

Submission to Qld Public Accounts Committee

Government Financial Reporting

1 Introduction

This submission addresses the fundamental purpose of the inquiry about “whether the current reporting regime enables stakeholders to readily assess the integrity, economy, efficiency and effectiveness of government financial management and if not, what improvements could be made.” It will do this in two sections, the first will comment on annual reports and financial reports and their usefulness in providing performance information to stakeholders and the second which will comment on suggested areas for improvement. In doing so, this approach will address each of 9 ‘other considerations’ referred to.

As a prelude to these comments, it is noted that a general purpose financial reporting model based on a decision-useful framework (used in the private sector) was adopted in the public sector in the 1990’s in the belief that it would assist public sector agencies to manage their finances more efficiently and improve their accountability (Ryan, 1998, Chua and Sinclair, 1994; Guthrie, 1998). However, there was little empirical justification for the applicability of its underlying features to the public sector. These features include the identification of users, what information they require and the purposes for which they find general purpose financial reporting useful (Rutherford, 1992; Ma and Matthews, 1993). Specifically, there were concerns as to whether a financial reporting model primarily concerned with reporting performance in terms of profit and loss (financial bottom line) had the capacity to adequately and fairly reflect the performance of organizations for which the generation of profit was not the operating motive (Walker, 1989; Guthrie, 1998; Stanton and Stanton, 1998).

Given that the Queensland public sector has been preparing general purpose financial statements on an accrual basis for nearly a decade, it is now opportune to reflect on some of these earlier concerns, and our intention is to report on some Queensland based empirical research which does address some of these issues.

2 The role of annual reports and financial reports and their usefulness in providing performance information to stakeholders

2.1 Results of Empirical Study of Queensland public sector organizations

In the main, these results are drawn from a PhD Thesis which examined the role of the annual report and general purpose financial reports of public sector agencies in Queensland (Mack, 2004). Ninety seven (97) local governments, 5 Queensland government departments (including both line and policy departments) and 4 Queensland Government Owned Corporations (across a variety of categories) were surveyed to determine the use made of their annual reports . The survey involved sending a questionnaire to those who received the annual reports of these agencies for the year ended 30/6/99. 4,595 questionnaires were sent, and there was a response rate of 22%. This response rate is large enough to be able to draw valid statistical conclusions from the data. While it may appear that this is an old data set, the advantage of using this data is that in 1999, agencies did not put their reports on the internet, and so we were able, within a very small margin of error (eg. reports may be accessed at libraries etc) to identify actual users of the reports and access them directly for the survey. This same exercise would be very difficult today.

For each of the public sector entity types that were included in this research, findings were made with respect to four issues.

First there were findings regarding the identification of users of the annual reports. This was based on who could be classed as dependent users (defined by the accounting bodies to be those users who could not obtain financial information elsewhere) and who were non dependent users (users who could obtain information from elsewhere, for example management and elected officials).

Second, there were findings about which information in the annual report is used by users. Three distinct categories of information, general purpose financial information, performance information and narrative information were used to assess the information preferences of users.

Third, findings were made about the purposes – accountability or decision-making - for which users used the general purpose financial information provided in the annual report.

Fourth, findings were made about information sources users accessed about the entity. Users were asked to indicate how important (on a scale from very important to not important) six sources of information (newspapers; television/radio; internet; budget papers; annual reports; personal contact) were to them (Mack and Ryan 2003).

The findings of this research with respect to each of the public sector entity types examined are as follows;

Government Departments

With regard to the identification of users, 'non-dependent' users comprise nearly one third of all users. While users were keen for general purpose financial information to be disclosed it was not information they primarily used. The users of government department annual reports preferred performance information over general purpose financial information and narrative information. General purpose financial information was the information for which they had least preference and this type of information was not found to be useful for decision-making. Rather, users from government departments found financial statement information to be useful for accountability purposes. It could be argued that these results are indicative of general purpose financial reports having a compliance focus, rather than being used for decision making purposes. This is in direct contradiction to the 'decision-useful' model that emphasizes the importance of financial statement information for decision-making purposes.

