information. In most cases, both models record the same economic events and transactions and their results can be reconciled to each other.

The SSCFPA considered the impact of current reporting in the Budget Papers against the two accounting standards: the GFS and AAS. The Committee noted:

Witnesses acknowledged that the current use of two different accounting standards for the budget documents is at least potentially confusing and supported the harmonisation exercise that is underway. They also acknowledged that the harmonisation process has taken some time. The Committee considers that the sooner the matter is finalised the better because any confusion must inevitably lead to less transparency than would otherwise be the case. There were suggestions that if a standard were not agreed upon within twelve months, that the Parliament should unilaterally declare that the budget documents brought before must conform to one standard, and that this standard should be based on the GFS system. The Committee shares the frustration of those who have advocated this course and will revisit the issue if significant progress towards a single agreed standard has not been reported within twelve months from the time of the tabling of this report.<sup>45</sup>

The Committee recommended that: ‘the ongoing process being undertaken to harmonise the accounting standards should continue and should be expedited by the Government setting a deadline for its completion’.<sup>46</sup>

The Australian Accounting Standards Board (AASB) has promulgated AASB 1049, initially in 2006, to require reporting of the general government sector and again, in late 2007, to add reporting by government as a whole (replacing AAS 31). These are the major outcomes of the AASB’s work to achieve the Financial Reporting Council’s strategic direction of 2002 to harmonise the GFS and GAAP reporting. The standard, titled *Whole of Government and General Government Sector Financial Reporting*, will apply from the financial year commencing 1 July 2008.

The standard requires reporting of financial performance and position as well as key GFS fiscal aggregates recognised and measured in accordance with GAAP. Where key GFS fiscal aggregates measured in accordance with the rules in the ABS GFS Manual differ from the GAAP measure, they are reconciled to the GAAP figures in a note.

In the same year (2002) that the [Australian] Financial Reporting Council (FRC) made the strategic decision to harmonise GFS and GAAP reporting, it also decided that Australia should move to reporting under international financial reporting standards from 1 January 2005. Although the international standards are developed with a focus on corporate organisations, the AASB determined, in keeping with its role of making standards for both the private and public sectors and making them sector-neutral, that its Australian equivalents to IFRSs would be adapted to provide suitable requirements, where necessary, for the public sector.

A few other jurisdictions have also adopted IFRS for government reporting.

The New Zealand Accounting Standards Review Board (ASRB) decided that reporting organisations should use New Zealand’s International Financial Reporting Standards (NZ IFRS) for periods commencing after 1 January 2007. The ASRB has approved New Zealand equivalents to IFRS that address the reporting requirements of public benefit organisations. New Zealand had been actively converging to IFRS prior to the ASRB’s 2002 decision. New Zealand’s 2007

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<sup>45</sup> SSCFPA 2007, p.55.

<sup>46</sup> *ibid.* p.55.

Budget and all financial statements from 1 July 2007 will be prepared in accordance with NZ IFRS.

The UK's intention is for the whole of government accounts to be published on an IFRS basis for the first time for the 2008–09 financial year. Canada has announced a strategy to adopt IFRS and the United States has agreed a convergence policy with IFRS.

However, most other governments are in the process of transitioning from cash to accrual accounts.

### **IPSASB and IASB**

Internationally, work is being undertaken on the development of Conceptual Frameworks to underpin international GAAP.

The IASB is reviewing the Conceptual Framework underpinning International Accounting Standards (and hence Australian GAAP) in conjunction with the United States' Financial Accounting Standards Board (FASB); while concurrently, the International Public Sector Accounting Standards Board (IPSASB) is reviewing its framework.

The objective of the joint IASB/FASB project is the development of a common framework to provide a foundation for developing future accounting standards that are principles-based, internally consistent, internationally converged and that lead to financial reporting that provides information that is useful to present and potential investors and creditors and others in making, investment, credit and similar resource allocation decisions. The project will build on existing IASB and FASB conceptual frameworks and examine key areas for development of the framework, including objectives and qualitative characteristics, elements of financial reporting and their recognition, measurement, presentation and disclosure.

The IPSASB Project focuses on general purpose financial reporting by public sector entities to make explicit the concepts that underpin financial reporting in the public sector and the Australian Accounting Standards Board is representing Australia on the sub-committee for this project.

There are some other matters with implications for government accounting and reporting that are currently under consideration by the AASB. These are discussed below.

