

**Submission by BDO Kendalls
to the
Queensland Public Accounts Committee Inquiry
into
Government Financial Reporting**

Does the current reporting regime enable stakeholders to readily assess integrity, economy, efficiency and effectiveness?

There has been a significant upgrade in the quality of public sector financial reporting in Australia over the last fifteen years in conjunction with the development of public sector accounting standards and their adoption by the Australian Government and State and Territory governments. The reporting of financial information by public sector agencies is now similar to the level of reporting by private sector reporting entities.

However, the current reporting regime in the public sector is unlikely to be as useful to Parliamentarians as the private sector regime is to shareholders and other users of company reports.

One reason for this is that, for budget-funded agencies, non-financial aspects of performance – whether services delivered or outcomes achieved – are more important than in the private sector, but do not have the benefit of standards and generally-accepted measurement practices. (The measurement of outputs and outcomes is a necessary condition for assessing efficiency and effectiveness.) This contrasts with the reporting of profitability and other financial measures.

While Treasuries and other central agencies have attempted to redress this through reforms such as Queensland's *Managing for Outcomes*, the incentives to report performance in the public sector and the requirements to be held publicly accountable for it are generally weaker than they are in the private sector. Whilever governments accept this situation, there will be no imperative to ensure that all agencies report a minimum standard of relevant, reliable and timely non-financial performance information. Hence, there is a limited capacity for stakeholders to assess efficiency and effectiveness.

A second area in which public sector reporting is different from the private sector relates to the need for accountability on how public moneys are spent compared with the budget. To some extent, this relates to the assessment of integrity and economy. This issue is commented on below under the question "How useful are budgeted figures in the government financial reporting process?".

What information is available to assess specific public sector entity performance?

In terms of non-financial performance measures, the Ministerial Portfolio Statements (MPS) and annual reports provide information on outputs and outcomes, but this is often at too high a level or is not readily comparable or reliable to be useful.

More useful comparative information is available from the Productivity Commission's annual "Report on Government Services". While this information is also at a high level, it provides a useful basis for comparison across states and tends to be of significant public interest. The Committee could consider the benefits of requiring these inter-state comparisons to be included in the annual reports of the relevant agencies.

How useful are annual reports and other government financial reports?

Annual reports serve a number of purposes, including 'marketing' the agency, which they fulfil to varying extents. Their use in holding agencies accountable, either for compliance or performance, depends largely on the effectiveness of external review processes, particularly those of Parliament.

However, Parliament's traditional processes are not designed to review annual reports in a timely way – compared with its processes to review the State Budget, the MPS and Auditor-General's reports.

Is performance information readily accessible and can it be interpreted by non-expert users?

As indicated above, we consider that non-financial performance information is generally not as accessible to users as financial information.

While agencies provide a considerable amount of performance information in annual reports, it is understandable how it would be difficult for a Parliamentarian without financial training or an agency-specific background to adequately analyse this information.

We see that a three-pronged approach would be needed to address this issue:

1. Introduce Management Discussion and Analysis – type reports
2. Simplify reporting requirements
3. Provide Members of Parliament with access to financial and performance reporting guides, training and an expert advisory service.

Is the financial information presented in annual reports linked to management reporting?

One reason for making financial reporting by departments mandatory was to drive internal improvements in resource management. This was done on the basis that, if performance information is to be reported externally, it at least has to be collected internally. In our experience, this 'hidden agenda' has been reasonably successful in improving management reporting and decision-making.

However, there remains much to be done – particularly in measuring the effectiveness of agencies in achieving measurable outcomes. Until this point is reached, taxpayers will be unlikely to accept that governments are spending their taxes efficiently and effectively.

Do audited financial statements meet performance needs or do they only address compliance?

Audited financial statements can only inform users on an agency's financial performance. This includes:

- compliance issues – particularly whether the accountable officer has managed their finances within budget; and
- aspects of financial performance – such as:
 - 'balance sheet management'; and
 - productivity increases (where changes in service levels from one year to the next can be measured reliably).

How useful are budgeted figures in the government financial reporting process?

Budgeted expenditure figures provide the basis for assessing compliance with Parliamentary appropriations and are therefore an essential part of the government financial reporting process. On the other hand, budgeted revenue figures have less relevance, as the variability of revenue means that it is prudent for governments to adopt conservative estimates.

Reporting on variations from budget is particularly important now that agencies have significant discretion in re-prioritising spending from one line item to another. While these 'budget-actual' comparisons are provided to some extent in the MPS, these statements tend to focus more on the following year's budget. Therefore, it is suggested that annual reports could include explanations on any breach of appropriations and on any significant variations in the anticipated expenses on particular line items.

Will the introduction of international accounting standards provide more meaningful information about a public sector entity's performance?

While there are benefits in internationally-harmonising Australia's accounting standards for companies accessing capital markets overseas (even though this may not mean harmonisation with US accounting standards), the benefits for public sector entities are minimal.

Indeed, there is a risk that the compromises required to achieve harmonisation will lead to less meaningful information reported in Australia. An example is the requirement to depreciate intangible assets over no more than 20 years, regardless of whether a longer estimated useful life can be reliably established. Harmonisation could also make it more difficult to simplify the application of accounting standards that have less relevance in the public sector.

Other Issues?

It is not possible to discuss the issue of public sector performance reporting without considering the question of performance auditing, in either of its manifestations, namely:

1. auditing of economy, efficiency and effectiveness;
2. auditing of non-financial performance information in annual reports; and
3. auditing of performance management systems.

One of the main arguments against the introduction of the first and second forms of performance auditing has been the need for agencies to firstly develop reliable performance information to report on. With the implementation of *Managing for Outcomes* in the late 1990s, this argument now has less justification.

Therefore, it is considered timely for the Queensland Government to re-consider the public interest in improving the quality of performance information reported by budget-funded agencies. This improvement could be implemented through the phased introduction of a requirement to audit the validity, reliability and adequacy of output and outcomes measures in agency annual reports.