With regard to the information sources available to users, while users from government departments found the annual report to be an important source of information, it was ranked as the second most important information source. Personal contact with the entity was ranked as the most important source of information. and was also regarded as a very important source information. Budget papers, although being rated as an important source of information were ranked as the fourth most important source of information.

There are three implications that flow from these results. First, in terms of the overall distribution of annual reports, a large proportion is being distributed to users who have the capacity to obtain information specific to their own needs. It may be that annual reports are being used because they are a summary document. Our research did not uncover this. However, their utility as a method of disseminating information for the purposes of decision making or as a means of discharging accountability to dependent users is diminished because of the limited access by these users.

Second, the findings that users prefer performance information has implications that can be tied back to the results concerning users. It could be argued that the use of annual reports by dependent users would increase if the information content was more appropriate to their needs. While annual reports do contain limited performance information its provision is not regulated (either in terms of what is reported or how it is reported) and not audited. As a consequence it is not as reliable or credible as general purpose financial information which is both highly regulated and audited.

Third, that financial statement information is used to discharge accountability rather than for decision-making together with the findings that users have a preference for performance information are indicative of users having an accountability focus rather than a 'decision-useful' focus. These results reflect the often in-voluntary and non-reciprocal nature of the relationship an external stakeholder has with the public sector which means that the focus of the relationship is on the overall assessment of the delivery of services and programmes rather than decision-making.

Local Government Authorities

Nearly two thirds of users of local government authority annual reports were 'non-dependent' users. As was the case for users of government department annual reports, users were keen for general purpose financial information to be disclosed but it was not information they primarily used. The users of local government authority annual reports preferred performance information over general purpose financial information and narrative information. General purpose financial information was not found to be useful for decision-making. Rather, financial statement information was found to be most useful for accountability purposes. Once again these results are in direct contradiction to the 'decision-useful' framework that emphasizes the importance of financial statement information for decision-making purposes.

With regard to the information sources available to users, while users from local government authorities found the annual report and personal contact with the entity to be very important sources of information, personal contact with the entity was ranked as the most important source of information. Annual reports were ranked as the second most important information source. Budget papers which were rated as an important information source were ranked as the third most important source of information. These results have the same implications as those for government departments.

Government Owned Corporations

For government owned corporations 90% of users are 'dependent' users. This is contrary to the results found for local government authorities and government departments where 'dependent' users represented 1/3 and 2/3 respectively of all users. However, the results in terms of the information preferences of government owned corporation users and the reason they use general purpose financial information mirrors those of government departments and local government authorities. As was the case for government departments and local government authorities, users were keen for general purpose financial information to be disclosed but it was not information they primarily used. The users of government owned corporation annual reports preferred performance information over general purpose financial information and they preferred general purpose information over narrative information. General purpose financial information was found to be useful for accountability purposes rather than for decision-making.

In relation to the other information sources available to users, users from government owned corporations identified the annual report as an important source of information and the as the most important source of information. The implications of these results are similar to those for government departments and local government authorities. The notable difference is in regard to the distribution of annual reports to dependent users. It could be argued that there is a wider distribution of annual reports to external stakeholders for this type of entity because of their similarity to private sector organizations.

These findings have implications for a review of the current reporting regime. The findings of this research that performance information is preferred to general purpose financial information supports the anecdotal views that the information content of annual reports as they are currently constructed is insufficient to satisfy the needs of public sector users and that performance information is also required (Walker, 2002; Carlin and Guthrie, 2001; Sharp and Carpenter, 1998; Rutherford, 1992).

2.2 Reporting on cross agency/cross government programs

The second issue we would like to comment on is the issue of reporting on whole-of-government programs. There is increasing pressure being placed on government agencies both in Australia and internationally to act in a more collaborative, integrated or 'joined-up' manner. Shared programs, whether these be programs between different state government departments, with local government or the nonprofit sector are increasingly being used to deliver services and they pose a challenge to traditional models of public sector reporting. Existing accountability mechanisms are designed for traditional vertical accountability relationships. Accountability mechanisms have not kept pace with requirements for horizontal or 'networked' accountability that occurs when responsibility for program outcomes and outputs is shared across government agencies. Currently it is very difficult to assess the performance of cross agency collaboration, and as this means of delivering services increases, it is crucial that the accountability arrangements and the reporting and performance mechanisms be clarified. In Queensland, the Community Renewal Program is an example of a program which faces these challenges (Ryan and Walsh 2004).