### **Guidance on financial reporting by governments**

Prior to 1 July 2008, financial reporting by governments was dealt with by three accounting standards — *Financial Reporting by Local Governments* (AAS 27), *Financial Reporting by Government Departments* (AAS 29), and *Financial Reporting by Governments* (AAS 31). In December 2007, the AASB created new topic-based standards to accommodate some aspects of the existing standards, and to amend or revise five existing standards to accommodate other aspects of AASs 27, 29 and 31,<sup>47</sup> which were withdrawn. Together with AASB 1049 *Whole of Government and General Sector Financial Reporting*, issued in October 2007, the new standards and interpretation are applicable to annual reporting periods beginning on or after 1 July 2008.

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<sup>47</sup> The requirements contained in these AASs have been moved substantially unamended into: AASB 1004 *Contributions*, AASB 1050 *Administered Items*, AASB 1051 *Land Under Roads*, AASB 1052 *Disaggregated Disclosures*, AASB 2007–9 *Amendments to Australian Accounting Standards arising from the Review of AAS 27, AAS 29 and AAS 31*, as well as Interpretation 1038 *Contributions by Owners Made to Wholly-owned Public Sector Entities*.

## Defining ‘departmental’ and ‘administered’ items

This matter was mentioned earlier as being of concern to the SSCFPA in the context of improving transparency and specificity of Budget documents. The SSCFPA noted that there is an element of confusion surrounding the allocation of expenses as ‘departmental’ or ‘administered’ and this is reflected in documentation provided to the Parliament. The Committee indicated that it considered ‘...therefore that this issue should be resolved swiftly and trusts that the AASB will assist in this regard’.<sup>48</sup> The Committee recommended that the terms ‘administered’ and ‘departmental’ be defined in the appropriation bills or other appropriate documents.

While there has always been some uncertainty at the margin in relation to ‘departmental’ and ‘administered’ items, the intention is that ‘departmental’ items are those that the department has control over and for which the department’s chief executive may be held accountable. Other items such as payments made pursuant to the terms of legislation (for example programme payments) are ‘administered’ as the payments are made on behalf of the government.

The AASB is planning to create a new topic-based standard on administered items that presents, substantially unamended, the current requirements on administered items from AAS 29 into a standard applicable only to government departments. The ANAO’s *Opinions* newsletter reported in December 2006 (p.12) that the AASB had noted that the question of accounting for administered items by government departments raises some fundamental conceptual issues relating to users’ needs, the concept of control in the public sector, and the reporting organisation concept. The AASB agreed that it should continue accounting for administered items in a broader context rather than a separate issue.<sup>49</sup>

In its decision on *Combet vs Commonwealth of Australia*, the High Court did not define ‘departmental expenditure’ although it noted that departmental items are not tied to outcomes for appropriation and associated accountability, whereas administered items are. Departmental items are required to be reported against outcomes and are also required to report performance against outcome effectiveness indicators.

The ANAO’s submission<sup>50</sup> to the SSCFPA noted that the definition of departmental and administered expenditure has been refined over recent years but may benefit from a further review in light of the High Court decision. In its supplementary submission<sup>51</sup> the ANAO provided the Committee with several examples of inconsistent applications of the two categories.

Finance does not necessarily favour retaining the split between departmental and administered, but considers that some other form of disaggregated reporting may be more appropriate. However, to support the application of the current classifications, in June 2007 Finance provided guidance about criteria for determining departmental and administered classifications. It stated that from 1 July 2007, the Cabinet will decide departmental and administered classifications for all new policy proposals, including proposals to reallocate funding, for agencies subject to the FMA Act. The resource classifications are based on criteria consistent with AAS 29. All existing items have to be reviewed against these criteria in time for the 2008–09 Budget.

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<sup>48</sup> SSCFPA 2007, p.53.

<sup>49</sup> It is important to note that, while closely linked, there is not necessarily an exact legal relationship between an administered appropriation and administered reporting. Administered reporting depends on the interpretation of an accounting standard (currently AAS 29) while an administered appropriation is labelled as such in the appropriation acts/budget documentation.

<sup>50</sup> ANAO 2006d.

<sup>51</sup> ANAO 2006c.

## 6. Summary and Conclusion

Australia has undertaken extensive public sector reform over the past two decades, which has run from phases dominated by management (1980s), markets (1990s) and performance governance elements.<sup>52</sup> Performance governance aims to implement a performance culture supported by clear lines of responsibility in order to improve decision making and accountability.

The quality of decision making and extensiveness of accountability of public sector operations depends to a great extent on the availability and dissemination of full information on the operations of agencies and other related bodies. Performance information, assessment and reporting are critical tools for accountability.<sup>53</sup> The shift in focus to results needs to be balanced by enduring public sector values and principles, such as integrity, ethical behaviour and impartiality, which have been reinforced in recent years.