We would argue that there are 2 key issues here: first, to capture the full range of inputs and outputs for shared (whole-of-government) programs, and second is to ensure that there is not a separate layer (document) of reporting to respond to this challenge. The solution needs to be incorporated within the overall reporting regime, the consolidation and integration of which is the subject of this inquiry

3 Suggested areas for improvement

Financial management in the public sector is not just about whether the resources were managed well but includes an assessment of what was achieved in terms of the delivery of services to the community. As a consequence the provision of comprehensive information about the performance of government in delivering services and programs is essential to the ability of stakeholders to assess the integrity, economy, efficiency and effectiveness of government financial management. Without performance information, general purpose financial reports are limited to being a compliance mechanism.

The current framework provides a large amount of information albeit much of it financial. The two major documents in which this information is provided are the budget documents through the Ministerial Portfolio Statements and the Annual Reports. The annual report is the document which is prepared specifically for external stakeholders. As we have already noted, not only is performance information crucial to an assessment of the financial management of government, stakeholders have a preference for it. However, the current emphasis is on financial information. Consequently the suggestions for future improvement have focussed on strengthening the current accountability framework through existing reports – budget documents and the annual report. Further they have drawn on the findings of the research reported in the previous section.

Budget documents

- The development of a consistent set of cost-effective performance measures. These measures would be reported on in the budget documents of individual portfolios in terms of the linking to whole of government outcomes; the current-year projected target, and the historical actual achievements. These measures should go beyond traditional financial measures and include service delivery measures. While we recognise that there are many practical problems in this task, it is the comparative element which allows for trends to be examined, and assessments of performance to be more easily gauged.

Annual reports

Reporting of performance measures

- This same reporting be provided in the annual report, and in this way this will provide the framework for individual agencies to set strategic plans and operational plans towards achieving these objectives. It allows agencies to examine and explain how and why their budgeted measures were not achieved (often for very legitimate reasons), and it also gives more continuity, transparency and relevance to the current financial reporting regime involving: estimates and budgeting; financial management; expenditure and performance management; accountability and annual reporting and review and auditing.

Auditing of performance measures

- The actual performance measures achieved for each year be audited by the Auditor-General. This audit process provides the verification that all stakeholders need to be assured of the reliability of the indicators. There are various models operating in some other jurisdictions in Australia to provide valuable input to this element.

Guide to Financial Information (Discussion and Analysis)

- The current financial information is too complex for the ordinary stakeholder to understand, in any sort of meaningful manner. This has been recognised in other contexts – both in the private sector and in Queensland local governments where both are required to prepare reports which assist in the interpretation of the financial results. The two questions which remain are – should the format be prescribed, and if so, in what detail, and should this report be audited. In the private sector a Management Discussion and Analysis is produced and this is required to be audited for consistency with the general purpose financial reports. In the Local Government sector in Queensland a Community Financial Report is required to be prepared. This has been in operation for 2 years now. The content is not prescribed to any great extent, nor is it audited. Research by Ryan, Stanley and Mack (2004) show that the non-prescriptive approach taken forced many local government authorities to examine their accountability mechanisms in terms of what they perceived to be the information needs of users both in terms of content and presentation. Further, research by Jennings and Stanley (2004) identified that the form and content of the Community Financial Reports varied considerably. There was no definitive style, with each report being unique. It could be argued that these reports were different because of the diversity of local government authorities in terms of their population, revenue, and activities. Such diversity of reporting may not translate to other public sector entity types.

4 Conclusions

There have been significant financial management reforms in the public sector in the last 15 years. Great leaps have been made in Queensland in terms of the introduction of accrual accounting and accrual output budgeting, and yet we would argue it is still difficult for an individual stakeholder to assess, in an independent way, the performance of government. We believe the way forward is to continue to tighten and strengthen the current financial reporting cycle particularly the link between budget documents and annual reports. Further, performance information needs to be developed. The key elements need to be reported in both budget documents and annual reports and be audited.

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