As discussed in Section 1, monitoring and reporting the performance of Australian Government agencies is based around the outcomes and outputs framework, but with many additional, integrated and supplementary elements. The PBS and annual report are key elements of this framework, through which agencies discharge their external accountability obligations. There is potential for improved alignment between these two documents, whereby annual reports more clearly report performance against the PBS forecasts regarding outcomes, outputs and associated performance indicators.

There have been a number of developments in recent years that have had a direct or indirect bearing on the way the framework is applied by agencies and the extent to which information that is reported in accordance with the framework is utilised by stakeholders. These developments include the reporting to government of programme and cash information and an increasing emphasis on whole of government service delivery. In light of these developments, there are opportunities to improve consistency in agency reporting and to further assist in meeting the needs of stakeholders. This includes better specification of outcomes, and the development of performance indicators to enable agencies to identify and measure their contribution to the achievement of outcomes and the efficiency of outputs.

The question arises, however, as to whether the overall monitoring and reporting of the performance of Australian Government agencies meets the requirements of key users. Various Parliamentary Committees and the ANAO together with a range of other commentators have all pointed to the implementation of the framework as being 'work in progress'. This also mirrors the results of studies undertaken by the Organisation for Economic Co-operation and Development on the experience of overseas jurisdictions that have introduced an outcomes and outputs framework. As recently as 2007 the SSCFPA in its report on the *Transparency and Accountability of Commonwealth Public Funding and Expenditure* and the ANAO in its audit of the *Application of the Outcomes and Outputs Framework*<sup>54</sup> have identified a number of enhancements in relation to the framework which, if adopted, have the potential to improve consistency in agency reporting and improving the transparency and specificity of Budget documents to further assist in meeting the needs of stakeholders. The ANAO made recommendations or suggestions relating to the need for agencies to better comply with the requirements of the outcomes and outputs framework, and review and if necessary improve:

- the specification of outcome statements and output/output groups
- PBS performance indicators
- the integration of PBS indicators and internal performance indicators

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<sup>52</sup> Halligan, 2008, p.2.

<sup>53</sup> SFPARC 2000, p.35.

<sup>54</sup> ANAO 2007a.

- processes for capturing performance information, and
- compliance with all external performance reporting requirements.

While the implementation of the broad performance monitoring framework is ‘work in progress’, it has been a long-term, iterative process. This iterative approach to improvement has allowed Australia to proceed with care, making refinements as unanticipated or unintended affects occur, and keeping to a long-term path of management for results.<sup>55</sup>

The most influential voices in shaping the framework going forward will be those of government and the Parliament. The information collected and presented on outcomes and outputs needs to meet their requirements, as well as those of other stakeholders. The ongoing feedback of stakeholders on the elements of the framework, particularly portfolio presentations, will be important to the ongoing improvement of performance reporting in the Australian Government public sector. Such feedback may encourage good performance, promote candour in identifying where remedial actions are required or suggest improved presentation of information. It is through the use of the framework that the scope for further improvement will become evident.

### **Accrual accounting**

Accrual accounting and budgeting have made a significant contribution to public sector administration. Not all of the public sector accounting issues have been solved, or have some of the systems and processes been running as smoothly as desired, but much progress has been made in a relatively short period of time.

The real benefits of the more comprehensive information have been at the organisational level. This is because agencies have the benefit of information relating to their own operations and programmes administered by them. This aids decision making by agencies in respect to their own operations, but also allows policy advice to be better targeted because the cost, revenue or balance sheet dimensions of options are better understood. These developments have contributed to more informed policy choices, stronger performance and a more comprehensive basis for accountability.

Over the past few years there have been, for example, signs of the Australian Government balance sheet being managed rather than perhaps being seen solely as a stewardship report. The recent decisions relating to public sector superannuation reflect this. However, it is also true that the GFS and AAS (GAAP) presentation of data in the Budget Papers has confounded some Parliamentarians and other consumers of public sector Budget Papers. (The SSCFPA’s 2007 report uses the terms ‘confusion’ and ‘frustration’ in this context.<sup>56</sup>) The progress made recently through the release of AASB 1049 and ED 155 to harmonise governmental financial reports means that the full benefits of consistent accrual budgeting and reporting should come closer to realisation.

This simplification of reporting will contribute significantly to a better-informed constituency and, as a result, provide a better basis for holding governments to account. This is one of the last frontiers in Australian public sector reporting.

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<sup>55</sup> OECD 2007, p.101.

<sup>56</sup> SSCFPA 2007, p.55.

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